Court File No. CV15-10961-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON EDUCATION LTD. AND NELSON EDUCATION HOLDINGS LTD.

BOOK OF AUTHORITES OF THE FIRST LIEN HOLDERS

(Motions Returnable August 13, 2015)

August 11, 2015

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Lawyers for Wilmington Trust, National Association, as the First Lien Agent, Cortland Capital Market Services LLC, as the Supplemental Agent, and the First Lien Steering Committee

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22. *Asad v. Canada (Citizenship and Immigration)*, 2015 FCA 141

23. *Friedl v. Friedl*, 2009 BCCA 314

24. *JPMorgan Chase Bank v. Lanner (The)*, 2008 FCA 399

25. *General Motors Acceptance Corporation of Canada, Limited v. Town and Country Chrysler Limited*, 2007 ONCA 904

26. *R. v. Lyttle*, 2004 SCC 5

27. *Re Skylink Aviation Inc.*, Plan Sanction Order (April 23, 2013), Court File No. 13-1003300-CL (Ont. Sup. Ct. J.)

28. *Re 7588674 Canada Inc., Gateway Casinos & Entertainment Inc. and Gateway Casinos & Entertainment Limited*, Final Order (August 16, 2010), Court File No. S-105095 (B.C.S.C.)

29. *Re Mobilicity*, Vesting Order (June 29, 2015), Court File No. CV-13-10274CL (Ont. Sup Ct. J.)

30. *Re Canwest Publishing Inc.*, Conditional Credit Acquisition Sanction, Approval and Vesting Order (May 17, 2010), Court File No. CV-10-8533-00CL (Sup. Ct. J.)

TAB 1

CITATION: Nelson Education Limited (Re), 2015 ONSC 3580
COURT FILE NO.: CV15-10961-00CL
DATE: 20150602

SUPERIOR COURT OF JUSTICE – ONTARIO
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON EDUCATION LTD. AND NELSON EDUCATION HOLDINGS LTD.

Applicants

BEFORE: Newbould J.

COUNSEL: *Robert J. Chadwick, Caroline Descours and Sydney Young*, for the Applicants

D.J. Miller and Kyla E.M. Mahar, for the Royal Bank of Canada

Kevin J. Zych, for the First Lien Lenders

Jay Swartz and Robin Schwill, for Alvarez & Marsal Canada Inc.

HEARD: May 29, 2015

ENDORSEMENT

[1] On May 12, 2015, Nelson Education Ltd. ("Nelson") and its parent company, Nelson Education Holdings Ltd. sought and obtained an initial order pursuant to the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the "CCAA"). Notice had been given to RBC only late the day before and RBC took the position that it had not had sufficient time to consider or prepare a response to the application. The resulting initial order was pared down from what was sought by the applicants and it provided that on the comeback date the hearing was to be a true comeback hearing and that in moving to set aside or vary any provisions

of the initial order, a moving party did not have to overcome any onus of demonstrating that the order should be set aside or varied.

[2] On the comeback date, RBC moved to have Alvarez & Marsal Canada Inc. ("A&M Canada") replaced with FTI Consulting Canada Inc. ("FTI") as the Monitor, and for other relief. At the conclusion of the hearing, I ordered that FTI replace A&M Canada as Monitor for reasons to be delivered. These are my reasons.

Relevant History

[3] Nelson is a Canadian education publishing company, providing learning solutions to universities, colleges, students, teachers, professors, libraries, government agencies, schools, professionals and corporations across the country.

[4] The business and assets of Nelson were acquired by an OMERS entity and certain other funds from the Thomson Corporation in 2007 together with U.S. assets of Thomson for U.S. $7.75 billion, of which US$550 million was attributed to the Canadian business. The purchase was financed with first lien debt of approximately US$311.5 million and second lien debt of approximately US$171.3 million.

[5] The first lien debt is currently approximately US$269 million plus accrued interest. There are 22 first lien lenders. RBC is a first lien lender holding approximately 12% of the principal amount outstanding. The first lien debt matured on July 3, 2014. It has not been repaid.

[6] The second lien debt is currently approximately US$153 million plus accrued interest. RBC is a second lien lender, holding the largest share of the principal amounts outstanding, and is the second lien agent for all second lien lenders. The maturity date is July 3, 2015 subject to acceleration.

[7] According to Mr. Greg Nordal, the CEO of Nelson, the business of Nelson has been affected by a general decline in the education markets over the past few years. In the past year,

overall revenues in the K-12 market have declined by 13% and in the higher education market by 3%.

[8] Notwithstanding the industry decline over the past few years, Nelson according to Mr. Nordal has maintained strong EBITDA, which is a credit I am sure to the efforts of Mr. Nordal and the management of Nelson. Nelson's EBITDA has remained positive over the last several years. For the fiscal year ended June 30, 2011 it was $47.4 million, for the fiscal year ended June 30, 2012 it was approximately $37.3 million and for the year ended June 30, 2013 it was approximately $40.9 million.

[9] Mr. Nordal is of the view that Nelson is well positioned to take care of increasing future opportunities in the digital educational market.

[10] Nelson had a leverage ratio of debt to EBITDA of approximately 17:1 for the fiscal year 2015. Its first lien debt matured and has not repaid and it has made no interest payments on the second lien debt since March 31, 2014.

[11] Nelson's efforts to deal with this situation have led to a proposed sale transaction under which the business of Nelson would be sold to the first lien lenders by way of a credit bid and the second lien lenders would be wiped out. In their application requesting an initial order, the applicants proposed a hearing date to be held nine days after the Initial Order to approve this sale transaction. That request was not granted.

[12] In March 2013, Nelson engaged Alvarez and Marsal Canada Securities ULC ("A&M") as its financial advisor to assist the Company in reviewing and considering potential strategic alternatives, including a refinancing and/or restructuring of its credit agreements.

[13] Commencing in April 2013, Nelson, with the assistance of A&M and legal advisors, entered into discussions with a number of stakeholders, including RBC as the second lien agent, the first lien steering committee, and their advisors, in connection with potential alternatives to address Nelson's debt obligations. A number of without prejudice and confidential proposed

transaction term sheets were discussed between August 2013 and September 2014, without any agreement being reached.

[14] During this time, interest continued to be paid on the first lien debt. In March, 2014 Nelson did not paid interest on the second lien debt. In return for a short cure period to May 9, 2014, a partial payment of US$350,000 towards interest was paid on the second lien debt. A further cure period to May 30, 2014 was given on the second lien debt but nothing was paid on it by that date. No further cure period was agreed and no further interest has been paid. Initially during the discussions that took place with the second lien lenders' agent, the professional fees of the advisors to the second lien lenders were paid by Nelson but these were stopped in August, 2014 after there was no agreement regarding further extensions of the second lien debt or agreement on any term sheet.

[15] On September 10, 2014, Nelson announced to the first lien lenders Nelson's proposed transaction framework on the terms set out in the First Lien Term Sheet dated September 10, 2014 (the "First Lien Term Sheet") for a sale or restructuring of the business and sought the support of all of its first lien lenders.

[16] In connection with the First Lien Term Sheet, Nelson entered into a support agreement (the "First Lien Support Agreement") with first lien lenders representing approximately 88% of the principal amounts outstanding under the first lien credit agreement. The consenting first lien lenders comprise 21 of the 22 first lien lenders, the only first lien lender not consenting being RBC. Consent fees of approximately US$12 million have been paid to the consenting first lien lenders.

[17] Pursuant to the terms of the First Lien Term Sheet and the First Lien Support Agreement, Nelson, with the assistance of its financial advisor, A&M, commenced on September 22, 2014, a sale and investment solicitation process (the "SISP") to identify one or more potential purchasers of, or investors in, the Nelson business, which process was conducted over a period of several months. According to Mr. Nordal, Nelson and A&M conducted a thorough canvassing of the market and are satisfied that all alternatives and expressions of interest were properly and thoroughly pursued.

[18] The SISP did not result in an executable transaction acceptable to the first lien lenders holding at least 66 2/3% of the outstanding obligations under the first lien credit agreement. Accordingly, pursuant to the First Lien Support Agreement Nelson wishes to proceed with a transaction pursuant to which the first lien lenders will exchange and release all of the indebtedness owing under the first lien credit agreement for: (i) 100% of the common shares of a newly incorporated entity that will own 100% of the common shares of the purchaser to which substantially all of the Nelson's assets would be transferred, and (ii) the obligations under a new US$200 million first lien term facility to be entered into by the purchaser.

[19] The proposed transaction provides for:

(a) the transfer of substantially all of Nelson's assets to the purchaser;

(b) the assumption by the purchaser of substantially all of Nelson's trade payables, contractual obligations (other than certain obligations in respect of former employees, obligations relating to matters in respect of the second lien credit agreement, and a Nelson promissory note) and employment obligations incurred in the ordinary course and as reflected in the Nelson's balance sheet; and

(c) an offer of employment by the purchaser to all of Nelson's employees.

[20] Under the proposed transaction, with the exception of the obligations owing under the second lien debt and intercompany amounts, substantially all of the liabilities of Nelson are being paid in full in the ordinary course or are otherwise being assumed by the purchaser. The purchaser will not assume Nelson's obligations to the second lien lenders.

[21] On September 10, 2014, pursuant to the First Lien Support Agreement Nelson agreed not to make further payments in connection with the second lien debt, including any payment for fees, costs or expenses to any legal, financial or other advisor to RBC, the second lien agent, without the consent of the consenting first lien lenders.

Role of A&M Securities

[22] Nelson engaged A&M, an affiliate of Alvarez & Marsal Canada Inc., as its financial advisor in March, 2013. A&M has been operating as a financial advisor to Nelson for more than two years prior to the date of the Initial Order.

[23] The scope of A&M's engagement in 2013 included the following:

(a) Analyze and evaluate Nelson's financial condition;

(b) Assist Nelson to prepare its 5-year financial model, including balance sheet, income statement and cash flow statement and its 5-year business plan;

(c) Assist Nelson to respond to questions from its lenders regarding Nelson's business plan and financial model;

(d) If requested by management, attend and participate in meetings of the board of directors with respect to matters on which A&M was engaged to advise Nelson; and

(e) Other activities as approved by management or the board of Nelson and agreed to by A&M.

[24] In September 5, 2014 A&M was further engaged to act as the exclusive lead advisor for the transaction that has led to the proposed transaction, including the SISP process undertaken by Nelson. A&M's goal was identified as completing a successful transaction in the most expedient manner. Under this second engagement, A&M's compensation was described as being based on time billed at standard hourly rates and "subject to any other arrangements agreed upon among Nelson, the lenders and A&M". The word "lenders" referred only to the first lien lenders.

[25] In undertaking its mandate under the 2013 and 2014 engagements, A&M was authorized to utilize the services of employees of its affiliates under common control with A&M and subsidiaries. The sample accounts provided by A&M indicate that a substantial number of hours

were billed to the A&M engagement for work of the personnel who are intended to act on behalf of the Monitor in this proceeding. A total of approximately $5.5 million plus HST and disbursements have been billed by A&M for its services to Nelson.

[26] An affiliate of A&M was engaged in 2013 to advise Cengage Learnings, the name of the U.S. operations of Thomson that was changed when Thomson sold its business. The 2013 and 2014 engagements of A&M by Nelson sought Nelson's waiver of any conflict of interest in connection with an A&M affiliate's engagement with Cengage. At the time of the 2013 engagement, A&M U.S. was engaged by Cengage to provide restructuring and financial advisory services and Cengage and Nelson had common shareholders. At the time of the September 2014 engagement, an A&M affiliate was providing financial advisory and financial management services to Cengage. Nelson maintains a strong relationship with Cengage and is the exclusive distributor for Cengage educational content in Canada pursuant to an agreement that expires on January 1, 2018. Cengage also provides certain operational support to Nelson. According to Mr. Nordal, Cengage is a preferred and key business partner of Nelson.

[27] A&M was present at the meetings of Nelson's board of directors wherein the decision was made by that board to not make interest payments to the second lien lenders on March 20, 2014, March 27, 2014, April 7, 2014 and June 27, 2014. A&M was also involved in discussions with RBC and its financial advisors in connection with the extension of the cure period for payment of interest to the second lien lenders as the financial advisor to Nelson.

Analysis

[28] In its factum, RBC asserted that the application by Nelson was not an appropriate use of the CCAA as it was intended to be a nine-day proceeding to bless a quick flip credit bid by the first lien lenders to acquire the business of Nelson and extinguish the second lien lenders interest in the assets. RBC however also took the position that it would support a CCAA proceeding on the basis that there would be a neutral Monitor. I must say that in reviewing the circumstances of this application, I can see the issues raised by RBC as to whether this CCAA proceeding was an appropriate use of the CCAA. However in light of the position taken by RBC and my ruling that

A&M Canada should be replaced by FTI as Monitor, I make no further comment or finding on the issue.

[29] This is a true comeback motion with no onus on RBC to establish that A&M Canada should not be the Monitor. Rather the situation is that it is Nelson who is required to establish that A&M Canada is an appropriate monitor.

[30] The problem is that Nelson has proposed a quick court approval of a transaction in which the first lien lenders will acquire the business of Nelson and in which essentially all creditors other than the second lien lenders will be taken care of. Nelson has asserted in its material that the SISP process undertaken by Nelson prior to the CCAA proceedings has established that there is no value in the Nelson business that could give rise to any payout to the second lien lenders. The SISP process was taken on the advice of A&M and under their direction. It was put in Nelson's factum that:

> The Applicants, with the assistance of their advisors, conducted a comprehensive SISP which did not result in an executable transaction that would result in proceeds sufficient to repay the obligations under the First Lien Credit Agreement in full or would otherwise be supported by the First Lien Lenders;

[31] Nelson intends to request Court approval of the proposed transaction. An issue that will be front and centre will be whether the SISP process prior to this CCAA proceeding can be relied on to establish that there is no value in the security of the second lien lenders and whether other steps could have been taken to obtain financing to assist Nelson in continuing in business other than a credit bid by the first lien lenders. A&M was centrally involved in that process. It is in no position to be providing impartial advice to the Court on the central issue before the Court.

[32] There is no suggestion that A&M are not professional or not aware of their responsibilities to act independently in the role of a monitor. A&M is frequently involved in CCAA matters and is understandably proud of its high standard of professionalism. However, that is not the issue. In my view, A&M should not be put in the position of being required to step back and give advice to the Court on the essential issue before the Court in light of its central role in the whole process that will be considered.

[33] In an article in the Commercial Insolvency Reporter, (LexisNexis, August 2010), entitled *Musings (a.k.a. Ravings) about the Present Culture of Restructurings,* former Justice James Farley, the doyen of the Commercial List for many years and no stranger to CCAA proceedings, had this to say about the role of a monitor:

> I mean absolutely no disrespect or negative criticism towards any monitor when I observe that they are only human. I think it is time to consider whether a monitor can truly be objective and neutral under present circumstances- it would take a true saint to stand firm under the pressures now prevailing. It should be appreciated that monitors are in fact hired by the debtor applicant (aided by perhaps a party providing interim financing, possibly in the role of the power behind the throne) and retained to advise the debtor well before the application is made. Is it not human nature for a monitor to subconsciously wonder where the next appointment will come from if it crosses swords with its hirer?

[34] Mr. Farley went on to suggest that the role of a monitor be split in two. That may be a laudable objective, but would require legislation. In this case, I do not think it would be appropriate in light of the extremely extensive work done by A&M over the course of two years.

[35] A monitor is an officer of the Court with fiduciary duties to all stakeholders and is required to assist the Court as requested. It has often been said that a monitor is the eyes and ears of the Court. It is critical that in this role a monitor be independent of the parties and be seen to be independent. I can put it no better than Justice Topolniski in *Winalta Inc. (Re),* 2011 ABQB 399 in which she said:

> **67** A monitor appointed under the *CCAA* is an officer of the court who is required to perform the obligations mandated by the court and under the common law. A monitor owes a fiduciary duty to the stakeholders; is required to account to the court; is to act independently; and must treat all parties reasonably and fairly, including creditors, the debtor and its shareholders.
>
> **68** Kevin P. McElcheran describes the monitor's role in the following terms in *Commercial Insolvency in Canada* (Markham, Ont.: LexisNexis Butterworths, 2005) at p. 236:
>
> > The monitor is an officer of the court. It is the court's eyes and ears with a mandate to assist the court in its supervisory role. The monitor is not an advocate for the debtor company or any party in the *CCAA* process. It has

> a duty to evaluate the activities of the debtor company and comment independently on such actions in any report to the court and the creditors.

[36] In this case, A&M is in no position to comment independently on the activities of Nelson in regards to the very issue in this case, namely the reliability of the SISP program in determining whether the second lien lenders' security has any value.

[37] There is also a question of the appearance of a lack of impartiality. During the two years that A&M was engaged prior to this CCAA proceeding, for which it billed over $5 million, it was involved in advising Nelson during negotiations with the interested parties, including RBC, and in participating in those negotiations with RBC on behalf of Nelson. This history can cause an appearance of impartiality, something to be avoided in order to provide public confidence that the insolvency system is impartial. See *Winalta* at para. 82. It was this concern of a perception of bias that led to the prohibition being added to section 11.7(2) of the CCAA preventing an auditor of a company acting as a monitor of the company.

[38] The issue of an appropriate monitor requires the balancing of interests. This is not like some cases in which a financial advisor has had some advisory role with the debtor and then becomes a monitor, usually with no objection being raised. Often it may be appropriate for that to occur taken the knowledge of the debtor acquired by the advisor. This case is different in that the financial advisor has been front row and centre in the very sales process that will be the subject of debate in these proceedings and has engaged in negotiations on behalf of Nelson.

[39] In all of the circumstances of this case, I concluded that it would be preferable for another monitor to be appointed and for that reason replaced A&M Canada as Monitor with FTI.

Other issues

[40] In the Initial Order, RBC was directed to continue its cash management system. There was no charge provided in favour of RBC. RBC says that it should not be required to continue the cash management system without the protection of a charge. During this hearing, Mr. Chadwick on behalf of Nelson said that it might be possible to satisfy RBC by requiring some

minimum balance in the accounts, failing which a charge would be provided in favour of RBC. I take it that this issue will be worked out.

[41] In the draft Initial Order that accompanied the CCAA application at the outset, a paragraph was included that provided that Nelson could not pay any amounts owing by Nelson to its creditors except in respect of interest, expenses and fees, including consent fees, payable to the first lien lenders and fees and expenses payable to the first lien agent under the support agreement. That provision was deleted from the Initial Order. It was replaced with a provision that Nelson could pay expenses and satisfy obligations in the ordinary course of business.

[42] RBC takes the position that there should be a level playing field for the second lien lenders consistent with the treatment of the first lien lenders in this CCAA process, and that if interest is to be paid to the first lien lenders and expenses of their financial and legal advisors paid, the same should happen to the second lien lenders.

[43] RBC points out that it was Nelson who decided in June, 2014 to stop paying interest on the second lien debt and a little later reduce paying RBC's advisors in light of Nelson's view that there was not sufficient progress in negotiations with RBC. Payment of these professional fees was stopped in August, 2014. In September 2014 Nelson agreed in the First Lien Support Agreement not to make further payments in connection with the second lien debt, including any payment for fees, costs or expenses to any legal, financial or other advisor to RBC, the second lien agent, without the consent of the consenting first lien lenders. The consenting first lien lenders are opposed to any interest or expenses being paid to the second lien lenders.

[44] The second lien credit agreement provides for interest to be paid on the debt and in section 10.03 for all costs of the second lien agent, RBC, arising out of CCAA proceedings. The intercreditor agreement between the first and second lien agents provides in section 3.1(f) that nothing in the agreement save section 4 shall prevent receipt by the second lien agent payments for interest, principal and other amounts owed on the second lien debt. Section 4 provides that any collateral or proceeds of sale of the collateral shall be paid to the first lien agent until the first lien debt has been repaid and then to the second lien agent. As there has been no sale of the collateral, there is nothing in the intercreditor agreement that prevents payment of interest and

expenses of the second lien lenders. The second lien lenders are contractually entitled to receive payment of their interest, costs, expenses and professional fees.

[45] No determination has been made in these proceedings that there is no value available for the second lien lenders. RBC disputes the applicants' views on this point. RBC contends that these CCAA proceedings should not commence with the Court accepting as a *fait accompli* that the second lien lenders should not be paid in the proceeding when every other stakeholder is being paid.

[46] There is no evidence that Nelson has not been in a position to pay the interest, costs, expenses and professional fees of the second lien lenders since it made a decision in 2014 to stop paying these amounts. Since the First Lien Support Agreement with the consenting first lien lenders, the decision has been taken out of the hands of Nelson and turned over to the consenting first lien lenders.

[47] In my view, on the basis of the evidence, there is no justification to pay all of the interest, costs and expenses of the first lien lenders but not pay the same to the second lien lenders. In the circumstances, it is only fair that pending further order, Nelson be prevented from paying any interest or other expenses to the first lien lenders unless the same payments owing to the second lien lenders are made, and it is so ordered.

[48] RBC has requested costs of the comeback motion and I believe other costs. A request for costs may be made in writing by RBC within 10 days, along with a proper cost outline, and the parties against whom costs are claimed shall have 10 days to file a response to the cost request.

Newbould J.

Date: June 2, 2015

TAB 2

1999 CarswellOnt 4661
Ontario Superior Court of Justice [Commercial List]

T. Eaton Co., Re

1999 CarswellOnt 4661, [1999] O.J. No. 5322, 15 C.B.R. (4th) 311, 95 A.C.W.S. (3d) 219

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 T. Eaton Company Limited, Applicant

Farley J.

Judgment: November 23, 1999
Docket: 99-CL-3516

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered by *Farley J.*:

Cadillac Fairview Inc., Re (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]) — considered

Campeau Corp., Re (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) — considered

Central Guaranty Trustco Ltd., Re (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) — referred to

Keddy Motor Inns Ltd., Re (1992), 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245, 6 B.L.R. (2d) 116, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 110 N.S.R. (2d) 246, (sub nom. *Keddy Motor Inns Ltd., Re (No. 4))* 299 A.P.R. 246 (N.S. C.A.) — applied

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) — applied

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

Olympia & York Developments Ltd., Re (1993), (sub nom. *Olympia & York Developments Ltd. v. Royal Trust Co.)* 18 C.B.R. (3d) 176, 102 D.L.R. (4th) 149 (Ont. Gen. Div.) — applied

Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1, (sub nom. *Olympia & York Developments Ltd., Re)* 12 O.R. (3d) 500 (Ont. Gen. Div.) — considered

Royal Oak Mines Inc., Re (1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List]) — considered

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

Sorsbie v. Tea Corp, [1904] 1 Ch. 12 (Eng. C.A.) — referred to

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16
Generally — referred to

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

APPLICATION by company for court approval of plan under *Business Corporations Act*.

Subject:

***Farley J.*:**

1 The criteria that a debtor company must satisfy in seeking the court's approval for a plan under the *Companies' Creditors Arrangement Act* ("*CCAA*") are well established:

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

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

(c) the plan must be fair and reasonable.

See: *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at pp.182-3, affirmed (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) and *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at p. 172.

2 In exercising its discretion to approve an arrangement under the *Ontario Business Corporations Act* ("*OBCA*"), the court must be satisfied that the arrangement meets the same criteria as set out above for approving a plan under the *CCAA*. See *Re Olympia & York Developments Ltd.* (1993), 18 C.B.R. (3d) 176 (Ont. Gen. Div.) at p. 186.

3 It would appear to be undisputed by anyone (including myself) that items (a) and (b) have been met and complied with. That leaves the question of whether what is advanced is fair and reasonable. The majority can bind the minority in a plan provided that the purchase does not bind the minority to terms that are unfair or unconscionable. See *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.) at pp.247-8, 258.

4 In reviewing the fairness and reasonableness of a plan the court does not require perfection; nor will the court second guess the business decisions reached by the stakeholders as a body.

5 In *Sammi Atlas Inc.*, *supra*, I cited *Re Campeau Corp.* (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.), *Northland Properties Ltd.*, *supra*, and *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.) at pp.173-4 where I observed:

... A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment. One must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights ...

Those voting on the Plan (and I noted there was a very significant "quorum" present at the meeting) do so on a business basis. As Blair J. said at p. 510 of *Olympia & York Developments Ltd.*:

> As the other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspects of the Plan, descending into the negotiating arena and substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas.
>
> The court should be appropriately reluctant to interfere with the business decisions of creditors reached as a body. There was no suggestion that these creditors were unsophisticated or unable to look out for their own best interests ...

6 As well there is a heavy onus on parties seeking to upset a plan that the required majority have supported. See *Sammi Atlas Inc.*, *supra*, at p.274 citing *Re Central Guaranty Trustco Ltd.* (1993), 21 C.B.R. (3d) 139 (Ont. Gen. Div. [Commercial List]) at p.141.

7 It is also appropriate to take into consideration the fact that both classes of creditors as well as the shareholders voted overwhelmingly in favour of the Eaton's Plan. In the case of the unsecured creditors this was 99% plus in number and 94% plus in value; the landlords unanimously; and the shareholders 99.5%. This was not a scrape by the minimum requirement situation.

8 The alternative to a favourable vote would be that Eaton's would be in bankruptcy today as per the provisions of last week. Thus there would be some uncertainty as to recoveries - and whether or not a plan could arise from the ashes so as to utilize the tax loss potential. *I note specifically that no one presented an alternative plan for the interested parties to vote on.*

9 What is of concern is the question of the size of the pot going to the shareholders. That was a bone of contention amongst the various creditors - but as I have observed, no one advanced a competing plan. I would also like to make it clear that I have no doubt that many of the shareholders have suffered significant losses as a result of the demise of Eaton's and I know that it is painful for them. It is not my intention to increase that pain but I do think that it is important for at least future situations that in devising and considering plans persons recognize that there is a natural and legal "hierarchy of interest to receive value in a liquidation or liquidation related transaction" and that in that hierarchy the shareholders are at the bottom. See my endorsement of November 22, 1999 in *Re Royal Oak Mines Inc.* [(1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List])]:

> Further in these particular circumstances [here I was talking of Royal Oak, but the same would appear to hold true for Eaton's], there are, in relation to the available tax losses (which is in itself a "conditional" asset), very substantial amounts of unsecured debt standing on the shareholders' shoulders. That is, the shareholders, even assuming an ongoing operation without restructuring, would have to wait a long while before their interests saw the light of day.

10 I think it appropriate to note that in *Sammi Atlas Inc.*, the shareholder got $1.25 million U.S.; in *Re Cadillac Fairview Inc.*; nothing; and in *Royal Oak Mines Inc.* it is proposed the shareholders be diluted down to 1% equity interest underneath a heavy blanket of other obligations. When viewed in contrast, the Eaton's deal would appear to be on the rich side.

11 I also think it helpful to note my observations in *Re Cadillac Fairview Inc.* (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), at pp.11-16 and especially the analysis *Sorsbie v. Tea Corp*, [1904] 1 Ch. 12 (Eng. C.A.) as well as the other cases referred to therein.

12 I trust that a forward thinking analysis of these views will be of assistance to those involved in future cases.

13 However, in the subject Eaton's case, in the circumstances here prevailing, I find the plan to be fair and reasonable, notwithstanding my concerns that it might well have been appropriately modified to get it closer to perfection. While "perfection" is an impossible goal, "closer to perfection" should always be strived for. The Eaton's plan is approved for both *CCAA* and *OBCA* purposes.

Application granted.

1999 CarswellOnt 4661, [1999] O.J. No. 5322, 15 C.B.R. (4th) 311, 95 A.C.W.S. (3d) 219

End of Document

TAB 3

COURT FILE NO.: CV-08-7672-00CL
DATE: 20090727

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF WINDSOR MACHINE & STAMPING LIMITED, LIPEL INVESTMENTS LTD., WMSL HOLDINGS LTD., 442260 ONTARIO LTD., WINMACH CANADA LTD., PRODUCTION MACHINE SERVICES LTD., 538185 ONTARIO LTD., SOUTHERN WIRE PRODUCTS LIMITED, PELLUS MANUFACTURING LTD., TILBURY ASSEMBLY LTD., ST. CLAIR FORMS INC., CENTROY ASSEMBLY LTD., PIONEER POLYMERS INC., G&R COLD FORGING INC., WINDSOR MACHINE DE MEXICO, WINMACH INC., WINDSOR MACHINE PRODUCTS, INC. WAYNE MANUFACTURING INC. AND 383301 ONTARIO LIMITED

Applicants

BEFORE: **MORAWETZ J.**

COUNSEL: **Andrew Hatnay & Andrea McKinnon, for United Auto Workers Local 251**

Daniel Dowdall & Jane Dietrich, for Bank of Montreal

Joseph Marin, for the Applicants

Tony Reyes, for RSM Richter Inc., Monitor

Raong Phalavong, for Saginaw Pattern

HEARD: **MARCH 6 and 10, 2009**

E N D O R S E M E N T

INTRODUCTION

[1] International Union, United Automobile Aerospace & Agricultural Implement Workers of America ("United Auto Workers, Local 251" or the "Union") bring this motion for an order requiring the Applicants to pay termination and severance pay that is due and owing to the unionized employees of Tilbury Assembly Ltd. ("Tilbury") and Pellus Manufacturing Limited ("Pellus") under the *Employment Standards Act*, 2000 ("ESA") as result of terminations that occurred subsequent to the filing of proceedings by the Applicants under the *Companies' Creditors Arrangement Act* ("CCAA").

[2] The motion was opposed by Bank of Montreal (the "Bank"), the secured creditor of the Applicants and by the Applicants.

[3] The amount owing to the Tilbury employees for termination pay is approximately $23,000 and the amount owing for severance pay is approximately $216,000. These amounts are not in dispute.

[4] The amount claimed to be owing to the Pellus employees (assuming that the employees were terminated on February 20, 2009) is approximately $132,000 and the amount claimed to be owing for severance pay as of that date is approximately $326,000. This amount is disputed by Pellus.

[5] The Union submits that the Applicants should be required to pay the termination pay and severance pay owing to the Tilbury and Pellus employees for the following reasons:

(a) The ESA sets out a comprehensive code that requires an employer who terminates an employee to give the employee prior notice of termination, or if such notice is not given, pay in lieu of notice (commonly referred to as "termination pay"). The ESA also requires that an additional amount (referred to as "severance pay") be paid to certain long service employees if criteria in the ESA are met.

(b) The Amended and Restated Initial CCAA Order and the consent orders issued by this Court dated October 29, 2008, do not authorize the company to avoid paying termination pay and severance pay. The October 29, 2008 consent orders state that "the *Employment Standards Act, 2000* continues to apply".

(c) 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.

(d) The Supreme Court of Canada has held that federally regulated bankruptcy and insolvency proceedings cannot be used to subvert provincially regulated property and civil rights, as long as the doctrine of paramountcy is not triggered. In the

absence of paramountcy, a provincial law such as the ESA continues to apply in insolvency proceedings.

(e) For the Tilbury and Pellus employees who continued to work for the Company after it went into CCAA protection and who were subsequently terminated, the payment of termination pay and severance pay is an ordinary course payment by the Company. It is to be paid the same way wages, benefits and other aspects of employee compensation are paid.

(f) The payment of termination pay and severance pay in a CCAA proceeding is not a re-ordering of priorities among creditors nor is it giving a higher rank to unsecured employee creditors. Termination pay and severance pay that arises on the termination of employees post-CCAA filing is not pre-filing debt. It is an ordinary course payment.

(g) The payment of termination pay and severance pay in the case at bar is within the reasonable expectations of the parties because:

(i) Company management represented to the Union employees from the outset of the CCAA proceedings that it would continue to pay all contractual amounts due to employees who worked during the CCAA proceedings, which would include amounts for termination pay and severance pay; and

(ii) The Company, the Bank and the Monitor consented to the terms of court orders that expressly state that the "*Employment Standards Act 2000* continues to apply".

(h) The employees have no recourse to be compensated for the unpaid termination pay and severance pay. There will be no Plan of Compromise.

(i) The *Wage Earner Protection Plan* (WEPP) is not available to the employees because the Company is in CCAA proceedings and the WEPP is only available to terminated employees if their employer is a bankrupt or in receivership.

(j) The amount of termination pay and severance pay owing is relatively low.

(k) The Company has the cash to pay the termination pay and severance pay that is owing.

(l) The payment of termination pay and severance pay will not jeopardize the Company's restructuring which is to be a Proposed Transaction involving a purchase of the company by its controlling shareholders.

(m) The Company has not drawn on the DIP Facility throughout the CCAA proceedings.

(n) The Company should not be able to use the CCAA to avoid its employee termination pay and severance pay obligations under the ESA.

(Note: In the excerpt from the factum, counsel to the Union references "Applicants", and the "Company". Hereafter, the collective reference is to "Applicants".)

[6] The Bank submits that the Union's motion for the payment of termination and severance claims should be dismissed because:

(a) the termination and severance claims are unsecured obligations of Tilbury and Pellus which are not afforded any priority under the Amended and Restated Initial Order, or any other orders that have been made in the CCAA proceeding, and are therefore unsecured claims subordinate to the claims of the Bank as a secured creditor. Any amount paid in respect of the termination and severance claims is a direct deduction from recoveries for the secured creditors; and

(b) the provisions of the Amended and Restated Initial Order granted by this Court on September 2, 2009 (the "Amended and Restated Initial Order") do not permit the Applicants to pay termination and severance claims at this time.

[7] The Applicants submit that the Union's motion should be dismissed because:

(a) the provisions of the Amended and Restated Initial Order do not permit the Applicants to pay the termination and severance claims in the circumstances in which the Union is seeking such payment;

(b) the Union has not sought to amend the Amended and Restated Initial Order at any time during these proceedings to require the Applicants to pay the termination and severance claims; and

(c) the effect of granting the relief to the Union would be to accord termination and severance claims a special status over the claims of other unsecured creditors of the Applicants and would result in the payment of such claims in priority to the claims of the Applicants' secured creditors.

FACTS

[8] The Union represents employees at four facilities of the Applicants: Tilbury, Pellus, G&R Cold Forging Inc. and Pioneer Polymers Inc. The Union represents approximately 180 employees out of the total workforce of 300 employees.

[9] On August 1, 2008, Windsor Machine & Stamping Ltd. ("WMSL"), 538185 Ontario Ltd. (Pellus Tool), Pellus, Tilbury, G&R Cold Forging Inc. and 383301 Ontario Limited (the "BIA Proposal Proponents") each filed a notice of intention ("NOI") to make a proposal pursuant to s. 50.4(1) of the *Bankruptcy and Insolvency Act* ("BIA").

[10] On August 6, 2008, the Applicants (including the BIA Proposal Proponents) were granted protection under the CCAA.

[11] As of the date of the initial CCAA order on August 6, 2008, the Monitor reported that the Bank was owed approximately $16.25 million comprised of approximately $8.1 million under an operating line of credit and approximately $8.15 million under a term loan. The Bank agreed to make available up to an additional $2 million to fund the Applicants' operations during the CCAA proceedings under a DIP Loan Agreement.

[12] The amount owing to various vendors as of the date of the NOI Filing was approximately $6.5 million.

[13] The DIP Facility was extended to the Applicants under the terms of a DIP Loan Agreement. The DIP Facility was approved under the terms of the Initial Order at the outset of the CCAA proceedings.

[14] The provisions of the DIP Loan Agreement provide that advances from the Bank to WMSL could be loaned to Pellus and Tilbury, (among other Applicants) to fund ordinary course operations of those affiliates. Counsel to the Applicants submits that as Tilbury and Pellus have no funds to pay any termination or severance pay to the employees at Tilbury and Pellus represented by the Union (the "Tilbury Union Employees" and "Pellus Union Employees"), respectively, and they would have to ask that WMSL lend them sufficient funds for that purpose.

[15] Under the terms of the Amended and Restated Initial Order, counsel to the Applicants submit that the right of the Applicants to negotiate the terms on which termination and severance payments may be made upon termination of the employment of the Applicants' employees was subject to the covenants which are contained in the DIP Loan Agreement and that the Applicants, with limited exceptions that do not include the making of termination and severance payments, are not permitted to do anything which adversely affects the ranking of the obligations of WMSL to the Bank under either the DIP Loan Agreement or under the Amended and Restated Credit Agreement that governs the terms of loans made by the Bank to the WMSL prior to the commencement of the CCAA proceedings.

[16] On October 8, 2008 a sales process was approved by court order. The deadline for submission of offers to the Monitor was November 18, 2008. On November 18, 2008 there were no offers received, however, certain parties continued to express an interest in the Applicants' operations.

[17] Orders were made in these proceedings on October 29, 2008 (the "October 29 Orders") at the time that access agreements with two major customers of the Applicants were approved by the court. The October 29 Orders included provisions stating that the notice of one week for termination of the employment of employees on the expiry of the access periods under the Access Agreements would not operate to neutralize or suspend the provisions of the ESA.

[18] In September or October, 2008, the Union was informed of the possibility of the closure of the Tilbury facility. The Union advised the Applicants at that time that should the

employment of any Tilbury Union Employees be terminated, those employees should be paid termination and severance pay as required under the ESA.

[19] The efforts of the Applicants in October and early November, 2008, were directed to securing sources of funding for the Applicants' restructuring initiatives from prospective purchasers, financial institutions and other providers of capital as strategic partners and investors. The Applicants submit that they considered filing a plan of arrangement during that period if their efforts to secure funding had been successful.

[20] When no offer was received to purchase the assets of the Applicants, the principals of WMSL (the "Shareholders") negotiated with the Bank and with Export Development Canada ("EDC") to obtain financing from the Bank and from EDC for two newly incorporated corporations ("New Cos") to be controlled by the Shareholders which would purchase the Applicants' assets, properties and undertakings on a going-concern basis (the "Proposed Sale").

[21] The Applicants were of the view that the Proposed Sale was the only alternative to a liquidation sale or auction of the Applicants' assets and properties.

[22] The Applicants acknowledge that they are not in a position to proceed with a plan of arrangement that would see value paid to their unsecured creditors.

[23] At the end of November 2008, the management of Tilbury determined that a transfer of the employment of any of the Tilbury Union Employees was no longer economically feasible because of the decline in current and projected volume for the Applicants. The Union was advised of this decision and effective December 5, 2008, the Applicants terminated 47 Tilbury Union Employees at the Tilbury plant. The Tilbury Union Employees did not receive termination pay and severance pay.

[24] On January 21, 2009, the Applicants informed the Pellus Union Employees that the operations of Pellus would be closed down and that their employment would be terminated. The closure date was subsequently extended to late February 2009. The number of Pellus Union Employees whose employment will be terminated as a result of the closure of the Pellus facility is 43, of whom 40 are Pellus Union Employees.

[25] Pellus advised the Union of its position that under the provisions of the ESA, the Pellus Union Employees are not entitled to be paid severance pay because each Pellus Union Employee is not one of 50 or more employees who will have had the employment relationship with Pellus severed within a six-month period and Pellus does not have a payroll of $2.5 million of more. The adjudication of this issue is not before me at this time.

[26] In January 2009, the Applicants paid $2.8 million toward the Bank operating line as a repayment of pre-filing debt. In addition, as a result of asset sales and collections a further $1.2 million was also paid to the Bank toward its term loan facilities.

[27] The Monitor's Sixth Report is dated February 23, 2009 and at that date, the Applicants had approximately $3.4 million in cash and at the end of April 2009, the Applicants were

expected to have $3 million. The Applicants has not drawn the DIP Facility throughout the CCAA proceedings.

[28] Periodically during the CCAA proceedings, the Applicants returned to court and obtained orders extending the CCAA proceedings. Extensions were granted, under s. 11(4) of the CCAA based upon the court making required findings that the Applicants were operating in good faith and with due diligence such as to justify an extension of the stay.

ISSUES AND ANALYSIS

[29] The issue to be determined on this motion is: Should the Applicants, in these CCAA proceedings, be required to pay termination pay and severance pay to the Tilbury Union Employees and the Pellus Union Employees.

[30] This issue was recently considered in *Nortel Networks Corp., Re*, 2009 CanLII 31600 (On. S.C.) in the context of proceedings commenced by Nortel Networks Corp., et al (the "Nortel Applicants") under the CCAA (the "Nortel CCAA Proceedings").

[31] In the Nortel CCAA Proceedings, both unionized and non-unionized employees brought motions seeking an order to vary the Initial Order to require the Nortel Applicants to pay, among other things, termination pay and severance pay, in accordance with the applicable collective agreement and/or the *Employment Standards Act*. The motions were dismissed.

[32] The initial order in the Nortel CCAA Proceedings (the "Nortel Initial Order") was similar to the Amended and Restated Initial Order. Both were based on the Model Order.

[33] The applicable order in each case, (a) entitles but did not require the Applicants to pay outstanding and future wages, salaries, vacation pay,…, in each case incurred in the ordinary course of business; (b) provides that the Applicants were entitled to terminate the employment or lay off any of its employees and to deal with the consequences in the Plan.

[34] Many of the submissions raised by the Union at [5], were considered in the Nortel decision.

[35] Included in the conclusions in Nortel were statements to the effect that:

(i) claims for termination pay and severance pay are unsecured claims. These claims do not have any statutory priority;

(ii) Section 11.3 of the CCAA is an exception to the general stay provisions authorized by Section 11 and as such should be narrowly construed;

(iii) Section 11.3 applies to services provided after the date of the Initial Order;

(iv) the triggering of the payment obligations for termination and severance pay may have arisen after the Initial Order but it does not follow that a service was

provided after the Initial Order. The claims for termination and severance pay are based, for the most part, on services that were provided pre-filing.

(v) a key factor is whether the employee provided services after the date of the Initial Order. If so, he or she, is entitled to compensation benefits for such services.

(vi) the court has the jurisdiction to order a stay of outstanding termination pay and severance pay obligations under Section 11 of the CCAA.

(vii) the failure to pay outstanding termination pay and severance pay obligations does not amount to 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. The ESA applies, but during the stay period, there is a stay of the enforcement of the payment obligation.

[36] In my view, these conclusions are equally applicable to this motion.

[37] The submissions of the Union which are addressed in the Nortel decision are as follows:

(i) Payment of termination pay and severance pay are subject to the stay provisions.

(ii) The failure to pay outstanding termination pay and severance pay obligations does not amount to a 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. The ESA applies, but during the stay period, there is a stay of the enforcement of the payment obligations.

(iii) The ESA continues to apply but there is a stay of the enforcement of the payment obligations.

(iv) The triggering of the payment obligations for termination and severance pay may have arisen after the Initial Order but it does not follow that a service was provided after the Initial Order. The claims for termination and severance pay are based, for the most part, on services that were provided pre-filing.

(v) A key factor is whether the employee provided services after the date of the Initial Order. If so, he or see, is entitled to compensation benefits for such services.

[38] Two additional points that are not directly addressed in the Nortel decision are as follows:

(i) Counsel to the Union submitted that the recent case of *Re West Bay SonShip Yachts Ltd.* (2009) B.C.C.A. 31 stands for the proposition that claims for termination and severance pay becomes owing to the employees at the point where their employment was terminated during the post-filing period and

> therefore such claims are post-filing claims. In my view, this case can be distinguished. The claim in *West Bay* involved a common law claim for damages for wrongful dismissal. This type of claim is distinct from a claim for severance pay or termination pay under employment standards legislation, as noted by Levine J.A. at paragraph [14].
>
> (ii) Tilbury Union Employees and Pellus Union Employees did provide services after the date of the CCAA application. Any incremental increase in termination pay and severance pay attributable to the period of time after the Applicants went into CCAA protection may justify treatment as a post-filing claim.

[39] This motion raises an interesting question. Should the Applicants be faulted for commencing proceedings under the CCAA, even though it turns out that no plan can be proposed which provides value to the unsecured creditors. In this case, the alternative to filing under the CCAA would have been to continue with the NOI under the BIA. In light of the acknowledgment that no CCAA plan can be presented which would be of benefit for the unsecured creditors, it follows that no viable proposal could have been made under the BIA. The failure to file a proposal under the BIA would have resulted in a bankruptcy and likely a receivership. In a receivership/bankruptcy, the termination pay and severance pay claims of the Tilbury Union Employees and the Pellus Union Employees would rank as unsecured claims and subordinate to the secured creditors.

[40] In turn, this raises a further question. Should the priority status of the Tilbury Union Employees and Pellus Union Employees be different in the context of CCAA proceedings as opposed to a receivership or bankruptcy.

[41] In this case, the Monitor reports that certain secured creditors will suffer a loss. Any amount paid in respect of termination and severance pay claims would be as a result of a direct deduction from recoveries for the secured creditors. In my view, the effect of granting the requested relief would be to accord the termination and severance pay claims special status over the claims of other unsecured creditors of the Applicants and would also result in the payment of such claims in priority to the claims of the Applicants' secured creditors.

[42] In addition to my conclusions as set out in *Nortel,* I have not been persuaded that the requested relief can be justified in this case on the following grounds.

[43] First, the priority of secured creditors must, in my view, be recognized. Counsel to the Union made the submission that the Applicants and the Bank are advancing a priority argument that may be relevant in a bankruptcy or receivership proceeding but not in a CCAA proceeding, as there is no priority distribution scheme in the CCAA. In my view this submission is misguided. Although there is no specific priority distribution scheme in the CCAA, that does not mean that priority issues should not be considered. An initial order under the CCAA usually results in a stay of proceedings as against secured creditors as well as unsecured creditors. The stay prevents secured creditors from taking enforcement proceedings which would confirm their

priority position. The inability of a secured creditor to take such enforcement proceedings should not result in an enhanced position for unsecured creditors. There is no basis, in my view, for the argument that somehow the absence of a statutory distribution scheme entitles unsecured creditors to obtain enhanced priority over secured creditors for pre-filing obligations. To give effect to this argument would result in a situation where secured creditors would be prejudiced by participating in CCAA proceedings as opposed to receivership/bankruptcy proceedings. This could very well result in a situation where secured creditors would prefer the receivership/bankruptcy option as opposed to the CCAA option as it would recognize their priority position. Such an outcome would undermine certain key objectives of the CCAA, namely, (i) maintain the *status quo* during the proceedings; and (ii) to facilitate the ability of a debtor to restructure its affairs. In my view, it is essential, in a court supervised process, to give due consideration to the priority rights of secured creditors. In this case, the secured creditors have priority over the termination pay and severance pay claims of the Tilbury Union Employees and the Pellus Union Employees.

[44] Second, counsel to the Union also submits that based on the rationale in the decision of the Court of Appeal in *Re 1231640 Ontario Inc. (State Group)* (2007), 37 C.B.R. (5th) 185 (Ont. C.A.), priority rules do not crystallize in a CCAA proceeding. I do not accept this argument. *State Group* addressed a priority issue as between competing PPSA secured creditors in the context of a interim receivership under s. 47 of the BIA. The issue in *State Group* was whether a s. 47 BIA receiver was a person who represents creditors of the debtor under s. 20(1)(b) of the PPSA. The Court of Appeal held that an interim receiver was not such a person. The issue in *State Group* governs the relationship as between competing interests under the PPSA. In my view, it does not stand for the proposition that the priority position of a secured creditor vis-à-vis unsecured creditors should not be recognized in the context of a CCAA proceeding.

[45] Third, the Union put forth submissions to the effect that, in this particular situation, the amount of termination pay and severance pay is relatively low and the Applicants have the cash to pay the amounts owing and, further, that such payments would not jeopardize the Proposed Sale.

[46] In my view, the fact that the Applicants may have available cash does not mean that the Applicants can use the cash as they see fit. The asset is to be used in accordance with credit agreements and court authorized purposes, including those set out in the Amended and Restated Initial Order. I am in agreement with these submissions of counsel to the Applicants as set out at [15]. This Order placed restrictions on the use of cash, which restrictions are consistent with legal priorities. In my view, the fact that the Applicants have cash does not justify an alteration of legal priorities. The legal priority position is that the claims for termination pay and severance pay are unsecured claims which rank pari passu with other unsecured creditors and subordinate to the interests of the secured creditors. (See also Indalex Limited CV-09-8122-00CL – July 24, 2009 on this point.)

[47] I acknowledge that the situation facing the employees is unfortunate and that in Nortel, a hardship exception was made. However, this exception was predicated, in part, on the

reasonable expectation that there will be a meaningful distribution to unsecured creditors, including the former employees. Such is not the case in this matter.

[48] Counsel to the Union also submitted that paragraph 11(d) of the Amended and Restated Initial Order only allows the company to terminate employees on terms agreed to by the employees or "to deal with the consequences thereof in the plan". Counsel to the Union submits that there is no agreement in this case and there is no plan and consequently paragraph 11(d) does not authorize the company not to pay termination pay and severance pay.

[49] In my view, the Applicants provide a complete response to this argument in their submission summarized at [15] which I accept and at paragraph 32 of their factum by noting that the Applicants could have proposed a Plan that would not have seen value paid to the unsecured creditors and that could have effected the Proposed Sale through a Plan, and to require that the Applicants propose a Plan in order to effect the sale would be an overly technical requirement inconsistent with the CCAA's remedial objective. I also accept these submissions. In my view, this is not a case where the Applicants have used the CCAA to avoid termination and severance pay obligations under the ESA. The fact that these claims will not be paid is a result of legal priorities as opposed to any specific action of the Applicants.

[50] I also note the CCAA proceedings are ongoing and the Applicants have brought forth a motion to propose a plan directed only at the secured creditors, but such a plan has been accepted in other cases. (See *Anvil Range Mining Corp.* (2001), 25 C.B.R. (4th) page 1 (Ont. S.C.J.), aff'd 2002, 34 C.B.R. (4th) 157 (Ont. C.A.)) This motion has yet to be heard.

DISPOSITION

[51] In the result, I have not been persuaded that the facts of this case are such that would justify an outcome different from that of *Nortel*. The claims for termination pay and severance pay are unsecured claims and enforcement proceedings are stayed, save and except for any incremental amount of termination pay and severance pay attributable to the period of time after the Applicants went into CCAA protection.

[52] Counsel to the Bank also raised the issue that Tilbury and Pellus do not have the funds to pay the termination and severance claims as all cash is held by WMSL. Counsel to the Bank submits that if an order were to be made that WMSL were required to pay or to loan money to Tilbury or Pellus so that they could then pay the termination and severance pay claims, such would be equivalent to a common employer finding without a proper trial of such issue. I accept this position and to the extent that I have erred in my conclusions and this issue becomes relevant, it would be necessary, in my view, to have a hearing to determine whether WMSL, Tilbury and Pellus are a common employer. This possibility is recognized at paragraph 38 of the Reply Factum served by counsel to the Union.

[53] For the foregoing reasons, subject to the caveat in [51], the motion is dismissed.

MORAWETZ J.

DATE: **July 27, 2009**

TAB 4

CITATION: Re: Canwest Global Communications Corp., 2010 ONSC 1746
COURT FILE NO.: CV-09-8396-00CL
DATE: 20100614

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS

COUNSEL: *Lyndon Barnes, and Alex Cobb* for the CMI Entities
Maria Konyukhova for the Monitor, FTI Consulting Canada Inc.
Robert Chadwick and Logan Willis for the Ad Hoc Committee of Noteholders
Steve Weisz for CIT Business Credit Canada Inc.
D. Wray for the Communications, Energy and Paperworkers' Union

REASONS FOR DECISION

PEPALL J.

Introduction

[1] On October 6, 2009, I granted the CMI Entities an Initial Order which provided protection under the Companies' Creditors Arrangement Act[1] (the "CCAA") and stayed all proceedings against them. The Communications, Energy and Paperworkers' Union ("CEP") is the certified bargaining agent for certain employees of the CMI Entities. The CEP and the CMI Entities are parties to certain collective agreements. The CEP requests an order directing the CMI Entities to satisfy all obligations in respect of severance payments and notice of termination and/or notice of layoff payments in accordance with the terms of collective agreements. These payments are alleged to be due to union members who rendered services to the CMI Entities

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

after October 6, 2009, the date of the Initial Order. Payments to two groups of employees are in issue. CEP did not proceed with that part of the motion relating to a third group whose effective layoff date predated the Initial Order. In addition, the parties adjourned on consent CEP's request for the establishment of a financial hardship process.

Factual Background

[2] On September 3, 2009, the applicable CMI Entity employer announced nine layoffs of employees at the CHBC Kelowna television station. The effective layoff dates were in mid October or December of 2009. The applicable collective agreement provided for severance payments. Specifically, it stated:

> In the event that an employee who has completed their probationary period is laid off, he/she shall receive severance of two (2) weeks pay for each completed year of continuous service up to seven (7) years, and three (3) weeks severance pay for each year of continuous service beyond seven (7) years, to a maximum of fifty-two (52) weeks severance pay. Up to two (2) weeks of the total may be actual notice with the balance paid in a single lump sum or in payments agreeable between the employee and the Company. In the event of a temporary layoff not longer than eight (8) weeks, where the (sic) is guaranteed to be recalled, there shall be no requirement to pay severance pay.

[3] In lieu of lump sum severance payments, the CMI Entities proposed to make severance payments by way of "salary continuance". As such, post layoff, the CMI Entities would continue to pay the employees their regular salary until their severance obligations were exhausted. But for the CCAA proceedings and the insolvency of the debtor companies, this salary continuance would have commenced in mid October or December, 2009. All of the employees worked beyond October 6, 2009 and remained employed until their effective layoff dates. They were paid their ordinary wages and benefits until their effective layoff dates and thereafter nothing was paid.

[4] On November 12, 2009, the applicable CMI Entity employer announced nine terminations of employment at Global Saskatoon[2]. The effective termination date was November 30, 2009. The CMI Entities did not pay these employees any severance after they

[2] Two of these were later rescinded.

were laid off. Some of these employees are also owed money in respect of pay in lieu of notice of termination. These payments were also not made. While the applicable collective agreement was not filed on this motion, it is acknowledged that it provides for termination and severance payments to employees whose employment has been terminated or severed. Even though they were told that they would not be paid any severance, all of the affected employees continued to work until their effective termination date of November 30, 2009. The employer paid the employees their wages plus a retention bonus if they continued to work until November 30, 2009. For example, one employee was paid a retention bonus of $5400. Two layoffs were subsequently rescinded.

[5] CEP filed an affidavit of Robert Lumgair, a national representative of the Union. He emphasized the significance of severance payments to employees. He stated that employees consider the promise of severance pay to be part of their total compensation package. He also noted that anticipated severance often serves as an incentive for employees to remain in the employment of the employer.

[6] The Initial Order was largely based on the Commercial List Users' Committee Model Order. Paragraph 7(a) of the Initial Order entitles but does not require the CMI Entities: (a) to pay all outstanding and future wages, salaries, and employee benefits (including, but not limited to, employee medical, dental, disability, life insurance and similar benefit plans or arrangements, incentive plans, share compensation plans and employee assistance programs and employee or employer contributions in respect of pension and other benefits), current service, special and similar pension and/or retirement benefit payments, vacation pay, commissions, bonuses and other incentive payments, payments under collective bargaining agreements, and employee and director expenses and reimbursements, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements.

[7] Subject to certain conditions including such requirements as are imposed by the CCAA, paragraph 12 of the Initial Order authorizes the CMI Entities to terminate the employment of such of their employees or lay off or temporarily or indefinitely lay off such of their employees as the relevant CMI Entity deems appropriate on such terms as may be agreed upon between the

relevant CMI Entity and such employee, or failing such agreement, to deal with the consequences thereof in the CMI Plan.

[8] The CMI Entities sent letters to the affected employees outlining the anticipated payments due to them.

[9] Severance payments to sixteen employees totaling approximately $425,000 are in issue on this motion. Of the sixteen, eleven termination claims amounting to approximately $6000 are also in issue.[3]

Issue

[10] The parties agree that: (i) the collective agreements provide for severance and termination pay; (ii) the collective agreements remain in force during the CCAA proceeding; and (iii) section 11.01 of the CCAA provides that employees are entitled to immediate payment for services provided to the CMI Entities after the date of the Initial Order. The issue for me to consider is whether as a result of working for some period of time after the granting of the Initial Order, these sixteen employees are entitled to immediate payment of all severance and termination payments owed to them.

Positions of the Parties

[11] CEP submits that these groups of employees provided post-filing service to the CMI Entities and are entitled to severance and termination payments in accordance with the terms of the collective agreements. Section 11.01 of the CCAA provides that employees are entitled to payment for post-filing services. The collective agreements provide for severance and termination payments. Pursuant to section 33(1) of the CCAA, collective agreements remain in force during CCAA proceedings. Severance and termination payments are in respect of post-filing service and therefore should be paid. In the alternative, at a minimum, the termination payments are properly characterized as payments in respect of post-filing service. CEP relies on

[3] Of the eleven, four claim 3 months pay in lieu but these claims were not quantified.

Jeffrey Mines Inc. [4], *Nortel Networks Corp. (Re)*[5] , *West Bay SonShip Yachts Ltd. (Re)*[6], and *Fraser Papers Inc.*[7] CEP submits that *Windsor Machine & Stamping Ltd.*[8] was wrongly decided.

[12] The CMI Entities submit that they paid the ordinary wages and benefits of the two groups of employees until the effective date of their layoff, based on the fact that they remained at work until that date and that payment of their salary for such service was required by section 11.01 of the CCAA. The fact that these employees provided services following the date of the Initial Order did not convert their severance entitlements---which take effect upon the termination of their services and are calculated based on tenure of past service---into post-filing obligations. Such a holding would be contrary to the jurisprudence and would have wide spread and unprecedented implications generally for the application of a stay to pre-filing obligations owed to post-filing suppliers. There is a distinction between the conclusion that a collective agreement subsists during the CCAA stay period and the conclusion that any and all amounts owing under the collective agreement can be enforced during that period. The CMI Entities rely on the same cases relied upon by CEP plus *Communications, Energy, Paperworkers, Local 721G v. Printwest Communications Ltd.*[9], *Re ICM/Krebsoge Canada Ltd. and International Association of Machinists & Aerospace Workers, Local 1975*[10], *Re Lehndorff General Partner Ltd.*[11],*Re Mirant Canada Energy Marketing Ltd.*[12], *Providence Continuing Care Centre St. Mary's of the Lake v. Ontario Public Service Employees' Union-Local 483*[13], *Re Stelco Inc.*[14], and *Re Wright Lithographing Co. and Graphic Communications International Union Local 517*[15].

[13] The Ad Hoc Committee of Noteholders and CIT Business Credit Canada Inc. both supported the position advanced by the CMI Entities. Counsel for the Ad Hoc Committee also

[4] [2003] J.Q. No. 264.
[5] (2009), 55 C.B.R. (5th) 68 (ont. S.C.J.), aff'd 2009 ONCA 833 .
[6] [2009] B.C.J. No. 120 [B.C. C.A.].
[7] [2009] O.J. No. 3188.
[8] [2009] O.J. No. 3195.
[9] 2005 SKQB 331.
[10] 38 L.A.C. (4th).
[11] (1993), 9 B.L.R. (2d) 275.
[12] 2004 ABQB 218.
[13] 85 C.L.A.S.149, 2006 C.L.B. 12961.
[14] (2005), 75 O.R. (3d) 5 (C.A.).
[15] 91 L.A.C. (4th) 141.

observed that under the proposed Plan, unsecured creditors owed $5000 or less would be paid in full. As such, approximately one half of the 16 employees would be paid in full provided the Plan is approved, sanctioned and remains unchanged in that regard. The Monitor took no position on the motion.

Discussion

[14] To properly assess these issues, it is necessary to examine the relevant provisions of the CCAA, the treatment of termination and severance obligations, and recent case law.

[15] The CCAA was amended on September 18, 2009. The relevant provisions of the CCAA are sections 11 and 33. Subject to the restrictions set out in the Act, section 11 provides the court with the power to make any order that it considers appropriate in the circumstances and the power to grant a stay of proceedings. Additionally, section 11.01 states:

> 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.

Case law on this provision has focused on the provision of services after the Initial Order has been made.

[16] Section 33 for the most part incorporates law that has been established and applied for some time[16]. It is, however, a new provision in the statute itself. Section 33.1 states:

> 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.

[16] See for example *Jeffrey Mines*, supra note 3.

[17] Both termination and severance pay are designed to "cushion the economic dislocation that an employee suffers upon termination of employment and provide support to allow terminated employees to secure new employment: M. Starnino, J-C Killey and C. P. Prophet in "*The Inter Section of Labour and Restructuring Law in Ontario: A Survey of the Current Law*"[17] In discussing the treatment of termination and severance in CCAA proceedings, the same authors note,

> "…amounts owing to employees whose employment has been terminated in the course of or at the end of the restructuring proceeding are typically treated as unsecured creditors in the restructuring proceeding and subject to compromise in accordance with the plan of compromise or arrangement….
>
> There are remarkably few cases expressly considering whether post-employment benefits, termination pay and severance pay are subject to compromise. What little authority there is tends to support the treatment of these claims as unsecured claims subject to compromise in the plan of arrangement. The apparent rationale behind this approach is that in bankruptcy these claims would be treated as unsecured claims subject to compensation in accordance with the scheme of distribution set forth in the BIA."[18]

[18] Turning to the relevant case law, in *Re: Nortel Networks Corp.*[19], two motions were involved. In the first motion, the Union requested a declaration that certain former employees were entitled to post-employment retirement benefits and termination and severance amounts. None of the former employees had provided services to Nortel after the Initial Order. The Union argued that the collective agreement was a bargain that should not be divided into separate obligations and therefore the compensation for services should include all monetary obligations and not just those owed to active employees.

[19] The Court of Appeal rejected the Union's appeal. The Court acknowledged the purpose of the CCAA, namely the facilitation of a compromise or an arrangement between a company and its creditors and stated that the Initial Order stays obligations; it does not eliminate them.

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[17] Ontario Bar Association Continuing Legal Education, April 24, 2009.
[18] Ibid, at p.27-29. Although logical, the authors state that there is a lack of clarity as to whether the analysis should end there.
[19] (2009) ONCA 833.

The Court reiterated that section 11.3 (now section 11.01(a)) of the CCAA is an exception to the general stay provision and should be narrowly construed. Payment for services provided by the continuing employees did not extend to encompass payments to former employees. The latter were in the nature of deferred compensation for prior, not current services. Furthermore, these were independent vested rights.

[20] The ratio of *Re: Nortel Networks Corp* did not address post-filing employees and their rights, if any, to severance and termination payments nor did it address any of the amendments to the CCAA[20]. The Court of Appeal did state:

> "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 [Initial Order]: see *Re: Mirant Canada Energy Marketing Ltd.* (2004), 36 Alta. L.R. (4th) 87 (Q.B.)."[21]

[21] The second motion in the *Re Nortel Networks* case was brought by former non-unionized employees who sought payment of statutory termination and severance claims under the *Employment Standards Act, 2000*[22]. In addressing their appeal, in a footnote, the Court of Appeal observed that:

> "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

[20] The *Nortel* filing predated the CCAA amendments in September, 2009.
[21] *Supra* note 19 at paragraph 19.
[22] 2000, S.O, c 41.

> not in issue on the motion. In *Windsor Machine & Stamping Ltd (Re)* [2009] O.J. 3195, 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."

[22] The leave to appeal proceedings in *Windsor Machine* have been delayed. Although it was a pre-amendment case, the issue was similar to that before me. While it would have been helpful to have the benefit of the Court of Appeal's decision in that case, unfortunately, given timing requirements, I am rendering this decision beforehand.

[23] In *Windsor Machine and Stamping Ltd.*[23], the Union sought an order that the CCAA applicants pay termination and severance pay arising from terminations that occurred some time after the CCAA Initial Order. Morawetz J. reiterated and applied certain of his conclusions from *Re: Nortel Networks Corp.* including that the claims for termination and severance pay were unsecured claims and based for the most part on services that were provided pre-filing. A failure to pay did not amount to a contracting out of a payment obligation; rather, during the stay period, there was a stay of the enforcement of the payment obligation.

[24] There, as in the case before me, the claims for termination and severance were for the most part based on services that were provided pre-filing. Morawetz J. stated that the court has jurisdiction to order a stay of outstanding termination and severance pay obligations and concluded that the effect of paying termination and severance would be to accord to those claims special status over the claims of other unsecured and secured creditors. He noted that the priority of secured creditors had to be recognized. He also observed that in a receivership or bankruptcy, termination and severance pay claims would rank as unsecured claims.

[25] Morawetz J. did order that any incremental increases in termination and severance pay attributable to the post-filing time period were not stayed.

[26] The case relied upon by the Court of Appeal in *Re: Nortel Networks Corp.* was *Mirant Canada Energy Marketing.*[24] In that case, a letter agreement provided for severance pay in the

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[23] [2009] O.J. 3195.
[24] (2004) A.B.Q.B. 218.

event that an employee's employment was terminated without cause. Kent J. held that an obligation to pay severance was an obligation that arose on termination of services, not an obligation that was essential for the continued supply of services. She wrote:

> 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 his salary which he has been paid falls within that definition.[25]

[27] Similarly, in *Communications, Energy, Paperworkers, Local 721G v. Printwest Communications Ltd.* [26], the court held that severance pay did not fall within the category of essential services provided during the reorganization period in order to enable the debtor company to function.

[28] Other cases of note include *Jeffrey Mines Inc.*[27] and *TQS Inc.*[28] both of which accepted that an employer is bound by its collective agreement notwithstanding CCAA proceedings, however, both courts concluded that obligations governed by collective agreements may be compromised.

[29] Having conducted this review, I have concluded that CEP's request for immediate payment should be dismissed. I do so for the following reasons.

[30] As noted by numerous courts including the Court of Appeal in *Re: Nortel Networks Corp.*, the purpose of the CCAA is to facilitate a compromise between a company and its creditors. The Act is rehabilitative in nature. A key feature of this purpose is found in the court's power to stay the payment of obligations including termination and severance payments.

[25] Supra, note 11 at para. 28.
[26] Supra, note 8.
[27] 2003 CarswellQue 90 (C.A.).
[28] 2008 CarswellQue 7132 (C.A.).

Section 11.01(a) permits payment for services provided after the date of the Initial Order. Consistent with the purpose of the statute, that subsection is to be narrowly construed.

[31] Termination and severance payments have traditionally been treated as unsecured claims. There is no express statutory priority given to these obligations. The nub of the issue is whether section 33 of the CCAA dealing with collective agreements alters the treatment of these obligations. In my view, it does not.

[32] Consistent with established law, section 33 of the CCAA does provide that a collective agreement remains in force and may not be altered except as provided by section 33 or under the laws of the jurisdiction governing collective bargaining. It does not provide for any priority of treatment though. The section maintains the terms and obligations contained in the collective agreement but does not alter priorities or status. The essential nature of severance pay is rooted in tenure of service most of which will have occurred in the pre-filing period. As established in the *Re Nortel Networks Corp.*, *Windsor Machine*, and *Mirant* decisions, severance pay relates to prior service regardless of whether the source of the severance obligation is a collective agreement, an employment standards statute or an individual employment contract. As such, terminated employees are entitled to termination and severance but payment of that obligation is not immediate; rather it is stayed and is subject to compromise in a Plan. This conclusion is consistent with the case law and with the statute. As noted by the CMI Entities in their factum, the case law affirms that severance pay is the antithesis of a payment for current service.

[33] Furthermore, there is no statutory justification for giving these employees priority of payment over secured creditors. As stated by Morawetz J. in *Windsor Machine*, the priority of secured creditors must be recognized. There are certain provisions in the amendments that expressly mandate certain employee-related payments. In those instances, section 6(5) dealing with the sanction of a Plan and section 36 dealing with a sale outside the ordinary course of business being two such examples, Parliament specifically dealt with certain employee claims. If Parliament had intended to make such a significant amendment whereby severance and termination payments (and all other payments under a collective agreement) would take priority over secured creditors, it would have done so expressly.

[34] The same is true with respect to other unsecured creditors including other non-unionized employees. Quite apart from the priority to which secured creditors are entitled, quere the merits of a priority regime that treated unionized and non-unionized employees differently. Under such a regime, unionized employees would get immediate payment of termination and severance obligations based on section 33 of the CCAA whereas non-unionized employees would not.

[35] Additionally, based on CEP's submissions, someone who worked a day after the Initial Order would be entitled to full and immediate payment of termination and severance obligations ahead of all others whereas someone who was terminated the day before the Initial Order would not. This cannot be the scheme contemplated by the statutory amendments.

[36] I should say in all frankness that it would be appealing to find in favour of the employees in this case. They are a small group and the quantum in issue is not large relative to the amounts involved in this CCAA proceeding. That said, I have a very serious concern that while such a decision would result in immediate payment for these sixteen employees, the precedent such a decision would establish would have long term and negative consequences for employees generally. Although case law on a superficial read might cause one to conclude otherwise, in CCAA proceedings, a judge is extraordinarily conscious of the fate of employees. Indeed, one of the primary benefits of a restructuring that sees the continuance of the debtor company as a going concern is the maintenance of jobs for the employees. Acceptance of CEP's submissions could well result in behavior modification that would be an anathema to the interests of employees as a whole. As stated by Morawetz J. in *Windsor Machine and Stamping Ltd.*, the giving of priority to termination and severance payments would result in:

> "a situation where secured creditors would be prejudiced by participating in CCAA proceedings as opposed to receivership/bankruptcy proceedings. This could very well result in a situation where secured creditors would prefer the receivership/bankruptcy option as opposed to the CCAA option as it would recognize their priority position. Such an outcome would undermine certain key objectives of the CCAA, namely, (i)

> maintain the status quo during the proceedings; and (ii) to facilitate the ability of a debtor to restructure its affairs."[29]

Other alternatives such as mass pre-filing terminations are even less palatable.

[37] As to CEP's alternative submission that termination payments are properly characterized as payments in respect of post-filing service, I am not persuaded that the distinction between severance and termination payments is a meaningful one within the context of this case. The *West Bay* decision supported the conclusion that a claim for damages for wrongful dismissal carried out in the post-filing period gave rise to a monetary claim that was subject to compromise under a plan. The clear inference to be drawn from the case is that the claim had been stayed and there was no immediate requirement to pay. The same is true in the case before me.

[38] As in *Windsor Machine*, any incremental amount of termination and severance pay attributable to the period of time after the date of the Initial Order in which services were actually provided is not stayed. Otherwise, for the reasons outlined, I am dismissing CEP's motion.

Pepall J.

DATE: June 14, 2010

[29] *Ibid* paragraph 43.

CITATION: Re: Canwest Global Communications Corp., 2010 ONSC 1746
COURT FILE NO.: CV-10-8533-00CL
DATE: 20100614

ONTARIO

SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C-36, AS AMENDED AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS

REASONS FOR DECISION

Pepall J.

Released: June 14, 2010

TAB 5

CITATION: Redstone Investment Corporation (Re), 2015 ONSC 533
COURT FILE NO.: CV-14-10495-00CL
DATE: 2015-01-30

SUPERIOR COURT OF JUSTICE - ONTARIO

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF REDSTONE INVESTMENT CORPORATION AND REDSTONE CAPITAL CORPORATION

BEFORE: Regional Senior Justice Morawetz

COUNSEL: *Aubrey Kauffman* and *Zohaib Maladwala,* for Maplebrook Capital Corp.

Steven Graff and *Ian Aversa,* for Grant Thornton Ltd., in its capacity as Receiver and Manager of Redstone Investment Corporation, Redstone Capital Corporation and 1710814 Ontario Inc. o/a Redstone Management Services

Geoff R. Hall, for Warner Sulz Family Trust and Gino Martone (Investors in Maplebrook)

HEARD: October 31, 2014 and November 12, 2014

ENDORSEMENT

INTRODUCTION

[1] Maplebrook Capital Corp. ("Maplebrook") brought this motion to compel Grant Thornton Ltd. ("GTL"), in its capacity as the Court appointed Receiver and Manager (the "Receiver") of Redstone Investment Corporation ("RIC"), Redstone Capital Corporation ("RCC") and 1710814 Ontario Inc. o/a Redstone Management Services ("RMS") to pay the following amounts to Maplebrook:

a) $750,000 advanced by Maplebrook to fund the Pro-Hairlines transaction (as defined below), less 37.5% of the legal fees ($13,189.12) incurred by RIC;

b) $150,000 that was received on April 7, 2014 in full satisfaction of the outstanding principal owed under the CFT Properties Loan (as defined below) and any interest payments collected under the CFT Properties Loan after March 28, 2014;

c) $311,400 that was received on March 31, 2014 in full satisfaction of the outstanding interest and principal owed under the Chiu Chow Loan (as defined below); and

d) $28,494 that was collected after March 28, 2014 in satisfaction of interest payments owed under the AG Loans (as defined below).

[2] The Receiver opposed the relief requested by Maplebrook. The Receiver took the position that all funds in which Maplebrook claimed an ownership interest formed part of the property of RIC and ought not to be paid to Maplebrook in priority to RIC's other creditors.

[3] On March 28, 2014, RIC and a related company RCC, made an application to commence proceedings under the *Companies' Creditors Arrangement Act* (the "CCAA Proceedings"). An order (the 'Initial Order") was granted which appointed GTL as Monitor in the CCAA.

[4] On August 8, 2014, an order was made (the "Receivership Order") appointing GTL as the Receiver and Manager of all of the assets, undertakings and properties of RIC and RCC.

[5] On September 17, 2014, the Receivership Order was amended to include RMS as a party subject to the Receivership Order.

[6] At the outset, it is noted that Maplebrook accepted and agreed to GTL's recommendation to terminate the Agency Agreements in respect of the AG Loans and the Quality Contract Loan (as defined below). This relief was granted by order dated November 12, 2014. The AG Loans and the Quality Contract Loan were declared to be the property of Maplebrook and the stay of proceedings was lifted in order to allow Maplebrook to terminate its Agency Agreements with RIC effective as of November 12, 2014.

FACTS

[7] Maplebrook is an Ontario corporation established in May 2013. Its President and sole Officer and Director is Mr. John Pizzacalla. Maplebrook carries on business as a short-term lender to small and medium sized Canadian businesses.

[8] In the fall of 2013, Maplebrook advanced five loans to borrowers through RIC (the "Assigned Loans"). The Assigned Loans are comprised of:

a) A $500,000 loan to CFT Properties Inc. ("CFT Properties");

b) A $650,000 to AG Yonge Street Investments Inc. ("AG Investments");

c) A further $350,000 loan to AG Investments;

d) A $300,000 loan to Chiu Chow Koon Chinese Restaurant Inc. ("Chiu Chow"); and

e) A $400,000 loan to Quality Contract Manufacturing Ltd. ("Quality Contract").

[9] The general structure of the Assigned Loans was such that RIC would obtain an assignable promissory note from the borrower, which RIC would assign to Maplebrook. Maplebrook would irrevocably appoint RIC as its agent to collect and enforce the Assigned Loans and the related security. Maplebrook would advance the funds to RIC. The loan proceeds would be advanced to the borrowers. RIC would collect and remit payments of principal and interest in respect of the loan to Maplebrook.

[10] RIC has not remitted any payments of interest and principal that it has received with respect to the Assigned Loans since February 22, 2014 (when RIC remitted payments to Maplebrook in respect of interest and principal collected in January 2014).

[11] On March 31, 2014, RIC received $311,000 from Chiu Chow in full satisfaction of the Chiu Chow Loan that had been assigned to Maplebrook.

[12] On April 7, 2014, RIC received $150,000 from CFT Properties in full satisfaction of the CFT Properties Loan that had been assigned to Maplebrook.

[13] After the Initial Order, RIC also received $28,494 in interest payments from AG Investments in respect of the AG Loans that had been assigned to Maplebrook.

[14] RIC deposited these post-CCAA collections in its general account rather than remitting them to Maplebrook or keeping them segregated from RIC's other assets.

[15] Since its appointment, the Receiver has not remitted any payments to Maplebrook in respect of the Assigned Loans.

[16] With respect to the AG Loans and the Quality Contract Loan, the Receiver acknowledges that, pursuant to the assignments entered into between Maplebrook and RIC, these loans are Maplebrook property.

[17] With respect to the Chiu Chow Loan and the CFT Properties Loan, the Receiver also appears to acknowledge that these loans were Maplebrook Property and that RIC acted as Maplebrook's agent to collect and enforce these loans. However, as noted above, the Receiver takes the position that the interest and principal that RIC collected on these loans does not belong to Maplebrook and should not be returned to Maplebrook, ahead of RIC's other creditors.

[18] The Receiver's position is based on its assertion that the funds collected by RIC in respect of the assigned loans are not trust funds. The Assignment Agreements for the Assigned Loans do not explicitly state that the proceeds of the Assigned Loans are to be held in "trust" for Maplebrook. Further, the Receiver relies upon the fact that the proceeds of the Chiu Chow and CFT Properties Loans were deposited to RIC's general account.

[19] Maplebrook takes the position that RIC has no beneficial entitlement to the funds, and neither the Receiver nor RIC's creditors can have any higher claim. Accordingly, a constructive trust in Maplebrook's favour is necessary to prevent this unjust result.

[20] In addition to the Assigned Loans, Maplebrook also agreed to participate in a sixth loan through RIC in late February 2014. The loan to 2234241 Ontario Inc. c.b.a. Pro-Hairlines ("Pro-Hairlines"), was to be for $2 million, with RIC advancing $1.25 million of the total loan and Maplebrook advancing the remaining $750,000 of the loan. The Maplebrook portion of the loan was to have been structured in the same manner as the Assigned Loans (the "Pro-Hairlines Transaction").

[21] In anticipation of closing, Maplebrook transferred $750,000 to RIC on March 4, 2014 (the "Pro-Hairlines Advance") to acquire its portion of the loan. The Pro-Hairlines Advance was subsequently transferred by RIC to its lawyers trust account in anticipation of closing.

[22] The Pro-Hairlines Transaction did not close. On March 25, 2014 RIC informed Maplebrook that it would not participate in the Pro-Hairlines Transaction. Maplebrook decided not to participate and requested that RIC return the Pro-Hairlines funds.

[23] On March 25, 2014, Mr. Karim Habib, the RIC consultant who was in charge of the Pro-Hairlines Transaction informed Mr. Eric Hansen, the sole director and officer of RIC, and Mr. Chris Shaule, a consultant of RIC, that the Pro-Hairlines Advance should "immediately" be returned to Maplebrook after RIC's lawyer transferred it back to RIC.

[24] The funds were returned by RIC's lawyer to RIC on April 1, 2014, which post-dated the commencement of CCAA Proceedings.

[25] The Receiver takes the position that Maplebrook did not transfer the Pro-Hairlines Advance to a trust account (instead, transferring the funds directly to RIC) and the funds were transferred in the absence of any executed agreement. Consequently, as no trust was created, there is no basis upon which to repay the Maplebrook Advance to Maplebrook.

[26] Maplebrook takes the position that RIC received the Pro-Hairlines Advance in trust and that the Pro-Hairlines Advance remains subject to that trust obligation in the Receiver's hands.

[27] The Receiver asserts that Mr. Pizzacalla acknowledged that Maplebrook had a close relationship with RIC and RMS. For example, RIC (presumably through RMS, since RIC had no employees) would carry out the bookkeeping and accounting functions for Maplebrook. RMS's and RIC's bookkeeper has signing authority on Maplebrook's accounts, but was required to seek Mr. Pizzacalla's instructions before dealing with Maplebrook's funds. The Receiver also suggested that RIC and/or RMS did not appear to have received any compensation for the performance of these management functions. The Receiver also suggests that Mr. Pizzacalla appeared to have acted as a representative of RIC, RCC and RMS for the purpose of soliciting investments in these entities from various individual third parties.

[28] Additionally, the Receiver pointed out that there may be funds owing to RMS from Maplebrook.

[29] During oral argument on October 31, 2014, I raised questions with respect to the apparent lack of formal documentation in respect of the Assigned Loans. I also raised questions as to whether there was any type of a relationship as between Maplebrook and RIC that was not fully explained in the materials.

[30] Prior to the continuation of oral argument on November 12, 2014, a supplementary affidavit of Mr. Pizzacalla was filed.

[31] In the supplementary affidavit, Mr. Pizzacalla provided additional information concerning:

1. A step-by-step explanation of the Loan Purchase Transactions;
2. Maplebrook's financial statements;
3. Maplebrook/Pizzacalla's relationship with RIC/RMS/RCC; and
4. Details with respect to other transactions.

[32] Mr. Pizzacalla stated the following at paragraph 3 of the supplementary affidavit as follows:

> **1. A STEP BY STEP EXPLANATION OF THE LOAN PURCHASE TRANSACTIONS**
>
> 3. As explained in paragraph 23 of the First Pizzacalla Affidavit, all of the Assigned Loans were structured in essentially the same way. In connection with RIC's loan to the ultimate borrower (the "Borrower"), RIC would obtain an assignable promissory note from the Borrower. RIC would, in turn, absolutely assign the promissory note and related security to Maplebrook in consideration for Maplebrook's investment (which was in the same amount as the assigned promissory note). Maplebrook would, in the assignment agreement, appoint RIC as its agent to collect and enforce the promissory note and security on its behalf. RIC would then collect the lender fees, interest and principal in respect of the Assigned Loans and deposit those amounts, in full, into Maplebrook's account. Thereafter, Maplebrook would remit RIC's share of the lender fees and interest spread.

[33] On the issue of the interest split in the Lender Fees Split Arrangement, when Maplebrook was interested in a potential transaction, it would offer the transaction to its investors at a lower interest rate than would be paid by the Borrower. The difference between the interest rate paid by the Borrower and the interest rate paid to investors would be split equally between RIC and

Maplebrook (the "Interest Split"). The Interest Split for the Assigned Loans varied between 4% and 8%.

[34] The Borrowers of the Assigned Loans paid lender fees ("Lender Fees") in addition to interest. With the exception of the CFT Transaction, Lender Fees were split equally between Maplebrook and RIC.

[35] Mr. Pizzacalla acknowledged there was no written formal agreement with regard to the Interest Split and Lender Fees. The oral agreement was the same for each transaction, which was reflected in the loan schedules for the Assigned Loans. Mr. Pizzacalla did acknowledge that with respect to the CFT Transaction, which had been sourced by Mr. Habib, the parties agreed that Mr. Habib would receive a 1% "Finders Fee".

[36] Mr. Pizzacalla also elaborated on the method by which RIC would collect the interest, principal and Lender Fees owing under the Loans and remit these amounts to Maplebrook.

[37] Specifically, after Maplebrook purchased the Loan, RIC, as Maplebrook's agent, would collect all interest, Lender Fees and principal payments due from the Borrower and remit those amounts, in full, to Maplebrook.

[38] Mr. Pizzacalla would meet Ms. D'Leon, usually on a monthly basis to confirm the interest, principal and Lender Fees due to Maplebrook on each of the Assigned Loans. Ms. D'Leon would cause these amounts to be transferred from RIC's bank account to Maplebrook.

[39] On a monthly basis, Maplebrook would pay its investors the interest and principal owed to them on any transactions that the investors had participated in, including the Assigned Loans.

[40] After RIC collected and remitted to Maplebrook all interest and Lender Fees due under the Assigned Loans, Ms. D'Leon would then calculate the Interest Split and Lender Fees Split that Maplebrook owed.

[41] Ms. D'Leon also maintained a loan schedule for every loan that Maplebrook was involved in. The Loan Schedules included all the pertinent details for each transaction that Maplebrook was involved in.

[42] During the October 31, 2014 hearing, I requested copies of Maplebrook's financial statements in order to review how the Assigned Loans were recorded. The financial statements were produced. The Assigned Loans were individually recorded and the Borrowers set out.

[43] With respect to the relationship as between Maplebrook and RIC/RMS and RCC, Mr. Pizzacalla stated that neither he, nor Maplebrook, has ever had an interest in, or control of RIC/RCC or RMS.

[44] With respect to other transactions, Mr. Pizzacalla acknowledged that, in light of RIC's refusal to pay certain amounts owing to Maplebrook, Maplebrook was retaining certain funds due to RMS on account of potential set-off claims.

[45] The evidence of Mr. Pizzacalla was not challenged.

ISSUES

[46] From the standpoint of Maplebrook, the following issues have to be addressed:

a) Who owned the loans in issue?

b) Is Maplebrook entitled to the post-CCAA collections?

c) Is Maplebrook entitled to a return of the Pro-Hairlines Advance?

[47] The Receiver submits that the issues to be resolved on the motion are:

a) Are the proceeds of the RIC/Maplebrook loans subject to a constructive trust in favour of Maplebrook?

b) Is the Maplebrook advance subject to a specific purpose or *Quistclose* Trust in favour of Maplebrook?

c) Should Maplebrook be denied the equitable relief it seeks on the basis that it does not come to court with clean hands.

[48] Maplebrook submits that, in each of the Assigned Loans, RIC obtained from the Borrower an assignable promissory note and, in each case, that promissory note and related security was absolutely assigned to Maplebrook. In each assignment document, Maplebrook also engaged RIC as its agent with authority to, on Maplebrook's behalf and for Maplebrook's benefit, collect any payment under the promissory note and enforce the security.

[49] The Receiver submits that the facts give rise to a debtor-creditor relationship between RIC and Maplebrook and do not give Maplebrook any proprietary interest in the Assigned Loans proceeds.

[50] The Receiver takes the position that the agency relationship pursuant to which RIC collected the Assigned Loan proceeds was created as part of the assignments executed in respect of each of the Assigned Loans. The Receiver points out that these assignments to do not impose any obligations on RIC with respect to how the funds are to be collected, how they are to be held by RIC on Maplebrook's behalf, nor how they are to be paid to Maplebrook.

[51] The Receiver submits that it is well established that, in the absence of an agreement to hold funds collected on a principal's behalf in a separate account, an agent and its principal are in a debtor/creditor relationship. In support of this proposition, the Receiver relies on *Re General Publishing Co.* (2002), OJ No. 2270 (ONCA) and *M.A. Hanna Co*. v. *Provincial Bank of Canada* (1935), S.C.R. 144 (SCC).

ANALYSIS

[52] With respect to the AG Loans and the Quality Contract Loan, the Receiver acknowledged that these are the property of Maplebrook and that RIC was acting as Maplebrook's agent in administering the Loans and even recommended terminating the agency relationship in order to allow Maplebrook to enforce its security. In my view, there is no material difference between the structure, documentation, and administration of the AG Loans and the Quality Contract Loans and the CFT Property Loans and the Chiu Chow Loan. These loans were also the subject of absolute equitable assignments to Maplebrook.

[53] The documentation establishes RIC's intention to covey the debts to Maplebrook, thereby transferring all credit risks to Maplebrook, retaining only the administrative role of Maplebrook's agent for collection purposes. The evidence also establishes that the parties conducted themselves in a manner consistent with the assignment documentation.

[54] Counsel to Maplebrook submits that where there has been an assignment of a debt, and the assignor becomes bankrupt or otherwise seeks protection from its creditors, the debt will no longer form part of the bankrupt's estate. Insofar as the assignor receives repayments of interest or principal of such an assigned debt, these receipts are held in trust for the assignee and are not available for distribution among the assignors' creditors (see *Pythe Navis Adjusters Corp.* v. *Columbus Hotel Co.* (1991), 2014 BCCA 262).

[55] In this case, prior to RIC and RMS seeking protection in the CCAA Proceedings on March 28, 2014, agreed upon amounts were forwarded by RIC to Maplebrook in accordance with the terms of the Assigned Loans.

[56] Upon the commencement of CCAA Proceedings, the Court issued a stay order. RIC remained a debtor-in-possession (under the supervision of the Court and GTL as Monitor, carrying on RIC's business). As a consequence of the stay order, Maplebrook was precluded from terminating its agency arrangements with RIC, revoking RIC's authority as agent and retaking its property (that is, the Assigned Loans).

[57] The purpose of a CCAA stay order is to maintain the status quo amongst creditors and prevent their maneuvering for position. While the stay order prevents secured creditors and other parties from exercising and confirming their security for proprietary rights, it should not be used to prejudice those rights or to reorder the priorities as they existed on the date that the stay is granted (see: *Re Sharpe-Rite Technologies Ltd.*, 2000 BCSC 414 and *Re Windsor Machine & Stamping Limited*, 2009 CanLII 39771 (ON. S.C.)).

[58] The stay order effectively prevented Maplebrook from terminating RIC's agency agreement so as to take over the administration of the loans and ensure that it receive the post-CCAA collections directly from the debtors, CFT Properties, Chiu Chow and AG Properties. Counsel to Maplebrook submitted that RIC was not at liberty – during the status quo period – to negate these propriety rights by receiving the post-CCAA collections and depositing them in its general account. I agree

[59] The Receiver relies on general statements as set out in *General Publishing* and *Hanna*, to the effect that the absence of an agreement to hold funds in a separate account results in a legal conclusion that the parties are in a debtor/creditor relationship. These statements have to be considered in the context of the facts in *General Publishing* and *Hanna* and also subsequent jurisprudence. *Hanna* involved a priority dispute as between a secured creditor bank and a supplier who sought to establish the foundations for a consignment agreement that, if demonstrated, would result in a proprietary right. *General Publishing* involved a priority dispute between the secured creditor (Bank of Nova Scotia) and publishers who claimed a proprietary right and resulting priority over the Bank with respect to accounts billed to and collected by the distributor, General Distribution Services. In both cases, *Hanna* and *General Publishing* collections were deposited into the general account of the debtor.

[60] This case does not involve a priority dispute between a secured creditor and a third party. Rather, it involves a dispute between the Receiver and Maplebrook, with Maplebrook asserting a proprietary right to the loans, a right that the Receiver has acknowledged with respect to the AG Investments and Quality Contract loans.

[61] The Chiu Chow and CFT Properties loans were structured in the same way as the AG Investors and Quality Contract loans. In my view, it is surprising that the Receiver maintains that the interest and principal that RIC collected on the Chiu Chow and CFT Properties loans does not belong to Maplebrook and should be available to RIC's other creditors. The explanation for and the flaw in the Receiver's position can be found in a review and analysis of the authorities relied upon by Maplebrook.

[62] The Receiver submits that, in the absence of an agreement to hold funds collected on a principal's behalf in a separate account, an agent and its principal are in a debtor/creditor relationship which would defeat the property claim of Maplebrook. However, the cases relied upon by the Receiver to support its submissions, predate the controlling authority and do not consider cases relied upon by Maplebrook, which address whether the absence of a separate account determines the issue.

[63] In *Shenzhen City Luohu District Industrial Development Co.* v. *Yao*, 2000 BCSC 677, the Court enumerated a number of factors that should be considered in deciding whether a party receiving funds does so as a mere debtor, or as a trustee:

> [T]he presence of comingling, while a factor to be weighted in favour of a debtor-creditor relationship is not necessarily determinative. The nature of the relationship depends on whether the certainties which constitute a trust are present. Factors to consider include: whether there was an obligation to keep the funds separate; whether the terms of the agreement clearly set out an obligation to keep the funds separate; whether it was intended that, should the funds be comingled, the trustee could do as he pleased with the money; whether the trustee was required to fulfil a specific purpose; whether the recipient could use the funds for any other purpose before making payment for the specific purpose; and

> whether the settlor had any direct supervision or control over the financial dealings of the recipient.

[64] *Shenzhen City* followed the decision of the Alberta Court of Appeal in *R.* v. *Lowden*, 1981 ABCA 79, where the Court held that a travel agent receiving funds from a customer for the specific purpose of purchasing travel services or hotel accommodations assumed a trust obligation to apply the funds as directed or return them to the customers:

> Undoubtedly a direction that monies are to be kept separate and apart is a strong indication of a trust relationship being created. It does not appear to me, however, that the converse is necessarily so (…). The fact that there is no specific discussion about monies being kept separate and apart from other monies does not detract from the fact that the money is paid first for a particular purpose, namely the obtaining of tickets for specific flights or reservations at named accommodation for a particular period. … To my mind, the paying of money to a travel agency for a particular trip on a particular date with a carrier flying regularly, or the payment of money for a particular reservation with a particular hotel for a particular period, creates more than a simple debtor and creditor relationship. To my mind, it is implicit that the agent is either expected to get the ticket or to return the money.

[65] These principles were confirmed by the Supreme Court of Canada in *Air Canada* v. *M & L Travel Ltd.*, [1993], 3 SCR 787, where the Court cited *McEachern* v. *Royal Bank of Canada*, [1990] A.J. No. 1145 (ABQB) and *Lowden*, the Court agreed that "while the presence or absence of a prohibition on the comingling of funds is a factor to be considered in favour of a debt relationship, it is not necessarily determinative".

[66] In my view, these cases stand for the proposition that the absence of an agreement to hold funds collected in a separate account is not necessarily determinative of whether a debtor-creditor relationship is established. In the circumstances of this case, further examination is necessary, including an examination as to whether a constructive trust may be imposed.

[67] Counsel to the Receiver acknowledges that a constructive trust may be imposed in circumstances where:

a) the alleged constructive trustee has engaged in the type of wrongful conduct that is capable of giving rise to a constructive trust; or

b) the alleged constructive trustee has been unjustly enriched, and a constructive trust is the appropriate remedy (see: *Gorecki* v. *Canada (Attorney General)* 2006 CarswellOnt 1745 (Ont. C.A.); and *Re Confederation Life Insurance Company*, [1995] CarswellOnt 318 (Ont. Gen. Div.), affirmed 1997 CarswellOnt 62 (Ont. C.A.)).

[68] The test for finding a constructive trust based on wrongful conduct was set out by the Supreme Court of Canada in *Soulos* v. *Korkontzilas*, [1997] 2 SCR 217. The following criteria is to be considered in determining the availability of the remedial constructive trust:

1. The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;

2. The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;

3. The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties; and

4. There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected.

[69] Counsel to Maplebrook submits that these criteria are satisfied in the present case.

a) Under the Assignment Agreements, RIC acted as Maplebrook's agent in enforcing the CFT Properties Loan, Chiu Chow Loan and AG Investments Loan. As such, and as the assignor under the Equitable Assignments, RIC owed equitable obligations to Maplebrook to remit all sums paid. This is how the parties operated prior to the CCAA Proceedings and it was by virtue of this agency relationship that the post-CCAA collections came to be in RIC's hands.

b) The post-CCAA collections came to be in RIC's possession by virtue of this agency relationship. While it may not have been a breach of RIC's fiduciary obligations to receive that money, it constitutes a breach of RIC's equitable obligations to retain that money and not to remit it to Maplebrook.

c) There is nothing "illegitimate" about Maplebrook's claim for a proprietary remedy. Failing to grant this remedy would result in an unjust enrichment of RIC's creditors. As in *Soulos*, "no less is required … to return the parties to the position that they would have been in had the breach not occurred".

d) There is nothing that would render the imposition of a constructive trust unjust in these circumstances. On the contrary, it would be unjust if RIC's creditors received a windfall by virtue of the stay order, which effectively prevented Maplebrook from revoking the agency and retaking its property. The creditors that would benefit are not "intervening creditors"; rather, they are creditors who, before the stay order, had interests that were subordinate to

> Maplebrook's ownership interests. It would be unjust for the stay orders – and RIC's actions under that order to extinguish those proprietary rights and defeat that priority.

[70] Counsel to Maplebrook also submits that there is an overriding principle of "good conscience". In this case, Maplebrook does not allege that RIC or its creditors having engaged in any actionable conduct; it is simply that it would be contrary to good conscience to permit them to retain the benefits derived from Maplebrook's properties. The Court, in *Soulos*, expressly recognized this broader principle, quoting with approval:

> A constructive trust is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts into a trustee: *Soulos, supra* at paragraph 29, quoting *Beatty* v. *Guggenheim Exploration Co.*, 225 NY 380 (1919) at 386-387.

[71] This principle was the basis for imposing a constructive trust in *Cummings* v. *Peopledge HR Services*, 2013 ONSC 2781, a case that arose out of the receivership of a payroll management company. When payroll went into receivership, employers sought to recover funds that had been conveyed to *Peopledge*, but that had not yet been distributed to employees. Some of the agreements with the employers imposed express trust obligations or segregated obligations but many did not. Further, *Peopledge* did not maintain segregated employer-by-employer accounts. In *Peopledge*, the Court held that the terms of the agreements, and the manner in which *Peopledge* actually handled the funds were not determinative; all such funds were received by *Peopledge* as agent for the employers and, therefore, they could not in good conscience be applied to discharge *Peopledge*'s obligations to its own creditors:

> In these circumstances, it would appear to be inequitable to permit the general creditors of *Peopledge* other than the customers who provided the funds to now be paid their claims from those funds. It was never intended that *Peopledge* or its creditors would have any beneficial interest in these funds. … Under the umbrella of good conscience, constructive trusts are recognized to remedy the unjust and corresponding deprivation (see McLaughlin J. in *Soulos* at paras. 20 and 43). In this case, *Peopledge* and its general creditors would be enriched by having the ability to access the payroll funds advanced by customers to *Peopledge*. The customers and their employees, would be deprived by not having the funds paid to them and there would be no juristic reason for this to occur. It was never intended that *Peopledge* or its creditors, would have any beneficial interest in the payroll funds advanced by customers.

[72] In this case, while the documents may not have expressly obligated RIC to segregate the loan payments received from borrowers, or to hold these funds in trust, it was nevertheless understood between the parties that these funds were the property of Maplebrook. In addition, as previously noted, the Receiver has acknowledged that the structure of the Assigned Loans results in Maplebrook being the owner and equitable assignee of the loans originated by RIC.

[73] After March 28, 2014, the stay order effectively stayed any right of Maplebrook to terminate RIC's agency and retake its property. The monies at issue in this case were received after the granting of the Initial Order. In my view, if these post-CCAA collections were to form part of RIC's assets, RIC's creditors would receive a windfall; RIC had no beneficial entitlement to these funds, and neither the Receiver nor RIC's creditors can have any higher claim. Accordingly, I am satisfied that the absence of RIC to maintain a separate trust account, although a factor to be taken into account, is not determinative of the issue as to whether the relationship between Maplebrook and RIC was one of debtor-creditor. In my opinion, the relationship was not one of debtor-creditor. RIC recognized the assignment in favour of Maplebrook and there is no basis to alter this recognition after the CCAA filing. To alter the relationship would be inconsistent with the long recognized principle that the purpose of the CCAA is to preserve the status quo. Accordingly, I am satisfied the *Soulos* test has been met and it is appropriate and necessary to impose a constructive trust in Maplebrook's favour to prevent an inequitable and unjust result.

[74] On the issue of Maplebrook's entitlement to repayment of the Pro-Hairlines Advance, Maplebrook submits that there can be no question that RIC received the Pro-Hairlines Advance in trust and that the Pro-Hairlines Advance remains the subject of that trust obligation in the Receiver's hands.

[75] The existence of a trust depends upon satisfying the three certainties of (1) an intention to create a trust; (2) the subject matter of the trust; and (3) the trust objects or purposes.

[76] There is no issue respecting the latter two requirements as the subject matter or corpus of the trust was the Pro-Hairlines Advance, and the object was to fund the Pro-Hairlines Transaction. While Maplebrook did not impose any express obligation requiring RIC to hold the Pro-Hairlines Advance "in trust" or to segregate the Pro-Hairlines Advance from RIC's own funds, I am satisfied that there was no question that the Pro-Hairlines Advance was being advanced for, and could only be used for, one particular purpose: to fund the loan to Pro-Hairlines.

[77] I accept the submission of Maplebrook that RIC received the Pro-Hairlines Advance in trust and that the Pro-Hairlines Advance remains the subject of that trust obligation in the Receiver's hands. The actions of both RIC and Maplebrook established that there was an intention to settle a trust and impose trust obligations.

[78] Although the Pro-Hairlines Advance was transferred into RIC's general account, the analysis in *Shenzhen*, *Lowden*, *Air Canada* and *McEachern* referred to above is relevant to this issue as the absence of a specific trust account is not determinative of the issue.

[79] In my view, the trust principles described above, result in a conclusion that the Pro-Hairlines Advance is being held on a trust obligation in favour of Maplebrook. Maplebrook never parted with beneficial title to the funds: they were conveyed to RIC subject to an equitable obligation to use those funds to make the loan to Pro-Hairline (that is, to "purchase a $750,000 debt to be assigned to Maplebrook", or to return the funds to Maplebrook if the transaction did

not close). I am in agreement with counsel to Maplebrook that nothing in the evidence supports the view that the Pro-Hairlines Advance was advanced to RIC to use in any way that it saw fit, with a mere obligation to make repayment to Maplebrook if and when RIC elected to do so. At the time that the funds were returned to RIC, with RIC operating under court supervision and under the supervision of a Monitor, the obligations in favour of Maplebrook are even more definite. The position of Maplebrook should not be prejudiced during the CCAA proceedings.

[80] Counsel to Maplebrook also submitted that another line of cases that supports the existence of a trust in the present case is that applying the principle developed by the English House of Lords in *Barklays Bank Ltd.* v. *Quistclose Investments Ltd.* (1968), UKHL 4. The Alberta Court of Appeal summarized that principle in the following terms:

> This type of trust, commonly called a *Quistclose* trust, arises when funds are advanced for a specific purpose, but cannot be or are not used for that purpose.

[81] The Ontario Court of Appeal has commented that the *Quistclose* trust has not yet been adopted in Ontario, and has warned against the potential negative impact such trust may have on creditors who have no notice that a debtor's funds are not available to general creditors, as follows:

> "As I have concluded that the requirements for a *Quistclose* trust have not been met in this case, I do not need to decide to what extent that expansion should be adopted in Ontario. However, when that decision does have to be made, the Court will have to consider a number of commercial consequences, one of the most significant of which is the potential effect on the creditors of the borrower (or grantee) of the subject funds. For example, as in this case, where funds are advanced to a business with no registration under the *Personal Property Security Act*, RSO 1990, cP-10, creditors will have no notice, and in many cases no knowledge, that they are dealing with a debtor whose money is subject to a trust and not available to general creditors." *Ontario (Minister of Training, Colleges and Universities* v. *Two Feathers Forest Products LP*, 2013 ONCA 598 ("*Two Feathers*").

[82] In the circumstances of this case, with the Pro-Hairlines Advance being provided to RIC and forwarded on to RIC's counsel expressly for the purpose of being held by counsel pending the completion of the transaction, and then being returned to RIC subsequent to the filing of the CCAA Proceedings, there does not appear to be any opportunity for any creditor of RIC to have been misled or in any way detrimentally affected by having the knowledge that the funds were subject to a trust and not available to general creditors.

[83] The principle of *Quistclose* as summarized by the Alberta Court of Appeal in *Carevest Capital Inc.* v. *Leduc (County)*, 2012 ABCA 161 is as follows:

> This type of trust, commonly called a *Quistclose* trust, arises when funds are advanced for a specific purpose, but cannot be or are not used for that purpose.

[84] I am mindful of the comments of the Ontario Court of Appeal in *Two Feathers* to the effect that *Quistclose* has not yet been adopted in Ontario. In my view, it is not necessary to determine this issue as I have determined that the Pro-Hairlines Advance is being held in a trust obligation in favor of Maplebrook. However, if I am in error in reaching that conclusion, I am also of the view that this is a situation where the requirements for a *Quistclose* trust have been met. In reaching this conclusion, I have taken into account that:

1. The funds were advanced by Maplebrook for a specific purpose;

2. The funds were returned to RIC at a time when RIC was operating under court supervised creditors' protection and under the supervision of the Monitor; and

3. If the funds are returned to Maplebrook, there is no effect on the other creditors of RIC. The funds were never the property of RIC and the creditors of RIC have no entitlement to the funds in question.

DISPOSITION

[85] In the result, Maplebrook's motion is granted. The Receiver is to pay the following amounts to Maplebrook's legal counsel, Fasken, in trust:

i) The sum of $750,000, less 37.5% of legal fees ($13,189.12) incurred by RIC in respect of the Pro-Hairlines Transaction;

ii) The sum of $150,000 and any interest payments collected after March 28, 2014 in respect of the CFT Properties Loan;

iii) The sum of $311,400 representing the outstanding principal and interest collected after March 28, 2014 in respect of the Chiu Chow Loan; and

iv) The sum of $28,494 representing interest collected after March 28, 2014 in respect of the AG Loans.

[86] However, prior to making payment to Maplebrook, the Receiver, in consultation with Maplebrook, is to establish the amount owing by Maplebrook to RMS. This amount is to be held back from the amount due to Maplebrook. The Receiver can apply for directions, if necessary, as to how the amount held back is to be allocated as between the Redstone estates. If the parties are unable to come to agreement on the amount to be held back, a 9:30 a.m. appointment can be scheduled.

[87] Maplebrook has been the successful party and is entitled to its costs on a partial indemnity basis. I would ask counsel to confer in an effort to settle on an appropriate amount of costs, taking into account the submissions made on this subject at the conclusion of oral argument. If not agreement can be reached, brief submissions to a maximum of 3 pages can be submitted, within thirty days.

Morawetz, RSJ

Date: January 30, 2015

TAB 6

Court of Queen's Bench of Alberta

Citation: Re SemCanada Crude Company (Companies' Creditors Arrangement Act), 2009 ABQB 90

Date: 20080211
Docket: 0801 08510
Registry: Calgary

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

And in the Matter of a Plan of Compromise or Arrangement of SemCanada Crude Company, SemCAMS ULC, SemCanada Energy Company, A.E. Sharp Ltd., CEG Energy Options, Inc., 3191278 Nova Scotia Company and 1380331 Alberta ULC

Applicants

Reasons for Decision of the Honourable Madam Justice B.E. Romaine

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Introduction

[1] Three of this group of CCAA debtors have applied for an order authorizing an interim distribution of funds to a banking syndicate, their major secured creditor under a guarantee of the indebtedness of the entire corporate group, including debtors engaged in Chapter 11 proceedings in the United States.

Background to Application

[2] SemCanada Energy Company ("SemCanada Energy") and its subsidiaries A.E. Sharp Ltd. ("AES") and CEG Energy Options, Inc. ("CEG") are three of a group of seven companies referred to as the SemCanada Group that obtained protection from their creditors pursuant to an Order granted under the Companies' Creditors Arrangement Act, R.S.C. 1985, c.C-36, as amended, on July 30, 2008. Prior to the initial order, SemCanada Energy, AES and CEG had

commenced proceedings under the Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3, on July 24, 2008 and those proceedings were then converted to proceedings under the CCAA.

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

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

[5] The SemCanada Group are indirect wholly-owned subsidiaries of SemGroup LP. The SemCanada Group is comprised of three separate businesses:

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

[6] SemCrude, L.P. as U.S. borrower and a predecessor company of SemCAMS as Canadian borrower, certain U.S. SemGroup corporations and Bank of America as administrative agent for a syndicate of lenders (the "Lenders") entered into a credit agreement in 2005 (the "Credit Agreement"). The Credit Agreement provides four different credit facilities. There are no advances outstanding with respect to the Canadian term loan facility, but in excess of U.S. $2.5 billion is owing under the U.S. term loan facility, the working capital loan facility and the revolver loan.

[7] Five of the SemCanada Group of companies, including SemCanada, have provided a guarantee of all obligations under the Credit Agreement to the Lenders, who rank as senior secured lenders, and to a US $600 million bond indenture issued by SemGroup. The amount owing under these instruments is in excess of US $3.3 billion. The guarantee is secured by a security and pledge agreement (the "Security Agreement") signed by five members of the SemCanada Group.

[8] While it is intended to present a plan of arrangement or compromise with respect to at least one of the other two businesses, the SemEnergy Group is in self liquidation and has no significant ongoing operations. As a result of liquidation proceedings and the collection of

outstanding accounts receivable, SemCanada Energy, AES and CEG now hold $113 million in cash.

[9] The SemEnergy Group proposes to make an interim distribution payment to the Lenders of $90 million. The remainder of the $113 million would be held back to satisfy claims that may rank in priority to that of the Lenders, costs and fees related to the CCAA proceedings and the employee retention plan, potential claims under the Directors' Charge and a general contingency reserve. Since the time of the first application, the Lenders have requested that the outstanding and continuing fees of their Canadian advisors be paid by the SemEnergy Group. The current outstanding fees amount to approximately $1.8 million. It is common ground that if such interim payment is allowed, there will be nothing left from the $113 million to be distributed to unsecured creditors, subject to certain recovery measures in the United States proceedings that will be referred to later in this decision.

[10] A number of unsecured creditors objected to the application, and it was adjourned to allow the unsecured creditors access to the security opinion of the Monitor's counsel, cross-examination on affidavits and the preparation of a report from the Monitor on the status of the restructuring efforts of the U.S. Debtors to date.

[11] The unsecured creditors of the SemCanada Group that object to the application have raised a number of issues. They can be summarized as follows:

(a) the obligations of the SemCanada Group under the guarantee to the Lenders may be voidable as fraudulent preferences or fraudulent conveyances. The Court has insufficient evidence on that issue to grant the order sought, and the SemCanada Group should be compelled to provide further financial information and to answer specific questions on the issue during cross-examination on the affidavits;
(b) the amounts that the SemCanada Group are obligated to pay under the guarantee are expressly limited by the terms of the guarantee itself;
(c) the interim distribution may unfairly prejudice Canadian unsecured creditors and bestow an unwarranted benefit on unsecured creditors in the United States proceedings; and
(d) there is no urgency and a delay may provide more clarity with respect to the situation in the U.S. Chapter 11 proceedings.

Analysis

(a) *The Fraudulent Preferences Issue*

[12] The opinion obtained by the Monitor from counsel on the validity of the Lenders' security does not address any issue of fraudulent preference. It would not be normal practice in this kind of proceeding for the Monitor's counsel to address the possibility of fraudulent preference unless the Monitor is alerted to some evidence that this may be an issue. The Monitor has not identified any such concern in this case. Thus, in the normal course, it would be up to

creditors, if they believe circumstances exist, to bring appropriate proceedings to attack the guarantee and Security Agreement. The SemCanada Group points out that the unsecured creditors have not brought any action (which might leave them open to sanctions of costs if unsuccessful) and submit that they are attempting to use the proceeding as a fishing expedition to delay and obfuscate the application. The applicants and the Lenders submit that the analysis of the possibility of fraudulent preference submitted by the unsecured creditors is flawed at any rate and lacking in merit.

[13] There is, however, a complication in the argument as to who has the onus to address the possibility of fraudulent preferences. The unsecured creditors point out that the draft order proposed by the applicants for the interim distribution seeks a declaration that the Lenders' security (as embodied in the guarantee and the Security Agreement, which was executed by all five major companies in the SemCanada Group) constitutes a valid and enforceable obligation of the SemEnergy Group and that the payment of the interim distribution will not be void or voidable at the instance of creditors and does not constitute an unjust preference, fraudulent conveyance or reviewable transaction. Pursuant to the proposed order, this declaration would be binding on any trustee in bankruptcy or receiver that may be appointed in respect of the debtors. Thus, the unsecured creditors argue, the issue of fraudulent preferences is relevant and the SemCanada Group should be obligated to file more complete affidavits providing financial statements at relevant periods at and around the time the loan documents and guarantee were entered into and to answer cross-examination questions on the value of the assets of the SemEnergy Group at such times.

[14] The declaratory language at issue is common to this type of order, and the SemEnergy Group and the Lenders submit that it applies only to the interim distribution, not the underlying guarantee and Security Agreement that precedes it. They also submit that, at any rate, language can be crafted to ensure that the declaration is not given effect beyond a limited purpose. While it could be argued that declaratory relief relating to the interim distribution could be construed as extending to the underlying guarantee obligations, I accept that the language of the proposed order was not intended to protect the guarantee and the Security Agreement from the possibility of attack as a fraudulent preference, conveyance or reviewable transaction.

[15] It is not inappropriate for the applicants to ask for a declaration that the interim distribution is not a fraudulent preference or conveyance and such a declaration would arise from the Court's review of the relief sought as a part of CCAA process. Given the limited nature of what is being sought and the purpose of the proceedings, the creditors are not entitled to a full review of the possibility of historical fraudulent preferences or fulsome financial information from the CCAA debtors arising from this application standing alone. This does not preclude the unsecured creditors from applying to lift the stay to bring an independent action if they believe that it is justified by evidence.

[16] The applicants and the Lenders raised a number of arguments about the weakness of any allegations of fraudulent preference, the passing of limitation periods and the absence of any

intent that could form the basis for such an action. It is not necessary to address these submissions at this point in time.

[17] I therefore decline to require the CCAA debtors to file further financial information on this application or to answer the questions or provide the undertakings previously refused.

(b) The Guarantee is Limited - Section 2(f) of the Guarantee

[18] The guarantee signed by SemEnergy and the other guarantors includes the following provision:

> 2(f) The liability of each Guarantor hereunder shall be limited to the maximum amount of liability that can be incurred without rendering this Guaranty, as it relates to such Guarantor, voidable under applicable Law relating to fraudulent conveyance or fraudulent transfer, and not for any greater amount.

[19] It appears from academic commentary that this clause was designed to address an issue that exists under United States corporate law relating to the inability of a corporation to grant a guarantee if it causes the guarantor to become insolvent: Corporate Guarantees As a Form of Financial Assistance: The Banker's View, S.D.N. Belcher and Peter J. Lewarne, (1990)5 B.F.L.R. at 1. While certain insolvency tests under corporate legislation historically limited Canadian corporations in granting guarantees, they have now been repealed, and the same issue does not exist under Canadian law.

[20] Thus, while this clause may have effect when construed under U.S. law to limit the guarantee to an amount that would not render the guarantors insolvent at relevant periods of time, there are no corresponding obligations under the laws of Alberta (the governing law of the guarantee) or the corporate statutes of Nova Scotia, Alberta and Saskatchewan that govern SemEnergy, AES and CEG, respectively, that would limit the amount of the guarantee arising from the potential of insolvency when the guarantee was granted, or to the asset value of the guarantor, net of unsecured indebtedness, as suggested by the unsecured creditors. The "next asset value" limitation argued by the unsecured creditors appears to arise from either the wording of Section 6(c) of the guarantee (set out later in these reasons) or a representation as to solvency given by the SemGroup companies to the banking syndicate in the Credit Agreement for the indebtedness that underlies the guarantee.

[21] The wording of Section 6(c) relating to the concept of "net worth" is restricted to the subsection and plainly refers only to the calculation of a limited right of subrogation.

[22] While the breach of the representation in the Credit Agreement may form the basis for an action by the banking syndicate under the Credit Agreement it if is established to be incorrect, there is no evidence incorporating this representation into Section 2(f) of the guarantee, or that would warrant it being read into the section or otherwise modifying the section's plain meaning.

[23] While Section 2(f) may take effect in addition to the standard statutory remedies if the guarantee is determined to be a fraudulent conveyance or fraudulent transfer under applicable Canadian insolvency law, that argument refers back to the issue of fraudulent preferences in the more generally understood "all or nothing" sense, and the current lack of any persuasive evidence that would indicate a fraudulent preference. Thus, Section 2(f) of the guarantee does not, as submitted by the unsecured creditors, limit the liability of each individual guarantor to its net asset value on certain relevant dates, either by its plain language, the operation of any ambiguity or cross-reference to another agreement or a reference to applicable Canadian law, and there is no reason arising from this provision of the guarantee to require further financial information from the applicants.

(c) Potential Prejudice to Canadian Unsecured Creditors

[24] The unsecured creditors submit that the payment of the interim distribution may give rise to the development of inequities among the unsecured creditors of the SemCanada Group and the U.S. Debtors. They note that, according to material filed with the application for the initial order, all the CCAA applicants were solvent but for their secured guarantee obligations. The declaration filed at the commencement of Chapter 11 proceeding in the United States disclosed that the consolidated assets of the SemGroup as of May 31, 2008 totalled approximately $6.14 billion. It appears that subsequent events have reduced the value of the SemGroup's assets by approximately $2 billion and it must be noted that the value declared is book value. However, given that secured and senior debt totals approximately $3.3 billion, it does not appear that there are insufficient assets in the U.S. estate to fully pay the Lenders.

[25] There have been no distributions made to the Lenders in the United States since the commencement of the U.S. proceedings. The unsecured creditors submit that, if the interim distribution is authorized, an inequitable situation arises whereby the SemEnergy Group of debtor companies will have applied all of their assets to the secured debt, leaving their unsecured creditors without the possibility of recovery, while other debtor companies, including in the U.S. proceedings, will have their burdens reduced, making it possible that U.S. unsecured debtors will benefit disproportionally.

[26] The applicants and the Lenders point out, firstly, that the guarantee is an unconditional guarantee and that the Lenders are not required to exhaust their remedies against any other party before invoking its provisions against the applicants. That is clear from the language of the guarantee and the law. However, the contractual rights of the Lenders, in common with the contractual rights of many stakeholders, have been stayed by the CCAA proceedings. The rights of a secured creditor are not awarded a unique status under the CCAA: *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (.C.A.) at page 92. It is not uncommon for contractual rights to be affected by CCAA proceedings and it is important to note that what is being proposed by the applicants is a deviation from the normal course of such proceedings, which are designed to prevent manoeuvring for position among creditors while a reorganization is attempted.

[27] While orders allowing interim distributions to creditors for one reason or another are not without precedent, at the least, an application for an interim distribution to one creditor must be carefully scrutinized and found to be justifiable for good and sustainable reasons, recognizing that it may create a preference. The court is required to consider the advantages, disadvantages and potential prejudice of such an interim distribution to all the stakeholders of the debtor entity.

[28] The applicants and the Lenders point out that the Lenders have established the indebtedness of the SemEnergy Group and that their security is valid and ranks first in priority. While the Lenders have not made a formal demand of payment or filed a notice of intention, they are only precluded from doing so by the stay provisions of the initial order. The SemEnergy Group has been liquidated, and, they submit, these companies were only included in the CCAA proceedings for administrative convenience. The unsecured creditors counter that the SemEnergy Group sought the protection of the CCAA in July of 2008 purportedly to "reorganize and/or liquidate", that the CCAA applicants argued that adding the SemEnergy Group to the CCAA proceedings made sense given the inter-relationship of the SemCanada Group's businesses, and that, having chosen to use the CCAA process, the SemEnergy Group should be compelled to live with its choice.

[29] I agree that I cannot ignore the fact that this is a CCAA proceeding and not a receivership merely because it is more convenient for the applicants and the Lenders at this point to characterize the proceedings in those terms. While the SemEnergy Group standing alone may have liquidated with no current intention of formulating a reorganization plan, the whole of the SemGroup is under the protection of the CCAA in Canada and Chapter 11 in the United States. This is not only for the convenience of the debtors and the Lenders, but to allow the corporate group time to accomplish the goals of such legislation in terms of attempting to reorganize its business, maximizing the value of its estate for the benefit of all stakeholders, and ensuring fairness of treatment. I am not only permitted but required in my supervisory role under the CCAA to consider the implications of the corporate group's cross-border reorganization efforts as a whole.

[30] The applicants argue that if the application does not succeed, the Lenders will apply to appoint a receiver. The Lenders in fact invite the Court to convert the proceedings to a receivership on its own motion. That application is not before me and not likely to be unopposed in any event.

[31] The applicants and the Lenders submit that the interim distribution would not prejudice the SemEnergy's Group's other creditors because SemCanada Energy has rights of indemnification and subrogation from the other members of the corporate group.

[32] Sections 6(a) and 6(c) of the guarantee, however, read as follows:

Section 6. Limited Subrogation

> (a) Until all of the Obligations have been paid and performed in full, no Guarantor shall have any right to exercise any right of subrogation, reimbursement, indemnity, exoneration, contribution or any other claim which it may now or hereafter have against or to any Obligor or any Security in connection with this Guaranty (including any right of subrogation under any law, as amended), and each Guarantor hereby waives any rights to enforce any remedy which such Guarantor may have against either Borrower or any other Obligor and any right to participate in any Security until such time. ...
>
> (c) Upon full and final payment of the Obligations, each guarantor of the Obligations which has made payments upon the Obligations shall be entitled to contribution from each other guarantor of the Obligations, to the end that all such payments upon the Obligations shall be shared among all such guarantors in proportion to their respective net worth, provided that the contribution obligations of each Guarantor shall be limited to the maximum amount that it can pay at such time without rendering its contribution obligations voidable under applicable Law relating to fraudulent conveyances or fraudulent transfers. As used in this subsection, the "Net Worth" of each guarantor means, at any time, the remainder of (i) the fair value of such guarantor's assets (other that such right of contribution), minus (ii) the fair value of such guarantor's liabilities (other than its liabilities under its guaranty of the Obligations).

[33] It appears, therefore, that the SemEnergy Group's right of subrogation and indemnity may not be enforceable against other borrowers or guarantors unless and until all the indebtedness to the Lenders is paid in full. It also appears that the right to contribution from other members of the SemGroup may be limited under U.S. law to amounts that would not result in the insolvency of such a entity in proportion to such entity's net worth. At this stage of proceedings, both in Canada and in the United States, it is not possible to say with certainty that the reorganization of the corporate group will result in the payment of indebtedness to the Lenders in full or in such a fashion that the limitation upon subrogation is not triggered. It is possible, for example, that a reorganization may compromise the claims of the Lenders or may have them continue the loans on revised terms to a reorganized corporate group. The SemEnergy Group's right of subrogation and indemnity could prove to be a hollow or inadequate remedy.

[34] The unsecured creditors submit that the language of the guarantee prevents the SemEnergy Group from filing a claim for subrogation in the U.S. proceedings. The applicants submit that, if payment under the guarantee is authorized, they would file a claim and the Lenders agree that, in their view, such a filing would not be a breach of Section 6 of the guarantee. What is not clear is whether the U.S. debtors would also agree. Even if they did, the filing of a claim does not eliminate the contractual limits on subrogation.

[35] The Lenders submit that making the payment and subsequently filing a claim in the U.S. proceedings may ultimately be beneficial to the SemEnergy Group's other creditors, as it allows the timely filing of a claim. The unsecured creditors do not appear to agree.

[36] The Lenders submit that there is no good reason to delay the rights of the Lenders to collect on the guarantee, and that to refuse the application would be to improve the position of the unsecured creditors to the detriment of the secured creditor. I am satisfied that an interim distribution to the Lenders gives rise to the possibility that unsecured creditors may be prejudiced and that such potential for prejudice outweighs the benefits of an early payment on the guarantee to the Lenders. To suggest, as the Lenders do, that if the right to subrogation is contractually barred or is compromised by a plan of arrangement in the United States, the unsecured creditors are where they would be if the Lenders had exercised their contractual rights in any event is to treat the Canadian CCAA proceedings as a mere administrative convenience.

[37] The unsecured creditors made certain representations regarding a claim by NGX Financial Inc. Given the decision I have reached, it is not necessary that I address this issue at this time.

(*d*) *The Lack of Urgency and Benefit of Delay*

[38] The unsecured creditors submit that the applicants have shown no urgency to this application, and the only evidence before this court to justify the application is the statement of the Chief Executive Officer of the SemEnergy Group that, given the status of the group and the significant proceeds in their bank accounts, an interim distribution is appropriate. The Monitor, in commenting that the interim distribution is appropriate, repeats these reasons and notes that the claims bar date has passed and that it has received its security opinion from counsel. While the Monitor's recommendations are entitled to great deference, the Monitor has not delved into or addressed the issues of potential prejudice raised by the unsecured creditors in its analysis of the issue.

[39] The unsecured creditors submit that even a short delay in the distribution of funds may provide more clarity with respect to the situation in the U.S. Chapter 11 proceedings. They refer to media reports that indicate that a third party may be purposing a plan of arrangement or reorganization to the U.S. Debtors in the near future, and the Monitor reports that it understands that business plans and confidential information memorandums have been prepared for some of the significant U.S. Debtors and the SemGroup's intention is to either seek a sale of certain operating units or companies or restructure under the ownership of Semgroup. The Monitor advises, however, that it is premature and unrealistic to estimate the timing for the conclusion of the U.S. proceedings.

[40] It is not necessarily the case that a distribution of funds from the Canadian estate must await the resolution of Chapter 11 proceedings in the United States. The Canadian CCAA proceedings may advance at a different pace if the Court is satisfied by evidence before it that it is appropriate to do so. In the case of this application, however, it is prudent to delay an interim distribution until there is sufficient information to better evaluate the potential of prejudice to Canadian creditors.

Conclusion

[41] I find the application to be premature, and adjourn it sine die with leave to the applicants and the Lenders to reapply with more current information if it becomes apparent that the potential prejudice identified to the unsecured creditors is unlikely to materialize, can be avoided by other measures or that the balance of prejudice and benefit has shifted.

Heard on the 19th day of January, 2009.
Dated at the City of Calgary, Alberta this 11th day of February, 2009.

B.E. Romaine
J.C.Q.B.A.

Appearances:

A. Robert Anderson, Q.C., Cynthia L. Spry and Douglas Schweitzer
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David R. Byers, Ashley J. Taylor and Maya Poliak
Stikeman Elliott LLP
for The Bank of America

Patrick T. McCarthy and Josef A. Kruger
Borden Ladner Gervais LLP
for the Monitor

Chris Simard
Bennet Jones LLP
for Iteration Energy Ltd. Plains Canada Marketing, L.P. Plains Midstream Canada ULC, Sabre Energy Partnership (by its Managing Partner Sabre Energy Ltd.), 1316751 Alberta Ltd., Northern Sun Exploration Inc., ATCO Midstream Ltd. And Devon Canada Corporation

Craig McMahon
Gowling Lafleur Henderson LLP
for Barnwell of Canada, Limited and Celtic Exploration Ltd.

Douglas S. Nishimura and Brian O'Leary
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Goodmans LLP
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Travis Lysak
Fraser Milner Gasgrain LLP
for Nexen Marketing and Keyera Energy Partnership

William E.J. Skelly
Heenan Blaikie LLP
for Fractal Systems Inc. Bellamont Exploration Ltd., Enersul Limited Parthership and Dynamysk Automation Ltd.

TAB 7

2002 CarswellOnt 790
Ontario Superior Court of Justice [Commercial List]

Laidlaw Inc., Re

2002 CarswellOnt 790, 112 A.C.W.S. (3d) 203, 34 C.B.R. (4th) 72

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

In the Matter of the Canada Business Corporations Act, R.S.C. 1985, c. C-44, as Amended

In the Matter of the Business Corporations Act (Ontario), R.S.O. 1990, c. B-16, as Amended

Laidlaw Inc. and Laidlaw Investments Ltd.

Farley J.

Heard: February 28, 2002
Judgment: February 28, 2002
Docket: 01-CL-4178

Counsel: *David Burnham*, *Patrick Alpaugh*, for Moving Parties
B. Zarnett, *J. Carfagnini*, *B. Empey*, for Laidlaw Inc., Laidlaw Investment Ltd.
D. Tay, for Ernst & Young Inc.
R. Orzy, *K. Zych*, for Laidlaw Bondholders Subcommittee
D. Byers, for Laidlaw Banks Subcommittee
R. Jaipargas, for Chubb and Federated Insurance

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered by *Farley J.*:

Brown v. Maxim Restoration Ltd., 1998 CarswellOnt 2265, 3 C.B.R. (4th) 225, 42 B.L.R. (2d) 243 (Ont. Gen. Div.) — referred to

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

Ferguson v. Imax Systems Corp., 44 C.P.C. 17, 47 O.R. (2d) 225, 52 C.B.R. (N.S.) 255, 11 D.L.R. (4th) 249, 4 O.A.C. 188, 1984 CarswellOnt 155 (Ont. Div. Ct.) — referred to

Loewen Group Inc., Re, 2001 CarswellOnt 4910, 32 C.B.R. (4th) 54, 22 B.L.R. (3d) 134 (Ont. S.C.J. [Commercial List]) — referred to

T. Eaton Co., Re, 1999 CarswellOnt 4661, 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

Business Corporations Act, R.S.O. 1990, c. B.16
Generally — referred to

Canada Business Corporations Act, R.S.C. 1985, c. C-44
Generally — referred to

s. 229(2) — referred to

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

MOTION by individuals for orders establishing shareholders oversight committee, appointment of committee as inspectors, requiring calling of annual meeting and requiring companies to fund costs of committee.

***Farley J.*:**

1 It may be questionable whether the moving parties are technically shareholders of Laidlaw Inc. However it was determined to be appropriate to deal with this motion as if they were shareholders. Mr. Burnham, a non-lawyer, spoke for both Mr. Alpaugh and himself. They wished various relief:

> a) the establishment of a Shareholders Oversight Committee ("SOC") to represent the rights and interests of shareholders with the regard to all business activities of Laidlaw Inc. and Laidlaw Investments Ltd. from 1997 to the present, including through the SOC directly participating in the CCAA Plan of Reorganization, direct participation in the mediation process between Laidlaw and Safety-Kleen ("SK") relating to the pending litigation and review and approval of the proposed litigation settlement between Laidlaw and the bondholders;
>
> b) orders pursuant to the OBCA and the CBCA appointing the SOC as inspectors to investigate the activities of the board, officers, management, auditors and legal counsel of Laidlaw;
>
> c) an order requiring an annual meeting to be called by Laidlaw Inc. upon completion of the inspector's (SOC's) report in (b) above; and
>
> d) an order requiring the Laidlaw companies to fund the costs of the SOC, including the retainer of legal counsel and a forensic accountant.

2 Mr. Burnham quite fairly noted that, if in fact Laidlaw Inc. was so insolvent that the shareholders were so far under water that they had no reasonable expectation that they would come close to having a positive economic interest in the corporation, then the relief which he was seeking would not be appropriate. However, he pointed out that Laidlaw had a $6.5 billion claim against SK and that this was a flicker of hope that, if realized, could result in Laidlaw Inc. having a positive shareholder equity. It is of course important for the objective appreciation of this situation to realize that the $6.5 billion is not a sure thing — in fact far from it. The Monitor Ernst & Young Inc. is a court-appointed officer which must objectively look out for and be concerned for the interests of all stakeholders — including the shareholders in that capacity. However, both the Monitor and the investment-banking firm with extensive experience providing valuation services, Dresdner Kleinwort Wasserstein Inc., have concluded that on any reasonable scenario the shareholders are very significantly underwater. Further, it is realistic to note that creditors (Bondholders and Banks) will take a very severe "haircut" so that they will not come close to being paid out in full. Thus, under all foreseeable circumstances, it appears that the shareholders have no economic interest to protect.

3 What of the $6.5 billion claim against SK? Aside from the fact that SK has a $4.3 billion claim against Laidlaw, Laidlaw's claim against SK is unsecured and therefore junior to SK's secured debt. At the present SK's 2008 Notes, which are junior to the secured bank debt, are trading at less than five cents on the dollar. Thus, even if Laidlaw were entirely successful against SK, it appears that the "market" is confirming that it would in all probability be a "paper judgment" in the sense that there would

be no assets available to collect against. However, if there were a radical change in major parts of this equation, then — if, as and when that unexpected good fortune smiles upon Laidlaw — it is possibly conceivable that the shareholders would have a *bona fide* economic interest in Laidlaw Inc. — with the result that the Plan of Reorganization would have to be changed to reflect that. That would have to come back before the courts. In the interim the Monitor is of course charged with the continuing task of looking out for the reasonable interests of all stakeholders — but looked at in a realistic way. That is, there must be an air of reality to the analysis.

4 It would be inappropriate to saddle the creditors (who would bear the burden of the costs of the SOC) with the expense of the SOC, at a time when their expected recovery is at a significant discount. See the view of the legal hierarchy of interests (creditors standing before or on top of shareholders) I discussed in *T. Eaton Co., Re* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]). See also Paperny J.'s views in *Canadian Airlines Corp., Re* (2000), 20 C.B.R. (4th) 1 (Alta Q.B.) at p. 22 concerning not involving shareholders where they do not have a true economic interest. See also *Loewen Group Inc., Re* [2001 CarswellOnt 4910 (Ont. S.C.J. [Commercial List])] released December 13, 2001.

5 I also note that the creditors in the subject case have a great and abiding interest in maximizing the value of the enterprise as in achieving the greatest out of the SK claim. As discussed above, I do not see any reasonable prospect for the shareholders to be on the cusp of economic value, but if they were, then they have the safeguards above discussed.

6 As for an investigation, I would note that the moving parties have not met the test of s. 229 (2) of the CBCA. See *Ferguson v. Imax Systems Corp.* (1984), 47 O.R. (2d) 225 (Ont. Div. Ct.) and *Brown v. Maxim Restoration Ltd.* (1998), 42 B.L.R. (2d) 243 (Ont. Gen. Div.). I understand that there is a class proceeding of shareholders in the works; it would not be appropriate to ask the creditors of Laidlaw to fund a shareholder investigation in any event.

7 With respect to an annual meeting, given that Laidlaw Inc. is heavily insolvent and well into the restructuring process, I do not see on the record before me that there is any material benefit to be gained from requiring an annual meeting under the corporate legislation, given the sad financial state of Laidlaw Inc. with the shareholders having no economic interest given their very significant underwater location on the depth gauge.

8 I would also note that it would be inappropriate to interject the SOC into negotiations (either re the Plan of Reorganization or the SK claim mediation or otherwise) as this could have a very disruptive effect on those processes.

9 Motion dismissed.

Motion dismissed.

End of Document

TAB 8

2002 CarswellOnt 2254
Ontario Court of Appeal

Anvil Range Mining Corp., Re

2002 CarswellOnt 2254, [2002] O.J. No. 2606, 115 A.C.W.S. (3d) 923, 34 C.B.R. (4th) 157

IN THE MATTER OF ANVIL RANGE MINING CORPORATION; AND IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C. c-36, AS AMENDED; IN THE MATTER OF THE COURTS OF JUSTICE ACT, R.S.O. 1990, c. C-43, AS AMENDED; AND IN THE MATTER OF THE BANKRUPTCY AND INSOLVENCY ACT, R.S.C. 1985, C. B-3, AS AMENDED; AND IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF ANVIL RANGE MINING CORPORATION

Morden, Borins, Feldman JJ.A.

Heard: March 6, 2002
Judgment: July 5, 2002
Docket: CA C36919

Proceedings: affirming (2001), 25 C.B.R. (4th) 1 (Ont. S.C.J. [Commercial List])

Counsel: *Kevin R. Aalto*, *David Estrin*, for Appellants, Cumberland Asset Management, Berner & Company, Global Securities Corporation, Peel Brooke Inc, Inukshuk Resources Inc., Robert N. Granger, Adrian M.S. White
George Karayannides, *Kenneth Kraft*, for Respondent, Deloitte & Touche Inc., Interim Receiver of Anvil Range Mining Corporation and Anvil Mining Properties Inc.
David Hager, for Respondent, Cominco Ltd.
John Porter, for Respondent, Department of Indian Affairs and Northern Development
Jeremy Dacks, for Respondent, Yukon Territories Government
Derek T. Ross, for Respondent, Ross River Dena Council, Ross River Development Corporation
Geoffrey B. Morawetz, for Respondent, Yukon Energy Corporation

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered:

Equity Waste Management of Canada Corp. v. Halton Hills (Town), 1997 CarswellOnt 3270, 40 M.P.L.R. (2d) 107, 103 O.A.C. 324, 35 O.R. (3d) 321 (Ont. C.A.) — considered

Northland Properties Ltd., Re, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 34 B.C.L.R. (2d) 122, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* 73 C.B.R. (N.S.) 195, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada)* [1989] 3 W.W.R. 363, 1989 CarswellBC 334 (B.C. C.A.) — referred to

Statutes considered:

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

Generally — considered

s. 5 — considered

s. 6 — considered

APPEAL by creditors from judgment reported at 2001 CarswellOnt 1325, 25 C.B.R. (4th) 1 (Ont. S.C.J. [Commercial List]) sanctioning plan of arrangement under *Companies' Creditors Arrangement Act*.

***The Court*:**

1 Cumberland Asset Management, and others, appeal from orders made by Farley J. dated March 29, 2001 and May 7, 2001. In the March 29, 2001 order Farley J. sanctioned a plan of arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (C.C.A.A.) proposed by Deloitte & Touche Inc., the Interim Receiver of Anvil Range Mining Range Mining Corporation and Anvil Range Properties Inc. In his May 7, 2001 order, Farley J. ordered that the appellants pay costs relating to the sanction motion in the total amount of $28,500.

2 The facts respecting the sanctioning of the plan are set forth in Farley J.'s reasons which are reported at (2001), 25 C.B.R. (4th) 1 (Ont. S.C.J. [Commercial List]) and need not be repeated in detail. The following is an outline, which contains some history of this proceeding which is not included in Farley J.'s reasons.

3 Anvil Range Mining Corporation is the owner of a lead and zinc mine, known as the Faro Mine, in the Yukon Territory. It bought this mine for about $27,000,000 in 1994 from KPMG Inc., in its capacity as Interim Receiver of the then owner, Curragh Inc.

4 Anvil Range began production in August 1995 after conducting a nine-month $75,000,000 pre-stripping and mill refurbishment program. It suspended mining operations in December 1996 and milling operations in the spring of 1997 because of falling metal prices. It recommenced operations in the fall of 1997 but ceased mining and milling early in 1998.

5 In January 1998, Anvil Range applied for and received protection from its creditors under the C.C.A.A. This was the beginning of the proceeding in which the orders under appeal were, eventually, made. In March 1998, Cominco Ltd., a secured creditor of Anvil Range, moved for the appointment of an interim receiver and termination of the stay provided for in the C.C.A.A. proceeding. Deloitte & Touche Inc. was appointed Interim Receiver and the court directed it to report to the court on certain matters, including seeking advice and directions respecting a marketing plan for the mine.

6 In response to this, the Interim Receiver filed its second report dated June 17, 1998 in which it recommended that "no funds be spent on marketing the mine for the present". This was based on several different facts, one of them being "the fact that no prospective purchasers had emerged to that date . . . . to express even minimal interest in the mine site despite the well publicized facts in the industry press".

7 As part of the ongoing dispute among the parties, the Interim Receiver brought a motion before Blair J., which was heard on August 20, 1998, seeking approval to sell certain assets at the mine. Blair J. noted that the Interim Receiver had expressed the opinion on the basis of its market analysis that it was "unlikely that the Faro Mine can be reopened within the next 2-3 years and possibly as long as 5 years." He then said:

> I agree that it is difficult to be very optimistic about the future prospects of the Faro Mine, including the chance of its re-opening. On the other hand, Strathcona (acknowledged by all to be expert in the field) seems to feel strongly that the best chance of recovery is if the Grum Pit at least is kept on a "standby-mode" ready to be made operative quickly when a period of good metal prices arrives. To do this the equipment in question will be necessary. To replace it would be costly and it may well be a non-starter if what is being considered is only a 3 year operation or so.

8 Blair J. did not dismiss the request for approval to sell the equipment but adjourned it to October 29, 1998 to enable the Yukon Territorial Government to do further analysis. This was because of the importance of the mine to the fabric of the Yukon Territory.

9 After extensive negotiations and a filing of the Yukon Territorial Government report, a funding formula was established in December 1998 whereby the Department of Indian Affairs and Northern Development ("DIAND") assumed most of the funding obligations of going forward. This funding was secured by a charge against the real property.

10 In December 1999, the court granted leave to the Interim Receiver or the secured creditors to file a plan of arrangement. About a year of negotiations among the secured creditors followed, eventually leading to an extensive settlement conference held in Vancouver under the direction of Justice Kierans, sitting as a justice of the Supreme Court of the Yukon Territory. The conference resulted in a settlement among three groups of secured creditors: (1) the Mining Lien Act Claimants; (2) Cominco Ltd.; and (3) DIAND, the Yukon Territorial Government and the Yukon Workers' Compensation, Health and Safety Board. The settlement was to be implemented by a plan under the C.C.A.A.

11 As will be set forth in more detail later in these reasons, the three groups of secured creditors were the only parties with a legal and economic interest in the assets of Anvil Range. The plan settled a series of complex priority disputes both within creditor classes and among creditor classes and also dealt with allocating funds in the Interim Receiver's possession.

12 The plan divides the creditors who are affected by it (the "Affected Creditors") into three classes (the three groups mentioned above):

1. The Mining Lien Act Claimants.

2. Cominco Ltd.

3. The government creditors, DIAND, the Yukon Territorial Government, and the Yukon Workers' Compensation, Health and Safety Board.

13 The plan provides for the class 3 creditors to acquire the mine and the mill located on it and certain other assets (the "Excluded Assets") and to assume responsibility for funding the ongoing necessary environmental, maintenance and security programs. The other two classes of Affected Creditors are to share in the proceeds of the sale of the remaining assets (the "Realization Assets").

14 The Interim Receiver recommended approval of the plan as the best alternative for settling the outstanding priority issues in dispute and because there was no recovery possible other than to the Affected Creditors.

15 The class 1 creditors' secured claims against Anvil Range property, as judicially declared by judgments of the Supreme Court of the Yukon Territory, total $18,312,169. The claim of the class 2 creditor, Cominco Ltd., was judicially determined by the Superior Court of Justice (Ontario) on January 27, 1999 to be $24,353,657 with post-judgment interest accruing on this amount at 8.5% per annum.

16 With respect to the class 3 creditors, the Yukon Territorial Government and the Yukon Workers' Compensation and Health and Safety Board claim is about $1,000,000. The claim advanced on behalf of DIAND is said to total over $60,000,000 for funding the Interim Receiver's expenses and, also, the environmental remediation costs. We shall deal with the salient details of it shortly.

17 The Affected Creditors unanimously approved the plan which was then sanctioned by the order of Farley J. dated March 29, 2001.

18 The appellants' appeal is substantially based on the following submissions:

1. The plan is not "fair and reasonable" in all of its circumstances as it effectively eliminates the opportunity for unsecured creditors to realize anything.

2. The plan is contrary to the purposes underlying the C.C.A.A.

3. DIAND's reclamation claim is inconsistent with the "fair and reasonable principles" of the C.C.A.A. and environmental remediation legislation.

19 Underlying these submissions is the submission that Farley J. erred in not requiring a more complete and in-depth valuation of Anvil Range's assets be obtained by the Interim Receiver.

20 This last submission should be dealt with first because it is fundamental to the success of the appeal. Farley J.'s findings were based on two reports, one by Strathcona Mineral Services Ltd. dated March 12, 2001 and the other by Deloitte & Touche Corporate Finance Canada, Inc. dated March 13, 2001. In preparing its report, Deloitte & Touche reviewed the Strathcona report, among other materials.

21 In its report Strathcona noted that in the Interim Receiver's 22nd report there was an estimate of the capital expenditures that would be required to resume mining activity at the Grum deposit (which was the only accessible resource base on the Anvil property) including the purchase of mining equipment, rehabilitation of the pit walls, and modifications and repairs to the process facilities. Strathcona said:

> The total is estimated at $80 to $100 million before working capital requirements and we consider this estimate to be reasonable and in the general range of what could be expected. It is clear that the capital expenditures to restart mining operations are going to exceed, perhaps by a factor of two, the cumulative gross operating margins for three years of operation that are indicated.

22 Strathcona concluded its report as follows:

> The total amount realized from the sale or disposition of the foregoing assets on a salvage basis would appear to be in the order of $10-$15 million without making any contribution towards the ongoing care and maintenance costs for the property or the reclamation requirements which we understand have become the responsibility of DIAND. There may also be some value ascribed to tax pools that remain from operating losses, capital expenditures and exploration expenditures by Anvil Range. However, presumably most of the value, if any, of those tax pools would only be applicable upon the resumption of mining operations on the property, and the Interim Receiver would be best positioned to comment on this item.

23 Deloitte & Touche Corporate Finance Canada, Inc. concluded that the established market value of all the assets to be "in the range of $11.1 to $19.9 million (Schedule 1), as at January 31, 2001" and that, if it were asked to be more specific, "[it] would suggest the mid-point of the foregoing range, being $15.5 million." It concluded: "Based on the above, there is no value remaining for the unsecured creditors, as the amount owed to secured creditors of over $90.0 million exceeds the value of the assets of Anvil Range."

24 The appellants submitted a letter from Watts, Griffis & McOuat, Consulting Geologists and Engineers, dated March 21, 2001 which reviewed several documents, "in particular" the Strathcona report dated March 12, 2001. In this letter, Watts, Griffis & McOuat stated "a number of questions about the methodology and logic that Strathcona is using". It did not state an opinion on the value of the Anvil Range property.

25 On these materials, Farley J. concluded that "the secured claims are far in excess of the value of the assets" and that the value had to be determined "on a current basis" and not "on a speculative or (remote) possibility basis." He dealt with the evidence submitted by the appellant as follows:

> The Watts, Griffis & McOuat letter of March 21, 2001 has been hastily prepared in an attempt to throw doubt on some of the Strathcona observations and conclusions - but not to discredit them. In fact in numerous instances [the] letter concurs

> with the Strathcona report. Rather the author of the letter has some questions. It must be appreciated that Strathcona/Farquharson has had significant involvement with the Anvil mining facilities over the past several years, whereas Watts, Griffis & McOuat has only had this rather peripheral engagement. I do not find it unusual that two experienced consultants in this mining field may have different views or approaches, nor that one may feel the need for more information than it was able to glean from reviewing the listed documents before reaching a conclusion. In the result, I think it reasonable to accept the views of Farquharson, an established and recognized expert in this field, who has had, as indicated, considerable experience with this matter over the past several years. Further, I think it inappropriate and unnecessary to further delay and incur additional costs to engage upon a further study.

26 In our view, Farley J. did not err in accepting the respondent's evidence as affording a reasonable basis for his findings and, further, he did not make any error in his assessment of this evidence that would justify our interfering with his conclusions: *Equity Waste Management of Canada Corp. v. Halton Hills (Town)* (1997), 35 O.R. (3d) 321 (Ont. C.A.) at 333-336.

27 It may be that the Strathcona report, as a free standing document, could have been more detailed but this is far from saying that it was not capable, particularly in the context of this proceeding, which began in 1998, of forming a reasonable basis for Farley J.'s findings. This context includes the evidence that Anvil Range bought the property in 1994 for $27,000,000, that its resources underwent depletion since then, that the cost of putting the property in a state where it could recommence operations was some $80,000,000 to $100,000,000 and, although it had been known for sometime in the industry that the property was "available", no one had expressed any interest in it.

28 We turn now to the three basic submissions of the appellant set forth in paragraph 18 of these reasons.

29 It will be helpful to deal with the third submission first, that relating to the DIAND claim. The total DIAND claim is for something over $60,000,000. The appellants submit that by reason of the "polluter pays" principle, it is wrong that DIAND should have a secured claim against the assets of Anvil Range for environmental remediation at the expense of the unsecured creditors. There are several facets to this submission but, because of the particular facts of this case, we need not explore them. Of the total DIAND claim, some $16,000,000 relates to funds expended under court orders for the Interim Receiver and this is, undeniably, a valid secured claim. As will be apparent, it is sufficient to resolve this appeal if only this part of DIAND's claim is taken into account - and it may well not be necessary to take any part of the claim into account.

30 We turn now to the first two of the appellant's specific submissions. The first is that the plan is not fair and reasonable because it effectively eliminates the opportunity for unsecured creditors to realize anything.

31 From the accepted valuation the maximum possible total value of Anvil Range's assets is $19,900,000. After eliminating the portion of DIAND's claim for remediation costs, the secured claims total at least $60,000.000. Accordingly, even after allowing for a fair margin of error on each side of the equation (the assets side and the claims side) it can be seen that the unsecured creditors have no legal or economic interest in the assets in question.

32 The second submission is that the plan is contrary to the purposes of the C.C.A.A. Courts have recognized that the purpose of the C.C.A.A. is to enable compromises to be made for the common benefit of the creditors and the company and to keep the company alive and out of the hands of liquidators. See, for example, *Northland Properties Ltd., Re* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) at 201. Farley J. recognized this but also expressed the view in paragraph 11 of his reasons that:

> The CCAA may be utilized to effect a sale, winding up or a liquidation of a company and its assets in appropriate circumstances. See *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at p. 32; *Re Olympia & York Developments Ltd.* (1995), 34 C.B.R. (3d) 93 (Ont. Gen. Div. [Commercial List] at p. 104. Integral to those circumstances would be where a Plan under the CCAA would maximize the value of the stakeholders' pie.

33 Further to this it may be noted that the plan in this case reflected a compromise of difficult priority issues among the secured creditors and, as stated later in Farley J.'s reasons, "the approval of this Plan will allow the creditors (both secured and unsecured) and the shareholders of Anvil to move on with their lives and activities while the mining properties including the mine will be under proper stewardship."

34 It may also be noted that s. 5 of the C.C.A.A. contemplates a plan which is a compromise between a debtor company and its secured creditors and that by the terms of s. 6 of the Act, applied to the facts of this case, the plan is binding only on the secured creditors and the company and not on the unsecured creditors.

35 Relevant to this issue is the fact that the appellants put forward an alternative plan, which involved their receiving the corporate shell of Anvil Range together with $500,000, and other terms. This plan, however, had no viability. As Farley J. noted in his reasons for the costs disposition it was "doomed to failure given the stated opposition to same [the alternate plan] of the secureds-Cominco Lien and Claimants and DIAND".

36 It is not necessary to resolve this issue to decide the appeal. If the order under appeal was not properly made under the C.C.A.A., there is no doubt that it could have been made by Farley J. in response to the alternative relief sought, which was that of approving a sale of Anvil Range's assets by the Interim Receiver on terms substantially similar to those provided for in the plan. Taking into account that the assets are insufficient to pay even half of the secured creditors claims, it is clear that the order under appeal occasioned no prejudice whatsoever to the appellants. Accordingly we do not give effect to this submission.

37 In the complex circumstances of the operation of the mine and given that there is no hope of the sale generating sufficient funds to satisfy the secured creditors, it cannot be said that Farley J. erred in approving the plan as being fair and reasonable.

COSTS

38 The other appeal is from Farley J.'s order requiring the appellants to pay costs relating to the motion which he fixed in the total amount of $28,500 and allocated as follows:

$15,000 to the Interim Receiver;

$7,000 to Cominco;

$5,000 to DIAND;

$1,500 to Yukon Energy Corporation

39 The appellants submit that Farley J. erred in this costs disposition because parties with an interest in a company governed by the C.C.A.A. should be free to appear in court and oppose the sanctioning of a plan on legitimate grounds without the threat of the penalty of the costs being imposed against them.

40 The award of costs, of course, was a matter within the discretion of the judge and we are not entitled to interfere with the exercise of the discretion just because we may have exercised it differently. To succeed the appellants must show that the exercise of discretion was affected by some error in principle or by misapprehension of the facts. In this case, while we might have been inclined simply to deprive the appellant of costs relating to the motion, we cannot say that there was no principled basis for the disposition which Farley J. made. He was entitled to conclude, as he did, that there was no realistic basis supporting the appellants' opposition to the plan.

DISPOSITION

41 In the result, the appeal is dismissed with costs payable by the appellants to the respondents who delivered factums and appeared on the hearing of the appeal. These respondents should deliver their submissions respecting the costs of the appeal, in writing, within seven days of the release of these reasons and the appellants should deliver their submissions within fourteen days of the release of the reasons.

Appeal dismissed.

End of Document

TAB 9

2002 CarswellOnt 5046
Ontario Superior Court of Justice [Commercial List]

GT Group Telecom Inc., Re

2002 CarswellOnt 5046, 41 C.B.R. (4th) 60

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 GT Group Telecom Inc., GT Group Telecom Services Corp., GT Group Telecom Services (USA) Corp. and LondonConnect Inc.

Farley J.

Heard: December 23, 2002
Judgment: December 23, 2002
Docket: 02-CL-4580

Proceedings: refused leave to appeal *GT Group Telecom Inc., Re* (2003), 2003 CarswellOnt 448, 41 C.B.R. (4th) 62 ((Ont. C.A.))

Subject: Insolvency; Corporate and Commercial

Table of Authorities

Statutes considered:

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

APPLICATION for approval of plan of compromise or arrangement.

***Farley J.*:**

1 I am satisfied on the three-part test as to a CCAA sanction that the subject Plan is to be approved. The $850 million U.S. Noteholders in the parent company object to the fairness and reasonableness of the parent not being included in the Plan - with the result that while their claims are not compromised, they get nothing out of the reorganization (and in fact, will get nothing out of the soon to occur bankruptcy since they are some $400 million CDN underwater and there is no foreseeable realistic (or even remote) possibility that they will come close to the surface). The fact circumstances of the parent's unsecured creditors being subordinate to the claims of the secured and unsecured creditors of the operating subsidiaries, which subsidiaries are in the Plan, was clearly spelled out in the 2000 Offering Circular for these 13 $^{1}/_{4}$% Notes. Clearly, the Noteholders have no economic interest in the situation - either in a plan of the operating companies or in any anything to do with the parent which is not included in the Plan. That the parent is not in the Plan is not unfair or unreasonable in these circumstances. The Noteholders have been aware since November 8th, 2002, that there would be nothing for them, yet they lay in the weeds until December 11, 2002. Under these circumstances they ought not to complain about the quality and expansiveness of the response to their voluminous questions.

2 The compromise of the unsecureds in the operating companies allows for these companies to continue - with the benefits to the employees, suppliers and customers of the operating companies.

3 The jurisprudence is clear as to not having all applicants - or all classes of any applicant in a Plan. Here that possibility was very clear from the get go and stated in paragraph 13 of the Initial Order of June 26, 2002.

4 The aspersions against the monitor are unfortunate as they do not appear to be grounded in any factual basis.

5 The transfer down of the assets (fair market value of some $300,000) is well within the $400 million CDN of water over the notes. Substance should prevail over form.

6 The Plan is approved.

7 Order to issue as per my *fiat*.

Application granted.

2003 CarswellOnt 448
Ontario Court of Appeal

GT Group Telecom Inc., Re

2003 CarswellOnt 448, 41 C.B.R. (4th) 62

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 GT Group Telecom, Inc., GT Group Telecom Services Corp., GT Group Telecom Services (USA) Corp. and LondonConnect Inc.

Rosenberg, Moldaver, Simmons JJ.A.

Judgment: January 28, 2003
Docket: CA M29418

Proceedings: refusing leave to appeal *GT Group Telecom Inc., Re* (2002), 2002 CarswellOnt 5046, 41 C.B.R. (4th) 60 ((Ont. S.C.J. [Commerical List]))

Counsel: William J. Burden for JPMorgan Chase Bank

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

MOTION by creditor for leave to appeal from judgment approving arrangement pursuant to Companies' Creditors Arrangement Act.

***Rosenberg J.A.*:**

1 For oral reasons leave to appeal is refused with costs on a partial indemnity basis fixed as follows:

To GT Group of Companies	$10,000
To The Minister	$ 5,000
To The other respondents	$ 7,500

to be shared pari passu or as they may agree amongst themselves. All the above inclusive of applicable GST and disbursements.

Leave to appeal refused with costs.

TAB 10

2009 CarswellOnt 4505
Ontario Superior Court of Justice [Commercial List]

Windsor Machine & Stamping Ltd., Re .

2009 CarswellOnt 4505, 179 A.C.W.S. (3d) 513

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

IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF WINDSOR MACHINE & STAMPING LIMITED, LIPEL INVESTMENTS LTD., WMSL HOLDINGS LTD., 442260 ONTARIO LTD., WINMACH CANADA LTD., PRODUCTION MACHINE SERVICES LTD., 538185 ONTARIO LTD., SOUTHERN WIRE PRODUCTS LIMITED, PELLUS MANUFACTURING LTD., TILBURY ASSEMBLY LTD., ST. CLAIR FORMS INC., CENTROY ASSEMBLY LTD., PIONEER POLYMERS INC., G&R COLD FORGING INC., WINDSOR MACHINE DE MEXICO, WINMACH INC., WINDSOR MACHINE PRODUCTS, INC. WAYNE MANUFACTURING INC. AND 383301 ONTARIO LIMITED (Applicants)

Morawetz J.

Heard: March 11, 2009
Judgment: March 11, 2009
Docket: CV-08-7672-00CL

Counsel: Tony Reyes, Evan Cobb for Monitor, RSM Richter Inc.
Raong Phalavong for Saginaw Pattern
Andrew Hatnay, Andrea McKinnon, D. Youkaris for U.A.W., Local 251
Joseph Marin for Windsor Machine & Stamping Ltd.
D. Dowdall, J. Dietrich for Bank of Montreal
J. Archibald for Magna
John D. Leslie for Ford Motor Company
P. Shea for Johnson Controls Inc.
Jackie Moher for Ryder Finance Corporation

Subject: Insolvency; Contracts; Property

Table of Authorities

Statutes considered:

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

***Morawetz J.*:**

1 On March 11, 2009, the motion of RSM Richter Inc. was heard and granted with reasons to follow. These are those reasons.

2 RSM Richter Inc., in its capacity as Monitor, brought this motion for:

(a) an Approval and Distribution Order;

(b) a Vesting Order relating to the sale of personal property assets from WMSL to the Canadian Purchaser;

(c) a Vesting Order relating to the sale of real property from Lipel Investments Ltd. to the Canadian Purchaser;

(d) a Vesting Order relating to the sale of real property from 383301 to the Canadian Purchaser;

(e) an Order approving the fees and disbursements of the Monitor and its counsel.

3 The motion has the support of the Applicants, Bank of Montreal (the "Bank"), Magna, Ford and Johnson Controls. The Union was not opposed to the sale. An unsecured creditor, Saginaw Pattern, objected. Ryder Finance, an unaffected party did not oppose.

4 I am satisfied that the record supports the requested relief. During these CCAA proceedings, the Applicants explored a number of restructuring alternatives. The Monitor also ran a sale process to identify a potential buyer or buyers for the business. The Applicants were unable to implement a restructuring within the current corporate entities and were unable to identify an arm's length buyer of the business that would pay an amount greater than the forced liquidation value of the business. The sale process conducted by the Monitor did not result in any offers being submitted to purchase the Applicants' assets.

5 The Monitor is of the view that the Applicants could not carry on as currently structured. Both the Bank and EDC indicated that they would continue their support for the business and they have had negotiations with the Purchasers and the Applicants, with a view to financing the Purchasers and then working with the Applicants to complete a sale of the business to the Purchasers.

6 The Monitor is of the view that the proposed transactions result in an outcome that preserves the business. The Monitor supports the approval of the transactions described in the Seventh Report.

7 With respect to the Approval and Distribution Order and the three Vesting Orders, these transactions notionally result in the Bank's loans being repaid by the Purchasers (who are being financed by the Bank and EDC) and will permit the business to continue. A portion of the secured debt owing by WMSL to WMSL Holdings Ltd. will be paid by way of a promissory note from the Canadian Purchaser to WMSL Holdings Ltd. The Canadian Purchaser will not have the burden of the remaining secured debt owing to WMSL Holdings Inc., nor the burden of substantial unsecured debt.

8 The Monitor is of the view that the holdbacks described in the Approval and Distribution Order are desirable and appropriate in the circumstances so that goods and services supplied post-filing can be paid, and so that the Union, if it is successful in its claims, can be paid.

9 In addition to the three transactions for which the Vesting Orders are sought, a fourth transaction is covered by the Approval and Distribution Order. The fourth transaction is with respect to personal property owned by two U.S. companies. These companies operate in the State of Michigan. The Applicants did not seek formal recognition of the CCAA proceedings in the United States. The parties are of the view that the most cost efficient means of completing the transaction with respect to these assets would be for the Bank to take its remedies under the U.S. Uniform Commercial Code, ("UCC") and issue notices of sale under the UCC with respect to the personal property. The Monitor consented to this process and notices were issued by the Bank.

10 It is specifically noted, that notwithstanding anything in the Approval and Distribution Order, Vesting Orders or purchase agreements referenced therein, the purchase orders or releases issued by Magna Structural Systems Inc. and/or Magna Seating of America, Inc. (collectively, "Magna") or Ford Motor Company ("Ford") to WMSL or any other Applicant will be assigned and vested in and to the purchaser, upon the consent of Magna or Ford, as the case may be, to the assignment of such purchase orders and releases being provided to WMSL and the Purchaser on Closing and the Certificate having been filed.

11 Further, nothing in the Approval and Distribution Order or the Vesting Orders made in accordance with such Approval and Vesting Order shall, unless JCI consents, impact or terminate the IP licence or option to purchase assets granted to JCI pursuant to the Accommodation Agreement dated October 24, 2008 and approved by the Order dated October 29, 2008, and

the vesting of assets pursuant to Approval and Distribution Order or the Vesting Orders shall, unless JCI otherwise consents, be subject to the IP licence and option in favour of JCI.

12 Finally, it is noted that employee matters are specifically addressed at Article 2.13 of the Agreement of Purchase and Sale.

13 Although the outcome of this process does not result in any distribution to unsecured creditors, this does not give rise to a valid reason to withhold court approval of these transactions. I am satisfied that the unsecured creditors have no economic interest in the assets.

14 As previously indicated, the record supports the requested relief in all respects. Orders have been signed and issued in the form requested.

End of Document

TAB 11

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

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

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

BEFORE: Newbould J.

COUNSEL:

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

Harry M. Fogul, for 22 former CLCA partners

Orestes Pasparakis and Evan Cobb, for the Insurers

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

James H. Grout, for 22 former CLCA partners

Chris Reed, for 8 former CLCA partners

Andrew Kent, for 5 former CLCA partners

Richard B. Jones, for one former CLCA partner

John MacDonald, for Pricewaterhouse Coopers LLP

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

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

HEARD: December 8, 2014 and January 6, 2015

ENDORSEMENT

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

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

[3] I granted the order with a stay to January 7, 2015 for reasons to follow, but in light of the fact that Chrysler Canada Inc., with a very large claim against CLCA in the litigation, had not been given notice of the application, ordered that Chrysler be given notice to make any submissions regarding the Initial Order if it wished to do so.

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

Structure of Coopers & Lybrand Chartered Accounts

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

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

[7] In order to comply with the requirements of the various provincial Institutes of Chartered Accountants across Canada, many of which restricted chartered accountants providing audit services from being partners with persons who were not chartered accountants, Coopers & Lybrand Consulting Group ("CLCG") was established under the *Partnerships Act (Ontario)* in

September 1985 to provide management consulting services. Concurrent with the formation of CLCG, Coopers & Lybrand ("OpCo") was established as a partnership of CLCA, CLCG and two other parties to develop and manage the CLCA audit and CLCG management consulting practices that had to remain separate. Until 1998, OpCo owned most of the operating assets of CLCA and CLCG. OpCo is governed by the Partnerships Act (Ontario) and its registered head office is in Toronto.

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

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

Castor Holdings litigation

[10] Commencing in 1993, 96 plaintiffs commenced negligence actions against CLCA and 311 of its individual partners claiming approximately $1 billion in damages. The claims arose from financial statements prepared by Castor and audited by CLCA, as well as certain share

valuation letters and certificates for "legal for life" opinions. The claims are for losses relating to investments in or loans made to Castor in the period 1988 to 1991. A critical issue in the Castor litigation was whether CLCA was negligent in doing its work during the period 1988-1991.

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

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

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

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

share of the damages suffered by each plaintiff in each action in the Castor litigation for the period that he or she was a partner in the years of the negligence.

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

[16] The Widdrington action has resulted in a judgment in the amount of $4,978,897.51, inclusive of interest, a cost award in the amount of $15,896,297.26 plus interest, a special fee cost award in the amount of $2.5 million plus interest, and a determination of the common issue that CLCA was negligent in performing its services as auditor to Castor during the relevant period.

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

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

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

(b) Certain of the plaintiffs have brought an action against 51 insurers of CLCA. They seek a declaration that the policies issued by the insurers are subject to Quebec law. The action would determine whether the insurance coverage is

costs-inclusive (i.e. defence costs and other expenses are counted towards the total insurance coverage) or costs-in-addition (i.e. amounts paid for the defence of claims do not erode the policy limits). The insurers assert that any insurance coverage is costs-inclusive and has been exhausted. If the insurers succeed, there will be no more insurance to cover claims. If the insurers do not succeed and the insurance policies are deemed to be costs-in-addition, the insurers may assert claims against CLCA for further premiums resulting from the more extensive coverage.

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

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

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

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

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

Individual partner defendants

[21] Of the original 311 defendant partners, twenty-seven are now deceased. Over one hundred and fifty are over sixty-five years of age, and sixty-five more will reach sixty-five years of age within five years. There is a dispute about the number of defendant partners who were partners of CLCA at the material time. CLCA believes that twenty-six were wrongly named in the Castor litigation (and most have now been removed), a further three were named in actions that were subsequently discontinued, some were partners for only a portion of the 1988-1991 period and some were named in certain actions but not others. Six of the defendant partners have already made assignments in bankruptcy.

Analysis

(i) Applicability of the CCAA

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

[23] The insolvency of a debtor is assessed at the time of the filing of the CCAA application. While the CCAA does not define "insolvent", the definition of "insolvent person" under the *Bankruptcy and Insolvency Act* is commonly referred to for guidance although the BIA definition is given an expanded meaning under the CCAA. See Holden, Morawetz & Sarra, *the 2013-2014 Annotated Bankruptcy and Insolvency Act* (Carswell) at N§12 and *Re Stelco Inc*. (2004), 48

C.B.R. (4th) 299 (per Farley J.) ; leave to appeal to the C of A refused 2004 CarswellOnt 2936 (C.A.).

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

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

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

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

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

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

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

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

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

[32] It is obvious in this case that if the litigation continues, the defence costs for which the applicant 451 will have liability alone will continue and will more than eat up whatever cash OpCo may have. As well, the contingent liabilities of CLCA in the remaining $1.5 billion in

claims cannot be ignored just because CLCA has entered defences in all of them. The negligence of CLCA has been established for all of these remaining cases in the Widdrington test case. The term sheet provides that the claims of the German and Canadian banks, approximately $720 million in total, and the claim of the Trustee of CLCA of approximately $108 million, will be accepted for voting and distribution purposes in a plan of arrangement. While there is no evidence before me at this stage what has led to the decision of CLCA and its former partners to now accept these claims, I can only conclude that in the circumstances it was considered by these defendants that there was exceptional risk in the actions succeeding. I hesitate to say a great deal about this as the agreement in the term sheet to accept these claims for voting and distribution purposes will no doubt be the subject of further debate in these proceedings at the appropriate time.

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

[34] For this reason, as well as the contingent risks of liability of CLCA in the remaining claims of $1.5 billion, it is highly likely that the $100 investment of the applicant 451 in CLCA is worthless and unable to fund the current and future obligations of the applicant caused by the CLCA litigation.

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

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

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

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

[38] The applicant 451's sole asset is its partnership interest in the CLCA partnership and its liabilities are derived solely from that interest. The affairs of the applicant and CLCA are clearly intertwined. Not extending the stay to CLCA and the Castor litigation would significantly impair the effectiveness of the stay in respect of 451. It would in fact denude it of any force at all as the litigation costs would mount and it would in all likelihood destroy any ability to achieve a global settlement of the litigation. CLCA is a necessary party to achieve a resolution of the outstanding litigation, and significant contributions from its interest in OpCo and from its former partners are anticipated under the term sheet in exchange for releases to be provided to them.

[39] Chrysler relies on the principle that if the technical requirements for a CCAA application are met, there is discretion in a court to deny the application, and contends that for several

reasons the equities in this case require the application to be met. It says that there is no business being carried on by the applicant or by CLCA and that there is no need for a CCAA proceeding to effect a sale of any assets as a going concern. It says there will be no restructuring of a business.

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

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

[42] Chrysler contends, as stated in its factum, that the pith and substance of this case is not about the rescue of a business; it is to shield the former partners of CLCA from their liabilities in a manner that should not be approved by this court. Chrysler refers to several statements by judges beginning in 2006 in the Castor litigation who have been critical of the way in which the Widdrington test case has been defended, using such phrases as "a procedural war of attrition" and "scorched earth" strategies. Chrysler contends that now that the insurance proceeds have run out and the former partners face the prospect of bearing the cost of litigation which that plaintiffs

have had to bear throughout the 22-year war of attrition, the former partners have convinced the German and Canadian banks to agree to the compromise set out in the term sheet. To grant them relief now would, it is contended, reward their improper conduct.

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

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

[45] I do understand that need for an applicant to act in the CCAA process with due diligence and good faith, but I would be reluctant to lay down any fixed rule as to how an applicant's actions prior to the CCAA application should be considered. I agree with the statement of Farley J. in *Muscletech Research and Development Inc. (Re)* (2006), 19 C.B.R. (5th) 57 that it is the good faith of an applicant in the CCAA proceedings that is the issue:

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

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

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

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

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

commencement of further trials, the rate of decrease of assets by funding legal costs will accelerate.

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

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

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

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

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

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

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

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

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

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

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

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

(e) the appointment of Ernst & Young Inc. as Monitor to oversee the implementation of the plan, including to assist with the realization and monetization of assets and

to oversee (i) the capital calls to be made upon the defendant partners, (ii) a claims process, and (iii) the distribution of the aggregate proceeds in accordance with the plan; and

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

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

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

[59] It is argued by the banks and others that if Chrysler is successful in defeating the CCAA proceedings, the consequence would be to punish all remaining Castor plaintiffs and to deprive them of the opportunity of arriving at a global settlement, thus exacerbating the prejudice which they have already suffered. Chrysler, as only one creditor of the CLCA group, is seeking to

> impose its will on all other creditors by attempting to prevent them from voting on the proposed Plan; essentially, the tyranny of the minority over the majority. I think the banks have a point. The court's primary concern under the CCAA must be for the debtor and all of its creditors. While it is understandable that an individual creditor may seek to obtain as much leverage as possible to enhance its negotiating position, the objectives and purposes of a CCAA should not be frustrated by the self-interest of a single creditor. See *Calpine Canada Energy Ltd., Re*, 2007 ABCA 266, at para 38, per O'Brien J.A.

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

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

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

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

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

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

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

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

> **3637** Defendants say litigation is far from being finished since debates will continue on individual issues (reliance and damages), on a case by case basis, in the other files. They might be right. They might be wrong. They have to

> remember that litigating all the other files is only one of multiple options. Now that the litigants have on hand answers to all common issues, resolving the remaining conflicts otherwise is clearly an option (for example, resorting to alternative modes of conflict resolution).

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

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

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

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

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

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

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

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

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

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

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

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

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

[77] Chrysler also takes exception to what it says is a faulty claims process proposed in the term sheet involving the creditors' committee. Whether Chrysler is right or not in its concern, that would not be a reason to deny the existence of the committee but rather would be a matter for discussion when a proposed claims process came before the court for approval.

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

[79] So far as the costs of the committee are concerned, I see this as mainly a final cri de couer from Chrysler. The costs in relation to the amounts at stake will no doubt be relatively minimal. Chrysler says it is galling to see it having to pay 28% (the size of its claim relative to the other claims) to a committee that it thinks will work against its interests. Whether the committee will

work against its interests is unknown. I would note that it is not yet Chrysler's money, but CLCA's. If there is no successful outcome to the CCAA process, the costs of the committee will have been borne by CLCA. If the plan is successful on its present terms, there will be $220 million available to pay claims, none of which will have come from Chrysler. I would not change the Initial Order an deny the right of CLCA to pay the costs of the creditors' committee.

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

Conclusion

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

Newbould J.

Date: January 12, 2015

TAB 12

CITATION: Re Crystallex International Corporation, 2012 ONSC 2125
COURT FILE NO.: CV-11-9532-00CL
DATE: 20120416

SUPERIOR COURT OF JUSTICE - ONTARIO
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CRYSTALLEX INTERNATIONAL CORPORATION

BEFORE: Newbould J.

COUNSEL: Markus Koehnen, Andrew J.F. Kent and Jeffrey Levine, for Crystallex International Corporation

Richard B. Swan, S. Richard Orzy and Emrys Davis, for Computershare Trust Company of Canada

David R. Byers and Maria Konyukhova, for Ernst & Young Inc., Monitor

Shayne Kukulowicz, for Tenor Special Situations Fund LP

John T. Porter, for Juan Antonio Reyes

Robert Frank, for Forbes & Manhattan Inc. and Aberdeen International Inc.

DATE HEARD: April 5, 2012

E N D O R S E M E N T

[1] Crystallex moves for four orders, the first being an order approving DIP financing pursuant to a credit agreement between Crystallex and Tenor Special Situation I, LLC ("Tenor"), the second being an order extending the stay referred to in paragraph 16 of the Initial Order dated

December 23, 2011 until July 16, 2012 or such further date as may be ordered, the third being an order approving a Management Incentive Plan ("MIP") and a Retention Advance Agreement in favour of Robert Fung and the fourth being an order to approve the actions of the Monitor referred to in the second and third reports of the Monitor.

[2] The noteholders of Crystallex[1] oppose the Tenor DIP facility. They propose a DIP loan which they would make for a smaller amount and for a shorter term than the Tenor DIP facility. They also oppose the MIP. In order to preserve any appeal rights they may have and may want to assert, they do not consent to an order approving the actions of the Monitor in the second and third reports, but take no position in opposition to the order sought.

[3] A shareholder, Mr. J.A. Reyes appeared on the motion to support the Tenor DIP facility and in principle the MIP, but has some concerns regarding the terms of the MIP.

[4] Forbes & Manhattan Inc. and Aberdeen International Inc., creditors owed approximately $2.5 million by Crystallex, oppose the Tenor DIP facility and the MIP.

Background to the Financing

[5] The history of the business of Crystallex and its mining project in Venezuela has been the subject of prior decisions in cases brought by the Noteholders. The evidence on the record before me indicates in summary as follows.

[6] The principal asset of Crystallex was its right to develop the Las Cristinas gold project in Venezuela. Las Cristinas is one of the largest undeveloped gold deposits in the world containing measured and indicated gold resources of approximately 20.76 million ounces.

[7] In September 2002 Crystallex obtained the right to mine the Las Cristinas project through a Mining Operation Contract (the "MOC") with the Corporacion Venezolana de Guayana (the "CVG"), a state-owned Venezuelan corporation. Crystallex complied with all of its obligations

[1] The noteholders in question are hedge funds that represent approximately 77% of the outstanding notes. It is they who have caused Computershare to take action on their behalf in the prior actions against Crystallex and in this CCAA proceeding.

under the MOC. Neither the CVG nor the Government of Venezuela raised any material concerns about lack of compliance. The CVG confirmed on several occasions that the MOC was in good standing and that Crystallex was in compliance with it.

[8] The Ministry of the Environment advised Crystallex in writing in April 2007 that Crystallex had completed all steps necessary to obtain the required environmental permit. Crystallex was shown a draft of the permit and was told that it would obtain the permit as soon as it had paid certain stamp duties and posted an insurance bond. Crystallex paid the duties, negotiated the bond with the Ministry and posted the bond.

[9] On February 3, 2011, despite confirming on several occasions that Crystallex's right to mine the Las Cristinas property continued unchallenged, CVG purported to "unilaterally rescind" the MOC.

[10] CVG rationalized its termination of the contract for reasons of "expediency and convenience" and because Crystallex had allegedly "ceased activities for over a year" on the project. Crystallex did not cease activities. It was maintaining the mining site in a shovel-ready state and was awaiting receipt of an environmental permit. Because of Venezuela's refusal to allow Crystallex to exploit Las Cristinas, Crystallex became unable to pay its debts as they became due effective December 23, 2011.

[11] Crystallex has a number of liabilities, the most of significant of which is a liability of approximately $100 million in senior unsecured notes that were issued pursuant to a Trust Indenture dated December 23, 2004. The notes were due on December 23, 2011. In addition, Crystallex has other liabilities of approximately CAD$1.2 million and approximately US$8 million.

[12] The principal asset of Crystallex is its arbitration claim of US$3.4 billion against Venezuela. In addition, Crystallex has mining equipment with a book value of approximately $10.1 million and cash of approximately $2 million.

[13] Crystallex asserts that the insolvency in which it finds itself is not attributable to poor business judgment by Crystallex but to the illegal conduct of the Venezuelan government in refusing to let Crystallex develop Las Cristina, even though Crystallex had the undisputed contractual right to do so.

Arbitration proceedings

[14] On February 16, 2011 Crystallex filed a Request for Arbitration with the International Centre for the Settlement of Investment Disputes ("ICSID") against Venezuela pursuant to a Bilateral Investment Treaty between Canada and Venezuela. ICSID is a mechanism through which private investors can seek legal redress against a foreign government for conduct that might be otherwise immune from suit. In the arbitration, Crystallex seeks compensation of $3.4 billion plus interest as full compensation for the loss of its investment.

[15] The Arbitration Tribunal held its first procedural meeting on December 1, 2011 in Washington, DC. At that hearing, the Tribunal established Washington, DC as the seat of the arbitration proceeding, and established a timetable for the arbitration. Pursuant to the timetable, Crystallex delivered its written case on February 10, 2012. Crystallex's written case comprises fourteen volumes of detailed witness statements, expert's reports, exhibits, law and argument. Its memorial summarizing the evidence, law and argument extends to 226 pages. Venezuela is required to respond to Crystallex's case by August 31, 2012. The hearing of the arbitration is scheduled for two weeks beginning on November 11, 2013.

[16] The valuation evidence Crystallex submitted with its ICSID case claims damages of $3.4 billion plus interest. While the result of the arbitration is unknown, if it is successful, and the award is collected, there will be far more available than necessary to pay the outstanding debts of Crystallex. It is also clear that any meaningful recovery for the creditors and possibly shareholders will require some success in the arbitration, either by a collectible award or a settlement.

DIP financing selection process

[17] In accordance with paragraph 12 of the Initial Order, Crystallex, with the assistance of its counsel and its financial advisor, commenced a process to seek DIP financing of $35 million with a term of December 13, 2014.

[18] With the approval of the Monitor, Crystallex hired a financial advisor, Skatoff & Company, LLC based in New York City. Mr. Skatoff is an independent financial advisory firm focused on debt advisory services, financial restructuring advisory services, financing advisory services and M&A services.

[19] Crystallex, in consultation with Mr. Skatoff and on its recommendation, prepared a set of bid procedures to govern the solicitation of bids to provide DIP financing to Crystallex. The bid procedures were approved by the Monitor. The bid procedures are referred to in some detail in my endorsement of January 25, 2012. They included a provision whereby the DIP lender could obtain a "back-end entitlement" of up to 49% of the arbitration proceeds.

[20] The bid procedures provided that Crystallex would only consider bids from qualified bidders. A qualified bidder was one who, among other things, complied with certain participation requirements including the submission of a participation package.

[21] As a result of the DIP financing auction, a small number of qualified bidders ultimately submitted proposals for the DIP financing. Among the bidders were the three hedge funds that hold approximately 77% of Crystallex's senior unsecured notes.

[22] Ultimately Mr. Skatoff recommended, and the board of Crystallex agreed, to accept the terms of the Tenor DIP financing now before the court for approval.

Proposed Tenor DIP financing

[23] The Tenor DIP facility contains the following material financial terms:

(a) Tenor will advance $36 million to Crystallex due and payable on December 31, 2016. This period for the loan is based on Crystallex's arbitration counsel's

assessment of the likely timing of a decision from the arbitral tribunal and collection of the award.

(b) The advances will be in four tranches, being $9 million upon execution of the loan documentation and approval of the facility by court order in Ontario, the second being $12 million upon any appeal of the Ontario court order approving the facility being dismissed and upon a U.S court order approving the facility, the third being $10 million when Crystallex has less than $2.5 million in cash and the fourth being $5 million when Crystallex again has less than $2.5 million in cash.

(c) The loans are to be used to (i) repay an interim bridge loan of $3.25 million advanced by Tenor with court approval of January 20, 2012 and payable on April 16, 2012, (ii) fees and expenses in connection with the facility, (iii) general corporate expenses of Crystallex including expenses of the restructuring proceedings and of the arbitration in accordance with cash flow statements and budgets of Crystallex approved by Tenor from time to time.

(d) Crystallex will pay Tenor a $1 million commitment fee.

(e) $35 million of the loan amount will bear PIK interest (payment in kind, meaning it is capitalized and payable only upon maturity of the loan or upon receipt of the proceeds of the arbitration) at the rate of 10% per annum compounded semi-annually.

(f) Tenor will receive additional compensation equal to 35% of the net proceeds of any arbitral award or settlement, conditional upon the second tranche of the loan being advanced. Net proceeds of the award or settlement is defined as the amount remaining after payment of principal and interest on the DIP loan, taxes and proven and allowed unsecured claims against Crystallex, including the noteholders, the latter of which will have a special charge for the unsecured amounts owing. Alternatively, Tenor can convert the right to additional

compensation to 35% of the common shares of Crystallex. This conversion right is apparently driven by tax considerations.

[24] The Tenor DIP facility also provides for the governance of Crystallex to be changed to give Tenor a substantial say in the governance of Crystallex. More particularly:

(a) Crystallex shall have a reduced five person board of directors, being two current Crystallex directors, two nominees of Tenor and an independent director selected by agreement of Crystallex and Tenor.

(b) The independent director shall be chair of the board of directors and shall not have a second-casting or tie-breaking vote.

(c) The independent director shall be appointed a special managing director and shall have all the powers of the board of directors to (i) the conduct of the reorganization proceedings in Canada and in the U.S. and the efforts of Crystallex to reorganize the pre-filing claims of the unsecured creditors, (ii) any matters relating to the rights of Crystallex and Tenor as against the other under the facility, (iii) the administration of the MIP to the extent not otherwise delegated to the bonus pool committee under the MIP, and (iv) to retain any advisor in respect of these matters. The special manager shall first consult with a non-board advisory panel, consisting of the three Crystallex directors who will step down from the board, and consider in good faith their recommendations.

(d) With respect to matters that may not at law be delegable to the special managing director, he will be required to obtain board approval. If the Tenor nominees use their votes to block that approval, Tenor will forfeit its 35% additional compensation.

[25] The Tenor DIP facility contains proscribed rights of Tenor in the event of default. Tenor may seize and sell assets other than the arbitration proceeding (i.e. any cash and unsold mining

equipment). It may not sell the arbitration claim. If there is a default before any arbitration award, Tenor would have the right to apply to court to have the Monitor or a Canadian receiver and manager appointed to take control of the arbitration proceedings. If such application were not granted, Tenor would be entitled to exercise the rights and remedies of a secured creditor pursuant to an order, the loan documentation or otherwise at law.

Proposed Noteholders DIP Loan and Plan

[26] The noteholders propose a DIP loan of $10 million with a simple interest rate of 1% repayable on October 15, 2012. This was essentially the same as the interim bridge loan of $10 million with simple interest of 1% proposed by the noteholders that would have been repaid on April 16, 2012 that was not accepted by Crystallex. It is quite clear that the interest rate is far below market in the circumstances of Crystallex, and it is referred to in the noteholders factum as "exceptionally favourable".

[27] During the process to find a DIP lender satisfactory to Crystallex and its advisors, the noteholders were asked to increase their proposed loan to $35 million but they refused. However, in his affidavit Mr. Mattoni on behalf of the noteholders stated that the noteholders would in the future be prepared under certain circumstances, if required by the court, to advance a DIP loan on the same terms as the Tenor DIP facility. He stated that the noteholders would do so in the event that prior to October 1, 2012, the court orders that such long-term financing is appropriate and necessary. The noteholders would reserve their ability as creditors to continue to oppose the need for such a loan and any stay extensions or attempts to secure such long-term financing outside of a plan of compromise. The $10 million which they provided in interim financing would be repaid from this financing such that the net effect of the financing would be the same as that of the Tenor DIP facility. During argument on this motion, Mr. Swan said that the noteholders were not prepared to agree to such a $35 million facility at this time but only at some future time as the $10 million facility they now proposed became due.

[28] The noteholders have also now proposed a restructuring plan, said to be in response to the Tenor DIP and the MIP. This was first proposed by Mr. Mattoni in his affidavit of March 27, 2012 as a proposal of the noteholders. At that time, he did not have any internal authority from

the QVT fund of which he is the investment manager, or from any of the other noteholders, to make such proposal. This was shored up as indicated in his further affidavit of April 4, 2012 served just before the hearing of this motion. The noteholders do not ask for approval of this plan on this motion, but put it forward as indicating a good faith intention to bargain for a plan. The noteholders plan would:

a) provide $10 million at 1% interest in a single-draw to meet Crystallex's funding needs over the next several months while a plan is negotiated;

b) provide $35 million to the Company in a straight exchange for 22.9% of Crystallex's equity;

c) exchange all outstanding debt for equity;

d) secure approximately 14% of the remaining equity for existing shareholders; and

e) provide incentives to management at a lesser level than the MIP. It would be up to the post-emergence board to ensure that management is properly incentivized, which could involve other compensation as well.

Management Incentive Plan

[29] In addition to approval of the DIP, Crystallex seeks approval of a Management Incentive Plan ("MIP") for certain of its key employees. The fundamental terms of the MIP are as follows:

(a) An amount equal to up to 10% of the first $700 million in net proceeds of the arbitration award and an amount equal to up to 2% of the net proceeds in excess of $700 million will be reserved as a retention pool for key management employees.

(b) The amount to be retained in this pool is the amount remaining after payment of the outstanding principal and interest on the DIP loan, outstanding operating and professional expenses, the unpaid claims of noteholders and other stayed unsecured creditors, together with post-filing interest and all taxes payable by the company on the award.

(c) The size of the pool shall not exceed 10% of the net proceeds of the arbitral award or one quarter of the amount that is available to shareholders of Crystallex after satisfaction of any additional compensation owing to Tenor under the loan agreement.

(d) A compensation committee consisting of three persons who are currently independent directors of Crystallex and who are expected to retire from the board in accordance with the governance provisions of the Tenor DIP facility, will determine the retention payment paid to each beneficiary of the MIP. The compensation committee will be entitled to distribute as much or as little of the retention pool as they see fit. Amounts remaining unpaid from the retention pool will be returned to Crystallex.

[30] Crystallex also proposes that there be a MIP charge to secure the payments, the charge to be subordinate to the Administration Charge, the DIP Charge, the Directors' Charge and the Pre-filing Unsecured Creditors Charge.

[31] Also sought for approval is a retention agreement for Mr. Fung which provides that at the end of each calendar quarter during 2012 and 2013 the board of Crystallex will pay a retention advance of $125,000 per quarter to Mr. Fung. The making of each payment will be at the discretion of the board but only to the extent that he remains properly engaged in the arbitration. Those payments are to be treated as if they were pre-payments of any payments that would otherwise be awarded to Mr. Fung from the retention pool under the MIP and therefore reduce any such amount he may receive from the retention pool.

DIP loan approval analysis

[32] Section 11.2 of the CCAA provides that a court may provide security in favour of an interim or DIP lender who agrees to lend to the debtor company having regard to its cash-flow statement. Section 11.2 (4) provides:

(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.

[33] Crystallex relies on the business judgment rule to support the decision of its board of directors to accept the Tenor DIP facility. It is clear that the business judgment rule can apply to a debtor in CCAA proceedings. In *Re Stelco*, (2009), 9 C.B.R. (5th) 135 (Ont. C.A.), Blair J.A. stated in that CCAA proceeding:

> 65. …It is well-established that judges supervising restructuring proceedings - and courts in general - will be very hesitant to second-guess the business decisions of directors and management. As the Supreme Court of Canada said in *Peoples*, *supra*, at para. 67:
>
> > Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making ...

[34] The noteholders point to *Kerr v. Danier Leather Inc*, [2007] 3 S.C.R. 331 per Binnie J. at para. 54 in which he stated that the business judgment rule could not be used to qualify or undermine the duty of disclosure required by the *Securities Act* and *Bennett v. Bennett Environmental Inc.* 2009 ONCA 198 per Lang. J.A. in which she held that whether a director could be indemnified depended on the application of section 123(4) of the CBCA and not the business judgment rule.

[35] I accept that in considering whether security under a DIP loan should be ordered, a court cannot ignore the factors directed to be considered in section 11.2 (4) of the CCAA and could not

order such security if a consideration of those factors led to an opposite conclusion. But in my view those factors are not the only factors that can be considered, as section 11.2(4) directs a court to consider the listed factors "among other things". One of the considerations that in my view can be taken into account is the exercise or lack thereof of business judgment by the board of directors of a debtor corporation in considering DIP financing.

(i) Consideration of the Tenor DIP facility

[36] In this case, the Crystallex board took legal advice from its solicitors McMillan LLP and financial advice from Mr. Skatoff. I am satisfied that they carefully considered the relevant matters leading to the decision to accept the terms of the Tenor DIP financing, including giving consideration to the noteholders' proposed DIP financing of $10 million to October, 2012, and that they acted on an informed basis and in good faith with a view to the best interests of Crystallex and its stakeholders. See the affidavits of Mr. Fung at paras. 52 to 67 and the reply affidavit of Mr. van't Hof at paras. 9 to 12. That being said, I must consider the contentions of the parties and the factors as set out in section 11.2 (4).

[37] The noteholders have made a number of objections to the Tenor DIP financing.

[38] They contend that Crystallex should have sought sufficient financing to pay the noteholders in full, as was attempted prior to the CCAA filing. The evidence indicates, however, that Mr. Skatoff attempted to do so with the market but the message he received back consistently was that the market had no interest in paying out existing noteholders at 100 cents on the dollar in a context where the notes were trading at a significant discount to par. Mr. Mattoni himself said on cross-examination that he did not believe it would be possible to raise sufficient money on the market to pay out the noteholders, as did the noteholder's financial expert witness Mr. Glenn Sauntry.

[39] Mr. Mattoni in his affidavit states that the Tenor DIP facility was a pre-ordained coronation rather than the result of a competitive bidding process. There is no evidentiary basis for this suggestion. It is clear from the evidence of Mr. Skatoff, Mr. Fung and Mr. van't Hof and from the Monitor's report that there was a robust competitive bidding process and that full consideration right up to the last minute was given to other bidders. The Monitor stated it its report that from its observation of the process, it saw no evidence that Tenor was afforded preferential treatment over other participants in the process. It is also clear that the noteholders' $10 million bid was considered by the board of Crystallex and, based on advice from its advisors, not accepted. Thus any complaint from the noteholders on this score could only be that the Tenor bid was higher than market pricing for the facility. They had no such evidence and on cross-examination their financial expert Mr. Sauntry acknowledged that he could not say that the Tenor bid was not reflective of market pricing.

[40] The noteholders also complain that Mr. Skatoff did not undertake a valuation of Crystallex. The response of Crystallex is that it was not Mr. Skatoff's job to do that. In light of the fact that the main asset of Crystallex is the arbitration claim, Mr. Skatoff in my view would be in a poor position to value Crystallex.

[41] Mr. Sauntry in his report attempted to value the arbitration claim in different ways. He is not a lawyer and has no knowledge of the treaties involved or of the merits of the arbitration claim. He made assumptions in his cash flow analysis that, based on the reply expert report of Mr. Dellepiane, which I have no reason to doubt as he was intimately involved in the preparation of the arbitration claim, indicate Mr. Sauntry's lack of knowledge of the basis of the claim. Regarding Mr. Sauntry's analysis in (i) implying a value to the arbitration claim from an analysis of the Tenor DIP proposal and stating that in substance that proposal is a sale of a percentage of Crystallex's assets to Tenor and (ii) using the market value of Crystallex's securities as a proxy for enterprise value, I accept the reply affidavit of Mr. Skatoff, and in particular paragraphs 34 to 41, as reason to doubt Mr. Sauntry's analysis. As well, Mr. Sauntry's evidence on cross-examination, and in particular that referred to in paragraphs 8 to 12 of the Summary of Key Points From Cross-examinations, indicates little reliability should be placed on Mr. Sauntry's evidence.

[42] In any event, in light of the lack of evidence from the noteholders that the Tenor bid was not above market, the contention that Mr. Skatoff did not undertake a valuation of Crystallex or of the arbitration claim is of little moment.

[43] The noteholders also contend that whereas the bid process spelled out terms that must not be contained in a bid and provided that some terms were to be discouraged, the Tenor bid in the end contained some such terms. In those circumstances, the noteholders contend that Crystallex should have re-canvassed the market. Mr. Skatoff's evidence is that other bidders presented loan terms that would have resulted in similarly extensive changes to the loan document that accompanied the bid packages. The world of restructuring is not a perfect world. A company seeking DIP financing can tell the market what it wants, but cannot dictate its terms if the market tells it otherwise. The alternative is to walk away from the market. Regarding the changes sought by the market, the Monitor in its report states:

> 50. During the negotiations, all bidders requested amendments to the template version of the loan agreement posted on the Monitor's website as part of the CCAA Financing Procedures. The Monitor is of the view that such requests are typical in any bidding or investment raising process. The Monitor observed that all parties were provided with the template loan agreement and, as is common in processes such as the CCAA Financing Procedures, the final forms of the selected commitment letter and senior credit agreement deviate from the template agreement.

[44] The noteholders take a fundamental objection to the Tenor DIP facility on the basis that it is inconsistent with the purposes of the CCAA and case law dealing with DIP loans. The noteholders say that it is not interim financing but a forced restructuring plan prejudicial to them and that it should not proceed without a vote as required by the CCAA for a plan of arrangement or compromise.

[45] *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp*., (2008), 46 C.B.R. (5th) 7 (B.C.C.A.) is authority for the proposition that a stay under the CCAA should not be continued if the debtor company does not intend to propose a compromise or arrangement to its creditors, and DIP financing should not be authorized to permit the debtor company to pursue a restructuring plan that does not involve an arrangement or compromise with its creditors. In that

case, the debtor wanted to obtain financing to complete the construction of a golf course development without proposing an arrangement or compromise with its creditors.

[46] The noteholders seize upon a statement made by Mr. Fung in his affidavit filed on the initial application leading to the Initial Order in which he said:

> Crystallex strongly desires to pursue the arbitration and have stayed all claims against it until the arbitration has been settled or Crystallex has realized on an arbitration award, at which point Crystallex expects that all creditors would be paid in full to the extent of their proven claims.

[47] While there is no doubt that Mr. Fung made that statement, I think it needs to be considered in light of the reality agreed by the parties that the only way any of the creditors will receive any substantial cash payment is from the proceeds of the arbitration. This would be the case whether a plan of arrangement could be agreed or not. Also Mr. Mattoni agreed on cross-examination that Crystallex's goal of pursuing the arbitration and using the proceeds to pay creditors in full did not prevent Crystallex from giving creditors some additional benefit in a plan of arrangement.

[48] Moreover, often statements are made in CCAA proceedings about the intention of a party that later change. Mr. Koehnen made clear in argument that Crystallex has every intention to attempt to negotiate a plan of arrangement with the noteholders and that this has already been going on now on a without prejudice basis. He said the purpose of the stay to July 16, 2012 is to negotiate a compromise with the noteholders during that time period. I accept that statement. The situation is not the same as in *Cliffs Over Maple Bay*.

[49] Is the Tenor DIP facility a plan of arrangement or compromise requiring a vote? In my view it is not.

[50] 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.

[51] I note that in this case the practical exercise of the rights of the noteholders is very problematical because of issues raised in Mr. Fung's confidential affidavit no. 2.

[52] The noteholders contend that giving Tenor 35% of the arbitration proceedings will take away from Crystallex a substantial amount of equity making a compromise more difficult and less available for the unsecured creditors.

[53] In *Re Calpine Canada Energy Inc.* (2007) 35 C.B.R. (5th) 1 (Alta. Q.B.), leave to appeal denied (2007) 35 C.B.R. (5th) 27, it was contended that a settlement of several claims in a complex cross-border restructuring constituted a plan of arrangement or compromise and thus required a vote under the CCAA by the creditors affected. It was contended that the settlement left less assets available for the Canadian unsecured creditors. In rejecting this contention, Romaine J. stated the following:

> 12. The primary objection is that the GSA [global settlement agreement] amounts to a plan of arrangement and, therefore, requires a vote by the Canadian creditors. The Opposing Creditors support their submissions by isolating particular elements of the GSA and characterizing them as either a compromise of their rights or claims or as examples of imprudent concessions made by the CCAA Debtors in the negotiation of the GSA. These specific objections will be analyzed in the next part of these reasons, but, taken together, they fail to establish that the GSA is a compromise of the rights of the Opposing Creditors for two major reasons:
>
> > (b) the Opposing Creditors blur the distinction between compromises validly reached among the parties to the GSA and the effect of those compromises on creditors who are not parties to the GSA. … If rights to a judicial determination of an outstanding issue have not been terminated by the GSA, which instead provides a mechanism for their efficient and timely resolution, those rights are not compromised.

> 19 … While settlements made in the course of insolvency proceedings may, in practical terms, result in a diminution of the pool of assets remaining for division, this is not equivalent to a compromise of substantive rights.
>
> 51. The GSA is not linked to or subject to a plan of arrangement. I have found that it does not compromise the rights of creditors that are not parties to it or have not consented to it, and it certainly does not have the effect of unilaterally depriving creditors of contractual rights without their participation in the GSA.
>
> 55. I am satisfied that the GSA is not a plan of compromise or arrangement with creditors. Under its terms, as agreed among the CCAA Debtors, the U.S. Debtors and the ULC1 Trustee, certain claims of those participating parties are compromised and settled by agreement. Claims of creditors who are not parties to the GSA either will be paid in full (and thus not compromised) as a result of the operation of the GSA, or will continue as claims against the same CCAA Debtor entity as had been claimed previously.

[54] In refusing leave to appeal from the decision of Romaine J., O'Brien J.A. stated:

> 34. … The GSA does not change its status as a creditor of those companies, nor does it bar the applicant from any existing claims against those companies.
>
> 35. … the fact that the GSA impacts upon the assets of the debtor companies, against which the applicant may ultimately have a claim for any shortfall experienced by it, is a common feature of any settlement agreement and as earlier explained, does not automatically result in a vote by the creditors. The further fact that one of the affected assets of the debtor companies is a cause of action, or perhaps, more correctly, a possible cause of action, does not abrogate the rights of a creditor albeit there may be less monies to be realized at the end of the day.

[55] While this case is not binding on me, it is persuasive and makes sense. It is also consistent with authorities in Ontario that a sale of assets or a settlement in a CCAA before a plan of compromise is put forward may be authorized even if there will be insufficient assets to retire the creditor claims in full. See *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299.

[56] In this case, it cannot be said that there will be insufficient assets coming from the arbitration to repay all of the outstanding notes in full, which at present is approximately $115 million. Even the valuation of Mr. Sauntry, which I do not accept as reliable, indicates far more than that as a possible outcome of the arbitration. While the outcome of the claim cannot be

known at this stage, it is a claim for $3.4 billion dollars in circumstances in which Crystallex spent approximately $500 million on the development of the mine.

[57] The fundamental purpose of the CCAA is well established, and indicates that flexibility is required in dealing with any particular case. In *A.G. Can. v. A.G. Que. (sub. nom. Reference re Companies' Creditors Arrangement Act)*, [1934] S.C.R. 659, the following was stated:

> ... the aim of the Act is to deal with the existing condition of insolvency in itself to enable arrangements to be made in view of the insolvent condition of the company under judicial authority which, otherwise, might not be valid prior to the initiation of proceedings in bankruptcy. *Ex facie* it would appear that such a scheme in principle does not radically depart from the normal character of bankruptcy legislation."
>
> The legislation is intended to have wide scope and allow a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors.

[58] Since 1934, of course, there has been wide experience in dealing with the CCAA, and it has been an evolving experience. In *Re Canadian Red Cross*, Blair J. (as he then was) approved the sale of the assets of the debtor that would result in the estate having less than sufficient money to pay all of its creditors in full, and before a plan of compromise was put forward. He discussed the flexibility involved in these terms:

> 45. It is very common in CCAA restructurings for the Court to approve the sale and disposition of assets during the process and before the Plan if formally tendered and voted upon. ... The CCAA is designed to be a flexible instrument, and it is that very flexibility which gives it its efficacy. As Farley J. said in *Dylex, supra* (p. 111), "the history of CCAA law has been an evolution of judicial interpretation". It is not infrequently that judges are told, by those opposing a particular initiative at a particular time, that if they make a particular order that is requested it will be the first time in Canadian jurisprudence (sometimes in global jurisprudence, depending upon the level of the rhetoric) that such an order has made! Nonetheless, the orders are made, if the circumstances are appropriate and the orders can be made within the framework and in the spirit of the CCAA legislation. Mr. Justice Farley has well summarized this approach in the following passage from his decision in *Re Lehndorff General Partner* (1993), 17 C.B.R. (3d) 24, at p. 31, which I adopt:

> 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 plan of compromise or arrangement to be prepared, filed and considered by their creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 7, 8 and 11 of the CCAA (a lengthy list of authorities cited here is omitted).
>
> 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 (citations omitted)

[59] In that case, Blair J. considered the factors in *Soundair* in deciding whether to approve of the sale, being whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; to consider the interests of the parties, to consider the efficacy and integrity of the process by which offers are obtained and to consider whether there has been unfairness in the working out of the process. Those factors are consistent with the factors to be taken into account in considering whether security for a DIP loan should be approved, and as the Tenor DIP facility involves a grant of a financial interest in part of the assets of Crystallex, being a percentage of the arbitration award, it seems to me that they can be looked at in this case.

[60] It was contended by the noteholders that the size of a loan of $36 million, an amount calculated to complete and collect the arbitration, was not in accordance with the purposes of a DIP loan as it would take Crystallex beyond what is required before any reorganization. However this complaint regarding the size of the loan was not strenuously pursued in argument, no doubt because of the new position of the noteholders that it would fund that amount on the terms of the Tenor DIP loan if later required and because of the provision in the proposed plan of arrangement put forward by the noteholders that it would provide $36 million in funding in return for an equity stake in Crystallex. There seems no doubt that the parties agree that at least $36 million is required to pursue the arbitration.

[61] The noteholders also contend that the term of the loan by Tenor is far too long and that it indicates an attempt by Crystallex to do an end run around the need to propose a plan of arrangement as the term would extend beyond the date of an anticipated award. I have already dealt with the issue of Crystallex proposing a plan of arrangement. The noteholders contend that the DIP loan, at least initially, should not extend beyond October, 2012 as by then a plan should have been negotiated. However, both sides agree that the only way that any substantial cash will be available to Crystallex or its creditors will be from the arbitration and that it will be necessary to prosecute the arbitration long after October, 2012. The proposed plan of the noteholders recognizes this as it proposes a $36 million injection for the purposes of prosecuting the arbitration. The $36 million figure is based on a projection of expenditures going far beyond 2012. That is, both sides agree that it will be necessary to have financing for the arbitration that will continue after October, 2012. The term of the Tenor DIP loan as to when the loan becomes due in itself is not an impediment to a restructuring.

[62] In my view, the term of the loan is not the substantive issue, so long as Crystallex intends to negotiate if possible an acceptable plan of arrangement or compromise, which it has indicated it intends to do. One of the factors required to be considered under section 11.2(4) is the time during which Crystallex is expected to be subject to the CCAA proceedings. Like many cases, it is not clear when these proceedings may be over. However, as the $36 million financing is going to be required whether Crystallex is out from under the CCAA in a short or longer period, and as the expenditures are to last for a few years, this factor of the time during which Crystallex is expected to be subject to the CCAA proceeding is not a determinative factor.

[63] The noteholders also contend that Tenor has been given control over Crystallex and the restructuring process by reason of the changes in the corporate governance required by the Tenor DIP facility. There is no doubt that Tenor has been given substantial governance rights, including the right to name two of the five directors and the right to agree on who the independent director shall be. An issue is whether the governance provisions are too intrusive for a DIP loan, which according to case law relied on by the noteholders should not be excessive or inappropriate. I note that there is no prohibition in the CCAA against the board of directors changing at the hands

of the debtor. There is a provision allowing the court to remove directors, which I shall later discuss.

[64] Any DIP lender wants to obtain as much control as possible over the affairs of the debtor during the term of the DIP financing, and terms are often imposed to that end. In this case, given the extreme hostility of the noteholders to the board and management of Crystallex over its actions over the few years prior to the arbitration being commenced, it is not surprising that Tenor has demanded what it has. The fact that Tenor at the last minute changed the governance terms that it was prepared to live with, and that the Crystallex board was not happy with the change, does not in itself mean that those terms should not be approved.

[65] To put up the financing and have it subject to change by the noteholders or Crystallex would make no economic sense to Tenor or to any other DIP lender in the circumstances of this case. Like the noteholders and shareholders, Tenor will only be able to have its loan repaid from the proceeds of the arbitration, and it has bargained for what it perceives to be necessary protection for that. I agree with the noteholders that the CCAA is not about protecting new DIP lenders. However, the issue is whether the protections negotiated in order to obtain the DIP loan from Tenor are reasonable or excessive.

[66] Even if there were a prospect of money being raised by Crystallex in some fashion to pay out the noteholders prior to an arbitration award or settlement, which on the evidence I have referred to is not the case, including the issues referred to in Mr. Fung's confidential affidavit no. 2, and the opinion of Freshfields, as a practical matter this is not a case in which the noteholders have any realistic steps to try to cash out now before the arbitration claim is dealt with.[2] A restructuring under the CCAA, or any bankruptcy of Crystallex, is not going to change that. The market cap of Crystallex is far too small to repay the noteholders, even if they were given 100% of the equity of Crystallex.

[67] The terms of the Tenor Dip facility give Tenor no right to conduct the reorganization proceedings in Canada and in the U.S. or interfere with the efforts of Crystallex to reorganize the

[2] The fact that the noteholders have an opinion questioning some of what Freshfields says does not change that.

pre-filing claims of the unsecured creditors. That will be in the hands of the independent/special managing director who will be required to consult with the non-board advisory panel consisting of the three directors of Crystallex who will step down from the board. With respect to matters that may not at law be delegable to the special managing director, he will be required to obtain board approval and if the Tenor nominees use their votes to block that approval, Tenor will forfeit its 35% additional compensation. Tenor is obviously not going to want to put itself in that position.

[68] Tenor recognizes that it cannot conduct the arbitration proceeding. Under the terms of the Tenor DIP facility, if there is a default before any arbitration award, Tenor would have the right to apply to court to have the Monitor or a Canadian receiver and manager appointed to take control of the arbitration proceedings. Whether it would make such an application is a question mark, and likely would depend on whether Crystallex were put into bankruptcy. There would likely be no other reason for wanting someone other than the Crystallex board to have control over the conduct of the arbitration.

[69] As a practical matter, the conduct of the arbitration will no doubt be in the hands of Freshfields who have the knowledge and expertise. Mr. Mattoni in his affidavit filed on behalf of the noteholders agreed that the arbitration is really in the hands of litigation counsel. As well, the management personnel of Crystallex that have been involved in the claim in presenting evidence and instructing counsel regarding the evidentiary issues are going to have to continue to be involved in order to prosecute the claim. Their failure to do so would compromise the claim.

[70] If any director, whether nominees of Crystallex or of Tenor, is unreasonably impairing the possibility of a viable compromise, the court under s. 11.5(1) of the CCAA has the power to remove such director. That section provides:

> 11.5 (1) The court may, on the application of any person interested in the matter, make an order removing from office any director of a debtor company in respect of which an order has been made under this Act if the court is satisfied that the director is unreasonably impairing or is likely to unreasonably impair the possibility of a viable compromise or arrangement being made in respect of the company or is acting or is likely to act inappropriately as a director in the circumstances.

[71] The noteholders point out that section 8.1(t) of the DIP facility makes it an event of default of the DIP loan if a Tenor nominee director is removed from the board without the consent of Tenor except "by reason of misconduct" of the director, and assert that "misconduct" is a considerably different standard from "unreasonably impairing" in section 11.5(1) of the CCAA, thus restricting a court's ability to remove a director for unreasonably impairing a compromise or arrangement. Of course, any application under the section would turn on the particular facts, but it would certainly be arguable that if a director were unreasonably impairing a compromise or arrangement, that could constitute misconduct, particularly as the purpose of a CCAA proceeding is to encourage a consensual compromise or arrangement.

[72] One of the factors required to be considered under section 11.2(4) is whether Crystallex's management has the confidence of its major creditors. There is no doubt from the prior litigation that the noteholders expressed extreme displeasure at the steps taken by its board and management to try to come to some accommodation with Venezuela to maintain the rights to the Las Cristinas mine project. The noteholders maintained that Crystallex should stop spending money and commence the arbitration. That of course is now water under the bridge and the only business of Crystallex is the arbitration that has been commenced. The noteholders did not previously take the position that the management should not be involved in the arbitration, nor do they now raise any such objection. The Monitor notes in its report that the noteholders' proposed plan contemplates keeping existing management. It is clear that the management who have been involved in the arbitration are going to be needed further, and this is not a situation in which the noteholders could want to insert themselves instead of management in the conduct of the arbitration. As Mr. Mattoni said, that is something in the hands of arbitration counsel.

[73] Another factor to be considered under section 11.4(2) is how the company's business and financial affairs are to be managed during the proceedings. In my view, the management of the business and affairs of Crystallex under the provisions discussed, being the conduct of the arbitration and paying for it, are a reasonable compromise between Crystallex and Tenor designed to protect the interests of the stakeholders, including the noteholders. The Monitor, of course, will continue to have an important role to play as well in the oversight of matters. If the

noteholders are unhappy with the expenditures for the arbitration claim being incurred in the future, and there is no indication so far that they are, they have the ability in the CCAA process to object to them.

[74] The noteholders also contend that because a term of default of the Tenor loan is a refusal of the court to extend the section 11 stay, that term ties the court's hands on any stay extension application, thus creating an incentive for Crystallex not to bargain towards a consensual resolution. I do not accept that the court's hands will be tied in any way. One would expect in any CCAA case that on a refusal to extend the stay, a DIP lender's loan would become payable. This provision in the Tenor loan is not remarkable.

[75] The noteholders make the same point about it being a term of default of the Tenor loan if the CCAA case is converted to a receivership, a proposal in bankruptcy or bankruptcy proceeding. Again, one would expect a DIP loan to become payable in these events. This is a normal provision in a DIP loan, as conceded by Mr. Swan in argument. If bankruptcy were appropriate, this provision would not prevent it.

[76] The noteholders contend that the right of Tenor to 35% of the proceeds of the arbitration, convertible into equity at Tenor's discretion, should not occur as it will hamper any ability to reach any restructuring resolution. In the bid procedures approved by the Monitor, the market was told that any "back-end entitlement" could not exceed 49% of the equity of Crystallex. 35% is a very large block of the arbitration proceeds and obviously Crystallex would not have been happy to give that up. It eats into any recovery for the shareholders who are entitled to receive any proceeds of the arbitration only after the noteholders have been paid in full. However, 35% on the record does not appear excessive. The process undertaken by Mr. Skatoff indicates that the terms of the Tenor bid were the result of a reasonable market search. Mr. Sauntry, the financial expert for the noteholders, could not say that the Tenor bid did not reflect market pricing. He also said on cross-examination that a return of 10% PIK interest would not be a reasonable return for DIP lender in this case because of the uncertainty of getting anything because of the arbitration risk and risk of collecting on any award, and that a lender would require some additional amount such as the 35% to make it a reasonable deal.

[77] The noteholders propose in their proposed plan that they receive 23% of equity for their infusion of the $36 million needed for the arbitration claim. There is no evidence as to how that 23% figure was arrived at. However, the plan also provides for the noteholders to be given approximately 58% of the equity in return for giving up their notes. Together this amounts to 81% of the equity, and it is artificial to say that the 23% for the $36 million infusion reflects a market indication of the value of the infusion. I realize that the plan of the noteholders is only a proposal, but it does reflect a recognition that someone financing the arbitration would require a considerable amount of any arbitration award in order to take the risk of financing it. If the 35% figure in the Tenor DIP facility is used by the noteholders for the $36 million infusion (which the noteholders say they would be prepared to lend for 35% of the equity if later required), the amount of equity to the noteholders in their plan in return for their notes would be 46% rather than 58%, indicating an interest in receiving that amount of equity for their notes. If the Tenor DIP facility is accepted, it would leave 65% of the equity available, less 10% if the MIP is approved, more than the noteholders propose in their plan.

[78] The noteholders also rely on a statement in Mr. Sauntry's expert report that the Tenor DIP proposal will prevent any plan of arrangement. He states:

> The Tenor DIP Proposal will prevent any plan of arrangement. In fact, it is the logical conclusion of a negotiation between the Company, which has stated that it does not want a CCAA plan prior to an Award or settlement arising from the Arbitration Claim, and Tenor, which may benefit from the Company's near-complete lack of flexibility, if future amendments are required.

[79] Much of Mr. Sauntry's report is little more than legal argument in the guise of an expert's opinion. I view a good deal of his report in much the same light as Farley J. did of an expert report of Mr. Dennis Belcher in *Re Royal Oak Mines Inc.* (1999) 7 C.B.R. (4th) 293, in which he stated "Mr. Belcher has set forth in essence his view of the CCAA situation; he should be regarded as a powerful advocate..." I see Mr. Sauntry being an advocate for the noteholders.

[80] Some things fundamental to Mr. Sauntry's report are wrong. For example, he states that "This is a situation where a material asset could be sold to provide a significant recovery for creditors" and "It is demonstrably possible to sell a significant interest in the Company's

business (i.e. the Arbitration Claim) for material proceeds." On cross-examination he acknowledged his understanding that the claim is not assignable. I have earlier referred to problems I have with Mr. Sauntry's attempts to value the arbitration claim.

[81] I do not see the Tenor DIP facility preventing a plan of arrangement. The noteholders have no right to keep Crystallex's assets and equity static for the purposes of a plan of arrangement, so long as the DIP loan meets the criteria required for approval. The provisions in the Tenor DIP facility complained of are the result of market forces, and unless there is some other preferable DIP available, which for reasons I will deal with is not the case, the question is whether the Tenor DIP facility should be approved.

[82] Reliance is placed by the noteholders on provisions of section 7.19 of the Tenor bid. It provides that Crystallex shall not without the consent of Tenor enter into an agreement with the noteholders that contains certain provisions, including:

(a) Paying any money to pre-filing creditors before Crystallex pays Tenor. The noteholders contend that this eliminated any realistic possibility of Crystallex being refinanced prior to the collection of an arbitral award or settlement. However, this is a normal provision in any DIP financing. Moreover, there is no realistic possibility of Crystallex being refinanced before an arbitration award or settlement, as previously discussed.

(b) Increasing interest payable to the pre-filing creditors above 15%. The reason for this provision was because under the Tenor bid, any post-filing interest to be paid to creditors is to be paid before the additional compensation of 35% is paid to Tenor, and Tenor negotiated to limit this amount. It perhaps is to be noted that on any bankruptcy of Crystallex, interest to the noteholders would be limited to 5%.

(c) Issuing any equity containing anti-dilution provisions, which the noteholders contend means that any new equity proposed to be issued as a compromise exchange for debt could immediately thereafter be completely devalued at the next moment. I am not clear why this was negotiated by Tenor. In reply Mr. Kent contended that the problem could be taken care of by issuing shares to the noteholders with a coupon or agreement that

> would lock in their right to a percentage of the arbitration award. As the equity in Crystallex is essentially the same as the proceeds of the arbitration, presumably this is something that could be taken care of in a plan. Whether Crystallex would ever attempt to later issue equity to a third party is of course completely unknown and speculative, but it were to be contemplated during the course of the CCAA proceedings, presumably the Monitor would be aware of it and it would become known to the noteholders who would be able to apply to court for any appropriate relief.

[83] I have previously discussed much of what is to be considered under s. 11.4 of the CCAA. Regarding (d), whether the loan would enhance the prospects of a viable compromise or arrangement, in my view it would. Crystallex requires additional financing to pay its expenses and continue the arbitration. A DIP loan allows the company to have the arbitration financed, which if it were not at this stage would impair the arbitration and perhaps the attitude of Venezuela towards the arbitration claim, and as such enhances the viability of a CCAA plan. I have not accepted the argument of the noteholders that the loan would prevent a plan of arrangement.

[84] Regarding (f), whether any creditor would be materially prejudiced by the security, the noteholders are unhappy with the Tenor bid and say they are materially prejudiced, for the reasons that I have discussed and largely rejected. I think their complaints have to be looked at in the context of what the market is demanding for a DIP loan. There was a sufficient arm's length and open effort by Crystallex with the assistance of the Monitor to get the best pricing and terms for the loan and the process was carried out with integrity and fairness. The noteholders were asked during the process to increase their proposal but refused to do so. When at the last moment they indicated they would if later required lend on the same terms as the Tenor DIP facility, they made clear they would not agree to do so at this time. That, of course, is their choice. In all of the circumstances, I would not find that they have been materially prejudiced.

(ii) Consideration of the noteholders' proposed DIP facility

[85] The noteholders' proposed DIP loan is for $10 million at 1% interest repayable on October 15, 2012. The term is said to give sufficient time to work out a plan of arrangement or

compromise. Mr. Swan said in argument that the noteholders were not being altruistic in this proposal, but merely wanted to maintain the status quo while a plan is being negotiated.

[86] The problem that the board of Crystallex had with this proposal was based on the advice of Mr. Skatoff. He advised the board that if Crystallex needed additional financing in October 2012, it would be difficult to return to the market for financing because there was only so much time and energy that bidders were willing to devote to a transaction. Having devoted the time and failed, bidders would be highly reluctant to spend additional time again. In his affidavit, Mr. Skatoff stated that if Crystallex accepted the $10 million DIP financing it would be highly challenged if not entirely impeded in any subsequent exercise to raise additional financing from parties other than the noteholders.

[87] The noteholders contend that Mr. Skatoff's views on the difficulty of any future financing if the noteholders' proposed DIP loan is approved is "complete puffery" as he said on cross-examination that the parties with whom he negotiated never told him that they would absolutely not participate in a financing in the fall of 2012 if it were necessary. I think this is oversimplification and I do not accept it. Mr. Skatoff also said on cross-examination-

> I know what the facts are in terms of the financing market and how it views Crystallex. …I believe that the company, if it were to accept a $10,000,000 financing, would need to go to the market in the very near term to start to address what happens if that $10,000,000 needed to be refinanced when… we reached October of 2012. And I believe in the construct of my experience with this situation over the last three months that if the company were to accept that $10,000,000, we would need to go back out to the market in the very near term to raise capital to possibly refinance that money in the event that $10,000,000 couldn't be extended, that the company would have a very difficult time in convincing potential financing parties to undertake to spend additional time and resources in evaluating potential financing, as we have been able to convince them to do over the last couple months.

[88] I accept that evidence as reliable. Common sense would indicate that persons who spent time and energy on pursuing a $36 million facility for a three year term only to see a 6 month

facility for $10 million being accepted would be very reluctant to go through the process again in the next few months.

[89] This is particularly the case, in my view, when the proposed interest rate by the noteholders is only 1%, clearly below the market rate.[3] The market would see that rate, as would any reasonable observer, as being used for some purpose to further the ends of the noteholders. Hedge funds are not in the business of lending money at less than market rates. The rate no doubt was proposed to assist an argument that the court should accept the noteholders' proposed loan. Why would the noteholders propose that? The answer, I believe, is that it would assist in removing, or seriously eroding, the chance of Crystallex going to the market in time for a new loan by October and thus further make Crystallex beholden to the noteholders in October, as stated by Mr. van't Hof and Mr. Skatoff. I do not view the noteholders proposed loan as being a *bona fide* loan at market rates but rather a loan to gain tactical advantage.

[90] Thus, I do not see the noteholders proposed $10 million 1% six month facility as maintaining the status quo. I accept the evidence of Mr. Skatoff that it would seriously erode the chances of Crystallex obtaining any third party financing in October.

[91] Had the noteholders been prepared to lend now on the basis of the terms of the Tenor DIP facility, that would have been a preferable outcome, even if it was not made within the terms of the bid process approved by the Monitor, as it would not have involved the insertion of any third party into the process. Unfortunately, it was made clear during argument that the noteholders were not prepared at this time to do so. The uncertainty of a short six month loan when it is clear that financing for a much longer term is required by Crystallex to prosecute the arbitration is something to be avoided.

(iii) Position of the Monitor

[92] I have previously referred to portions of the Monitor's report. The Monitor concludes that on the basis that Crystallex, with assistance of Mr. Skatoff, conducted a canvas of the market and determined that the Tenor Bid was the best available bid generated out of the process to meet its

[3] The Monitor calculates the savings in interest over the Tenor loan to October 15, 2012 to be approximately $300,000.

objectives, the Monitor supports approval of the Tenor DIP Loan. This position of the Monitor is subject to this court's determination of the validity of the noteholders' legal arguments, on which the Monitor expresses no view as these are legal issues to be determined by the Court.

[93] It is the case, as the Monitor points out, that the introduction of a third party, Tenor, with consent rights to certain actions will add complexity to the negotiation of a CCAA plan. I entirely agree with the Monitor that a mutually acceptable CCAA plan is preferable to continued expensive and protracted legal disputes between the Noteholders and Crystallex. However, in spite of the encouragement of the Monitor and of the court over the last while to see if a settlement could be reached, that has unfortunately not occurred.

(iv) Conclusion on DIP loan

[94] Taking into account all of the forgoing, I approve the Tenor DIP facility.

(v) Request for stay

[95] The noteholders ask that in the event that the Tenor DIP facility is approved, the order should be stayed pending an appeal to the Court of Appeal. The parties have already had discussion through the Monitor with the Court of Appeal which has agreed as I understand it to move as expeditiously as possible with any appeal from my decision.

[96] A judge whose decision is to be appealed can stay the order on such terms as are just. On motions for stays, courts apply the *RJR Macdonald* test and will order stays in restructuring and insolvency proceedings to allow sufficient to for consideration of an appeal.

[97] At first blush during the argument, I was inclined to agree with the noteholders that a stay would be appropriate pending an appeal, assuming that it could be dealt with expeditiously. However, argument from Crystallex gave me pause, particularly when the cash flow needs of Crystallex are considered. The cash flow projections as shown in the Monitor's report indicate that as of the end of the week ending April 13, 2012, Crystallex had only $346,000, and that during the following week, it had cash requirements of approximately $6 million, including

repayment of the bridge loan due on April 16. Crystallex does not have the luxury of waiting for the conclusion of a successful appeal.

[98] The answer of the noteholders to this was that the problem would be solved if the court approved its $10 million DIP proposal rather than the Tenor bid. I understand that the noteholders would be prepared to lend the $10 million if an appeal to the Court of Appeal from an order approving the Tenor DIP facility were successful.

[99] Under the Tenor DIP facility, the right of Tenor to the additional compensation of 35% of the proceeds of the arbitration does not arise until the second tranche of the loan of $12 million has been advanced, and this is not due until after any appeal to the Court of Appeal has been completed. As to concerns of the noteholders that Tenor might pre-pay the second tranche in order to fix its right to the additional compensation, I was advised during argument that Tenor has undertaken not to do so and Crystallex has undertaken as well not to draw on the second tranche without two weeks' notice to the noteholders.

[100] Crystallex, and I assume Tenor as well, has agreed that pending the completion of an appeal to the Court of Appeal, the right of Tenor to convert its rights to 35% of the arbitration proceeds and the governance provisions for Crystallex would also be stayed.

[101] In my view, and assuming that the first test of *RJR Macdonald* has been met, there should be no stay of my order approving the Tenor DIP facility, and this can be done in a manner that will protect the interests of the parties on the following basis:

(i) The order approving the Tenor DIP facility shall be subject to the undertakings and agreements of Crystallex and Tenor as referred to.

(ii) The Tenor DIP facility is approved on condition that in the event that the appeal to the Court of Appeal is successful, and the order approving the Tenor DIP facility is set aside in its entirety, the money advanced by Tenor on the first tranche shall be immediately repayable with interest at 1% per annum, in which case the Tenor DIP facility shall be terminated. Tenor shall have no right in that case to any

commitment fee which, if already paid, shall be deducted from the repayment of the loan to Tenor.

(iii) The noteholders shall in that event fund the repayment to Tenor by loan to Crystallex with interest at $1% per annum repayable on October 15, 2012 or at some other date as may be agreed or ordered by this court.

Management Incentive Plan (MIP)

[102] The terms of the MIP are set out above. In sum, a pool of money, consisting of up to 10% of the net proceeds of the arbitration up to $700 million and 2% of any further net proceeds, after all costs and charges, including the amounts owing to noteholders, is to be set aside and money in this pool may be paid to the beneficiaries of the MIP, depending on the determination of an independent committee. The amounts to be allocated to participants by the compensation committee are discretionary and could be nil. No one will be entitled to any particular amount. Members of the compensation committee will not be eligible for any payments.

[103] In exercising its discretion to consider whether and in what amount a payment should be made, the compensation committee will take the following factors into account:

(a) The amount of money recovered by Crystallex in the arbitration.

(b) The risks affecting the size of the retention pool including the quantum of the priority payments and the fact that others have influence on discussions relating to the settlement of the claim

(c) How quickly the funds are recovered.

(d) The impact the premature resignation of the individual from Crystallex would or could have had upon the results of the arbitration.

(e) The amount of time and energy spent by the individual on the arbitration.

(f) [Certain matters confidential to the parties.]

(g) The scale and scope of the balance of the compensation package provided by Crystallex to the individual.

(h) The opportunity cost to the individual in staying with Crystallex in terms of professional experience, money and the development of new opportunities.

(i) The amount of any severance payments the employee would receive on termination if such termination is reasonably foreseeable and will be accompanied by a severance payment.

(j) The extent to which the arbitration cost more than anticipated to prosecute and the degree to which it may be appropriate to reduce the bonus pool as a result.

(k) Any other relevant matter.

[104] The noteholders disagree with Crystallex on the quantum and method for providing an incentive to management. They have also expressed concerns as to the timing of the MIP approval motion and inclusion of some MIP participants in the MIP. Under their proposed plan, management would receive 5% through an equity participation in any after tax award.

[105] The Tenor DIP loan is conditional on the approval of a management incentive program acceptable to both Tenor and Crystallex. Tenor has not voiced any objection to the MIP proposal of Crystallex and I take it is in agreement with it. The requirement for a management incentive program acceptable to Tenor is a reflection, obviously, of the need to ensure the participation of the people necessary to pursue the arbitration to a satisfactory conclusion.

[106] The reasons for the MIP are set out in the affidavit of Mr. van't Hof. See paras. 4 to 10 and 14 to 23 of his affidavit. In the circumstances of this arbitration, these reasons appear legitimate. They were considered so by the independent directors of Crystallex constituting the compensation committee and by Mr. Jay Swartz of Davies Ward Phillips & Vineberg LLP.

[107] Mr. van't Hof states in his affidavit that because in past litigation the noteholders have criticized the independent directors of Crystallex as not being sufficiently independent because of prior business relationships with Robert Fung or companies with which Mr. Fung was associated, Crystallex retained Jay Swartz, a partner of Davies Phillips Vineberg, to determine, from the perspective of an independent director, what an appropriate MIP would be. In coming to that determination, Mr. Swartz was told he could retain such advisors as he saw fit and take such steps as he saw fit. Mr. Swartz' opinion of March 14, 2012 states that he was engaged on June 6, 2011 to negotiate the terms on which directors and members of management will be compensated for their ongoing duties. With the consent of Crystallex, Mr. Swartz retained Hugessen Consulting Inc., an independent national executive compensation consulting firm to provide expert advice with respect to compensation issues and to provide background information regarding compensation standards in circumstances which were analogous to the issues facing Crystallex. Mr. Swartz reviewed extensive documentation and carried out extensive discussions with various persons including the solicitors for Crystallex, counsel for the board and with Freshfields who are arbitration counsel.

[108] Mr. Swartz concluded that the overall compensation proposal for the establishment of the bonus pool for the benefit of management of Crystallex was reasonable in the circumstances, for reasons expressed in his opinion. Included in his reasons was the following:

> The current members of the Compensation Committee are granted substantial discretion to allocate, or not allocate, the bonus Pool and can do so in their discretion having regard to what actually occurs over time and the relative and absolute contributions of each party. In doing so, they are subject to fiduciary duties to Crystallex. In this regard, I note that there may be circumstances when the absolute amount of the bonus Pool may be very substantial in light of all of the factors to be considered by the Compensation Committee. In such circumstances, the Compensation Committee may have to carefully consider the absolute amounts to be paid to each member of a Management Group in order to satisfy its fiduciary duties.

[109] Whether KERP provisions such as the ones in this case should be ordered in a CCAA proceeding is a matter of discretion. While there are a small number of cases under the

CCAA dealing with this issue, it certainly cannot be said that there is any established body of case law settling the principles to be considered. In *Houlden & Morawetz Bankruptcy and Insolvency Analysis*, West Law, 2009, it is stated:

> In some instances, the court supervising the CCAA proceeding will authorize a key employee retention plan or key employee incentive plan. Such plans are aimed at retaining employees that are important to the management or operations of the debtor company in order to keep their skills within the company at a time when they are likely to look for other employment because of the company's financial distress.

[110] In *Canadian Insolvency in Canada* by Kevin P. McElcheran (LexisNexis -- Butterworths) at p. 231, it is stated:

> KERPs and special director compensation arrangements are heavily negotiated and controversial arrangements. ... Because of the controversial nature of KERP arrangements, it is important that any proposed KERP be scrutinized carefully by the monitor with a view to insisting that only true key employees are covered by the plan and that the KERP will not do more harm than good by failing to include the truly key employees and failing to treat them fairly.

[111] In *Re Grant Forest Products Inc*. (2009), 57 C.B.R. (5th) 128, I accepted these statements as generally being applicable to motions to approve key employee retention plans. See also *Re Canwest Global Communications Corp*. (2009), 59 C.B.R. (5th) 72, *Re Nortel Networks Corporation*, [2009] O.J. No. 1044, *Re Canwest Publishing Inc*., (2010), 63 C.B.R. (5th) 115 and *Re Timminco Ltd*. [2012] O.J. No. 472.

[112] I see no reason why the business judgment rule is not applicable, particularly when the provisions of the MIP have been approved by an independent committee of the board. See my comments in *Grant Forest Products*, in which the payments in question were approved by an independent committee of the board of the debtor, in which I said that the business judgment of the directors should rarely be ignored. See also Morawetz J. in *Re Timminco.*

[113] In this case, the qualifications of the independent board members, Messrs. Brown, Near and van't Hof, are impressive, and these people are non-conflicted as they will not

participate in the MIP. They acted on advice from Mr. Swartz and had market information from Mr. Skatoff as noted in paras. 10 and 33 of Mr. van't Hof's affidavit. Their judgment was informed and I am in no position to say it was unreasonable.

[114] There is no question that the judgment of Mr. Swartz is independent and informed, and I would not lightly ignore it without good reason.

[115] The noteholders contend that the MIP is something that should await the negotiations of a plan. I can understand the logic of that position, particularly when as here the MIP is to be funded from the proceeds of the arbitration, which is the "asset" that will be the subject of the negotiations of a plan, whether that asset is called the proceeds of the arbitration or equity. However, I am hesitant to have the uncertainty of such a situation hanging over the heads of the people meant to be protected by the MIP. In *Grant Forest Products,* over the objection of a substantial creditor, and in *Canwest Global, Canwest Publishing* and *Timminco*, employee retention plans were approved prior to any plan being negotiated, and it appears to be the practice today that these types of plans are generally approved at the time of the initial orders.

[116] The noteholders do not contend that there should not be any MIP. As the Monitor's report notes, under the noteholders' proposed plan, management would receive 5% through an equity participation in any after tax award. While the numbers between the Crystallex MIP (a pool of up to 10% of an award up to $700 million and 2% over that) and the noteholders plan (5%) are different, it is possible that the end result would not be different depending on what the independent compensation committee decided to allocate after the results of the arbitration were known.

[117] The noteholders contend that there are participants in the MIP that should not belong. That is a matter of judgment, and the independent committee has exercised its judgment on the matter. The participants were also known to Mr. Swartz who opined as to the reasonableness of the principles of the MIP. Having reviewed the evidence, including the affidavit of Mr. van't Hof and of Ms. Kwinter, I cannot say that any of the persons included in the MIP should not be there.

[118] Mr. Tony Reyes is a shareholder of Crystallex. He in principle is supportive of the MIP. He raises two concerns regarding the MIP.

[119] The first is the fact that some of the persons who may benefit already have stock options and it is not clear that the proposed MIP will replace and cancel those options. Thus, these persons could end up with more than the MIP proposes. In response to this, Crystallex advises that it will amend the MIP to provide that the value of any existing stock options ultimately realized by participants of the MIP will be deducted from the amount of any bonus awarded under the MIP on a tax neutral basis.

[120] The second relates to the method of calculating the bonus pool. It is described by the Monitor as follows:

> 83. Mr. Reyes also raises a concern that the MIP treats the creation of and payment out of the MIP Pool as a secured debt and not an equity distribution. The MIP Pool is to be protected by a Court-ordered charge and will be created out of the net proceeds of the Arbitration Proceedings but before any payment to shareholders. Value to shareholders is after the repayment of the additional compensation to Tenor and the MIP, while the MIP is calculated based on the gross award before repayment of additional compensation. He notes that the method of calculating the MIP Pool also serves to increase the potential effective "equity participation" of the pool participants well above the rate of 10% relative to the participation rate of existing shareholders, to an effective rate of 18% or more. This is due to the dilutive effect of Tenor's additional compensation on existing shareholders.

[121] The first sentence regarding this concern is not correct. The MIP is triggered by a receipt of funds, and the charge over that pool does not give any priority to the participants in the MIP. Regarding the remainder of the concern, it seems to me that this is something that could be taken into account by the compensation committee in determining what, if any, amount should be allocated to any particular person.

[122] The Monitor has reviewed the MIP and the noteholders proposal. The Monitor does not expressly state that it supports the MIP as proposed by Crystallex being approved, but clearly does not oppose it. Monitor concludes:

> 130. The MIP is ancillary to the Tenor DIP Loan and approval of a management incentive program is a condition of the Tenors DIP Loan. The Noteholders and Mr. Reyes appear to accept the Company's position that a substantial incentive plan is appropriate in these unique circumstances. Mr Swartz, from the perspective of the independent director with advice from Hugessen Consulting Inc., concludes that the Applicant's proposed MIP is "reasonable in the circumstances". The Noteholders and Mr. Reyes' position, however, is that the terms of any incentive plan should be less favourable to the participants than the MIP proposed by Crystallex.
>
> 131. Although the percentage amounts and debt structure provide the potential for compensation to management that could be substantial, both relative to the recoveries of other stakeholders and in absolute dollar terms, it is subject to the discretion of the independent directors who have fiduciary duties that will provide a measure of balance in the implementation of the MIP.

[123] Like the DIP issue, it is unfortunate that Crystallex and the noteholders have not been able to come to some agreement on an MIP. It would have been far more preferable for that to have occurred. However there has been no agreement and it falls for decision by the court.

[124] In all of the circumstances, as discussed, I approve the MIP proposed by Crystallex with the changes regarding the stock options agreed to by Crystallex.

Approval of Monitor's reports

[125] Approval is sought of the actions of the Monitor as disclosed in its second and third report. I have no hesitation in approving these actions. A Monitor plays a crucial role in any CCAA restructuring, and this is particularly so in this case. The Monitor is to be commended for the way in which it has participated and in its efforts to bring a consensual resolution of matters as they have arisen. This assistance is invaluable. I approve the actions of the Monitor as set out in its second and third report.

Continuation of the stay

[126] Crystallex seeks a continuation of the stay until July 16, 2012 or such further date as may be ordered. No one opposes the stay to that date, and it is supported by the Monitor who

recommends the continuation. Due to holiday considerations, I continue the stay to July 30, 2012.

Newbould J.

DATE: April 16, 2012

COURT OF APPEAL FOR ONTARIO

CITATION: Crystallex (Re), 2012 ONCA 404
DATE: 20120613
DOCKET: C55434 & C55435

O'Connor A.C.J.O., Blair and Hoy JJ.A.

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 Crystallex International Corporation

Richard B. Swan, S. Richard Orzy, Derek J. Bell and Emrys Davis, for the appellant Computershare Trust Company of Canada

Andrew J.F. Kent, Markus Koehnen and Jeffrey Levine, for the respondent Crystallex International Corporation

Barbara L. Grossman, for Tenor Capital Management Company, L.P. and Affiliates

Robert Frank, for Forbes & Manhattan Inc. and Aberdeen International Inc.

David Byers, for the Monitor Ernst & Young Inc.

Heard: May 11, 2012

On appeal from the order of Justice Frank J.C. Newbould of the Superior Court of Justice dated January 20, 2012, with reasons reported at 2012 ONSC 538, and from the orders of Justice Frank J.C. Newbould of the Superior Court of Justice dated April 16, 2012, with reasons reported at 2012 ONSC 2125.

Hoy J.A.:

I. OVERVIEW

[1] The primary issue in these appeals is the scope of financing the supervising judge can or should approve, without the sanction of creditors, while

a company is under the protection of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA").

[2] The respondent Crystallex International Corporation ("Crystallex") is a Canadian mining company. Its principal asset was the right to develop Las Cristinas in Venezuela, which is one of the largest undeveloped gold deposits in the world. Crystallex obtained this right through a contract with the Corporacion Venezolana de Guayana (the "CVG"), a state-owned Venezuelan corporation. On February 3, 2011, after Crystallex spent over $500 million on developing Las Cristinas, the CVG sent Crystallex a letter to "unilaterally rescind" the contract for reasons of "expediency and convenience". There is no suggestion in these proceedings that the rescission was due to any mismanagement by Crystallex.

[3] As a result of the cancellation of the contract, Crystallex was unable to pay its $100 million in senior 9.375 per cent notes due December 23, 2011 (the "Notes"). It sought and, on December 23, 2011 obtained, protection under the CCAA.

[4] At present, Crystallex's only asset of significance is an arbitration claim for US $3.4 billion against the government of Venezuela in relation to the cancellation of the contract. The arbitration claim is the "pot of gold" in the CCAA proceeding.

[5] The appellant Computershare Trust Company of Canada, in its capacity as Trustee for the holders of the Notes (the "Noteholders"), appeals, with leave, three orders made by the supervising judge in the CCAA proceeding: (i) the January 20, 2012 CCAA Bridge Financing Order (with reasons released January 25, 2012 and reported at 2012 ONSC 538 (the "Bridge Financing Reasons")) authorizing Crystallex to obtain bridge financing of $3.125 million (the "Bridge Loan") from the respondent Tenor Special Situations Fund, L.P. ("Tenor L.P."); (ii) the April 16, 2012 CCAA Financing Order authorizing Crystallex to obtain $36 million of what the supervising judge characterized as Debtor in Possession ("DIP") financing from Tenor Special Situation Fund I, LLC ("Tenor") (the "Tenor DIP Loan"); and (iii) the April 16, 2012 Management Incentive Plan Approval Order approving a Management Incentive Plan ("MIP") designed to ensure the retention of key executives until the arbitration is completed. The supervising judge's reasons for the CCAA Financing Order and Management Incentive Plan Approval Order are reported at 2012 ONSC 2125 (the "DIP Financing Reasons").

[6] Among other conditions, the Tenor DIP Loan, due December 31, 2016, entitles Tenor to 35 per cent of the net proceeds of the arbitration in addition to interest, provides governance rights that may continue after Crystallex exits from CCAA protection, and requires Tenor's approval to a range of options that might customarily be offered to unsecured creditors in seeking to negotiate a plan of compromise or arrangement.

[7] Substantially all of the creditors opposed the approval of the Bridge Loan, the Tenor DIP Loan and the MIP. Crystallex represents that it hopes to negotiate a plan of arrangement or compromise with the Noteholders and other creditors before the current stay until July 30, 2012 expires.

[8] The bulk of the $36 million Tenor DIP Loan comprises financing to pursue the arbitration claim, which may continue after the period of CCAA protection.

II. THE LEGISLATIVE FRAMEWORK

[9] The CCAA was amended effective September 18, 2009 to add the following provisions regarding the grant of a charge to secure financing required by the debtor:

> 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.
>
> ...
>
> 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.[1]

Prior to the enactment of these provisions, the court relied on its general authority under the CCAA to approve DIP financing: see Lloyd W. Houlden, Geoffey B. Morawetz & Janis P. Sarra, *The 2012 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 2011), at p. 1175.

III. THE BACKGROUND

A. Events Prior to the CCAA Filings

[10] Crystallex has filed a Request for Arbitration pursuant to the Canada-Venezuela Bilateral Investment Treaty, claiming $3.4 billion plus interest for the loss of its investment in Las Cristinas. The hearing of the arbitration is scheduled for November 11, 2013.

[1] Paragraph 23(1)(b) provides that the monitor shall "review the company's cash-flow statement as to its reasonableness and file a report with the court on the monitor's findings".

[11] Crystallex's most significant liability is its debt to the Noteholders. In addition to amounts owed to the Noteholders, Crystallex has other liabilities of approximately CAD $1.2 million and approximately US $8 million.

[12] The current Noteholders are hedge funds, some of whom purchased Notes after Venezuela announced its intention to expropriate Las Cristinas at prices as low as 25 cents on the dollar.

[13] The relationship between Crystallex and the current Noteholders is hostile. Crystallex and the Noteholders have been in litigation since 2008. Prior to the maturity date of the Notes, the Noteholders twice, unsuccessfully, brought court proceedings against Crystallex alleging that an event had occurred which accelerated Crystallex's obligation to pay the Notes. Those proceedings were also heard by the supervising judge: see *Computershare Trust Co. of Canada v. Crystallex International Corp.* (2009), 65 B.L.R. (4th) 281 (S.C.), aff'd 2010 ONCA 364, 263 O.A.C. 137; and *Computershare v. Crystallex*, 2011 ONSC 5748.

B. Commencement of Proceedings under the CCAA and Chapter 15

[14] On December 22, 2011, one day prior to the maturity of the Notes, Crystallex and the Noteholders filed competing CCAA applications. The Noteholders' application contemplated that all existing common shares would be cancelled, an equity offering would be undertaken, and if, or to the extent, the

equity proceeds were insufficient to pay out the Noteholders, the Notes would be converted to equity.

[15] Crystallex sought authority to file a plan of compromise and arrangement, the authority to continue to pursue the arbitration in Venezuela, and the authority to pursue all avenues of interim financing or a refinancing of its business and to conduct an auction to raise financing. In his supporting affidavit sworn December 22, 2011, Robert Fung, Crystallex's Chairman and Chief Executive Officer, indicated that Crystallex wished to have all claims stayed against it until the arbitration settled or Crystallex realized the arbitration award. Crystallex had already received an unsolicited offer of financing from Tenor Capital Management.

[16] It was (and is) expected that, if the arbitration is successful and the award is collected, there will be more than enough to pay the creditors and a significant amount will be available to shareholders.

[17] On December 23, 2011, the supervising judge made an order granting Crystallex's CCAA application (the "Initial Order"). In his reasons released December 28, 2011, he explained that the Noteholders' proposal was not a fair balancing of the interests of all stakeholders: *Re Crystallex International Corporation*, 2011 ONSC 7701, at para. 26. The Noteholders did not appeal the Initial Order.

[18] Crystallex obtained an order under chapter 15 of the United States Bankruptcy Code from the United States Bankruptcy Court for the District of Delaware, among other things giving effect to the Initial Order in the United States as the main proceeding.

C. Crystallex Develops a DIP Auction Process

[19] Paragraph 12 of the Initial Order authorized Crystallex to pursue all avenues of interim financing or a refinancing of its business or property, subject to the requirements of the CCAA and court approval, to permit it to proceed with an orderly restructuring. It further provided:

> Without limiting the foregoing, the Applicant may conduct an auction to raise interim or DIP financing pursuant to procedures approved by the Monitor and using such professional assistance as the Applicant may determine with the consent of the Monitor. If such approved procedures are followed to the satisfaction of the Monitor then the best offer as determined by the Applicant pursuant to the approved procedures shall be afforded the protection of the *Soundair* principles so that it will be too late to make topping offers thereafter and such offers will not be considered by this Court.

[20] Crystallex hired an independent financial advisory firm, Skatoff & Company, LLC, and developed a set of procedures to govern the solicitation of bids to provide financing to Crystallex. The Monitor, Ernst & Young Inc., approved the bid procedures. The bid procedures indicated that Crystallex's objective was to obtain financing of not less than $35 million, net of costs, that, on completion of the CCAA and U.S. Chapter 15 reorganization proceedings,

would roll into financing maturing not sooner than December 31, 2014. The bid deadline was February 1, 2012.

D. The Bridge Loan

[21] On January 20, 2012, the supervising judge considered competing proposals from Tenor L.P. and the Noteholders to provide bridge financing. Tenor L.P. offered $3.125 million with interest at 10 per cent per annum. The Noteholders offered $3 million with interest at 1 per cent per annum.

[22] The board of Crystallex, taking into account advice received from Mr. Skatoff, recommended the Tenor L.P. offer. Mr. Skatoff was concerned that the Noteholders' objective may have been to defeat the larger DIP financing process so that they could ultimately impose financing terms on Crystallex. It was also his view that Crystallex should avoid entering into an important financial relationship with a hostile party.

[23] The supervising judge approved Tenor L.P.'s offer.

E. The Noteholders Object to the DIP Auction Process

[24] On January 20, 2012, the Noteholders brought a cross-motion to modify the DIP auction process then underway, which they severely criticized. They objected to the amount sought, the term, and the lender back-end entitlement a successful DIP lender could acquire. In their view, Crystallex was inappropriately seeking financing in excess of amounts required until a compromise or plan of

arrangement could be arrived at between Crystallex and its creditors. Given their existing position in Crystallex, the Noteholders also objected to being required to sign a non-disclosure agreement containing a standstill provision in order to be a qualified bidder.

[25] The supervising judge held that if the Noteholders wished to be considered as a qualified bidder, they would have to sign a non-disclosure agreement: Bridge Financing Reasons, at para. 27. As to their other concerns, he wrote, at para. 29:

> In my view these objections are premature and it is not necessary for me to consider their strength at this stage. The time for filing bids from qualified bidders has not yet expired and what bids will be received is unknown. It is when a successful bidder has been chosen and the DIP facility is before the court for approval that these issues raised by the Noteholders would be more appropriately dealt with. Until then, there is no factual foundation for judgment to be passed on the bid procedures for the DIP facility for which Crystallex will seek approval.

F. Competing DIP Financing Offers: The Tenor DIP Loan and the Noteholders' Offer

[26] The bidders who responded to the request for DIP financing included three hedge funds that hold approximately 77 per cent of the Notes and Tenor.

[27] Those hedgefund Noteholders proposed a loan of $10 million with a simple interest rate of 1 per cent repayable on October 15, 2012.

[28] The supervising judge described Tenor's proposed terms in the DIP Financing Reasons:

> [23] The Tenor DIP facility contains the following material financial terms:
>
> > (a) Tenor will advance $36 million to Crystallex due and payable on December 31, 2016. This period for the loan is based on Crystallex's arbitration counsel's assessment of the likely timing of a decision from the arbitral tribunal and collection of the award.
> >
> > (b) The advances will be in four tranches, being $9 million upon execution of the loan documentation and approval of the facility by court order in Ontario, the second being $12 million upon any appeal of the Ontario court order approving the facility being dismissed and upon a U.S court order approving the facility, the third being $10 million when Crystallex has less than $2.5 million in cash and the fourth being $5 million when Crystallex again has less than $2.5 million in cash.
> >
> > (c) The loans are to be used to (i) repay an interim bridge loan of $3.25 million advanced by Tenor with court approval of January 20, 2012 and payable on April 16, 2012, (ii) fees and expenses in connection with the facility, (iii) general corporate expenses of Crystallex including expenses of the restructuring proceedings and of the arbitration in accordance with cash flow statements and budgets of Crystallex approved by Tenor from time to time.
> >
> > (d) Crystallex will pay Tenor a $1 million commitment fee.

(e) $35 million of the loan amount will bear PIK interest (payment in kind, meaning it is capitalized and payable only upon maturity of the loan or upon receipt of the proceeds of the arbitration) at the rate of 10% per annum compounded semi-annually.

(f) Tenor will receive additional compensation equal to 35% of the net proceeds of any arbitral award or settlement, conditional upon the second tranche of the loan being advanced. Net proceeds of the award or settlement is defined as the amount remaining after payment of principal and interest on the DIP loan, taxes and proven and allowed unsecured claims against Crystallex, including the noteholders, the latter of which will have a special charge for the unsecured amounts owing. Alternatively, Tenor can convert the right to additional compensation to 35% of the common shares of Crystallex. This conversion right is apparently driven by tax considerations.

[24] The Tenor DIP facility also provides for the governance of Crystallex to be changed to give Tenor a substantial say in the governance of Crystallex. More particularly:

(a) Crystallex shall have a reduced five person board of directors, being two current Crystallex directors, two nominees of Tenor and an independent director selected by agreement of Crystallex and Tenor.

(b) The independent director shall be chair of the board of directors and shall not have a second-casting or tie-breaking vote.

(c) The independent director shall be appointed a special managing director and shall have all the powers of the board of

> directors to (i) the conduct of the reorganization proceedings in Canada and in the U.S. and the efforts of Crystallex to reorganize the pre-filing claims of the unsecured creditors, (ii) any matters relating to the rights of Crystallex and Tenor as against the other under the facility, (iii) the administration of the MIP to the extent not otherwise delegated to the bonus pool committee under the MIP, and (iv) to retain any advisor in respect of these matters. The special manager shall first consult with a non-board advisory panel, consisting of the three Crystallex directors who will step down from the board, and consider in good faith their recommendations.
>
> (d) With respect to matters that may not at law be delegable to the special managing director, he will be required to obtain board approval. If the Tenor nominees use their votes to block that approval, Tenor will forfeit its 35% additional compensation.

> [25] The Tenor DIP facility contains proscribed rights of Tenor in the event of default. Tenor may seize and sell assets other than the arbitration proceeding (i.e. any cash and unsold mining equipment). It may not sell the arbitration claim. If there is a default before any arbitration award, Tenor would have the right to apply to court to have the Monitor or a Canadian receiver and manager appointed to take control of the arbitration proceedings. If such application were not granted, Tenor would be entitled to exercise the rights and remedies of a secured creditor pursuant to an order, the loan documentation or otherwise at law.

[29] Mr. Skatoff recommended, and the board of Crystallex agreed, to accept the Tenor DIP Loan. Mr. Skatoff indicated, in an affidavit sworn March 20, 2012,

that he had recommended that the board reject the Noteholders' offer of a $10 million loan for 6 months because Crystallex could not be assured that it could borrow the balance of the required funds at the expiry of that period on the same terms as the Tenor DIP Loan.

G. The Noteholders' Further, Competing Offer to Allay Mr. Skatoff's Concerns

[30] In his affidavit on behalf of the Noteholders, sworn March 27, 2012, Mr. Mattoni responded to Mr. Skatoff's concern by committing that the Noteholders would be prepared to,

> … provide financing to Crystallex on the same terms as the [Tenor DIP Loan], in the event that prior to October 1, 2012, the Court orders that such long-term financing is appropriate and necessary. The Noteholders would reserve their complete and unfettered ability as creditors to continue to oppose stay extensions or attempts to secure such long-term financing outside of a Plan of compromise (including, specifically, financing to the extent contemplated by the Proposed Loan), but they will provide it if it is ordered by the Court on the same basis as currently proposed with Tenor...

H. The Noteholders' Proposed Plan

[31] Prior to the April 5, 2012 hearing, the Noteholders proposed a plan to indicate a good faith intention to bargain. They did not seek approval of this proposed plan at the April 5, 2012 hearing.

[32] The plan's terms included that the Noteholders would provide a $10 million loan on the terms described above; exchange their debt for approximately 58 per cent of the equity; provide $35 million to Crystallex in exchange for 22.9 per cent of the equity; and provide incentives to management at a lesser level than the MIP. Their proposed plan left approximately 14 per cent of the equity for the existing shareholders.

I. The Management Incentive Plan

[33] The Noteholders had criticized the independent directors of Crystallex as not being sufficiently independent. As a result, the independent directors of Crystallex comprising the compensation committee retained Jay Swartz, a partner of Davies Phillips Vineberg, to determine, from the perspective of an independent director, what an appropriate MIP would be. He in turn retained an independent national executive compensation consulting firm to provide expert advice. Mr. Swartz opined that the overall compensation proposal for the establishment of the bonus pool for the benefit of Crystallex's management was reasonable in the circumstances. The independent directors of Crystallex comprising the compensation committee approved the MIP.

[34] At para. 102 of the DIP Financing Reasons, the supervising judge described the MIP:

> In sum, a pool of money, consisting of up to 10% of the net proceeds of the arbitration up to $700 million and

> 2% of any further net proceeds, after all costs and charges, including the amounts owing to noteholders, is to be set aside and money in this pool may be paid to the beneficiaries of the MIP, depending on the determination of an independent committee. The amounts to be allocated to participants by the compensation committee are discretionary and could be nil. No one will be entitled to any particular amount. Members of the compensation committee will not be eligible for any payments.

[35] The MIP sets out a number of factors to be considered by the compensation committee in exercising its discretion. They include the amount and speed of recovery, the amount of time and energy expended by the individual, and the opportunity cost to the individual in staying with Crystallex.

[36] In the view of the Noteholders, the MIP is too generous. They proposed that management receive 5 per cent through an equity participation in any after tax award. They also took issue with the range of persons eligible under the MIP.

J. The April 5, 2012 motion

[37] On April 5, 2012, Crystallex sought orders approving, among other things, the Tenor DIP Loan and the MIP. The Noteholders as well as Forbes & Manhattan Inc. and Aberdeen International Inc., creditors owed approximately $2.5 million by Crystallex, opposed both the Tenor DIP Loan and the MIP. The one shareholder who attended opposed the MIP.

[38] The supervising judge approved the Tenor DIP Loan and the MIP.[2] He also extended the stay until July 30, 2012.

K. Events since April 5, 2012

[39] Tenor made the first, $9 million advance under the Tenor DIP Loan. The Bridge Loan was repaid out of the first advance.

[40] At the hearing of this appeal, the Monitor advised that Crystallex would require further funds before the anticipated release of this court's decision. Crystallex accepted Tenor's offer to advance a further $4 million to Crystallex, on the same terms as the first, $9 million tranche of the Tenor DIP Loan. Accordingly, this further advance does not entitle Tenor to participate in any arbitration proceeds, or trigger any change in the governance of Crystallex. If the Noteholders' appeal succeeds, the additional amounts advanced by Tenor are, like the first tranche, to be immediately repaid with interest at the rate of 1 per cent per annum, and the Noteholders shall fund the repayment. No commitment fee is payable in respect of this additional advance.

[2] The MIP was approved subject to an amendment (agreed to by Crystallex) to provide that the value of any stock options ultimately realized by participants of the MIP would be deducted from the amount of any bonus awarded under the MIP on a tax neutral basis.

IV. THE SUPERVISING JUDGE'S REASONS

A. The Bridge Loan

[41] The supervising judge noted, at para. 5 of the Bridge Financing Reasons, that Tenor L.P.'s bridge financing proposal was "really short-term DIP financing". With respect to the boards' recommendation – based on Mr. Skatoff's advice – that Tenor L.P.'s proposal be approved, he wrote, at para. 12:

> This was a business judgment protected by the business judgment rule so long as it was a considered and informed judgment made honestly and in good faith with a view to the best interests of Crystallex. See *Re Stelco Inc*. (200[5]), 9 C.B.R. (5th) 135 (Ont. C.A.) regarding the rule and its application to CCAA proceedings. I see no grounds for concluding that the decision of Crystallex to prefer the Tenor bridge financing proposal is not protected by the business judgment rule or that I should not give it appropriate deference. [Citation corrected.]

[42] The supervising judge noted, at para. 13, that "the Monitor has no basis to say that the business judgment exercised by the Crystallex board of directors was unreasonable". The supervising judge accordingly approved the Bridge Loan.

[43] Mr. Skatoff expressed concern that the Noteholders' objective in offering bridge financing on such advantageous terms (interest at the rate of 1 per cent, as opposed to the 10 per cent in the Tenor L.P. offer) was to undermine the DIP auction process. The supervising judge observed, at para. 14:

> Whether Mr. Skatoff is correct in his concerns, it seems to me that the relatively minor extra cost involving the Tenor proposed bridge financing for at most a few months must be weighed against the risk of harm to the longer-term DIP financing auction process, and that for the sake of that process, it is preferable not to run the risks that Mr. Skatoff is concerned about.

B. The Tenor DIP Loan

[44] The substance of the supervising judge's reasons for approving the Tenor DIP Loan – as set out in the DIP Financing Reasons – may be summarized as follows.

i. The exercise of business judgment by the board of directors of Crystallex in approving the Tenor DIP Loan is a factor that can be taken into account by the court in considering whether to make an order under s. 11.2(1) of the CCAA (at para. 35).

ii. The Tenor DIP Loan did not amount to a plan of arrangement or compromise. Notably, it did not take away the rights of the Noteholders as unsecured creditors to apply for a bankruptcy order or to vote on a plan of compromise or arrangement. A vote of the creditors was therefore not required (at para. 50). In coming to this conclusion, the supervising judge relied on *Re Calpine Canada Energy Limited*, 2007 ABQB 504, 415 A.R. 196, leave to appeal refused, 2007 ABCA 266, 417 A.R. 25.

iii. Crystallex intended to negotiate a plan of compromise or arrangement with the Noteholders during the stay extension until July 30, 2012 (paras. 48, 126). The Tenor DIP Loan is therefore distinguishable from the financing rejected by the court in *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.*, 2008 BCCA 327, 296 D.L.R. (4th) 577, because in that case the debtor did not have an intention to propose an arrangement or compromise to its creditors.

iv. Because the Tenor DIP Loan involves the grant of a financial interest in part of the assets of Crystallex, it is appropriate to consider the *Soundair* factors in deciding whether to approve it (at para. 59). Crystallex conducted a robust competitive bidding process (at para. 39).

v. Mr. Skatoff's evidence was that the Noteholders' proposed six month facility "would seriously erode the chances of Crystallex obtaining third party financing in October" (at para. 90). Counsel for Computershare had said during argument on the motion that the Noteholders "were not prepared to agree to such a $35 million facility at this time but only at some future time as the $10 million facility they now proposed became due" (at para. 27). While it would have been preferable if the Noteholders had been willing to lend on the basis of the terms of the Tenor DIP facility, "it was made clear during argument that the noteholders were not prepared at this time to do so" (at para. 91).

vi. As to the enumerated factors in s. 11.2(4):

(a) Given that Crystallex intends, if possible, to negotiate an acceptable plan of arrangement or compromise, the length of time during which Crystallex is expected to be subject to the CCAA proceedings is not a determinative factor. The financing will be required to pursue the arbitration (at para. 62) and, as the supervising judge noted, “the only way any of the creditors will receive any substantial cash payment is from the proceeds of the arbitration” (at para. 47);

(b) The management of the business and affairs of Crystallex “are a reasonable compromise between Crystallex and Tenor designed to protect the interests of the stakeholders, including the noteholders” (at para. 73). The fact that Tenor is given substantial governance rights does not in itself mean that the DIP Tenor Loan should not be approved. Tenor does not have the right to conduct the reorganization proceedings or the arbitration proceeding. Moreover, under s. 11.5(1) of the CCAA, the court may remove a director whom it is satisfied is unreasonably impairing or is likely to unreasonably impair the possibility of a viable compromise or arrangement being made. Arguably, a court could remove a Tenor nominee under this section without triggering an event of default under the Tenor DIP Loan (at paras. 63-71);

(c) While the Noteholders expressed “extreme displeasure” at Crystallex’s management’s delay in commencing arbitration proceedings,

they do not oppose management having a continuing role in the arbitration (at para. 72);

(d) The Noteholders' argument that the terms of the Tenor DIP Loan – in particular, the fact that the refusal of the court to grant a stay or a bankruptcy are events of default, the grant of a 35 per cent interest in the arbitration proceeds, and the limits on the type of restructuring that can be concluded without the approval of Tenor – will effectively prevent any plan of arrangement was rejected (at paras. 74-82). While, as the Monitor points out, the introduction of a third party, Tenor, with consent rights to certain actions will add complexity to the negotiation of a CCAA plan (at para. 93), the Tenor DIP Loan would enhance the prospects of a viable compromise or arrangement (at para. 83):

> ... Crystallex requires additional financing to pay its expenses and continue the arbitration. A DIP loan allows the company to have the arbitration financed, which if it were not at this stage would impair the arbitration and perhaps the attitude of Venezuela towards the arbitration claim, and as such enhances the viability of a CCAA plan. I have not accepted the argument of the noteholders that the loan would prevent a plan of arrangement.

(e) The supervising judge noted that Crystallex's principal asset is its US $3.4 billion arbitration claim against Venezuela (at para. 12); and

(f) In considering the Noteholders' complaints of prejudice in the context of what the market is demanding for a DIP loan and in all the circumstances,

the creditors have not been materially prejudiced by the Tenor DIP Loan (at para. 84).

C. The Management Incentive Plan

[45] The supervising judge considered the Noteholders' objections to the quantum and method for providing an incentive to management, the inclusion of certain persons in the MIP, and the approval of the MIP before the negotiation of a plan.

[46] In the DIP Financing Reasons, the supervising judge observed, at para. 109, that whether employee retention provisions should be ordered in a CCAA proceeding was a matter of discretion. He noted that the provisions of the MIP had been approved by an independent committee of the board of directors with impressive qualifications, relying on the opinion of Mr. Swartz. In providing that opinion, Mr. Swartz indicated that the absolute amount of the bonus pool could be very substantial and, in allocating it, the compensation committee "may have to carefully consider the absolute amounts to be paid to each member of the Management Group in order to satisfy its fiduciary duties": see DIP Financing Reasons, at para. 108. The supervising judge also noted that Mr. Swartz had retained an independent national executive compensation consulting firm to provide expert advice.

[47] Citing *Grant Forest Products Inc. (Re)* (2009), 57 C.B.R. (5th) 128 (Ont. S.C.) and *Timminco Ltd. (Re)*, 2012 ONSC 948, the supervising judge wrote, at para. 112 of the DIP Financing Reasons, "I see no reason why the business judgment rule is not applicable, particularly when the provisions of the MIP have been approved by an independent committee of the board." He further noted, at para. 115, what appears to be the practice of approving employee retention plans before any plan has been negotiated and, at para.105, that the Tenor DIP Loan was conditional on the approval of a MIP acceptable to Crystallex and Tenor.

[48] As to who should be eligible to participate in the MIP, at para. 117, the supervising judge noted that the independent committee had exercised its business judgment on the matter and that the participants were known to Mr. Swartz . Having reviewed the evidence, the supervising judge could not "say that any of the persons included in the MIP should not be there".

V. THE PARTIES' SUBMISSIONS

A. The Noteholders' Submissions

[49] The Noteholders frame their opposition to the Tenor DIP Loan on a number of bases.

[50] They argue that s. 11.2, titled "Interim financing", only permits a supervising judge to approve financing to meet the debtor's needs while it is developing a plan to present to its creditors.

[51] The Noteholders also argue that the supervising judge's finding that the Tenor DIP Loan would enhance the prospects of a viable compromise or arrangement was unreasonable because it resulted from an error of principle, namely an improper focus on the fact that it provided financing for the arbitration.

[52] The Noteholders submit that the supervising judge misapprehended the evidence in finding that the Noteholders were not willing to match the Tenor DIP Loan, and this error affected the outcome of the motion.

[53] They argue that the supervising judge erred in deferring to the business judgment of the directors of Crystallex in approving both the Bridge Loan and the Tenor DIP Loan. They argue that directors always make a recommendation and, if Parliament had thought this was a relevant factor, it would have specifically enumerated it in s. 11.2(4) of the CCAA.

[54] They argue that the supervising judge erred in principle in focusing on what was the most expedient way to fund the arbitration (as opposed to Crystallex's needs while negotiating a plan with the Noteholders) and, in doing so, committed the same error as the motion judge in *Cliffs Over Maple Bay*.

[55] The Noteholders' position is that the Tenor DIP Loan is effectively an arrangement, in the guise of a financing, and Crystallex is misusing the CCAA to impose a restructuring without the requisite creditor approval.

[56] The Noteholders submit that this court should order Crystallex to accept the Noteholders' "matching" DIP loan offer.

[57] They also renew their objections to the MIP.

B. Crystallex's Submissions

[58] Crystallex argues that the Noteholders' appeal with respect to the Bridge Loan is moot because the loan has been advanced, spent and repaid.

[59] As to the Tenor DIP Loan, it argues that approving it was within the discretion of the supervising judge, the supervising judge exercised his discretion on a wide variety of findings of fact, capable of evidentiary support in the record, and there is no basis for this court to intervene. It relies on *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379, which recently addressed the broad discretionary jurisdiction of a supervising judge under the CCAA. Crystallex also points to *Air Canada (Re)* (2004), 47 C.B.R. (4th) 169 (Ont. S.C.), as an instance where exit financing was approved before a plan had been approved by creditors.

C. Tenor's Submissions

[60] Tenor argues that "interim financing" in the heading to s. 11.2 of the CCAA does not mean "short term", but rather refers to the interval between two points or events, and s. 11.2 does not contain anything that would fetter the discretion of the supervising judge to select an "end point" beyond the expected conclusion

of a plan. It argues that the duration of the Tenor DIP Loan is tailored to Crystallex's unique circumstance: all stakeholders acknowledge that the arbitration must be pursued in order for there to be meaningful recovery. In any event, it argues, marginal notes, such as the heading "interim financing" in s. 11.2, are not part of the statute, and their value is limited when a court must address a serious problem of statutory interpretation, citing the *Interpretation Act*, R.S.C. 1985, c. I-21, s. 14, and *Imperial Oil Ltd. v. Canada; Inco Ltd. v. Canada*, 2006 SCC 46, [2006] 2 S.C.R. 447, at para. 57.

[61] Moreover, Tenor submits, the supervising judge was in the best position to perform the careful balancing of interests required to facilitate a successful restructuring.

VI. ANALYSIS

A. The Appeal from the Bridge Financing Order

[62] The Noteholders did not strongly pursue their appeal of the Bridge Financing Order. The relief sought at the conclusion of the hearing related to the Tenor DIP Loan and not the Bridge Loan. The Bridge Loan was disbursed, spent and repaid. I agree with the respondents that the Noteholders' appeal with respect to the Bridge Loan is moot. I will therefore confine my analysis to the Tenor DIP Loan and the MIP.

B. The Appeal from the Tenor DIP Financing Order

(1) *Century Services Inc. v. Canada (Attorney General)*

[63] The Supreme Court of Canada had occasion to interpret the CCAA for the first time in *Century Services*. It used that opportunity to make clear that the CCAA gives the courts broad discretionary powers. Those powers must, however, be exercised in furtherance of the CCAA's purposes: para. 59. Section 11, in particular, was drafted in broad language which provides that a supervising judge "may, subject to the restrictions set out in this Act … make any order that it considers appropriate in the circumstances".[3] For the majority in *Century Services*, Deschamps J. wrote:

> [69] The *CCAA* also explicitly provides for certain orders…
>
> [70] The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* – avoiding the social and economic losses resulting from liquidation of an

[3] The full text of section 11 is as follows:

> 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.

> insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

[64] It is with the Supreme Court's interpretation of the scope of judicial discretion under the CCAA in mind that I turn to s. 11.2 and the question of whether it permits a supervising judge to approve financing that may continue for a significant period after CCAA protection ends, without the approval of creditors.

(2) Section 11.2 of the CCAA

[65] Section 11.2 is headed "Interim Financing". Headings may be used as an aid in interpreting the meaning of a statute: R. Sullivan, *Sullivan on the Construction of Statutes*, 5th ed. (Markham: LexisNexis Canada Inc., 2008), at p. 394, "Interim" generally means temporary or provisional: *Canadian Oxford Dictionary*, 2d ed. The weight to be given to a heading depends on the circumstances.

[66] I agree with the Noteholders that s. 11.2 contemplates the grant of a charge, the primary purpose of which is to secure financing required by the debtor while it is expected to be subject to proceedings under the CCAA. A further purpose, however, is to enhance the prospects of a plan of compromise or arrangement that will lead to a continuation of the company, albeit in restructured form, after plan approval.

[67] Section 11.2(4)(a) directs the court to consider the period during which the debtor is expected to be subject to proceedings under the CCAA. It stops short of confining the financing to the period that the debtor is subject to the CCAA. Section 11.2(4)(d) directs the court to consider if the financing would enhance the prospects of a viable compromise or arrangement.

[68] Having regard to the broad remedial purpose of the CCAA and the broad residual authority of a supervising judge described in *Century Services*, in my view section 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. Indeed, although in very different circumstances, financing to be available on the debtor's emergence from CCAA protection (sometimes called "exit financing") was approved before a plan was approved in *Air Canada*.[4] Both *Century Services* and section 11.2, however, in my view, signal that it would be unusual for a court to approve exit financing where opposed by substantially all of the creditors. Exit or post-plan financing is often a key element, or a pre-requisite, of the plan voted on by creditors.

[4] In *Air Canada,* Farley J. approved a "global restructuring agreement" which included a commitment of an existing creditor to provide exit financing of approximately US $585 million on the company's emergence from CCAA. DIP financing was in place; the financing at issue was clearly recognized as exit financing. The restructuring agreement was not opposed by substantially all of the creditors. Nor was it argued that it adversely affected the ability of the creditors and the debtor to negotiate a compromise or arrangement.

[69] The question becomes whether the unique facts of this case permitted the supervising judge to approve “interim financing” that was of such duration and structure that it could well outlast the CCAA protection period. This court should not substitute its decision for that of the supervising judge. I must ask this question through the lens of the applicable standard of review.

(3) Standard of review

[70] Appellate review of a discretionary order under the CCAA is limited. Intervention is justified only for an error in principle or the unreasonable exercise of discretion: *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108 (C.A.), at para. 71. An appellate court should not interfere with an exercise of discretion “where the question is one of the weight or degree of importance to be given to particular factors, rather than a failure to consider such factors or the correctness, in the legal sense, of the conclusion”: *New Skeena Forest Products Inc., Re*, 2005 BCCA 192, 39 B.C.L.R. (4th) 338, at para. 26.

(4) The supervising judge did not err in principle or unreasonably exercise his discretion

[71] As detailed below, I conclude that there is no basis for interfering with the supervising judge’s exercise of discretion in approving the Tenor DIP Loan.

[72] Most significantly, in this case, the supervising judge found there could be no meaningful recovery, and therefore no successful restructuring, without the

financing of the arbitration. Although the Noteholders characterized the Tenor DIP Loan as “exit financing”, it furthered the remedial purpose of the CCAA. To that extent, it is appropriate in the first sense used by Deschamps J. in *Century Services*, even though it may well outlast the period of CCAA protection. The supervising judge’s focus on the fact that the Tenor DIP Loan provided financing for the arbitration was not, in the circumstances, an error of principle.

[73] In my view, the Noteholders’ real argument is that the *means* by which the Tenor DIP Loan was approved were not appropriate. Ideally, a CCAA supervising judge is able to assist creditors and debtors in coming to a compromise. The creditors and Crystallex have not “achieved common ground” on a very significant matter. Effectively, the Noteholders argue that the creditors have not been treated as advantageously and fairly as the circumstances permit. They are the senior creditors and their offer to provide DIP financing on terms they argue matched those of the Tenor DIP Loan was not accepted. With sufficient financing in place to fund the arbitration, their leverage in negotiating a share of the arbitration proceeds has been reduced. Moreover, the Noteholders argue, the supervising judge erred in applying the business judgment rule, and, contrary to *Cliffs Over Maple Bay*, involuntarily stayed their rights during what they characterize as a restructuring. I consider each of these arguments below.

a. The Noteholders' competing DIP loan offer

[74] The Noteholders point to their affidavit on the April motion indicating they would submit to an order to advance funds on the same terms as the Tenor DIP Loan "in the event that prior to October 1, 2012, the Court orders that such long-term financing is appropriate and necessary". The supervising judge wrote that it would have been a preferable outcome if the Noteholders had been prepared to lend at the time of the April motion on the terms of the Tenor DIP facility: DIP Financing Reasons, at para. 91. The Noteholders argue that: they were prepared to advance funds on the terms of the Tenor DIP Loan, if so ordered; the supervising judge misapprehended the evidence; and, given the supervising judge's comment that it would have been preferable if the Noteholders had been prepared to lend, that misapprehension affected the outcome of the motion.

[75] The supervising judge's comment at para. 91 of the DIP Financing Reasons makes his real concern clear. There, he stated that "at this time" the Noteholders were not prepared to lend on the terms of the Tenor DIP Loan. The Noteholders' view as of April 5, 2012 was that such long-term financing was not necessary, as the $10 million they offered to advance at that time met Crystallex's then cash requirements. The Noteholders reserved their rights to continue to oppose the approval of long term financing before they had come to an agreement with Crystallex about their entitlement, as creditors. Further hearings, and further arguments, were required. The supervising judge found, at

para. 83 of the DIP Financing Reasons, that not putting sufficient financing in place to finance the arbitration "at this stage" would impair the arbitration. There was no suggestion from counsel for the Noteholders that on April 5, 2012 the Noteholders were prepared to waive the condition permitting them to continue to oppose the approval of long term financing. I am not satisfied that the supervising judge clearly misapprehended the evidence.

b. Loss of leverage

[76] In Crystallex's view, a reduction of the Noteholders' leverage was desirable. It points to the Noteholders' competing CCAA application, seeking to cancel all of the shareholders' equity, which the supervising judge rejected as not fairly balancing the interests of all stakeholders. The Noteholders' plan, subsequently proposed, would entitle them to 46 per cent of the equity in return for giving up their Notes, which Crystallex also views as excessive.[5]

[77] Crystallex argues that the Noteholders are not contractually entitled to convert their Notes to equity, and should therefore not be entitled to do so. Moreover, they argue, in the event of bankruptcy, the Noteholders would only be entitled to recover their principal and interest at the statutory rate of 5 per cent under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, and, if the

[5] The Noteholders proposed that they receive 22.9 per cent of the equity for the $36 million needed for the arbitration and 58 per cent of the equity in return for giving up their Notes, for a total of approximately 81 per cent of the equity. Assuming that the Noteholders sought a maximum total entitlement of 81 per cent, if they advanced the $36 million on the terms of the Tenor DIP Loan, as they now seek to do, the amount of equity on conversion of their notes would be 46 per cent. See the DIP Financing Reasons, at para. 77.

arbitration is realized, they will be entitled to the higher rate of interest they are contractually entitled to under the Notes. As Deschamps J. noted at para. 77 of *Century Services*, participants in a reorganization "measure the impact of a reorganization against the position they would enjoy in liquidation".

[78] The Noteholders counter that, contractually, they were entitled to be repaid on December 23, 2011 and, since they were not, and Crystallex proposes to defer repayment for several years and repay the Notes only if the arbitration is successful, the long delay entitles them to some equity participation. Moreover, contractually, Crystallex is restricted from incurring the Tenor DIP Loan, which will be senior to the Notes.

[79] Crystallex points to the terms of the Initial Order, affording the "best offer" the protection of the *Soundair* principles, and providing that "topping offers" would not be considered by the court. Crystallex points out that the Noteholders did not appeal the Initial Order and argues that accepting the Noteholders' matching offer would offend the *Soundair* principles. In Crystallex's view, the Noteholders were treated fairly.

[80] In turn, the Noteholders argue that the Initial Order authorized Crystallex to conduct an auction to raise *interim or DIP financing* pursuant to procedures approved by the Monitor. Since the outset, the Noteholders maintained their objection that the auction process sought more than interim or true DIP financing.

The supervising judge deferred consideration of their objections until the DIP facility was before the court for approval.

[81] The Noteholders are sophisticated parties. They pursued a strategy. It ultimately proved less successful than hoped. It appears that the supervising judge would have been prepared to approve the advance of funds to Crystallex by the Noteholders, on the terms of the Tenor DIP Loan, notwithstanding the *Soundair* principles, had the Noteholders agreed to do so, without condition, on April 5, 2012.

[82] 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.

c. The business judgment rule

[83] The supervising judge held that in addition to the factors in s. 11.2(4) of the CCAA, he could take into account the exercise or lack thereof of business judgment by the board of directors of a debtor corporation in considering DIP

financing: DIP Financing Reasons, at paras. 32-35. He cited *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (C.A.), as authority for this proposition.[6]

[84] The fact that a debtor's board of directors recommends interim financing is not a determinative factor, and in some cases may not be a material factor, in considering whether to make an order under s. 11.2. It would be unusual if the board did not recommend the financing for which the debtor seeks approval.

[85] *Stelco* should not be read as authority for the principle that the recommendation of the directors of a debtor under CCAA protection is entitled to deference in evaluating whether financing should be approved under s. 11.2 of the CCAA where the factors outlined in s. 11.2(4) have not been complied with. In *Stelco,* the debtor did not seek court approval of a recommendation of the board. In the case of interim financing, the court must make an independent determination, and arrive at an appropriate order, having regard to the factors in s. 11.2(4). It may consider, but not defer to, and is not fettered by, the recommendation of the board.

[86] The weight given by the supervising judge to the business judgment of the board of directors of Crystallex in recommending the Tenor DIP Loan is not, however, a basis for this court to interfere with his decision: *New Skeena Forest Products*, at para. 26.

[6] An incorrect citation for *Stelco* was given in the DIP Financing Reasons, at para. 33.

d. *Cliffs Over Maple Bay* is distinguishable

[87] In *Cliffs Over Maple Bay*, the debtor was the developer of a 300 acre site intended to include residential units, a golf course and a hotel. The debtor obtained protection under the CCAA and sought approval of financing that would permit it to complete material parts of the development. It believed that the proceeds generated from the sale of units thus completed would be sufficient to fund the remaining portions of the development and that, if the development were completed, there would be sufficient sale proceeds to satisfy all of the debtor's obligations.

[88] The motion judge approved the financing; the mortgagees of the development appealed. The British Columbia Court of Appeal noted, at para. 35, that it was not suggested that the debtor intended to propose an arrangement or compromise to its creditors before embarking on its restructuring plan. The court allowed the appeal, writing:

> [37] … DIP financing should not be authorized to permit the debtor company to pursue a restructuring plan that does not involve an arrangement or compromise with its creditors ...
>
> [38] ... What the Debtor Company was endeavouring to accomplish in this case was to freeze the rights of all of its creditors while it undertook its restructuring plan without giving the creditors an opportunity to vote on the plan. The CCAA was not intended, in my view, to accommodate a non-consensual stay of creditors' rights while a debtor company attempts to carry out a

> restructuring plan that does not involve an arrangement or compromise upon which the creditors may vote.

[89] I agree with the supervising judge that this case can be distinguished from *Cliffs Over Maple Bay*, which turned on the court's finding that the debtor did not intend to negotiate a plan with its creditors.

[90] While Mr. Fung initially indicated that Crystallex's plan was to stay creditors' claims until the arbitration was settled or realized, his more recent evidence was that approval of the Tenor DIP Loan does not preclude further discussions about a plan with the creditors. In submissions before the supervising judge, and again before this court, counsel for Crystallex reiterated that Crystallex intended to exit from CCAA protection as soon as a plan was negotiated with the creditors and approved, and that Crystallex intended to negotiate a plan by the expiry of the stay on July 30, 2012. The supervising judge found that Crystallex intended to negotiate a plan with its creditors. There is some basis in the record for such a conclusion.

(5) The Tenor DIP Loan is not an arrangement

[91] An arrangement or compromise cannot be imposed on creditors unless it has been approved by a majority in number representing two thirds in value of the creditors: see s. 6(1) of the CCAA.

[92] The supervising judge rejected the argument that the Tenor DIP Loan was a plan of arrangement or compromise and therefore required the approval of the creditors. He held, at para. 50 of the DIP Financing Reasons:

> 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.

[93] I agree. 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. In this case it was within the discretion of the supervising judge to approve the Tenor DIP Loan.

C. The Appeal from the Management Incentive Plan Approval Order

[94] In my view, the supervising judge did not err in principle or unreasonably exercise his discretion in approving the MIP. I see no basis for this court to intervene.

[95] As the supervising judge noted, employee retention provisions are frequently authorized before a plan is negotiated. The supervising judge was alive to the exceptionally large amounts that might be paid to beneficiaries of the MIP (including Mr. Fung) in this case. The supervising judge took specific note of the issues that the Noteholders had raised in the past regarding the extent to which the independent committee of the board that recommended the MIP was truly independent, and the steps taken by that committee to address those concerns.

[96] The recommendation of an independent committee of the board that has obtained expert advice is entitled to more weight in the consideration of a MIP than is the recommendation of the board in the consideration of whether financing should be approved under s. 11.2 of the CCAA. The CCAA does not list specific factors to be considered by the court in the case of a MIP. Moreover, the board would have the best sense of which employees were essential to the success of its restructuring efforts.

[97] In addition to considering the recommendation of the independent committee of the board and Mr. Swartz, the supervising judge also reviewed the evidence to consider whether any persons had been included in the MIP who should not have been. He did not rely solely on the board's recommendation.

VII. DISPOSITION

[98] Accordingly, I would dismiss the appeals of the CCAA Bridge Financing Order, the CCAA Financing Order, and the Management Incentive Plan Approval Order.

VIII. COSTS

[99] If the parties cannot agree, I would order that Crystallex and Tenor provide their submissions on the issue of costs within 14 days, and that the Noteholders, if so advised, provide their submissions in response within 10 days thereafter. No reply submissions are to be provided without leave.

Released: June 13, 2012
"DOC"

"Alexandra Hoy J.A."
"I agree D. O'Connor A.C.J.O."
"I agree R.A. Blair J.A."

TAB 13

2009 QCCS 6461
Quebec Superior Court

AbitibiBowater Inc., (Re)

2009 CarswellQue 14224, 2009 QCCS 6461, 190 A.C.W.S. (3d) 678, EYB 2009-171231

AbitibiBowater Inc., Abitibi-Consolidated Inc., Bowater Canadian Holdings Inc. and The other Petitioners listed on Schedules "A", "B" and "C", Petitioners and Ernst & Young Inc., Monitor

Gascon J.C.S.

Heard: November 9, 2009
Judgment: November 16, 2009
Docket: C.S. Qué. Montréal 500-11-036133-094

Counsel: Me Sean Dunphy, Me Joseph Reynaud, for Petitioners
Me Robert Thornton, for the Monitor
Me Jason Dolman, for the Monitor
Me Alain Riendeau, for Wells Fargo Bank, N.A., Administrative Agent under the Credit and Guarantee Agreement Dated April 1, 2008
Me Marc Duchesne, for the Ad hoc Committee of the Senior Secured Noteholders and U.S. Bank National Association, Indenture Trustee for the Senior Secured Noteholders
Me Frederick L. Myers, for the Ad Hoc Committee of Unsecured Noteholders of AbitibiBowater Inc. and certain of its Affiliates
Me Jean-Yves Simard, for the Ad Hoc Committee of Unsecured Noteholders of AbitibiBowater Inc. and certain of its Affiliates
Me Patrice Benoît, for Investissement Québec
Me S. Richard Orzy, for the Official Committee of Unsecured Creditors of AbitibiBowater Inc. & Al.
Me Frédéric Desmarais, for Bank of Montreal
Me Anastasia Flouris, for Alcoa

Subject: Insolvency

***Gascon J.C.S.*:**

CORRECTED JUDGMENT, NOVEMBER 23 ON RE-AMENDED MOTION FOR THE APPROVAL OF A SECOND DIP FINANCING AND FOR DISTRIBUTION OF CERTAIN PROCEEDS OF THE MPCo SALE TRANSACTION TO THE TRUSTEE FOR THE SENIOR SECURED NOTES (#312)

Introduction

1 In the context of their *CCAA* [1] restructuring, the Abitibi Petitioners [2] present a Motion [3] for 1) the approval of a second DIP financing and 2) the distribution of certain proceeds of the Manicouagan Power Company ("*MPCo*") sale transaction to the Senior Secured Noteholders *("SSNs")*.

2 More particularly, the Abitibi Petitioners seek:

> 1) Orders authorizing Abitibi Consolidated Inc. ("*ACI*") and Abitibi Consolidated Company of Canada Inc. ("*ACCC*") to enter into a Loan Agreement (the "*ULC DIP Agreement*") with 3239432 Nova Scotia Company ("*ULC*"), as lender, providing for a *CDN$230 million super-priority secured debtor in possession credit facility* (the "*ULC DIP Facility*").

The ULC DIP Facility is to be funded from the ULC reserve of approximately CDN$282.3 million (the "*ULC Reserve*"), with terms that will be substantially in the form of the term sheet (the "*ULC DIP Term Sheet*") attached to the ULC DIP Motion;

2) Orders authorizing the distribution to the SSNs *of up to CDN$200 million* upon completion of the sale of ACCC's 60% interest in MPCo and Court approval of the ULC DIP Agreement.

The distribution is to be paid from the net proceeds of the MPCo sale transaction after the payments, holdbacks, reserves and deductions provided for in the Implementation Agreement agreed upon in regard to that transaction; and

3) Orders amending the Second Amended Initial Order to increase the super priority charge set out in paragraph 61.3 (the "*ACI DIP Charge*") in respect of the ACI DIP Facility by an amount of CDN$230 million in favour of ULC for all amounts owing in connection with the ULC DIP Facility.

This increase in the ACI DIP Charge is to still be subordinated to any and all subrogated rights in favour of the SSNs, the lenders under the ACCC Term Loan (the "*Term Lenders*") and McBurney Corporation, McBurney Power Limited and MBB Power Services Inc. (the "*Lien Holders*") arising under paragraph 61.10 of the Second Amended Initial Order.

3 The SSNs and the Term Lenders, the only two secured creditor groups of the Abitibi Petitioners, do not, in the end, contest the ULC DIP Motion. Pursuant to intense negotiations and following concessions made by everyone, an acceptable wording to the orders sought was finally agreed upon on the eve of the hearing. The efforts of all parties and Counsel involved are worth mentioning; the help and guidance of the Monitor and its Counsel as well.

4 Of the unsecured creditors and other stakeholders, only the Ad Hoc Unsecured Noteholders Committee *(*the *"Bondholders")* opposes the ULC DIP Motion, and even there, just in part. At hearing, Counsel for the Official Committee of Unsecured Creditors set up in the corresponding U.S. proceedings pending in the State of Delaware also voiced that his client shared some of the Bondholders' concerns.

5 In short, while not contesting the request for approval of the second DIP financing, the Bondholders contend that the CDN $200 million immediate proposed distribution to the SSNs is inappropriate and uncalled for at this time.

6 Before analyzing the various orders sought, an overview of the MPCo sale transaction and of the ULC DIP Facility that are the subject of the debate is necessary.

The MPCo Sale Transaction

7 The MPCo sale transaction is central to the orders sought in the ULC DIP Motion.

8 Under the terms of an Implementation Agreement signed in that regard, Hydro-Québec *("HQ")* agreed to pay ACCC CDN $615 million (the "*Purchase Price*") for ACCC's 60% interest in MPCo.

9 Of this amount, it is expected that (i) CDN$25 million will be paid at closing to Alcoa, the owner of the other 40% interest in MPCo, for tax liabilities; (ii) approximately CDN$31 million will be held by HQ for two years to secure various indemnifications (the "*HQ Holdback*"); (iii) certain inter-party accounts will be settled; (iv) the CDN$282.3 million ULC Reserve, set up primarily to guarantee potential contingent pension liabilities and taxes resulting from the Proposed Transactions, will be held by the Monitor in trust for the ULC pending further Order of the Court; and (v) the ACI DIP Facility will be repaid.

10 That said, until the sale, ACCC's 60% interest in MPCo remains subject to the SSN's first ranking security. This first ranking security interest has never been contested by any party. In fact, after their review of same, the Monitor's Counsel concluded that it is valid and enforceable [4].

11 Accordingly, the proceeds of the sale less adjustments, holdbacks and reserve would normally be paid to the SSNs as holders of valid first ranking security over this asset.

12 To that end, the SSNs' claim of US$477,545,769.53 (US$413 million in principal and US$64,545,769.53 in interest as at October 1st, 2009) is not really contested except for a 0.5% to 2% additional default interest over the 13.75% original loan rate.

13 In that context, on September 29, 2009, the Court issued an Order approving the sale of ACCC's 60% interest in MPCo on certain conditions. Amongst others, the Court:

a) Approved the terms and conditions of the Implementation Agreement;

b) Authorized and directed ACI and ACCC to implement and complete the Proposed Transactions with such non-material alterations or amendments as the parties may agree to with the consent of the Monitor;

c) Declared that (i) the proceeds from the Proposed Transactions, net of certain payments, holdbacks, reserves and deductions, and (ii) the shares of the ULC, shall constitute and be treated as proceeds of the disposition of ACCC's MPCo shares (collectively, the *"MPCo Share Proceeds"*);

d) Declared that the MPCo Share Proceeds extend to and include (a) ACCC's interest in the HQ Holdback and (b) ACCC's interest in claims arising from the satisfaction of related-party claims;

e) Declared that the MPCo Share Proceeds will be subject to a replacement charge (the *"MPCo Noteholder Charge"*) in favour of the SSNs with the same rank and priority as the security held in respect of the ACCC's MPCo shares;

f) Declared that the ULC Reserve is subject to a charge in favour of the SSNs which is subordinate to a charge in favour of Alcoa (the *"ULC Reserve Charge*"); and

g) Ordered that the cash component of the MPCo Share Proceeds and the ULC Reserve be paid to and held by the Monitor in an interest bearing account or investment grade marketable securities pending further Order of the Court.

14 The Proposed Transactions are not expected to close until the latter part of November or early December 2009. ACI has requested and obtained an extension from Investissement Quebec *("IQ")* to December 15, 2009 for the repayment of the ACI DIP Facility that matured on November 1st, 2009.

15 Based on the amounts of the significant payments, holdbacks, reserves and deductions from the Purchase Price, and considering that the amount drawn under the ACI DIP Facility presently stands at CDN$54.8 million, the Net Available Proceeds after payment of the ACI DIP Facility would be approximately CDN$173.9 million.

The Ulc DIP Facility

16 Pursuant to the Implementation Agreement, ULC is required to maintain the ULC Reserve. On the closing of the Proposed Transactions, ULC will hold the ULC Reserve in the amount of approximately CDN$282.3 million.

17 This amount may be used for a limited number of purposes (the "*Permitted Investments*") that are described in the Implementation Agreement. Such Permitted Investments include making a DIP loan to either ACI or ACCC.

18 Based on that, the ULC DIP Term Sheet provides that the ACI Group will borrow CDN$230 million from the ULC Reserve as a Permitted Investment.

19 According to the Monitor [5], the significant terms of the ULC DIP Term Sheet are as follows:

i) *Manner of Borrowing* — Initially, the ULC DIP Facility was to be available by way of an immediate draw of CDN$230 million. After negotiations with the Term Lenders, it was rather agreed that (i) a first draw of CDN$130 million will be

advanced at closing, (ii) subsequent draws for a maximum total amount of CDN$50 million in increments of up to CDN $25 million will be advanced upon a five (5) business day notice and in accordance with paragraph 61.11 of the Second Amended Initial Order, and (iii) the balance of CDN$50 million shall become available upon further order of the Court.

ii) *Interest Payments* — No interest will be payable on the ULC DIP Facility;

iii) *Fees* — No fees are payable in respect of the ULC DIP Facility;

iv) *Expenses* — The borrowers will pay all reasonable expenses incurred by ULC and Alcoa in connection with the ULC DIP Facility;

v) *Reporting* — Reporting will be similar to that provided under the ACI DIP Facility and copies of all financial information will be placed in the data room. Reporting will include notice of events of default or maturing events of default;

vi) *Use of Proceeds* — The ULC DIP Facility will be used for general corporate purposes in material compliance with the 13-week cash flow forecasts to be provided no less frequently than the first Friday of each month (the "*Budget*");

vii) *Events of Default* — The events of default include the following:

(a) Substantial non-compliance with the Budget;

(b) Termination of the *CCAA* Stay of Proceedings;

(c) Failure to file a *CCAA* Plan with the Court by September 30, 2010; and

(d) Withdrawal of the existing Securitization Program unless replaced with a reasonably similar facility;

viii) *Rights of Alcoa* — Alcoa will receive all reporting noted above and notices of events of default. Alcoa's consent is required for any amendments or waivers;

ix) *Rights of Senior Secured Noteholders* — The Senior Secured Noteholders'rights consist of:

(a) Receiving all reporting noted above and any notice of an Event of Default;

(b) Consent of Senior Secured Noteholders holding a majority of the principal amount of the Senior Secured Notes is required for any amendments to the maximum amount of the ULC DIP Facility or any change to the Outside Maturity Date or the interest rate;

(c) Upon an Event of Default, there is no right to accelerate payment or maturity, subject to the right to apply to Court for the termination of the ULC DIP Facility, which right is without prejudice to the right of ACI, ACCC, the ULC or Alcoa to oppose such application;

(d) Entitlement to review draft of documents, but final approval of such documents is in Alcoa's sole discretion; and

(e) Entitlement to request the approval of the Court to amend any monthly cash flow budget which has been filed;

x) *Security* — Security is similar to the existing ACI DIP Facilityand ranking immediately after the existing ACI DIP Charge. There are no charges on the assets of the Chapter 11 Debtors (as defined in the existing ACI DIP Facility).

20 The Monitor notes that the ULC DIP Facility will provide the ACI Group with additional net liquidity (after the retirement of the ACI DIP Facility and after the payment of the proposed distribution to the SSNs) in the amount of some CDN$167 million.

The Questions at Issue

21 In light of this background, the Court must answer the following questions:

1) Should the ULC DIP Facility of CDN$230 million be approved?

2) Should the proposed distribution of CDN$200 million to the SSNs be authorized?

3) Is the wording of the orders sought appropriate, notably with regard to the additions proposed by the Bondholders in terms of the future steps to be taken by the Abitibi Petitioners?

Analysis and Discussion

1) The Approval of the DIP Financing

22 In the Court's opinion, the second DIP financing, that is, the ULC DIP Facility of CDN$230 million, should be approved on the amended terms agreed upon by the numerous parties involved.

23 In this restructuring, the Court has already approved DIP financing in respect of both the Abitibi Petitioners and the Bowater Petitioners.

24 On April 22, 2009, it issued a Recognition Order (U.S. Interim DIP Order) recognizing an Interim Order of the U.S. Bankruptcy Court for a DIP loan of up to US$206 million to the Bowater Petitioners. On May 6, 2009, it approved the ACI DIP Facility, a US$100 million loan to the Abitibi Petitioners by Bank of Montreal (*"BMO"*), guaranteed by IQ.

25 The jurisdiction of the Court to approve DIP financing and the requirement of the Abitibi Petitioners for such were canvassed at length in the May 6 Judgment. The requirements of the Abitibi Petitioners for liquidity and the authority of the Court to approve agreements to satisfy those requirements have already been reviewed and ruled upon.

26 There have been no circumstances intervening since the approval of the ACI DIP Facility that can fairly be characterized as negating the requirement of the Abitibi Petitioners for DIP financing.

27 The only issue here is whether this particular ULC DIP Facility proposal, replacing as it does the prior ACI DIP Facility, is one that the Court ought to approve. As indicated earlier, the answer is yes.

28 At this stage in the proceedings where the phase of business stabilization is largely complete, the Court is not required to approach the subject of DIP financing from the perspective of excessive caution or parsimony.

29 On the one hand, as highlighted notably by the Monitor [6], the Abitibi Petitioners have presented substantial reasons to support their need for liquidity by way of a DIP loan. Suffice it to note to that end that:

a) Without an adequate cushion, in view of potential adverse exchange rate fluctuations and further adverse price declines in the market, the Abitibi Petitioners'liquidity could easily be insufficient to meet the requirements of its Securitization Program (Monitor's 19th Report at paragraphs 49, 50 and chart at paragraph 61);

b) Absent a DIP loan, there is, in fact, a "high risk of default" under the Securitization Program (Monitor's 19th Report at paragraph 32);

c) Despite Abitibi Petitioners'best efforts at forecasting, weekly cash flow forecasts have varied by as much as US$26 million. Weekly disbursements have varied by 100%. Each 1¢ variation in the foreign exchange rate as against the US dollar could produce a US$17 million negative cash flow variation. The ultimate cash flow requirements will be highly dependent on variables that the Abitibi Petitioners'cannot control (Monitor's 19th Report at paragraphs 54, 60 and 61);

d) The market decline has eroded the Abitibi Petitioners'liquidity, while foreign exchange fluctuations are placing further strain on this liquidity. Even if prices increase, the resulting need for additional working capital to increase production will paradoxically put yet further strain on this liquidity;

e) Without the ULC DIP Facility, the Abitibi Petitioners would lack access to sufficient operating credit to maintain normal operations. They would be significantly impaired in their ability to operate in the ordinary course and they would face an increase in the risk of unexpected interruptions; and

f) The Abitibi Petitioners have yet to complete their business plan and it is premature to predict the length of the proceedings (Monitor's 19th Report at paragraphs 47 and 48).

30 In fact, based upon its sensitivity analysis, the inter-month variability of the cash flows, the minimum liquidity requirements under the Securitization Program, and the requirement to repay the ACI DIP Facility, the Monitor is of the view that the Abitibi Petitioners need the new ULC DIP Facility to ensure that ACI has sufficient liquidity to complete its restructuring.

31 On the other hand, the reasonableness of the amount of the ULC DIP Facility is supported by the following facts:

a) Only about CDN$168 million of incremental liquidity is being provided and post-transaction, the Abitibi Petitioners will have, at best, about CDN$335 million of liquidity (Monitor's 19th Report at paragraph 68);

b) The Bowater Petitioners, a group of the same approximate size as the Abitibi Petitioners, enjoy liquidity of approximately US$400 million (Monitor's 19th Report at paragraph 69) and a DIP facility of approximately US$200 million;

c) Even with the ULC DIP Facility, the Abitibi Petitioners will be at the low end of average relative to their peers in terms of available liquidity relative to their size;

d) The cash flow of the Abitibi Petitioners is subject to significant intra-month variations and has risks associated with pricing and currency fluctuations which are larger the longer the period examined; and

e) The Abitibi Petitioners are required by the Securitization Facility to maintain liquidity on a rolling basis above US $100 million.

32 In addition, the Court and the stakeholders have all the means necessary at their disposal to monitor the use of liquidity without, at the same time, having to ration its access at a level far below that enjoyed by the peers with whom the Abitibi Petitioners compete.

33 In this regard, it is important to emphasize that the ULC DIP Facility includes, after all, particularly interesting conditions in terms of interest payments and associated fees. Because ULC is the lender, none are payable.

34 Finally, the provisions of section 11.2 of the amended *CCAA*, and in particular the factors for review listed in subsection 11.2(4), are instructive guidelines to the exercise of the Court's discretion to approve the ULC DIP Facility.

35 Pursuant to subsection 11.2(4) of the amended *CCAA*, for restructurings undertaken after September 18, 2009, the judge is now directed to consider the following factors in determining whether to exercise his or her discretion to make an order such as this one:

a) The period during which the company is expected to be subject to *CCAA* proceedings;

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;

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.

36 Applying these criteria to this case, it is, first, premature to speculate how long the Abitibi Petitioners will remain subject to proceedings under the *CCAA*.

37 The Monitor's 19th Report has considered cash flow forecasts until December 2010. The Abitibi Petitioners are hopeful of progressing to a plan outline by year-end with a view to emergence in the first or second quarter of 2010.

38 In considering a DIP financing proposal, the Court can take note of the fact that the time and energies ought, at this stage in the proceedings, to be more usefully and profitably devoted to completing the business restructuring, raising the necessary exit financing and negotiating an appropriate restructuring plan with the stakeholders.

39 Second, even if the ULC DIP Facility of CDN$230 million is a high, albeit reasonable, figure under the circumstances, access to the funds and use of the funds remain closely monitored.

40 Based on the compromise reached with the Term Lenders, access to the funds will be progressive and subject to control. The initial draw is limited to CDN$130 million. Subsequent additional draws up to CDN$50 million will be in maximum increments of CDN$25 million and subject to prior notice. The final CDN$50 million will only be available with the Court's approval.

41 As well, the use of the funds is subject to considerable safeguards as to the interests of all stakeholders. These include the following:

a) The Monitor is on site monitoring and reviewing cash flow sources and uses in real time with full access to senior management, stakeholders and the Court;

b) Stakeholders have very close to real time access to financial information regarding sources and use of cash flow by reason of the weekly cash flow forecasts provided to their financial advisors and the weekly calls with such financial advisors, participated in by senior management;

c) The Monitor provides regular reporting to the Court including as to the tracking of variances in cash use relative to forecast and as to evolution of the business environment in which the Abitibi Petitioners are operating; and

d) All stakeholders have full access to this Court to bring such motions as they see fit should a material adverse change in the business or affairs intervene.

42 Third, there has been no suggestion that the management of the Abitibi Petitioners has lost the confidence of its major creditors. To the contrary:

a) Management has successfully negotiated a settlement of very complex and thorny issues with both the Term Lenders and the SSNs, which has enabled this ULC DIP Motion to be brought forward with their support;

b) While management does not agree with all positions taken by the Bondholders at all times, it has by and large enjoyed the support of that group throughout these proceedings;

c) Management has been attentive to the suggestions and guidance of the Monitor with the result that there have been few if any instances where the Monitor has been publicly obliged to oppose or take issue with steps taken;

d) Management has been proactive in hiring a Chief Restructuring Officer who has provided management with additional depth and strength in navigating through difficult circumstances; and

e) The Abitibi Petitioners' management conducts regular meetings with the financial advisors of their major stakeholders, in addition to having an "open door" policy.

43 The Court is satisfied that, in requesting the approval of the ULC DIP Facility, management is doing so with a broad measure of support and the confidence of its major creditor constituencies.

44 Fourth, with an adequate level of liquidity, the Abitibi Petitioners will be able to run their business as a going concern on as normal a basis as possible, with a view to enhancing and preserving its value while the restructuring process proceeds.

45 By facilitating a level of financial support that is reasonable and adequate and of sufficient duration to enable them to complete the restructuring on most reasonable assumptions, the Abitibi Petitioners will have the benefit of an umbrella of stability around their core business operations.

46 In the Court's opinion, this can only facilitate the prospects of a viable compromise or arrangement being found.

47 Fifth, there are only two secured creditor groups of the Abitibi Petitioners: the SSNs and the Term Lenders. After long and difficult negotiations, they finally agreed to an acceptable wording to the orders sought. No one argues any longer that it is prejudiced in any way by the proposed security or charge.

48 Lastly, sixth, the Monitor has carefully considered the positions of all of the stakeholders as well as the reasonableness of the Abitibi Petitioners' requirements for the proposed ULC DIP Facility. Having reviewed both the impact of the proposed ULC DIP Facility on stakeholders and its beneficial impact upon the Abitibi Petitioners, the Monitor recommends approval of the ULC DIP Facility.

49 On the whole, in approving this ULC DIP Facility, the Court supports the very large consensus reached and the fine balance achieved between the interests of all stakeholders involved.

2) The Distribution to the SSNs

50 The approval of the terms of the ULC DIP Facility by the SSNs is intertwined with the Abitibi Petitioners' agreement to support a distribution in their favor in the amount of CDN$200 million.

51 The Abitibi Petitioners and the SSNs consider that since the MPCo proceeds were and are subject to the security of the SSNs, this arrangement or compromise is a reasonable one under the circumstances.

52 They submit that the proposed distribution will be of substantial benefit to the Abitibi Petitioners. Savings of at least CDN$27.4 million per year in accruing interest costs on the CDN$200 million to be distributed will be realized based on the 13.75% interest rate payable to the SSNs.

53 Needless to say, they maintain that the costs saved will add to the potential surplus value of SSNs' collateral that could be utilized to compensate any creditor whose security may be impaired in the future in repaying the ULC DIP Facility.

54 The Bondholders oppose the CDN$200 million distribution to the SSNs.

55 In their view, given the Abitibi Petitioners'need for liquidity, the proposed payment of substantial proceeds to one group of creditors raises important issues of both propriety and timing. It also brings into focus the need for the *CCAA* process to move forward efficiently and effectively towards the goal of the timely negotiation and implementation of a plan of arrangement.

56 The Bondholders claim that the proposed distribution violates the *CCAA*. From their perspective, nothing in the statute authorizes a distribution of cash to a creditor group prior to approval of a plan of arrangement by the requisite majorities of creditors and the Court. They maintain that the SSNs are subject to the stay of proceedings like all other creditors.

57 By proposing a distribution to one class of creditors, the Bondholders contend that the other classes of creditors are denied the ability to negotiate a compromise with the SSNs. Instead of bringing forward their proposed plan and creating options for the creditors for negotiation and voting purposes, the Abitibi Petitioners are thus eliminating bargaining options and confiscating the other creditors'leverage and voting rights.

58 Accordingly, the Bondholders conclude that the proposed distribution should not be considered until after the creditors have had an opportunity to negotiate a plan of arrangement or a compromise with the SSNs.

59 In the interim, they suggest that the Abitibi Petitioners should provide a business plan to their legal and financial advisors by no later than 5:00 p.m. on November 27, 2009. They submit that a restructuring and recapitalization term sheet on terms acceptable to them and their legal and financial advisors should also be provided by no later than 5:00 p.m. on December 11, 2009.

60 With all due respect for the views expressed by the Bondholders, the Court considers that, similarly to the ULC DIP Facility, the proposed distribution should be authorized.

61 To begin with, the position of the Bondholders is, under the circumstances, untenable. While they support the CDN$230 million ULC DIP Facility, they still contest the CDN$200 million proposed distribution that is directly linked to the latter.

62 The Court does not have the luxury of picking and choosing here. What is being submitted for approval is a global solution. The compromise reached must be considered as a whole. The access to additional liquidity is possible because of the corresponding distribution to the SSNs. The amounts available for both the ULC DIP Facility and the proposed distribution come from the same MPCo sale transaction.

63 The compromise negotiated in this respect, albeit imperfect, remains the best available and viable solution to deal with the liquidity requirements of the Abitibi Petitioners. It follows a process and negotiations where the views and interests of most interested parties have been canvassed and considered.

64 To get such diverse interest groups as the Abitibi Petitioners, the SSNs, the Term Lenders, BMO and IQ, and ULC and Alcoa to agree on an acceptable outcome is certainly not an easy task to achieve. Without surprise, it comes with certain concessions.

65 It would be very dangerous, if not reckless, for the Court to put in jeopardy the ULC DIP Facility agreed upon by most stakeholders on the basis that, perhaps, a better arrangement could eventually be reached in terms of distribution of proceeds that, on their face, appear to belong to the SSNs.

66 The Court is satisfied that both aspects of the ULC DIP Motion are closely connected and should be approved together. To conclude otherwise would potentially put everything at risk, at a time where stability is most required.

67 Secondly, it remains that ACCC's interest in MPCo is subject to the SSNs' security. As such, all proceeds of the sale less adjustments, holdbacks and reserves should normally be paid to the SSNs. Despite this, provided they receive the CDN$200 million proposed distribution, the SSNs have consented to the sale proceeds being used by the Abitibi Petitioners to pay the existing ACI DIP Facility and to the ULC Reserve being used up to CDN$230M for the ULC DIP Facility funding.

68 It is thus fair to say that the SSNs are not depriving the Abitibi Petitioners of liquidity; they are funding part of the restructuring with their collateral and, in the end, enhancing this liquidity.

69 The net proceeds of the MPCo transaction after payment of the ACI DIP Facility are expected to be CDN$173.9 million. Accordingly, out of a CDN$200 million distribution to the SSNs, only CDN$26.1 million could technically be said to come from the ULC DIP Facility. Contrary to what the Bondholders alluded to, if minor aspects of the claims of the SSNs are disputed by the Abitibi Petitioners, they do not concern the CDN$200 million at issue.

70 Thirdly, the ULC DIP Facility bears no interest and is not subject to drawdown fees, while a distribution of CDN$200 million to the SSNs will create at the same time interest savings of approximately CDN$27 million per year for the ACI Group. There is, as a result, a definite economic benefit to the contemplated distribution for the global restructuring process.

71 Despite what the Bondholders argue, it is neither unusual nor unheard of to proceed with an interim distribution of net proceeds in the context of a sale of assets in a *CCAA* reorganization. Nothing in the *CCAA* prevents similar interim distribution of monies. There are several examples of such distributions having been authorized by Courts in Canada [7] .

72 While the SSNs are certainly subject to a stay of proceedings much like the other creditors involved in the present *CCAA* reorganization, an interim distribution of net proceeds from the sale of an asset subject to the Court's approval has never been considered a breach of the stay.

73 In this regard, the Bondholders have no economic interest in the MPCo assets and resulting proceeds of sale that are subject to a first ranking security interest in favor of the SSNs. Therefore, they are not directly affected by the proposed distribution of CDN$200 million.

74 In *Windsor Machine & Stamping Ltd. (Re),* [8] Morawetz J. dealt with the opposition of unsecured creditors to an Approval and Distribution Order as follows:

> 13 Although the outcome of this process does not result in any distribution to unsecured creditors, this does not give rise to a valid reason to withhold Court approval of these transactions. I am satisfied that the unsecured creditors have no economic interest in the assets.

75 Finally, even though the Monitor makes no recommendation in respect of the proposed distribution to the SSNs, this can hardly be viewed as an objection on its part. In the first place, this is not an issue upon which the Monitor is expected to opine. Besides, in its 19 th report, the Monitor notes the following in that regard:

a) According to its Counsel, the SSNs security on the ACCC's 60% interest in MPCo is valid and enforceable;

b) The amounts owed to the SSNs far exceed the contemplated distribution while the SSNs' collateral is sufficient for the SSNs' claim to be most likely paid in full;

c) The proposed distribution entails an economy of CDN$27 million per year in interest savings; and

d) Even taking into consideration the CDN$200 million proposed distribution, the ULC DIP Facility provides the Abitibi Petitioners with the liquidity they require for most of the coming year.

76 All things considered, the Court disagrees with the Bondholders' assertion that the proposed distribution is against the goals and objectives of the *CCAA*. For some, it may only be a small step. However, it is a definite step in the right direction.

77 Securing the most needed liquidity at issue here and reducing substantially the extent of the liabilities towards a key secured creditor group no doubt enhances the chances of a successful restructuring while bringing stability to the on-going business.

78 This benefits a large community of interests that goes beyond the sole SSNs.

79 From that standpoint, the Court is satisfied that the restructuring is moving forward properly, with reasonable diligence and in accordance with the *CCAA* ultimate goals.

80 Abitibi Petitioners' firm intention, reiterated at the hearing, to shortly provide their stakeholders with a business plan and a restructuring and recapitalization term sheet confirms it as well.

3) The Orders Sought

81 In closing, the precise wording of the orders sought has been negotiated at length between Counsel. It is the result of a difficult compromise reached between many different parties, each trying to protect distinct interests.

82 Nonetheless, despite their best efforts, this wording certainly appears quite convoluted in some cases, to say the least. The proposed amendment to the subrogation provision of the Second Amended Initial Order is a vivid example. Still, the mechanism agreed upon, however complicated it might appear to some, remains acceptable to all affected creditors.

83 The delicate consensus reached in this respect must not be discarded lightly. In view of the role of the Court in *CCAA* proceedings, that is, one of judicial oversight, the orders sought will thus be granted as amended, save for limited exceptions. To avoid potential misunderstandings, the Court felt necessary to slightly correct the specific wording of some conclusions. The orders granted reflect this.

84 Turning to the conclusions proposed by the Bondholders at paragraphs 8 to 11 of the draft amended order (now paragraphs 6 to 9 of this Order), the Court considers them useful and appropriate. They assist somehow in bringing into focus the need for this *CCAA* process to continue to move forward efficiently.

85 Minor adjustments to some of the wording are, however, required in order to give the Abitibi Petitioners some flexibility in terms of compliance with the ULC DIP documents and cash flow forecast.

86 For the expected upcoming filing by the Abitibi Petitioners of their business plan and restructuring and recapitalization term sheet, the Court concludes that simply giving act to their stated intention is sufficient at this stage. The deadlines indicated correspond to the date agreed upon by the parties for the business plan and to the expected renewal date of the Initial Order for the restructuring and recapitalization term sheet.

FOR THESE REASONS, THE COURT:

ORDERS the provisional execution of this Order notwithstanding any appeal and without the necessity of furnishing any security.

ULC DIP Financing

1 *ORDERS* that the Abitibi Petitioners are hereby authorized and empowered to enter into, obtain and borrow under a credit facility provided pursuant to a loan agreement(the "*ULC DIP Agreement*") among ACI, as borrower, and 3239432 Nova Scotia Company, an unlimited liability company ("*ULC*"), as lender (the "*ULC DIP Lender*"), to be approved by Alcoa acting reasonably, which terms will be consistent with the ULC DIP Term Sheet communicated as *Exhibit R-1* in support of the ULC DIP Motion, subject to such non-material amendments and modifications as the parties may agree with a copy thereof being provided in advance to the Monitor and to modifications required by Alcoa, acting reasonably, which credit facility shall be in an aggregate principal amount outstanding at any time not exceeding *$230* million.

2 *ORDERS* that the credit facility provided pursuant to the ULC DIP Agreement (the "*ULC DIP*") will be subject to the following draw conditions:

a) a first draw of $130 million to be advanced at closing;

b) subsequent draws for a maximum total amount of $50 million in increments of up to $25 million to be advanced upon a five (5) business day notice and in accordance with paragraph 61.11 of the Second Amended Initial Order which shall apply mutatis mutandis to advances under the ULC DIP; and

c) the balance of $50 million shall become available upon further order of the Court.

At the request of the Borrower, all undrawn amounts under the ULC DIP shall either (i) be transferred to the Monitor to be held in an interest bearing account for the benefit of the Borrower providing that any requests for advances thereafter shall continue to be made and processed in accordance herewith as if the transfer had not occurred, or (ii) be invested by ULC in an interest bearing account with all interest earned thereon being for the benefit of and remitted to the Borrower forthwith following receipt thereof.

3 *ORDERS* the Petitioners to communicate a draft of the substantially final ULC DIP Agreement (the "*Draft ULC DIP Agreement*") to the Monitor and to any party listed on the Service List which requests a copy of same (an "*Interested Party*") no later than five (5) days prior to the anticipated closing of the MPCo Transaction, as said term is defined in the ULC DIP Motion.

4 *ORDERS* that any Interested Party who objects to any provisions of the Draft ULC DIP Agreement as not being substantially in accordance with the terms of the ULC DIP Term Sheet, Exhibit R-1, or objectionable for any other reason, shall, before the close of business of the day following delivery of the Draft ULC DIP Agreement, make a request for a hearing before this Court stating the grounds upon which such objection is based, failing which the Draft ULC DIP Agreement shall be considered to conform to the ULC DIP Term Sheet and shall be deemed to constitute the ULC DIP Agreement for the purposes of this Order.

5 *ORDERS* that the Abitibi Petitioners are hereby authorized and empowered to execute and deliver the ULC DIP Agreement, subject to the terms of this Order and the approval of Alcoa, acting reasonably, as well as such commitment letters, fee letters, credit agreements, mortgages, charges, hypothecs and security documents, guarantees, mandate and other definitive documents (collectively with the ULC DIP Agreement, the "*ULC DIP Documents*"), as are contemplated by the ULC DIP Agreement or as may be reasonably required by the ULC DIP Lender pursuant to the terms thereof, and the Abitibi Petitioners are hereby authorized and directed to pay and perform all of their indebtedness, interest, fees, liabilities and obligations to the ULC DIP Lender under and pursuant to the ULC DIP Documents as and when same become due and are to be performed, notwithstanding any other provision of this Order.

6 *ORDERS* that the Abitibi Petitioners shall substantially comply with the terms and conditions set forth in the ULC DIP Documents and the 13-week cash flow forecast (the "Budget") provided to the financial advisors of the Notice Parties (as defined in the Second Amended Initial Order) and any Interested Party.

7 *ORDERS* that, in accordance with the terms and conditions of the ULC DIP Documents, the Abitibi Petitioners shall use the proceeds of the ULC DIP substantially in compliance with the Budget, that the Monitor shall monitor the ongoing disbursements of the Abitibi Petitioners under the Budget, and that the Monitor shall forthwith advise the Notice Parties (as defined in the Second Amended Initial Order) and any Interested Party of the Monitor's understanding of any pending or anticipated substantial non-compliance with the Budget and/or any other pending or anticipated event of default or termination event under any of the ULC DIP Documents.

8 *GIVES ACT* to the Abitibi Petitioners of their stated intention to provide a business plan to the Notice Parties (as defined in the Second Amended Initial Order) and any Interested Party by no later than 5:00 p.m. on November 27, 2009.

9 *GIVES ACT* to the Abitibi Petitioners of their stated intention to provide a restructuring and recapitalization term sheet (the "Recapitalization Term Sheet") to the Notice Parties (as defined in the Second Amended Initial Order) and any Interested Party by no later than 5:00 p.m. on December 15, 2009.

10 *ORDERS* that, notwithstanding any other provision of this Order, the Abitibi Petitioners shall pay to the ULC DIP Lender when due all amounts owing (including principal, interest, fees and expenses, including without limitation, all fees and disbursements of counsel and all other advisers to or agents of the ULC DIP Lender on a full indemnity basis (the "*ULC DIP Expenses*") under the ULC DIP Documents and shall perform all of their other obligations to the ULC DIP Lender pursuant to the ULC DIP Documents and this Order.

11 *ORDERS* that the claims of the ULC DIP Lender pursuant to the ULC DIP Documents shall not be compromised or arranged pursuant to the Plan or these proceedings and the ULC DIP Lender, in such capacity, shall be treated as an unaffected creditor in these proceedings and in any Plan or any proposal filed by any Abitibi Petitioner under the *BIA*.

12 *ORDERS* that the ULC DIP Lender may, notwithstanding any other provision of this Order or the Initial Order:

a) take such steps from time to time as it may deem necessary or appropriate to register, record or perfect the ACI DIP Charge and the ULC DIP Documents in all jurisdictions where it deems it to be appropriate; and

b) upon the occurrence of a Termination Event (as each such term is defined in the ULC DIP Documents), refuse to make any advance to the Abitibi Petitioners and terminate, reduce or restrict any further commitment to the Abitibi Petitioners to the extent any such commitment remains, set off or consolidate any amounts owing by the ULC DIP Lender to the Abitibi Petitioners against any obligation of the Abitibi Petitioners to the ULC DIP Lender, make demand, accelerate payment or give other similar notices, or to apply to this Court for the appointment of a receiver, receiver and manager or interim receiver, or for a bankruptcy order against the Abitibi Petitioners and for the appointment of a trustee in bankruptcy of the Abitibi Petitioners, and upon the occurrence of an event of default under the terms of the ULC DIP Documents, the ULC DIP Lender shall be entitled to apply to the Court to seize and retain proceeds from the sale of any of the Property of the Abitibi Petitioners and the cash flow of the Abitibi Petitioners to repay amounts owing to the ULC DIP Lender in accordance with the ULC DIP Documents and the ACI DIP Charge.

13 *ORDERS* that the foregoing rights and remedies of the ULC DIP Lender shall be enforceable against any trustee in bankruptcy, interim receiver, receiver or receiver and manager of the Abitibi Petitioners or the Property of the Abitibi Petitioners, the whole in accordance with and to the extent provided in the ULC DIP Documents.

14 *ORDERS* that the ULC DIP Lender shall not take any enforcement steps under the ULC DIP Documents or the ACI DIP Charge without providing five (5) business day (the "*Notice Period*") written enforcement notice of a default thereunder to the Abitibi Petitioners, the Monitor, the Senior Secured Noteholders, Alcoa, the Notice Parties (as defined in the Second AmendedInitial Order) and any Interested Party. Upon expiry of such Notice Period, and notwithstanding any stay of proceedings provided herein, the ULC DIP Lender shall be entitled to take any and all steps and exercise all rights and remedies provided for under the ULC DIP Documents and the ACI DIP Charge and otherwise permitted at law, the whole in accordance with applicable provincial laws, but without having to send any notices under Section 244 of the *BIA*. For greater certainty, the ULC DIP Lender may issue a prior notice pursuant to Article 2757 *CCQ* concurrently with the written enforcement notice of a default mentioned above.

15 *ORDERS* that, subject to further order of this Court, no order shall be made varying, rescinding, or otherwise affecting paragraphs 61.1 to 61.9 of the Initial Order, the approval of the ULC DIP Documents or the ACI DIP Charge unless either (a) notice of a motion for such order is served on the Petitioners, the Monitor, Alcoa, the Senior Secured Noteholders and the ULC DIP Lender by the moving party and returnable within seven (7) days after the party was provided with notice of this Order in accordance with paragraph 70(a) hereof or (b) each of the ULC DIP Lender and Alcoa applies for or consents to such order.

16 *ORDERS* that 3239432 Nova Scotia Company is authorized to assign its interest in the ULC DIP to Alcoa pursuant to the security agreements and guarantees to be granted pursuant to the Implementation Agreement and this Court's Order dated September 29, 2009.

17 *AMENDS* the Initial Order issued by this Court on April 17, 2009 (as amended and restated) by adding the following at the end of paragraph 61.3:

ORDERS further, that from and after the date of closing of the MPCo Transaction (as said term is defined in the Petitioners' ULC DIP Motion dated November 9, 2009) and provided the principal, interest and costs under the ACI DIP Agreement (as defined in the Order of this Court dated May 6, 2009), are concurrently paid in full, the ACI DIP Charge shall be increased by the aggregate amount of *$230* million (subject to the same limitations provided in the first sentence hereof in relation to the Replacement Securitization Facility) and shall be extended by a movable and immovable hypothec, mortgage, lien and security interest on all property of the Abitibi Petitioners (other than the property of Abitibi Consolidated (U.K.) Inc.) in favour of the ULC DIP Lender for all amounts owing, including principal, interest and ULC DIP Expenses and all obligations required to be performed under or in connection with the ULC DIP Documents. The ACI DIP Charge as so increased shall continue to have the priority established by paragraphs 89 and 91 hereof provided such increased ACI DIP Charge (being the portion of the ACI DIP Charge in favour of the ULC DIP Lender) shall in all respects be subordinate (i) to the subrogation rights in favour of the Senior Secured Noteholders arising from the repayment of the ACI DIP Lender from the proceeds of the sale of the MPCo transaction as approved by this Court in its Order of September 29, 2009

and as confirmed by paragraph 11 of that Order, notwithstanding the amendment of paragraph 61.10 of this Order by the subsequent Order dated November16,2009, as well as the further subrogation rights, if any, in favour of the Term Lenders; and (ii) rights in favour of the Term Lenders arising from the use of cash for the payment of interest fees and accessories as determined by the Monitor. No order shall have the effect of varying or amending the priority of the ACI DIP Charge and the interest of the ULC DIP Lender therein without the consent of the Senior Secured Noteholders and Alcoa. The terms "ULC DIP Lender", "ULC DIP Documents", "ULC DIP Expenses", "Senior Secured Noteholders" and "Alcoa" shall be as defined in the Order of this Court dated November 16,2009. Notwithstanding the subrogation rights created or confirmed herein, in no event shall the ULC DIP Lender be subordinated to more than approximately $40 million, being the aggregate of the proceeds of the MPCo Transaction paid to the ACI DIP Lender plus the interest, fees and expenses paid to the ACI DIP Lender as determined by the Monitor.

ACI DIP Agreement

18 *ORDERS* that the Abitibi Petitioners are hereby authorized to make, execute and deliver one or more amendment agreements in connection with the ACI DIP Agreement providing for (i) an extension of the period during which any undrawn portion of the credit facility provided pursuant to the ACI DIP Agreement shall be available and (ii) the modification of the date upon which such credit facility must be repaid from November 1, 2009 to the earlier of the closing of the MPCo Transaction and December 15, 2009, subject to the terms and conditions set forth in the ACI DIP Agreement, save and except for non-material amendments.

Senior Secured Notes Distribution

19 *ORDERS* that the Abitibi Petitioners are authorized and directed to make a distribution to the Trustee of the Senior Secured Notes in the amount of $200 million upon completion of the MPCo Transaction (as said term is defined in the ULC DIP Motion) from the proceeds of such sale and of the ULC DIP Facility, providing always that the ACI DIP is repaid in full upon completion of the MPCo Transaction.

20 *ORDERS* that, subject to completion of the ULC DIP (including the initial draw of $130 million thereunder) and providing always that the ACI DIP is repaid in full upon completion of the MPCo Transaction, the distribution referred to in the preceding paragraph and the flow of funds upon completion of the MPCo Transaction and the ULC DIP shall be arranged in accordance with the following principles: (a) MPCo Proceeds shall be used, first, to fund the distribution to the Senior Secured Notes referenced in the previous paragraph and, secondly, to fund the repayment of the ACI DIP; (b) the initial draw of $130 million made under the ULC DIP shall fund any remaining balance due to repay in full the ACI DIP and this, upon completion of the MPCo Transaction. The Monitor shall be authorized to review the completion of the MPCo Transaction, the ULC DIP and the repayment of the ACI DIP and shall report to the Court regarding compliance with this provision as it deems necessary.

Amendment to the Subrogation Provision

21 *ORDERS* that Subsection 61.10 of the Initial Order, as amended and restated, is replaced by the following:

Subrogation to ACI DIP Charge

[61.10] **ORDERS** that the holders of Secured Notes, the Lenders under the Term Loan Facility (collectively, the "**Secured Creditors**") and McBurney Corporation, McBurney Power Limited and MBB Power Services Inc. (collectively, the "**Lien Holder**") that hold security over assets that are subject to the ACI DIP Charge and that, as of the Effective Time, was opposable to third parties (including a trustee in bankruptcy) in accordance with the law applicable to such security (an "**Impaired Secured Creditor**" and "**Existing Security**", respectively) shall be subrogated to the ACI DIP Charge to the extent of the lesser of (i) any net proceeds from the Existing Security including from the sale or other disposition of assets, resulting from the collection of accounts receivable or other claims (other than Property subject to the Securitization Program Agreements and for greater certainty, but without limiting the generality of the foregoing, the ACI DIP Charge shall in no circumstances extend to any assets sold pursuant to the Securitization Program Agreements, any Replacement Securitization Facility or any assets of

ACUSFC, the term "Replacement Securitization Facility" having the meaning ascribed to same in Schedule A of the ACI DIP Agreement) and/or cash that is subject to the Existing Security of such Impaired Secured Creditor that is used directly to pay (a) the ACI DIP Lender or (b) another Impaired Secured Creditor (including by any means of realization) on account of principal, interest or costs, in whole or in part, as determined by the Monitor (subject to adjudication by the Court in the event of any dispute) and (ii) the unpaid amounts due and/or becoming due and/or owing to such Impaired Secured Creditor that are secured by its Existing Security. For this purpose "**ACI DIP Lender**" shall be read to include Bank of Montreal, IQ, the ULC DIP Lender and their successors and assigns, including any lender or lenders providing replacement DIP financing should same be approved by subsequent order of this Court. No Impaired Secured Creditor shall be able to enforce its right of subrogation to the ACI DIP Charge until all obligations to the ACI DIP Lender have been paid in full and providing that all rights of subrogation hereunder shall be postponed to the right of subrogation of IQ under the IQ Guarantee Offer, and, for greater certainty, no subrogee shall have any rights over or in respect of the IQ Guarantee Offer. In the event that, following the repayment in full of the ACI DIP Lender in circumstances where that payment is made, wholly or in part, from net proceeds of the Existing Security of an Impaired Secured Creditor (the "**First Impaired Secured Creditor**"), such Impaired Secured Creditor enforces its right of subrogation to the ACI DIP Charge and realizes net proceeds from the Existing Security of another Impaired Secured Creditor (the "**Second Impaired Secured Creditor**"), the Second Impaired Secured Creditor shall not be able to enforce its right of subrogation to the ACI DIP Charge until all obligations to the First Impaired Secured Creditor have been paid in full. In the event that more than one Impaired Secured Creditor is subrogated to the ACI DIP Charge as a result of a payment to the ACI DIP Lender, such Impaired Secured Creditors shall rank pari passu as subrogees, rateably in accordance with the extent to which each of them is subrogated to the ACI DIP Charge. The allocation of the burden of the ACI DIP Charge amongst the assets and creditors shall be determined by subsequent application to the Court if necessary.

[21.1] **DECLARES** that for the purposes of paragraphs 1, 5, 10, 12, 13, 17 and 18 of the present Order, the term "Abitibi Petitioners" shall not include Abitibi-Consolidated (U.K.) Inc. added to the schedule of Abitibi Petitioners by Order of this Court on November 10, 2009;

22 *ORDERS* the provisional execution of this Order notwithstanding any appeal and without the necessity of furnishing any security.

23 *WITHOUT COSTS.*

Schedule "A" — Abitibi Petitioners

1. *ABITIBI-CONSOLIDATED INC.*

2. *ABITIBI-CONSOLIDATED COMPANY OF CANADA*

3. *3224112 NOVA SCOTIA LIMITED*

4. *MARKETING DONOHUE INC.*

5. *ABITIBI-CONSOLIDATED CANADIAN OFFICE PRODUCTS HOLDINGS INC.*

6. *3834328 CANADA INC.*

7. *6169678 CANADA INC.*

8. *4042140 CANADA INC.*

9. *DONOHUE RECYCLING INC.*

10. *1508756 ONTARIO INC.*

11. *3217925 NOVA SCOTIA COMPANY*

12. *LA TUQUE FOREST PRODUCTS INC.*

13. *ABITIBI-CONSOLIDATED NOVA SCOTIA INCORPORATED*

14. *SAGUENAY FOREST PRODUCTS INC.*

15. *TERRA NOVA EXPLORATIONS LTD.*

16. *THE JONQUIERE PULP COMPANY*

17. *THE INTERNATIONAL BRIDGE AND TERMINAL COMPANY*

18. *SCRAMBLE MINING LTD.*

19. *9150-3383 QUÉBEC INC.*

20. *ABITIBI-CONSOLIDATED (U.K.) INC.*

Schedule "B" — Bowater Petitioners

1. *BOWATER CANADIAN HOLDINGS INC.*

2. *BOWATER CANADA FINANCE CORPORATION*

3. *BOWATER CANADIAN LIMITED*

4. *3231378 NOVA SCOTIA COMPANY*

5. *ABITIBIBOWATER CANADA INC.*

6. *BOWATER CANADA TREASURY CORPORATION*

7. *BOWATER CANADIAN FOREST PRODUCTS INC.*

8. *BOWATER SHELBURNE CORPORATION*

9. *BOWATER LAHAVE CORPORATION*

10. *ST-MAURICE RIVER DRIVE COMPANY LIMITED*

11. *BOWATER TREATED WOOD INC.*

12. *CANEXEL HARDBOARD INC.*

13. *9068-9050 QUÉBEC INC.*

14. *ALLIANCE FOREST PRODUCTS (2001) INC.*

15. *BOWATER BELLEDUNE SAWMILL INC.*

16. *BOWATER MARITIMES INC.*

17. *BOWATER MITIS INC.*

18. *BOWATER GUÉRETTE INC.*

19. *BOWATER COUTURIER INC.*

Schedule "C" — 18.6 CCAA Petitioners

1. *ABITIBIBOWATER INC.*

2. *ABITIBIBOWATER US HOLDING 1 CORP.*

3. *BOWATER VENTURES INC.*

4. *BOWATER INCORPORATED*

5. *BOWATER NUWAY INC.*

6. *BOWATER NUWAY MID-STATES INC.*

7. *CATAWBA PROPERTY HOLDINGS LLC*

8. *BOWATER FINANCE COMPANY INC.*

9. *BOWATER SOUTH AMERICAN HOLDINGS INCORPORATED*

10. *BOWATER AMERICA INC.*

11. *LAKE SUPERIOR FOREST PRODUCTS INC.*

12. *BOWATER NEWSPRINT SOUTH LLC*

13. *BOWATER NEWSPRINT SOUTH OPERATIONS LLC*

14. *BOWATER FINANCE II, LLC*

15. *BOWATER ALABAMA LLC*

16. *COOSA PINES GOLF CLUB HOLDINGS LLC*

Footnotes

1 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*").

2 In this Judgment, all capitalized terms not otherwise defined have the meaning ascribed thereto in either: 1) the *Second Amended Initial Order* issued by the Court on May 6, 2009; 2) the *Motion for the Distribution by the Monitor of Certain Proceeds of the MPCo Sale Transaction to U.S. Bank National Association, Indenture and Collateral Trustee for the Senior Secured Noteholders* (the "*Distribution Motion*") of the Ad Hoc Committee of the Senior Secured Noteholders and U.S. Bank National Association, Indenture Trustee for the Senior Secured Notes (respectively, the "*Committee*" and "*Trustee*", collectively the "*SSNs*") dated October 6, 2009; or 3) the Abitibi Petitioners' *Re-Amended Motion for the Approval of a Second DIP Financing in Respect of the Abitibi Petitioners and for the Distribution of Certain Proceeds of the MPCo Sale Transaction to the Trustee for the Senior Secured Notes* (the "*ULC DIP Motion*") dated November 9, 2009.

3 *Re-Amended Motion for the Approval of a Second DIP Financing in Respect of the Abitibi Petitioners and for the Distribution of Certain Proceeds of the MPCo Sale Transaction to the Trustee for the Senior Secured Notes* dated November 9, 2009 (the "*ULC DIP Motion*").

4 See Monitor's 19th Report dated October 27, 2009.

5 See Monitor's 19th Report dated October 27, 2009.

6 See Monitor's 19th Report dated October 27, 2009.

7 See *Re Windsor Machine & Stamping Ltd.*, 2009 CarswellOnt 4505 (Ont. Sup. Ct.); *Re Rol-Land Farms Limited* (October 5, 2009), Toronto 08-CL-7889 (Ont. Sup. Ct.); and *Re Pangeo Pharma Inc.*, (August 14, 2003), Montreal 500-11-021037-037 (Que. Sup. Ct.).

8 *Re Windsor Machine & Stamping Ltd.*, 2009 CarswellOnt 4505 (Ont. Sup. Ct.).

End of Document

TAB 14

CITATION: Harbert Distressed Investment Fund, L.P. v. General Chemical Canada Ltd., 2007 ONCA 600
DATE: 20070906
DOCKET: C45784 C45800

COURT OF APPEAL FOR ONTARIO

GOUDGE, BLAIR AND MACFARLAND JJ.A.

BETWEEN:

HARBERT DISTRESSED INVESTMENT FUND, L.P. and HARBERT DISTRESSED INVESTMENT MASTER FUND, LTD.

Plaintiffs (Respondents)

And

GENERAL CHEMICAL CANADA LTD.

Defendant (Respondent)

Mark Zigler, Andrew J. Hatnay, Fred L. Myers and Lawrence J. Swartz for the appellant Morneau Sobeco Limited. Partnership in its capacity as administrator of General Chemical Canada Ltd.'s pension plans

Ronald Carr for the appellant Ministry of the Environment

Ashley John Taylor for Pricewaterhouse Coopers Inc., the interim receiver of General Chemical Canada Ltd.

Richard B. Swan, Robert Staley, and Linda Visser for the respondents Harbinger Capital Partners Fund, L.P. and Harbinger Capital Partners Master Fund I, Ltd.

Tycho M.J. Manson for Honeywell ASCa Inc.

Heard: March 21 and 22, 2007

On appeal from the order of Justice Ruth E. Mesbur of the Superior Court of Justice, dated July 28, 2006, with reasons reported at (2006) 22 C.B.R. (5th) 298.

GOUDGE J.A.:

[1] The respondents, the two Harbert Funds ("Harbert")[1], are a secured creditor of General Chemical Canada Ltd. ("GCCL"), which was placed in bankruptcy effective November 18, 2005. Its interim receiver has accumulated $6.5 million from GCCL's operating assets, including cash, accounts receivable and inventory, and seeks the court's authorization to make an interim distribution from these funds to Harbert, as secured creditor, in the amount of $3.75 million.

[2] This proposal is opposed by the administrator of GCCL's two pension plans and by the Ontario Ministry of the Environment ("MOE").

[3] The administrator says that, pursuant to s. 57(5) of the *Pension Benefits Act*, R.S.O. 1990, c. P.8 ("*PBA*"), it holds a lien over GCCL's assets in relation to GCCL's unpaid pension contributions, and this gives it priority over Harbert's security.

[4] MOE says that GCCL has failed to comply with provincial environmental safety requirements, and there will therefore be significant cleanup costs that exceed GCCL's financial assurance given under the *Environmental Protection Act*, R.S.O. 1990, c. E.19 ("EPA"). MOE says that GCCL and its interim receiver have an obligation to meet these costs, and that any distribution at this stage is premature and may leave no assets for environmental remediation.

[5] At first instance, the motion judge found against both the administrator and MOE, and authorized the interim distribution to Harbert. Both the administrator and MOE have appealed. The appeals were argued together, although they each raise their own issues. I therefore propose to address each separately.

[6] In each case, I agree with the result reached by the motion judge, although for somewhat different reasons.

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[1] The two Harbert Funds have since changed their names to Harbinger Capital Partners Fund, L.P. and Harbinger Capital Partners Master Fund I, Ltd.

THE ADMINISTRATOR'S APPEAL

[7] Until January 2005, when it discontinued operations, GCCL manufactured calcium chloride at its plant in Amherstburg, Ontario. On March 31, 2004, Harbert advanced $9 million to GCCL, secured against GCCL's operating assets. No one questions that Harbert's security instruments were properly registered under the *Personal Property Security Act*, R.S.O. 1990, c. P.10 ("*PPSA*"), and constitute a perfected security interest in GCCL's personal property as of that date.

[8] However, GCCL developed financial problems, and on January 19, 2005, it was ordered under the protection of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, ("*CCAA*").

[9] By November 2005, it became clear that GCCL's attempt to restructure while under *CCAA* protection was unlikely to succeed. Effective November 18, 2005, pursuant to the order of C. Campbell J. of the Superior Court of Justice, GCCL made an assignment in bankruptcy and an interim receiver of certain of its assets was appointed pursuant to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

[10] GCCL maintained two pension plans for its employees, one for its salaried employees and one for its unionized employees. Both are defined benefit plans and both are completely employer funded.

[11] Until about January 2004, GCCL was making the contributions due under both plans. At that point, it began to fall into arrears, and by March 31, 2004, the date Harbert's security was perfected, that shortfall was $1,356,230 for the union plan and $107,499 for the salaried plan.

[12] After March 31, 2004, while GCCL made several sporadic payments to both plans, the shortfalls continued to grow. The only exception to this pattern occurred in October and November 2004 when GCCL made payments to both plans in excess of the required contributions for those months. That excess amounted to $2,164,492 for the union plan and $113,472 for the salaried plan. Thereafter, the shortfalls continued to grow, although nothing in the *CCAA* order prohibited GCCL from making the required contributions.

[13] The *PBA* requires that every pension plan have an administrator. Up until its bankruptcy on November 18, 2005, GCCL served in that role for both plans. However on December 8, 2005, the Ontario Superintendent of Financial Services, in his capacity as the regulator of Ontario registered pension plans, appointed Morneau Sobeco Limited Partnership (the "Administrator") as the administrator of both plans pursuant to s. 71 of the *PBA*.

[14] This proceeding arose because the interim receiver has now collected $6.5 million from GCCL's general operations. These funds do not come from any of GCCL's real estate holdings. Since it views Harbert as the only creditor with security against GCCL's operating assets, the interim proposes to distribute $3.75 million of those funds to Harbert as secured creditor.

[15] The Administrator opposes the motion approving that payment because of the security it says it has under the *PBA*. At the same time, the Administrator moved for a declaration that its security pursuant to s. 57(5) of the *PBA* makes it a secured creditor ranking ahead of Harbert's security.

[16] The motion judge granted the interim receiver's motion and dismissed that of the Administrator. She found that the lien created by s. 57(5) of the *PBA* was not enforceable under the *BIA* because it was an attempt by the province to do indirectly what it could not do directly, namely to legislate priority under the *BIA* for unpaid pension plan contributions.

[17] She drew support for this conclusion from Bill C-55, *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, 1st Sess., 38th Parl., 2005 (assented to 25 November 2005), which has been passed by the federal Parliament but not proclaimed, and which would create a "pension charge" over a debtor's assets for unpaid pension plan contributions of the kind in issue here. The motion judge concluded that since this amendment must be designed to alter the current state of the law, no such security presently exists.

[18] The motion judge went on to find that even if the Administrator held a lien effective for *BIA* purposes, the rule in *Devaynes v. Noble (Clayton's Case)* (1816), 1 Mer. 572, 35 E.R. 781 (C.A.), should be applied, and absent any evident intention at the time of the excess contributions paid by GCCL in October and November 2004 as to which particular deficiencies they were to apply to, they should be applied to reduce the earliest pension indebtedness. This would eliminate all shortfalls prior to the effective date of Harbert's security for which the Administrator might have had priority.

ANALYSIS

[19] The important section of the *PBA* for the Administrator's appeal is s. 57. Section 57(1) applies to employee contributions required under a pension plan and hence is not relevant here, where both plans are completely employer funded. The same is true of s. 57(4), which applies where a pension plan is wound up, since that has not yet happened in this case.

[20] The critical subsections are ss. 57(3) and 57(5). They read as follows:

> (3) An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to the employer contributions due and not paid into the pension fund.
>
> …
>
> (5) The administrator of the pension plan has a lien and charge on the assets of the employer in an amount equal to the amounts deemed to be held in trust under subsections (1), (3) and (4).

[21] The *BIA* sets out a scheme of priorities governing payment by creditors in the event of a bankruptcy. Section 67(1)(a) excludes from the bankrupt's property any property held by the bankrupt in trust for another person. Then, in distributing the bankrupt's estate, those meeting the definition of "secured creditor" in s. 2 of the *BIA* are paid first, generally on the basis that the earliest security is paid first. Then, s. 136(1) sets out a list of other creditors who, subject to the rights of secured creditors, are to be preferred and paid in the priority listed in that subsection. Finally, unsecured creditors share *pari passu* in what remains.

[22] The critical definition in the *BIA* is that of "secured creditor" defined in s. 2. It reads:

> "secured creditor" means a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property as security for a debt due or accruing due to the person from the debtor, or a person whose claim is based on, or secured by, a negotiable instrumental held as collateral security and on which the debtor is only indirectly or secondarily liable, and includes
>
> (a) a person who has a right of retention or a prior claim constituting a real right, within the meaning of the *Civil Code of Québec* or any other statute of the Province of Quebec, on or against the property of the debtor or any part of that property, or
>
> (b) any of

> (i) the vendor or any property sold to the debtor under a conditional or instalment sale,
>
> (ii) the purchaser of any property from the debtor subject to a right of redemption, or
>
> (iii) the trustee of a trust constituted by the debtor to secure the performance of an obligation,
>
> if the exercise of the person's rights is subject to the provision of Book Six of the *Civil Code of Québec* entitled *Prior Claims and Hypothecs* that deal with the exercise of hypothecary rights; [emphasis added]

[23] There is no doubt that once GCCL began to fall short of its required contributions to both pension funds in January 2004, s. 57(3) of the *PBA* applied and GCCL was deemed to hold in trust for the beneficiaries of those plans an amount equal to its unpaid contributions.

[24] However, the Administrator concedes that this section does not create a trust as contemplated by s. 67(1)(a) of the *BIA* and excludes nothing from the estate of GCCL for the purposes of distribution under the *BIA*. All parties to this appeal agree that that consequence is dictated by *British Columbia v. Henfrey Samson Belair Ltd.*, [1989] 2 S.C.R. 24. That case held that s. 67(1)(a) of the *BIA* does not apply to statutory deemed trusts that lack the common law attributes of a trust, such as the requirement that the property be kept separate and not commingled with the bankrupt's own property.

[25] The Administrator's argument, however, is simply that the lien and charge accorded to it by s. 57(5) of the *PBA* is separate from the deemed trust created by s. 57(3), and is effective for the purposes of the *BIA*, even if the deemed trust is not.

[26] For this argument to succeed, however, the first step is that, as holder of a s. 57(5) statutory lien, the Administrator must meet the definition of secured creditor in the *BIA*.

[27] In my view, it cannot do so. The Administrator does not hold a charge or lien as security for a debt due or accruing due to the Administrator from the debtor GCCL.

[28] The *PBA* provides that the Administrator is the person that administrates the pension plan. The Administrator is to ensure that the pension plan, and the pension fund maintained to provide benefits under the plan, are administered in accordance with the *PBA* and its regulations (s. 19(1)). In doing so, the Administrator must exercise the care, diligence and skill that a person of ordinary prudence would exercise in dealing with the

property of another person (s. 22(1)). Section 56(1) requires the Administrator to ensure that all contributions due under the pension plan are paid to the pension fund when due. To facilitate this, the Administrator is given the right to commence legal proceedings to obtain payment of contributions due under the pension plan (s. 59).

[29] Section 55(2) sets out the employer's obligation to make contributions under a pension plan. It reads as follows:

> (2) An employer required to make contributions under a pension plan, or a person or entity required to make contributions under a pension plan on behalf of an employer, shall make the contributions in accordance with the prescribed requirements for funding and shall make the contributions in the prescribed manner and at the prescribed times,
>
> (a) to the pension fund; or
>
> (b) if pension benefits under the pension plan are paid by an insurance company, to the insurance company that is the administrator of the pension plan.

[30] None of these provisions suggest that the contributions owed by GCCL are a debt due to the Administrator. Rather, GCCL's legal obligation was to make the contributions to the pension funds that were required under the pension plans. Nor is there even any indication that the contributions are owed to the Administrator to be held in trust for the pension funds. Rather, the legislation contemplates that those contributions are owed to the pension funds pursuant to the pension plans, and are not the property of the Administrator.

[31] The Administrator's right to commence legal proceedings simply permits it to seek to compel the employer to pay the contributions to the pension funds due under the pension plans.

[32] The consequence of this is that the lien and charge accorded to the Administrator secures the employer's obligation to pay the unpaid contributions required by the pension plans to the pension funds. It does not secure a debt owed to the Administrator. Hence s. 57(5) does not qualify the Administrator as a secured creditor for the purposes of the *BIA*.

[33] That conclusion is sufficient to dispose of the Administrator's appeal, and makes it unnecessary to decide whether, if s. 57(5) of the *PBA* qualifies the Administrator as a

secured creditor for the purposes of the *BIA*, that section is rendered inapplicable because its effect is to reorder the priorities for payment set out in the *BIA*.

[34] The motion judge found that s. 57(5) has this effect. Relying on *Husky Oil Operations Ltd. v. Minister of National Revenue*, [1995] 3 S.C.R. 453, she held that s. 57(5) does not give the Administrator an enforceable lien under the *BIA*. As I have indicated, I need not address this issue. Although it was not argued, my reluctance to do so is heightened because it does not appear that a notice of constitutional question was served, even though the issue squarely raises the constitutional applicability of s. 57(5) of the *PBA* in these circumstances.

[35] As I have said, the motion judge also decided that even if s. 57(5) of the *PBA* gives the Administrator a lien and charge that is effective for *BIA* purposes, the debt thus secured should be treated as having been fully discharged by the overpayments made in October and November 2004. The motion judge reached that conclusion by applying the general principle in *Clayton's Case* to treat these excess payments as being applied to the earliest arrears in GCCL's required contributions, consequently eliminating the shortfall that existed on March 31, 2004. This would exhaust the effect of any priority the Administrator's secured claim would have over Harbert's secured claim because it arose before Harbert registered its security on March 31, 2004. Any secured claim by the Administrator for GCCL contributions required after that date but not paid would rank after Harbert's secured interest.

[36] Given my conclusion that the Administrator is not a secured creditor for *BIA* purposes, I need not address this issue either. In any event, on the assumption she makes of constitutionality, I would not interfere with the motion judge's conclusion. In my view, it was open to her on the facts before her to adopt the evidentiary presumption suggested by the rule in *Clayton's Case*. Since there is no evidence from GCCL, the then administrator, concerning what indebtedness the overpayments in October and November 2004 were intended to apply to, and that the present Administrator was not in place when those overpayments were received or applied, I would conclude that the motion judge could properly resort to the default presumption suggested by the general principle. Nor do I see any equitable basis for not doing so. This is not a case where there is any suggestion that such a conclusion would reflect any attempt by GCCL to adversely affect pension plan members.

[37] To summarize, I would dismiss the Administrator's appeal for the reasons I have given.

THE MOE APPEAL

[38] At the root of the MOE opposition to the distribution ordered by the motion judge is one simple fact. In manufacturing calcium chloride at its Amherstburg plant, GCCL produced by-products that were deposited in what was called the Soda Ash Settling Basin ("SASB"). It is now a contaminated site and remedial costs could reach $64 million. The MOE is anxious to see that GCCL assets are available to pay for this clean up.

[39] The MOE has a number of regulatory tools to use to protect the environment. In 1997, it issued a Provisional Certificate of Approval to GCCL which *inter alia* required GCCL to provide for the closure of the SASB and assurance that the costs of the closure would be paid for by the company. The latter was provided by a financial assurance that was subject to annual review by the MOE. In March 2004, the MOE accepted $3.4 million as the appropriate amount required of GCCL. Since then, the MOE has vastly increased its estimate of the cost of clean up, to as much as $64 million.

[40] The *CCAA* order stayed the MOE's right to review and increase GCCL's financial assurance. In August 2005, the MOE sought the lifting of the stay to permit it to increase that amount, but it was unsuccessful.

[41] The November 18, 2005 order appointing the interim receiver did not exempt either the receiver or GCCL from compliance with environmental regulations, nor did it prevent the MOE from issuing orders in respect of the SASB. However, that order expressly excluded the SASB from the property of GCCL over which the interim receiver was appointed.

[42] It is uncontested that Harbert's security does not extend to the SASB. Rather, it expressly excludes it. Moreover, the MOE does not assert a security interest in GCCL's operating assets over which Harbert does have security. Section 14.06(7) of the *BIA* does give the MOE a security interest in the bankruptcy in GCCL's contaminated real property and any contiguous property related to the activity that caused the environmental damage. This security ranks above any other security against the same property.

[43] However, it is the MOE's position that the decision to distribute on an interim basis should be guided by what is fair and reasonable having regard to all stakeholders, akin to the considerations applied under the *CCAA*. It argues that the "polluter pays" principle for environmental remediation requires no distribution until there can be an assurance that GCCL's assets are sufficient to clean up the SASB.

[44] The motion judge found against the MOE and concluded that, in her discretion, the distribution should proceed. She held that the MOE was an unsecured creditor in relation to the GCCL operating assets that generated the funds to be paid out, that to permit the MOE to effect a delay in distribution would be to give it a *quasi* priority over other unsecured creditors, and in any event it has security over the SASB. She also found

no evidence of any imminent environmental effects or any non-compliance by GCCL with any environmental regulations.

[45] In this court, the MOE repeats its arguments below and raises, as it did there, the case of *Panamericana De Bienes Y Servicios (Receiver of) v. Northern Badger Oil and Gas Ltd.* (1991), 81 D.L.R. (4th) 280 (Alta. C.A.). In that case, the court found that provincial environmental legislation concerning oilwell clean up costs did not conflict with the scheme of distribution under the *BIA*, and had to be complied with even though that reduced the amounts otherwise available for distribution in the bankruptcy.

[46] I agree with the motion judge that the reasoning in that case has been overtaken because of subsequent amendments to the *BIA*. Section 14.06(7) now expressly provides for priority to be accorded to environmental clean up costs and s. 14.06(8) now ensures that a claim against the debtor for environmental clean up costs is a provable claim. Neither were in effect at the time of *Panamericana*. To give effect to provincial environmental legislation in the face of these amendments to the *BIA* would impermissibly affect the scheme of priorities in the federal legislation.

[47] Beyond that, I see no basis to interfere with the discretion of the motion judge to order the interim distribution. Harbert is the only creditor secured against the GCCL operating assets that generated the funds for distribution. In that regard, the MOE is an unsecured creditor. The MOE does, however, have security against GCCL's real property, as provided by the *BIA*. Harbert's security does not extend to the SASB, nor does the interim receiver have possession of that real property. The motion judge found no evidence of non-compliance with environmental orders nor any threat of imminent environmental harm. In these circumstances, I see nothing unreasonable in the interim distribution going forward.

[48] I would therefore dismiss the MOE appeal. In the result, both appeals are dismissed.

[49] Neither the Administrator nor Harbert sought costs. While the receiver sought costs against the MOE, the latter neither sought costs nor invited an adverse costs award. In the circumstances, I would order no costs to any party.

RELEASED: September 6, 2007 "STG"

"S.T. Goudge J.A."
"I agree R.A. Blair J.A."
"I agree J. MacFarland J.A."

COURT FILE NO.: 05-CL-6160
DATE: 20060728

SUPERIOR COURT OF JUSTICE - ONTARIO
COMMERCIAL LIST

RE: **HARBERT DISTRESSED INVESTMENT FUND, L.P. and HARBERT DISTRESSED INVESTMENT MASTER FUND, LTD.**, Plaintiffs

A N D:

GENERAL CHEMICAL CANADA LTD., Defendant

BEFORE: MESBUR J.

COUNSEL: Ashley John Taylor, for PricewaterhouseCoopers Inc., the Interim Receiver

Robert Staley, Kevin Zych and Alan Gardner, for the Plaintiffs

Mark Zigler and Andrew Hatnay for Morneau Sobeco Limited Partnership in its capacity as Administrator of General Chemical Canada Ltd.'s pension plans

Ronald Carr for the Ministry of the Environment

Tim Hogan for Sherway Contracting

Tyco Manson for Honeywell ASCA

HEARD: May 29 and 30, 2006

REASONS FOR DECISION

Nature of the motions and the positions of the parties:

[1] This series of motions arose out of the interim receiver, PricewaterhouseCoopers (PwC) moving to request the court's authorization to make an interim distribution of $3.75 million to the plaintiffs ("Harbert") as secured creditor of the defendant, General Chemical. The funds in question are a portion of the $6.5 million that has been generated from General Chemical's working capital assets, that is, its cash, accounts receivable and inventory, as opposed to being derived from any of its real estate assets. Harbert supports the interim receiver's motion, while the Administrator of General

Chemical's two pension plans, and the Ministry of the Environment (MOE) both oppose it.

[2] The Administrator takes the position that it has a lien over General Chemical's assets in relation to unpaid pension contributions and plan solvency issues, and that its lien takes priority over Harbert's alleged security. On this basis, it says there should be no interim distribution to Harbert. The Administrator goes even further, and says, first, that the Harbert secured loan transaction is really an equity acquisition disguised as debt, and should be treated as what it really is, and enjoy no priority at all. Second, it says that even if the transaction created valid security for Harbert, in priority to all or part of what it says is the Administrator's lien, the equities of the case require that Harbert's security be subordinated to the interests of the pension plan. The Administrator moves for declarations that it has a valid lien and charge on General Chemical's assets, and is a secured creditor ranking in priority to Harbert.

[3] The MOE says that General Chemical and PwC as interim receiver have both statutory and court-ordered obligations to comply with provincial environmental safety requirements. It says they have failed to do so, and as a result, there are significant potential environmental cleanup costs, that exceed General Chemical's financial assurance under the *Environmental Protection Act* [1](EPA). The MOE says that General Chemical has an obligation to meet those costs, and takes the position that until the environmental obligations have been quantified, it is premature to make any distribution to anyone, since to do so may have the result of leaving no assets to meet the costs of any environmental cleanup.

[4] In order to understand the positions of the parties, it will be helpful to outline some of the history of the General Chemical, and its American parent, their respective restructuring efforts, and General Chemical's underlying business.

Some background facts:

[5] General Chemical produces calcium chloride, a chemical that is used primarily for melting ice in winter, and controlling dust in summer. It is a Canadian company, and is a wholly owned subsidiary of an American company, General Chemical Industrial Products Inc. ("Industrial"). General Chemical's business operations create significant chemical by-products, which in turn, create environmental issues in and around their plant facilities.

[6] General Chemical's Canadian operations are centred primarily in a plant in Amherstberg, Ontario.

[1] R.S.O. 1990 c. E.19

Industrial's Chapter 11 proceedings

[7] In December of 2003, General Chemical's parent, Industrial, entered Chapter 11 protection pursuant to the United States Bankruptcy Code. Harbert was an Industrial bondholder. As such, it was a creditor of Industrial, and thus participated in the Chapter 11 proceedings. Industrial's initial debtor in possession (DIP) financing had been provided by JP Morgan Chase Bank in December of 2003. The DIP facility consisted of both a revolving line of credit, which the parties refer to as the Revolver, and a term loan facility.

[8] Under the JP Morgan Chase Revolver, General Chemical is described as a primary borrower, and is entitled to take advances under the facility. Industrial is also a primary borrower, with similar rights. Each company provided security and also cross-guaranteed the obligations of the other. The term loan was advanced only to Industrial, secured against Industrial's assets, with General Chemical guaranteeing those obligations, and providing security for its guarantee.

[9] JP Morgan continued as DIP lender until March of 2004, when it no longer was prepared to participate in Industrial's restructuring. At that point, Harbert took over that role.

Harbert's financing of Industrial and General Chemical

[10] On March 31, 2004, General Chemical entered into a number of financing arrangements with Harbert. These also comprised a revolving loan facility and a term loan facility. Both were structured in the same way as the JP Morgan Chase Bank loans. Both were secured against the assets of both General Chemical and Industrial. Both companies cross-guaranteed the other's liabilities.

[11] As was the case with the JP Morgan Chase financing, the Harbert term loan was made to Industrial only, with Industrial granting security in relation to the term loan, and General Chemical guaranteeing the term loan as well. General Chemical's guarantee was secured against General Chemical's assets.

[12] The Revolver was stated as being to both General Chemical and Industrial. Harbert advanced $9 million to General Chemical on March 31, 2004, which in turn was used to pay JP Morgan Chase, to retire the Revolver. This had the effect of paying off Industrial's DIP financing, and provided exit capital for Industrial to emerge from Chapter 11 protection on April 1, 2004. Industrial's restructuring was successful, and it continues to operate as an active company.

[13] After the $9 million advance on March 31, 2004, General Chemical drew down on the Revolver between April 4, 2004 and January 10, 2005, for an additional $7.5 million. During the same period, General Chemical made repayments totalling just over $3,070,000 on the Revolver.

[14] Harbert registered all the necessary financing statements under the *Personal Property Security Act* [2] (PPSA) on March 31, 2004. All parties concede that Harbert's security instruments have been properly registered under the PPSA, and that on that basis, Harbert has a technically perfected security interest in General Chemical's personal property, with effect on March 31, 2004.

General Chemical's CCAA proceedings

[15] General Chemical has not fared as well as Industrial. In January of 2004, it began to accumulate some arrears in its two pension plans. It also had difficulties in paying its accounts payable, its inter-company debt and its lenders. By January of 2005 it was in CCAA protection, with the usual stay of proceedings while it attempted to restructure or liquidate. From January to September of 2005 General Chemical actively tried to sell the company as a going concern. Unfortunately, their efforts failed, due in large part to ongoing environmental issues at the Amherstberg facility. For the purpose of these motions it is General Chemical's financial problems in relation to environmental costs and pension arrears that are most relevant.

Environmental issues at General Chemical

[16] As part of its manufacture of calcium chloride, certain by-products of the process are sent to a large depression on the Amherstberg property. This is called the Soda Ash Settling Basin, or SASB. The SASB is a contaminated site, with significant costs to remedy. These range from an estimated $3.5 million to as high as $64 million. Harbert's security expressly excludes the SASB. It is obviously more liability than asset.

[17] These potential environmental clean up costs were a significant factor in General Chemical's inability to restructure with a viable going concern sale. Environmental issues continue to be an ongoing issue.

[18] The MOE has significant powers in terms of forcing compliance with environmental standards. One of its tools, utilized with enterprises with significant environmental concerns, is obtaining what is called a Financial Assurance from a contaminating company. In the case of General Chemical, it has been dealing with the MOE under a Provisional Certificate of Approval, which was issued by the Director of the MOE to General Chemical in April 1997. Among other things, it requires General

[2] R.S.O. 1990 c. P.10

Chemical to provide for the closure of the SASB, and for financial assurance for the costs of closing it.

[19] The amount of the Financial Assurance is subject to annual review. Based on the information General Chemical provided to the MOE in March of 2004, the Director accepted $3.4 million in financial assurance at that time. The Ministry now takes the position that the costs of properly closing the SASB will be far in excess of the financial assurance amount, and may be as high as $64 million. Apparently the closure would take place over a number of years, and the cost is highly dependent on the supply of gypsum, which is required to cap the SASB.

[20] The initial CCAA order had the usual broad stay provisions. However, as far as the MOE's position was concerned, paragraph 8 of the initial order contained the following exceptions to the stay:

> "THIS COURT ORDERS that notwithstanding any other provision herein, but subject to paragraphs 9 and 10 herein:
>
> (a) with respect to Her Majesty the Queen in right of Ontario ("her Majesty"), as represented by the respective Ministers of Labour ("MOL") and of the Environment ("MOE"), and the Attorney General ("MAG"), each of which includes their respective employees and agents, this Order does not:
>
> (i) alleviate or alter in any way the obligations of the Applicant or any of its directors, officers and employees under any workplace health and safety statutes or regulations or instruments thereunder, administered by MOL or MOE, respectively;
>
> (ii) prohibit, restrain or in any way interfere with the exercise of the jurisdiction of MOE or MAG with respect to matters involving existing or imminent significant environmental effects (the "Environmental Matters"); or
>
> ...
>
> (iii)without detracting from the generality of paragraph 8(a), MOE, MAG and the Environmental Review Tribunal are permitted to immediately and at any time, with respect to Environmental Matters, exercise their powers and perform their duties under environmental statutes and regulations and instruments thereunder and the *Provincial Offences Act* (Ontario), including, without limitation, obtaining warrants and the commencement of enforcement proceedings thereunder;"

[21] The MOE's right to review General Chemical's financial assurance and require changes to it was, however, stayed by the CCAA order. In fact, the MOE sought of lifting of the stay for that very purpose in August of 2005. At that time it requested

the authority to amend General Chemical's Provisional Certificate of Approval to require further financial assurance from General Chemical concerning the cost of closing the SASB, and to have that additional financial assurance provided in cash. The MOE's motion was denied.

[22] In addition to these environmental cleanup issues, General Chemical also had problems maintaining proper funding for its pension plans.

The General Chemical Pension Plans

[23] General Chemical maintains two separate pension plans for its employees. One is a plan for its salaried employees, and the other is for its unionized employees. I will refer to the first as the "Salaried Plan", and other as the "Union Plan". Both plans are defined benefit pension plans, and both are completely employer-funded.

[24] The *Pension Benefits Act* [3] (PBA) requires pension plans to calculate the necessary amounts to fund what are called current service costs, and special payments. Actuaries conduct actuarial valuations of the pension plan's assets and liabilities in order to determine, on an annual basis, the amounts necessary to pay these current service costs, and the special payments. Included in the special payments are calculations to determine if there is any unfunded liability in the plan, or solvency deficiency. The actuary is also required to calculate what are called wind-up payments. Wind-up payments are to ensure the plan will have sufficient assets to provide the promised benefits to employees if the plan is wound up.

[25] Until about January of 2004 General Chemical was making all the necessary payments due under the plans. It made the monthly payments of $495,448 under the Union Plan, and $35,833 under the Salaried Plan. These monthly payments included both the current service costs and special payments. In January 2004, General Chemical first fell into arrears, paying only $86,743 to the Union Plan, and nothing to the Salaried Plan. At March 31, 2004, the date Harbert's security was perfected, there was a total of $1,356,230 owing to the Union Plan, and a total of $107,499 owing to the Salaried Plan.

[26] In 2005, General Chemical did not pay any special payments to either pension plan. The initial CCAA order permitted the company, but did not require it, to make payments to the plans during the CCAA process, except for the special payments. At the end of October, 2005, there were outstanding special payments owed to the Union Plan in the amount of $4,130,510 and to the Salaried Plan in the amount of $159,790, for a total outstanding of $4,290,300.

[3] R.S.O. 1990 c. P.8

[27] In addition to these sums, the Administrator points out that since General Chemical is now bankrupt, the PBA in section 69(1)(c) permits the Superintendent to make an order requiring the pension plans to be wound up, in whole or in part. The actuaries also make a calculation concerning the amount required to fund the plans on a winding up. The Administrator has calculated that the net deficiency, as of the date of bankruptcy was $47,648,626 for the Union Plan, and $14,178,692 for the Salaried Plan. As of the date of these motions, the Superintendent had not yet made any order pursuant to s. 69(1)(c), and thus there is currently no requirement for the winding up of the plans, although such an order is anticipated and will be requested by the Administrator.

The appointment of an interim receiver and General Chemical's Bankruptcy

[28] By November of last year, it became apparent to Harbert that General Chemical's restructuring efforts were not likely to succeed. Their attempts at a going concern sale failed. Harbert therefore moved to terminate the CCAA proceedings, and have an interim receiver appointed pursuant to s. 47 of the *Bankruptcy and Insolvency Act*. At the same time, General Chemical wished to assign itself into bankruptcy. By this point, the Superintendent of Financial Services had taken over General Chemical's pension plans. The Superintendent opposed the appointment of an interim receiver and a bankruptcy, as did the MOE. They did so primarily on the basis that their positions might be diminished by a bankruptcy and the imposition of the provisions of the *Bankruptcy and Insolvency Act.* They wished their rights to be determined in the context of CCAA proceedings, rather than under the BIA.

[29] On the motions before Campbell J. the Superintendent also sought payment of unremitted employer pension contributions to General Chemical's pension plans. Although current service payments were up to date at the time of the hearing before Campbell J, other payments were not.

[30] On November 18, 2005 Campbell J appointed the interim receiver and made the bankruptcy order, notwithstanding the Superintendent's and MOE's opposition. He rejected the Superintendent's motion for payment of funds to the pension plan prior to terminating the CCAA proceeding. He faulted the Superintendent for failing to move for the relief it sought earlier in the process. Having found that there was nothing improper in the CCAA proceedings, he granted the orders, stating that to do otherwise "would be to negate both CCAA proceedings and bankruptcy proceedings by preventing creditors from pursuing a process of equitable distribution of the debtor's property as they believe it to be when making their decisions."

[31] Justice Campbell found that the relief the MOE sought was similar to that of the Superintendent. He dismissed their motion for much the same reason, finding that since the MOE did not raise its objections while there was a prospect of a going

concern sale, it should not be permitted to effect a pre-emptive position by postponing a bankruptcy. He did, however, comment on the unsettled state of the law regarding the "constitutional interplay between the provincial environmental legislation and federal bankruptcy and insolvency law."

The appointment of an Administrator pursuant to the PBA

[32] Every pension plan must have an administrator. Prior to its bankruptcy, General Chemical was the administrator of its two pension plans. Once General Chemical was in CCAA protection, the Superintendent of Financial Services took over as the administrator of General Chemical's two pension plans. After General Chemical's bankruptcy, the Superintendent appointed Morneau Sobeco Limited as the Administrator of the General Chemical pension plans.

The current proposed distribution

[33] PwC, in its role as General Chemical's interim receiver, has now collected $6.5 million from General Chemical's general operations. Since the funds do not come from any of General Chemical's real estate holdings, and since Harbert is the only creditor with security against all General Chemical's operations, PwC proposes to distribute $3.75 million of those funds to Harbert.

[34] The MOE views a distribution now as being premature. Although the MOE concedes any secured claim it has attaches only to General Chemical's land, it still maintains that both General Chemical and the Receiver have an obligation to take care of the cost of the environmental cleanup before any funds are paid out to any creditor. It says that to allow any money to be paid out to any creditor before the environmental issues can be resolved will have the result of saddling the citizens of the Province of Ontario with these costs, if there are no funds remaining to pay the cost of cleanup.

[35] As far as the pension plan deficiencies are concerned, the Administrator takes the position that it has priority over Harbert, for the various reasons I have set out in paragraph 2 above.

[36] It is against this general factual background that I turn to the applicable law and an analysis of it.

The law and analysis:

[37] Disposing of the issues here requires an analysis of the interplay among the provisions of the *Bankruptcy and Insolvency Act*, the *Pension Benefits Act*, the *Environmental Protection Act*, and the *Personal Property Security Act*. I will set out

briefly the most salient features of each of these statutes that bear on these motions. In this context, it must be remembered that the BIA, as federal legislation, occupies the field of bankruptcy and insolvency, and has paramountcy over the other statutes, which are all provincial legislation. Central to this discussion is the concept that provincial legislation may not, either directly or indirectly, seek to reorder the priorities set out in the BIA. [4]

[38] For the purpose of the discussion, it is important to remember that the BIA does two things. First, it allows a secured creditor to give notice and have a receiver appointed pursuant to the terms of its security in order to realize on the security. [5] Second, it sets out a scheme of priorities, which governs payment to the various creditors. The general rule is that unsecured creditors are paid subject to the rights of secured creditors. As to secured creditors, the order of payment is generally made on the basis of the timing of their respective securities in the same collateral, with those creditors having the earliest security being paid first. Unsecured creditors share in whatever remains, on a *pari passu* basis. There are some special rules giving special protection concerning environmental issues, and also concerning wage claims. There are also special rules concerning Crown claims, preferred creditors, and how they are dealt with.

[39] As to environmental issues, the Crown's claim "for costs of remedying any environmental condition or environmental damage affecting real property" is given priority under section 14.06(7) of the *Bankruptcy and Insolvency Act*, and is a statutory exception to the general scheme under the BIA. Any claim by either the federal or provincial Crown for the costs of remedying any environmental condition or damage affecting real property is "secured by a charge on the real property and on any other real property of the debtor that is contiguous" to the real property, and "is related to the activity that caused the environmental damage or charge." Subsection 14.06(7)(a) makes the Crown's charge enforceable in the same way as a mortgage or charge on real property, and subsection (b) makes this Crown charge against the realty rank above any other claim, right or charge against the property.

[40] The EPA permits the MOE to issue orders to a polluter to clean up polluted property. This right extends, in some limited circumstances, to issuing these kinds of orders to interim receivers or trustees in bankruptcy, but only in exceptional circumstances, namely, where there is danger to the health or safety of any person, there is an impairment or serious risk of impairment of the quality of the natural

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[4] *Husky Oil Operations Ltd. v. Minister of National Revenue,* [1995] 3 S.C.R. 453

[5] See sections 244 and 47 of the BIA. Where a secured creditor has given, or is about to give notice, of its intention to enforce its security under s. 244(1) of the BIA, the court may appoint a trustee as interim receiver over the debtor's property, if the court is satisfied that the appointment is necessary to protect the debtor's estate or the interests of the creditor. Here, C. Campbell J appointed PwC in that capacity, pursuant to Harbert's s. 47 notice.

environment, or there is injury or damage or serious risk of injury or damage to any property or to any pant or animal life. [6] Unless these exceptional circumstances exist, the MOE is prohibited from issuing orders to receivers or trustees unless the order arises from the gross negligence or wilful misconduct of the receiver or trustee.[7]

[41] The PBA is designed to protect the pension rights of workers in Ontario. It sets up various methods by which unpaid pension payments are to be secured. It creates what is called a "deemed trust" against the employer's assets in an amount equal to the unpaid payments. [8] It goes further, and creates a lien in favour of the pension administrator. This is described as a "lien and charge" on the employer's assets, in an amount equal to the amounts deemed to be held in trust by the deemed trust provisions.[9]

[42] The PPSA sets up a scheme for "perfection" of security interests in personal property. An unperfected security interest will be subordinated to a perfected security interest in the same collateral.[10] While registration of a financing statement is the way to perfect general security agreements, such as those at issue in this case, this does not apply to certain statutory liens, which do not require registration.[11] The PPSA, and thus its registration requirements, do not apply to either statutory liens, or deemed trusts arising out of a statute. Thus, the PPSA does not apply to the deemed trusts or statutory liens established by the PBA in favour of the pension administrator. In situations where a debtor is bankrupt, however, the PPSA says that these statutory liens arise on the effective date of the bankruptcy. [12]

[43] I propose to discuss the law, and analyse the positions of the parties by first considering the validity of the MOE's position. Having done that, I will consider the Administrator's position, first by determining whether it has a lien. If I decide that it does, I will then consider whether its lien has priority in whole or in part over Harbert's security. I will also decide whether, as the Administrator suggests, the Harbert transaction is really equity acquisition, not debt. Lastly, I will consider the Administrator's submission that even if Harbert has priority, its priority should be subordinated to the interests of the pension plans for equitable reasons.

The MOE's position:

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[6] EPA, s. 168.20(1)
[7] EPA, s. 168.19(1)
[8] PBA, s. 57(1),(3) and (4)
[9] PBA, s. 57(5)
[10] *Personal Property Security Act,* section 20(1)(a)(i)
[11] PPSA, ss 4(1)(a) and (b)
[12] PPSA, section 20(2)(a)(i)

[44] One of the roles of the MOE is to protect the public against environmental hazards. For this reason, the MOE is given special status in the BIA. As stated above, it has security on the contaminated property, and any contiguous property related to the activity that caused the contamination. The MOE's security is enforceable in the same way as a mortgage, and has priority over any other security in the same property.

[45] Here, the MOE has valid concerns about the sufficiency of its security on realty to cover all the considerable cleanup costs relating to the SASB. Its position is that the current Financial Assurance it has from General Chemical is insufficient to meet any shortfall from the secured real property to pay the cleanup costs. In fact, in the CCAA proceedings, the MOE sought unsuccessfully to have the CCAA stay lifted to increase General Chemical's Financial Assurance. What it is seeking to do here, in delaying any distribution, is much the same.

[46] Apart from its security, the MOE is an unsecured creditor like any other, and must prove its claim in the General Chemical bankruptcy. To permit the MOE to delay distribution to a secured creditor would give the MOE a quasi-priority to other unsecured creditors, and would defeat or delay the legitimate interests of secured creditors. I have been pointed to no precedent that would permit the court to do so.

[47] The MOE argues that the court should apply similar principles here to those applied in CCAA proceedings, in considering whether a distribution should be made. The CCAA proceedings have been terminated. General Chemical is in bankruptcy, and its first secured creditor has had an interim receiver appointed. I fail to see how CCAA principles are applicable here.

[48] Here, the assets that have generated the funds to be paid out are not derived from any real property that General Chemical owns. The MOE can have no lien or priority in relation to these funds.

[49] The MOE suggests that somehow both General Chemical and the Receiver have an additional obligation to meet the unsecured liability for environmental cleanup. As I see it, this position runs contrary to both the initial CCAA order, the current order appointing the interim receiver, and the provisions of the BIA.

[50] The initial CCAA order provided that General Chemical's obligations concerning any statutes or regulations administered by the MOE were not alleviated or altered in any way by the CCAA stay. The order also did not prohibit the MOE from exercising its jurisdiction with respect to "matters involving existing or imminent significant environmental effects". There is no suggestion General Chemical has failed to comply with any statutes or regulations. There is also no evidence of any imminent environmental effects.

[51] The order appointing the interim receiver contains the following provision:

> "9. THIS COURT ORDERS that all rights and remedies against the Debtor or affecting the Property are hereby stayed and suspending pending written consent of the Receiver or leave of this Court, provided however that nothing in this paragraph shall (a) empower the Receiver or the Debtor to carry on any business which the Debtor is not lawfully entitled to carry on, (b) exempt the Receiver or the Debtor from compliance with statutory or regulatory provisions relating to health, safety or the environmental or other mandatory statutory or regulatory provisions of applicable law ... or (e) prevent the Ministry of the Environment from issuing orders or other instruments pursuant to the *Environmental Protection Act* in respect of this Property.

[52] Lastly, the BIA itself has provisions concerning the rights and obligations of trustees and receivers concerning environmental issues. These are found in section 14.06. First, section 14.06(1.1) provides that the section applies equally to a bankruptcy trustee, a proposal trustee and an interim receiver within the meaning of subsection 243(2).

[53] The section goes on to state in subsection (2) that a trustee is not personally liable for any environmental damage that arose prior to the trustee's appointment, or after the trustee's appointment unless the condition arose because of the trustee's gross negligence or wilful misconduct.

[54] The MOE suggests that the provisions of the order appointing the interim receiver are sufficient to require both General Chemical and the receiver to comply with all provisions of the *Environmental Protection Act*, including complying with orders issued by the MOE. It says that because the current financial assurance is insufficient to meet the costs of cleanup for the SASB, it should be able to require an increase in the financial assurance, and require the company to pay it. This may well be correct, as far as it goes. The position fails to consider, however, the status of the obligation in relation to the rights of secured creditors. The provisions of the order do not create a secured claim for the MOE's orders, nor do they suggest the MOE has priority over the interests of secured creditors.

[55] As I read these provisions, and consider their interrelationships, I am drawn to the conclusion that first, none of General Chemical, the interim receiver or the trustee have any personal obligation to pay the cost of environmental cleanup; and second, the MOE can be nothing more than an unsecured creditor in the General Chemical bankruptcy for cleanup costs to the extent General Chemical's real property and the existing financial assurance are insufficient to meet those costs. As a result, I see no basis on which the court can delay the requested distribution on the bases advanced by the MOE.

[56] In coming to this conclusion I have considered the MOE's argument concerning the applicability of the *Panamericana* decision[13] from the Alberta Court of Appeal. In *Panamericana,* the Alberta Court of Appeal found that a bankrupt company had an inchoate liability for the ultimate abandonment (or clean closure) of certain oil wells. The court found that the liability for the wells passed to the receiver-manager, who had been appointed pursuant to a secured creditor's security under s. 47 of the BIA. The court held that the Alberta statutory requirements concerning abandonment did not directly conflict with the scheme of distribution under the BIA, and thus the doctrine of paramountcy had no application. Even though this result meant less money for distribution in the bankruptcy, the court imposed the obligation.

[57] At first glance, the reasoning in *Panamericana* seems somewhat compelling. However, it must be kept in mind that it was decided before section 14.06(7) of the BIA was enacted. It seems to me that section 14.06(7) now specifically legislates concerning the issue of priority of any environmental cleanup costs. That being the case, the provisions of the BIA must take precedence over any provincial legislation. The field has now been occupied, and any provincial effort to extend further rights to the Crown in respect of environmental contamination must be viewed as being in conflict with the provisions of the federal statute.

[58] In addition, Harbert points out that *Panamericana* can also be distinguished on the basis that in *Panamericana* the interim receiver had taken possession of the contaminated wells pursuant to the secured creditor's security. Here, the Harbert security does not include the SASB, and thus the interim receiver is not in possession of the contaminated site.

[59] As to the MOE's suggestion that the receiver and the company have free-standing personal obligations to remedy the contamination, that argument must also fail, in light of the fact that there is no suggestion the receiver has created environmental problems through gross negligence or wilful misconduct.

[60] For these reasons, I reject the MOE's suggestion that an interim distribution should be delayed. I turn now to the more complex and vexing questions raised by the position of the Administrator.

Does the Administrator have a lien?

[61] The Administrator relies on section 57(5) of the PBA to support its position that it has a valid lien against General Chemical's assets. Section 57 of the PBA deals

[13] *Panamericana de Bienes y Servicos SA v. Northern Badger Oil & Gas Ltd.,* 8 C.B.R. (3d) 31 (Alberta Court of Appeal)

with both trust obligations of employers regarding pension contributions, and the creation of a lien and charge in favour of a plan administrator.

[62] Since both of General Chemical's pension plans are employer-funded, it is not necessary to consider section 57(1), which deals with the employer's obligation to hold employee contributions in trust until they are paid into the plan. In employer-funded plans, there are trust provisions relating to employer contributions. These are set out in section 57(3), which reads as follows:

> An employer who is required to pay contributions to a pension fund shall be deemed to hold in trust for the beneficiaries of the pension pan an amount of money equal to the to the employer contributions due and not paid not the pension fund.

[63] In subsection (4), section 57 goes on to make provision for what happens on a wind up of a pension plan. Section 57(4) says:

> Where a pension plan is wound up in whole or in part, an employer who is required to pay contributions to the pension fund shall be deemed to hold in trust for the beneficiaries of the pension plan an amount of money equal to employer contributions accrued to the date of the wind up but not yet due under the plan or regulations.

[64] In the context of subsection (4), it must be remembered that General Chemical's pension plans have not yet been wound up, although the Administrator expects that the Superintendent of Financial Services will no doubt request their winding up.

[65] Lastly, in section 57(5), the PBA creates a lien and charge on an employer's assets in an amount equal to the amounts deemed to be held in trust under the trust provisions of sections 57(1), (3) and (4). Section 57(5) provides:

> The administrator of the pension plan has a lien and charge on the assets of the employer in an amount equal to the amounts deemed to be held in trust under subsections (1), (3) and (4).

[66] Since General Chemical is now bankrupt, these provisions must be considered in the context of the BIA. All parties agree that the trust provisions created by sections 57(3) and (4) do not create true "trusts" of the sort contemplated by section 67(1)(a) of the BIA. That section excludes from the bankrupt's property, "property held by the bankrupt in trust for any other person". In *British Columbia v. Henfrey Samson Belair Ltd.* [14] , the Supreme Court of Canada held that s. 67(1)(a) did

[14] [1989] 2 S.C.R. 24

not apply to statutory deemed trusts that lack the common law attributes of a trust. One of these attributes is that the property be kept separate, and not commingled with the bankrupt's own property. Clearly, a deemed trust does not meet this necessary criterion. Part of the court's reasoning was that to permit a provincially created statutory trust to operate as a "true" trust would permit provinces "to create their own priorities under the *Bankruptcy Act* and to invite a differential scheme of distribution on bankruptcy from province to province."[15]

[67] Here, the question is whether the PBA's section 57(6) lien is similarly tainted. The Administrator takes the position that the lien is quite independent of the deemed trust provisions, and is no different than other provincially created statutory liens that create secured creditor status in a bankruptcy. For example, the Administrator points to the lien on cattle created by the British Columbia *Cattle Lien Act,* the lien on real property in favour of the Law Society created by Ontario's *Legal Aid Act,* a lien on horses or other animals created under Ontario's *Innkeepers Act*, or municipality that has a lien on real property for overdue taxes. All of these create secured debt under the BIA.[16] A significant difference, however, between these liens and the PBA statutory lien is that all these others are registered,[17] or require possession[18] of the collateral in order to be effective.

[68] Harbert says that the lien provisions of the PBA were designed specifically to do indirectly what the trust provisions could not; that is, protect unpaid pension payments as secured claims in a bankruptcy. Harbert says two things suggest that the lien was expressly created to attempt to do indirectly what the trust provisions had failed to do directly.

[69] First, Harbert points to Ontario's 1980 *Report of the Royal Commission on the Status of Pensions in Ontario.* This Report noted that although the PBA "purports" to create a trust for unpaid contributions, the Act "makes no provisions for the enforcement of the trust by statutory lien or other such means, and it is doubtful if the trust as presently constituted is enforceable." The Report also recognized that "to the extent that such legislation falls within the federal bankruptcy jurisdiction, any provincial initiative to enforce the trust may be beyond the legislative authority of the province".

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[15] *Ibid.* at 33

[16] See, for example, *Canada Exotic Cattle Breeders Co-op (Re)*, (1979), 103 D.L.R. (3d) 112 (BCSC); *Re Calla*, (1975), 9 O.R. (2d) 755 (S.C.); *Re Rauf* (1974) 5 O.R.(2d) 31 (Ont. S.C.); *Re Rockland Chocolate and Cocoa Co.* (1921), 61 D.L.R. 363 (Ont. S.C.); *Condominium Plan No. 7620380 v. Edmonton* (2001), 24 C.B.R. (4th) 9 (Alta. Q.B.)

[17] for example, s. 48(1) of the *Legal Aid Services Act*, *1998* .S.O. 1998 c. 26 permits the Corporation to register a lien against the land of the person to whom a legal aid certificate is provided. S. 48(2) permits the lien to be enforced in the same manner as a mortgage.

[18] *Cattle Lien Act,* R.S.B.C. 1960, c44; section 3 of the *Innkeepers Act,* R.S.O. 1970 c.223, now R.S.O. 1990 c. I.7, the former *Mechanics and Wage Earners' Line Act,* R.S.O. 1914 c.140, as referred to in *Re Rockland Chocolate,* above

The Report went on to state that existing bankruptcy legislation did not give any special protection to pension contributions, and that pension plan trustees could claim as ordinary creditors only.[19] The Report discussed proposed amendments to the BIA that might remedy the situation, but concluded at the present time there was no mechanism to protect these unpaid claims on a bankruptcy or insolvency. The Report therefore recommended that it would "seem advisable for the Government of Ontario to create by statute a lien to enforce the trust protection ... We recommend that legislation for this purpose be passed as soon as possible." [20]

[70] I am drawn to the conclusion, therefore, that the lien provisions were enacted to try to enforce the deemed trust provisions on bankruptcy, and thus circumvent the difficulties encountered by the PBA trust provisions on bankruptcy. That being the case, it appears the lien provisions are an indirect attempt by the province to do indirectly what it could not do directly, and to legislate priorities for unpaid pension plan contributions. This is a matter solely within the sphere of federal legislation.[21]

[71] Second, Harbert notes that Bill C-55, if proclaimed in force by the federal government, will amend the BIA to create a "Pension Charge" over all of a debtor's assets to secure first, any unremitted employee pension contributions, second, any unpaid employer-defined pension and contributions, and third, any unpaid normal costs as required by the applicable pension legislation. The proposed amendments in Bill C-55 exclude funding deficiencies under defined benefit plans from the proposed Pension Charge. Bill C-55 has not yet been proclaimed in force. I assume, however, that it is designed to alter the current state of the law. That being the case, I must conclude that the Pension Charge provisions are intended to create a charge where none existed before. That being the case, I am drawn to the conclusion that under the current provisions of the BIA there can be no lien or charge related to unpaid pension contributions. The proposed amendments must be designed to remedy something. Parliament will only pass or amend legislation for an intelligible purpose.[22]

[72] As I see it, under the current BIA, the Administrator has no enforceable lien under the BIA. I am supported in this view by the decision of Farley J. in *Re Ivaco Inc.*[23] In *Ivaco,* Farley J expressly held that "an administrator's lien pursuant to s. 57(5) of the *Pension Benefits Act* (Ontario) would also be ineffective in a bankruptcy ... Even

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[19] Report of the Royal Commission on the Status of Pensions in Ontario, Vol. 2 pp 148-149
[20] *Ibid.*
[21] *Re Deloitte Haskins & Sells Ltd. And Workers' Compensation Board et al.,* [1985] S.C.R. 785
[22] Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes,* 4th ed., (Markham:Butterworths, 2002) at 472-473
[23] (2005), 12 C.B.R. (5th) 213 (S.C.J.), leave to appeal allowed 10 November 2005. For other cases taking a similar view, see Re *Graphicshoppe Limited,* (2005), 78 O.R. (3d) 401 (C.A.); *Re United Air Lines Inc.* (2005), 9 C.B.R. (5th) 159; *Continental Casualty Co. v. MacLeod-Stedman Inc.* (1996), 141 D.L.R. (4th) 36 (Man.C.A.)

though provincial legislation may deem something to be a lien, that deeming does not make it a s. 2(1) BIA lien." Campbell J followed this reasoning in his decision in this case to appoint the interim receiver. I, too, accept and follow their reasoning, and must conclude the Administrator has no lien.

[73] If I am wrong on the issue of whether there is a lien or not, I will also consider the Administrator's position as if a lien were created, and address the issues of priority of such a lien in the context of all the arguments the Administrator has submitted.

Would a lien have priority over Harbert's security?

[74] The question of priority is dependent on many things. As far as Harbert is concerned, their rights are easy to determine. There is no question that their security interest was perfected on March 31, 2004. The real question is whether the pension plan administrator would have had lien rights prior to this date, and if so, in what amount.

[75] The BIA sets out a scheme of distribution among secured, preferred and unsecured creditors. It does not, however, determine the priorities of secured creditors among themselves. In bankruptcy, priorities between competing secured creditors in the same collateral are determined according to the "first in time" rule, subject to the principles of equity. Therefore, where the equities between two competing secured creditors are equal, the creditor whose security arose first will have priority over the other.

[76] It is clear that Harbert's security was effective March 31, 2004, when it was perfected under the PPSA. As between Harbert and the Administrator, the question, then, is if the Administrator had a lien, did it have a lien prior to March 31, 2004, and if so, in what amount.

[77] The Administrator's lien is described in s. 57(5) of the PBA as being "in an amount equal to the amounts deemed to be held in trust." The deemed trusts are in "an amount of money equal to the employer contributions due and not paid into the pension fund." According to the Administrator's material, the employer contributions due and not paid as of March 31, 2004 totalled $1,356,230 for the Union Plan, and $107,499 for the Salaried Plan. Thus, the amount of the Administrator's lien that would have predated Harbert's security totalled $1,463,729. That, however, is not the end of the inquiry. The next issue is to consider the positions of the parties at the date of the bankruptcy, and to determine what was owing to each on that date in respect of their March 31 2004 secured debt.

[78] In the case of the Administrator, matters are complicated by the fact that between March 31, 2004 and the date of the bankruptcy, further deficiencies accrued in both plans, and significant payments were also made. The question is whether the payments should be applied to the earliest deficiencies or not. The Administrator takes the position that it can decide where to apply the payments, while Harbert suggests that the court should apply the rule in *Clayton's* case[24], and credit the payments against the earliest deficiencies.

[79] For the Union Plan, General Chemical should have paid $495,448 per month to cover both the current service costs and special payments due under the plan. As I have stated, at March 31, 2004, there were arrears of $1,356,230 in relation to this plan. Following March 31, 2004, General Chemical made some monthly payments to the Union Plan, but they were never in the total amount due. In June, September and December, they made no payments at all. By the end of December, the cumulative total of the arrears was $2,452,485. General Chemical did, however, make significant payments in both October and November of 2004. They paid $1,577,694 in each of those months, or $1,082,246 more than the amount due in each of those months. If those payments are applied to the oldest arrears, then General Chemical would have paid off the amount owing on the portion of the Administrator's lien that would have priority over Harbert.

[80] Similarly, for the Salaried Plan, General Chemical made significant payments in both October and November of 2004. These payments exceeded the total monthly obligation for these two months by $113,472. Again, if these excess payments are applied to the earliest arrears, they would have discharged the Administrator's prior lien.

[81] The question, therefore, is how the excess October and November payments should be allocated. The general rule, enunciated in *Clayton's Case*, is that the court matches the repayment of various related debts so that the earliest payment goes toward the satisfaction of the earliest debts. This is also referred to as the "first in first out" rule. Cumming J. helpfully enunciated the rule in the *Sagaz* case [25] as follows:

> The rule is that when a debtor makes a payment to a creditor he may appropriate it to any debt owed to that creditor he pleases. The creditor must apply the payment accordingly. If the debtor does not so appropriate his payment, then the creditor has the right to do so to any debt he wishes. However, in the event there is no appropriation made by either party and there is one continuous account of several items, the rule is that the payment will be credited against the indebtedness according to the priority of time.

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[24] *Devaynes v. Noble* (1816), 1 Mer.572 (Eng. Ch. Div.)
[25] *671122 Ontario Ltd. V. Sagaz Industries Canada Inc.* [2000] O.J. No. 77 (S.C.J), aff'd (Ont.C.A.)

[82] Here, there is no evidence from either General Chemical or the pension plans that either indicated any intention of how the payments were to be allocated when they were paid. It is true that the Administrator now seeks, some 18 months after the last payment was made, to allocate it to later debt. Surely the intention must be manifest at or around the time the payment is made, not so long after the fact. Absent any evident intention from anyone at the time the payments were made, I apply the general rule, and find the payments were made to reduce the earliest pension indebtedness, thus retiring any lien for which the Administrator would have had priority.

[83] I therefore conclude that even if the Administrator had a lien in priority to Harbert, it would have been discharged by the payments made in October and November of 2004. Harbert would be entitled to be paid on its security first, with the balance of the Administrator's lien ranking behind Harbert.

[84] This leaves the Administrator's remaining two arguments. First I will consider its argument that the Harbert financing was really an equity acquisition, rather than true debt.

Is the Harbert transaction really equity, not debt?

[85] The Administrator suggests that because Harbert became the majority shareholder of Industrial as part of its financing, with the right to appoint three members of its Board of Directors, its financing of Industrial was essentially an equity purchase, rather than debt. The Administrator says that as a result, Harbert is not really a creditor, and should have no priority at all. I disagree.

[86] As Harbert points out, the initial DIP financing JP Morgan Stanley Chase provided was in virtually identical terms to the financing Harbert replaced it with. All the financing was court-approved in the Chapter 11 proceedings in the USA. Contrary to what the Administrator says, all the loans were cross-collateralized on the assets of both Industrial and General Chemical.

[87] The Administrator also suggests that General Chemical did not receive any benefit from the Harbert loans, but rather, all money was advanced to Industrial, but secured only on the assets of General Chemical. The evidence does not bear this out. As I have already mentioned, all the loans were cross-collateralized on the assets of both Industrial and General Chemical. Also, the Revolver records show General Chemical draws on the facility quite apart from the $9 million used to repay the Industrial DIP loan. There were both draws, and repayments throughout the period from April 2004 to January of 2005, all of which suggests to me that General Chemical was using the facility for corporate purposes, in the usual fashion revolving lines of credit are used. Lastly, the Guarantee and Security Agreement, executed by both Industrial and General Chemical expressly recites that both borrowers "are engaged in

related businesses, and...will derive substantial direct and indirect benefit from the making of the extensions of credit under the Credit Agreement."[26] Similarly, the Introductory Statement to the Revolver loan states that the proceeds of the loans will be used to repay all outstanding obligations under the DIP facility, and "for working capital and other general corporate purposes of the Borrowers and their respective subsidiaries."[27] I conclude from all of this that General Chemical received direct benefit from the Harbert's loan facility.

[88] The Administrator also suggests that the Harbert financing documents lack true indicia of debt, such as repayment terms, interest and the like. This is not the case. The Revolver sets interest rates, and payment dates. It requires both Industrial and General Chemical to repay both principal and interest. The Revolver also requires principal payments in the amount of 75% of what is defined as "Excess Cash Flow", to ensure speedier repayment of the debt. All of these things point to true debt, not an equity acquisition.

[89] As a result, I cannot conclude that the Harbert financing was designed solely to finance an equity investment in Industrial, as opposed to being a true loan to General Chemical. This aspect of the Administrator's argument must therefore fail.

Do the equities require an inversion of priorities?

[90] The Administrator takes the position that even if Harbert is a secured lender, with priority over the Administrator, the equities require the subordination of Harbert's security to the position of the Administrator, and thus of the pension plans. The equitable jurisdiction of the bankruptcy court is likely broad enough to permit this.[28]

[91] In *Re Christian Brothers*, the court relied on three requirements for a successful claim of equitable subordination, as these had been articulated in both the

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[26] Guarantee and Security Agreement dated March 31, 2004, recitals, page 512 of Harbert's responding motion record.

[27] Introductory Statement to the Revolving Credit Agreement among General Chemical Industrial Products Inc., General Chemical Canada Ltd. As Borrowers, and The Banks Party Hereto, and HSBC Bank USA, as Administrative Agent and Canadian Administrative Agent, dated as of March 31, 2004, found at page 190 of Harbert's responding motion record.

[28] Section 183 of the BIA vests the bankruptcy court with equitable jurisdiction. See *Re Christian Brothers of Ireland in Canada* (2004) O.R. (3d) 507 (S.C.J.) in which the court held there is no jurisdictional or constitutional impediment to the court utilizing the concept of equitable subordination if it feels it is appropriate to do so.

American case of *Mobile Steel* [29], and by the Supreme Court of Canada in *Canadian Deposit Insurance Corp.* [30] These requirements are the following:

> (1) The Claimant must have engaged in some type of inequitable conduct;
>
> (2) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the Claimant; and
>
> (3) Equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

[92] It should be remembered, however, that equitable subordination has been used sparingly by Canadian courts. Inequitable conduct requires the court to conduct a broad inquiry into the conduct of the parties to determine what is right and just in all the circumstances. The test is a "sense of simple fairness." [31] Equitable subordination is not used, however, to "adjust the legally valid claim of an innocent party who asserts the claim in good faith merely because the Court perceives the result as inequitable." [32] The court must therefore be careful not to approach the question on the basis of who the competing creditors are (i.e., the "innocent and vulnerable" employees, as opposed to the "sophisticated and wealthy" lender), but rather by the nature of their respective claims.

[93] In support of its position concerning "inequitable conduct", the Administrator relies on the fact that as a result of the March 31, 2004 transaction, Harbert become the controlling shareholder of Industrial, General Chemical's parent. The Administrator claims that the Harbert $9 million advance was used to pay off Industrial's DIP loan, rather than directly benefit General Chemical. It says that as a result it would be inequitable for Harbert to be given priority over General Chemical's assets, when General Chemical did not benefit from the advance on the Revolver. To allow this would be at the expense of the members and retirees of the pension plans.

[94] The essence of the Administrator's claim in relation to this part of the test is that General Chemical had no benefit from the Harbert loans. As I have already stated, the evidence does not bear this out. I am persuaded on the basis of Appendices "C" and "D" to the Monitor's twelfth report to the court (attached to the Interim Receiver's first report to the court), that General Chemical itself took draws on the Revolver, quite apart from the $9 million draw used to repay the Industrial DIP loan. That being the case, General Chemical did benefit from the loans.

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[29] *Benjamin v. Diamond (In re Mobile Steel Co.),* 563 F.2d 692 (5th Cir. 1977), Court of Appeal for the First Circuit, per Clark J.
[30] *Canadian Deposit Insurance Corp. v. Canadian Commercial Bank* (1992) 97 D.L.R. (4th) 385 (S.C.C.)
[31] *Re Blue Range Resource Corp.* (2002) 15 C.B.R. (4th) 196 (Alberta Q.B.)
[32] *United States v. Noland (In re First Truck Lines, Inc.)* 48 F.3rd 210 (1995)

[95] It therefore cannot be said that it would be inequitable for Harbert to be given priority for its loans to General Chemical. Since the Administrator must meet all three elements of the test, its failure to meet this branch is sufficient to dispose of the issue of equitable subordination. For the sake of completeness, however, I will deal with the two remaining aspects of the question as well.

[96] As to the requirement for injury to creditors or an unfair advantage to Harbert, the Administrator says that the true nature of the Harbert loans gives Harbert an unfair advantage over the other General Chemical creditors. There is no question that as first secured lender, Harbert has an advantage over the other creditors. That is the nature of having this kind of security. It is true that the interests of General Chemical's innocent and vulnerable employees and pensioners will be adversely affected by Harbert's priority. I cannot see, however, that Harbert's advantage is an *unfair* advantage, of the sort contemplated by the case law. This part of the argument must fail as well.

[97] Lastly, equitable subordination is only permitted where it would not run contrary to the statutory scheme in the *Bankruptcy and Insolvency Act*. As the Administrator points out, Canadian courts have shown a willingness to apply the principle of equitable subordination where the ranking provisions of the BIA are not applicable.[33] As the court put it in *Bulut,* the court will not apply the doctrine of equitable subordination to alter a *statutory* scheme for determining priorities among creditors. Here, if the Administrator had a lien, the issue of priority between its security and Harbert's would lie outside the BIA. The BIA does not set out a scheme of priorities among secured creditors; it merely says that secured creditors are to be paid in priority to unsecured creditors.

[98] While the Administrator could meet the third branch of the test, its failure to meet the other two is sufficient to defeat the claim for equitable subordination. As a result, I do not view this as an appropriate case to employ the doctrine of equitable subordination.

Disposition:

[99] For these reasons, the interim receiver's motion is granted, and an order will go authorizing the interim receiver to pay out to Harbert the sum of $3.75 million on account of their secured debt, from the $6 million proceeds the interim receiver currently holds. The interim receiver's motion for similar relief and for the approval of the Receiver's First Report to the Court and the activities of the Receiver described therein is also granted. The Administrator's motion is dismissed.

[33] See *Christian Brothers,* supra, and *Bulut v. Brampton* (2000), 48 O.R.(3d) 108 (C.A.)

[100] As the parties have agreed, there will be no costs of any of the motions.

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MESBUR J.

TAB 15

Most Negative Treatment: Distinguished
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2010 SCC 60
Supreme Court of Canada

Ted Leroy Trucking [Century Services] Ltd., Re

2010 CarswellBC 3419, 2010 CarswellBC 3420, 2010 SCC 60, [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, [2011] 2 W.W.R. 383, [2011] B.C.W.L.D. 533, [2011] B.C.W.L.D. 534, 12 B.C.L.R. (5th) 1, 196 A.C.W.S. (3d) 27, 2011 D.T.C. 5006 (Eng.), 2011 G.T.C. 2006 (Eng.), 296 B.C.A.C. 1, 326 D.L.R. (4th) 577, 409 N.R. 201, 503 W.A.C. 1, 72 C.B.R. (5th) 170, J.E. 2011-5

Century Services Inc. (Appellant) and Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada (Respondent)

Deschamps J., McLachlin C.J.C., Binnie, LeBel, Fish, Abella, Charron, Rothstein, Cromwell JJ.

Heard: May 11, 2010
Judgment: December 16, 2010
Docket: 33239

Proceedings: reversing *Ted Leroy Trucking Ltd., Re* (2009), 2009 CarswellBC 1195, 2009 G.T.C. 2020 (Eng.), 2009 BCCA 205, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.); reversing *Ted Leroy Trucking Ltd., Re* (2008), 2008 CarswellBC 2895, 2008 BCSC 1805, [2008] G.S.T.C. 221, 2009 G.T.C. 2011 (Eng.) (B.C. S.C. [In Chambers])

Counsel: Mary I.A. Buttery, Owen J. James, Matthew J.G. Curtis for Appellant
Gordon Bourgard, David Jacyk, Michael J. Lema for Respondent

Subject: Estates and Trusts; Goods and Services Tax (GST); Tax — Miscellaneous; Insolvency

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Mansfield Alternative Investments II Corp., Re) 296 D.L.R. (4th) 135, *(*sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 92 O.R. (3d) 513, 45 C.B.R. (5th) 163, 47 B.L.R. (4th) 123 (Ont. C.A.) — considered

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s. 11 — considered

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s. 11(3) — referred to

s. 11(4) — referred to

s. 11(6) — referred to

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Generally — referred to

s. 67(2) — considered

s. 67(3) — considered

Canada Pension Plan, R.S.C. 1985, c. C-8
Generally — referred to

s. 23 — considered

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

s. 11 — considered

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 18.3(2) [en. 1997, c. 12, s. 125] — considered

s. 37(1) — considered

Employment Insurance Act, S.C. 1996, c. 23
Generally — referred to

s. 86(2) — referred to

s. 86(2.1) [en. 1998, c. 19, s. 266(1)] — referred to

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

s. 222 [en. 1990, c. 45, s. 12(1)] — considered

s. 222(1) [en. 1990, c. 45, s. 12(1)] — considered

s. 222(3) [en. 1990, c. 45, s. 12(1)] — considered

s. 222(3)(a) [en. 1990, c. 45, s. 12(1)] — considered

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.)
Generally — referred to

s. 227(4) — considered

s. 227(4.1) [en. 1998, c. 19, s. 226(1)] — considered

s. 227(4.1)(a) [en. 1998, c. 19, s. 226(1)] — considered

Statutes considered *Abella J.* (dissenting):

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

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

s. 11 — considered

s. 11(1) — considered

s. 11(3) — considered

s. 18.3(1) [en. 1997, c. 12, s. 125] — considered

s. 37(1) — considered

Excise Tax Act, R.S.C. 1985, c. E-15

Generally — referred to

s. 222 [en. 1990, c. 45, s. 12(1)] — considered

s. 222(3) [en. 1990, c. 45, s. 12(1)] — considered

Interpretation Act, R.S.C. 1985, c. I-21
s. 2(1)"enactment" — considered

s. 44(f) — considered

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

APPEAL by creditor from judgment reported at 2009 CarswellBC 1195, 2009 BCCA 205, [2009] G.S.T.C. 79, 98 B.C.L.R. (4th) 242, [2009] 12 W.W.R. 684, 270 B.C.A.C. 167, 454 W.A.C. 167, 2009 G.T.C. 2020 (Eng.) (B.C. C.A.), allowing Crown's appeal from dismissal of application for immediate payment of tax debt.

***Deschamps J.*:**

1 For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

1. Facts and Decisions of the Courts Below

2 Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

3 Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a deemed trust in favour of the Crown for amounts collected in respect of GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA*. However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA*. Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA*. The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

4 On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

5 On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA*. The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, [2009] G.S.T.C. 79, 270 B.C.A.C. 167 (B.C. C.A.)). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

7 First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)*, [2005] G.S.T.C. 1, 73 O.R. (3d) 737 (Ont. C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA*.

8 Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by the Monitor in trust be paid to the Receiver General.

2. Issues

9 This appeal raises three broad issues which are addressed in turn:

(1) Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

(2) Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

(3) Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the Crown in respect of those funds?

3. Analysis

10 The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite ... any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

11 In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will

be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

3.1 Purpose and Scope of Insolvency Law

12 Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

13 Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute — it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

14 Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below, the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

15 As I will discuss at greater length below, the purpose of the *CCAA* — Canada's first reorganization statute — is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

16 Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659 (S.C.C.), at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

17 Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected — notably creditors and employees — and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

18 Early commentary and jurisprudence also endorsed the *CCAA's* remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

19 The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA's* objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

20 Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 15, October 3, 1991, at pp. 15:15-15:16).

21 In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (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. 481).

22 While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

23 Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c. 30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, ss. 25 and 29; see also *Alternative granite & marbre inc., Re*, 2009 SCC 49, [2009] 3 S.C.R. 286, [2009] G.S.T.C. 154 (S.C.C.); *Quebec (Deputy Minister of Revenue) c. Rainville* (1979), [1980] 1 S.C.R. 35 (S.C.C.); *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)).

24 With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, [2003] G.S.T.C. 193, 30 Alta. L.R. (4th) 192 (Alta. Q.B.), at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

3.2 GST Deemed Trust Under the CCAA

26 The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

27 The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts follow it (see, e.g., *Komunik Corp., Re*, 2009 QCCS 6332 (C.S. Que.), leave to appeal granted, 2010 QCCA 183 (C.A. Que.)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

28 The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as am. by S.C. 1997, c. 12, s. 126).

29 Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States

and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bank. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims.

30 Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at § 2).

31 With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

32 Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

33 In *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. Minister of National Revenue*, 2002 SCC 49, [2002] G.S.T.C. 23, [2002] 2 S.C.R. 720 (S.C.C.), this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

34 The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA*. The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

> **222.** (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed ....

35 The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an unsecured creditor in respect of GST only under the *BIA*. This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA*.

36 The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

37 Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

38 An analogous provision exists in the *BIA*, which, subject to the same specific exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

> **18.3** (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

39 Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions *(CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

> **18.4** (3) Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of
>
> (a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,
>
> (b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution ....

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

40 The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

41 A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219, [2003] G.S.T.C. 21 (Alta. Q.B.); *Gauntlet*

42 The Ontario Court of Appeal in *Ottawa Senators* rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

> The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

43 Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.), and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47-49).

44 Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

45 I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA*. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA*. Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

46 The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA*. Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

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

48 Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA*. The anomaly of this result is made manifest by the fact that it would deprive companies

of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

49 Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA*. However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA*.

50 It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA*. However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

51 Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3) was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA*.

52 I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

53 A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA*. Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA*.

54 I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect

to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

55 In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA's* override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

56 My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation. Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

3.3 Discretionary Power of a Court Supervising a CCAA Reorganization

57 Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List])), at para. 10, *per* Farley J.).

58 *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

59 Judicial discretion must of course be exercised in furtherance of the *CCAA's* purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
>
> (*Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57, *per* Doherty J.A., dissenting)

60 Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134 (B.C. C.A. [In Chambers]), at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9 (Alta. Q.B.), at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J. [Commercial List]), at para. 3; *Air Canada, Re* [2003 CarswellOnt 4967 (Ont. S.C.J. [Commercial List])], 2003 CanLII 49366, at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92

and 217-26). In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed (see, e.g., *Canadian Red Cross Society / Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

61 When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA*. Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

62 Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Gen. Div. [Commercial List]); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96 (B.C. C.A.), aff'g (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see Metcalfe & Mansfield). As well, the appointment of a Monitor to oversee the reorganization was originally a measure taken pursuant to the *CCAA's* supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

63 Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

64 The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (B.C. C.A.), at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.), paras. 31-33, *per* Blair J.A.).

65 I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts 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 (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

66 Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

67 The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

68 In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA*. Thus in s. 11 of

the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

69 The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)).

70 The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

71 It is well-established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA's* purposes, the ability to make it is within the discretion of a *CCAA* court.

72 The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

73 In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA*. Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA*.

74 It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

75 The question remains whether the order advanced the underlying purpose of the *CCAA*. The Court of Appeal held that it did not because the reorganization efforts had come to an end and the *CCAA* was accordingly spent. I disagree.

76 There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA*, the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA*. In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA*. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA's* objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA*. That section provides that the *CCAA*

"may be applied together with the provisions of any Act of Parliament... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA*.

77 The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

78 Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108 (Ont. C.A.), at paras. 62-63).

79 The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA*. Accordingly, creditors' incentives to prefer one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claims in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

80 Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA*. The court must do so in a manner that does not subvert the scheme of distribution under the *BIA*. Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA*. This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA*.

81 I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

3.4 Express Trust

82 The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

83 Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of

law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29 especially fn. 42).

84 Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order of April 29, 2008, sufficient to support an express trust.

85 At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

86 The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

87 Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008, denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

4. Conclusion

88 I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

89 For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

***Fish J. (concurring)*:**

I

90 I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

91 More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

92 I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

93 In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

94 Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

95 Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA* and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

96 In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* — or explicitly preserving — its effective operation.

97 This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

98 The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*") where s. 227(4) *creates* a deemed trust:

> **227 (4) Trust for moneys deducted** — Every person who deducts or withholds an amount under this Act is deemed, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, to hold the amount separate and apart from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act. [Here and below, the emphasis is of course my own.]

99 In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

> **(4.1) Extension of trust** — Notwithstanding any other provision of this Act, the *Bankruptcy and Insolvency Act* (except sections 81.1 and 81.2 of that Act), any other enactment of Canada, any enactment of a province or any other law, where at any time an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty in the manner and at the time provided under this Act, property of the person ... equal in value to the amount so deemed to be held in trust is deemed
>
> > (a) to be held, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, in trust for Her Majesty whether or not the property is subject to such a security interest, ...
> >
> > ...
>
> ... and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

100 The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

101 The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

> **67** (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
>
> (3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

102 Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA* deemed trust under *both* the *CCAA* and the *BIA* regimes.

103 The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).

104 As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) the *CCAA* and in s. 67(3) the *BIA*. In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.

105 The same is not true with regard to the deemed trust created under the *ETA*. Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust — or expressly provide for its continued operation — in either the *BIA* or the *CCAA*. The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

106 The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:

> **222. (1) [Deemed] Trust for amounts collected** — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
>
> ...
>
> **(3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, ...
>
> ...
>
> ... and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

107 Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.

108 In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA*. Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.

109 With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.), at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA*. Section 222 of the *ETA* does not break the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA*.

110 Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit — rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA*.

111 Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA*. Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.

112 Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA*. Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.

III

113 For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

***Abella J. (dissenting)*:**

114 The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*EIA*"), and specifically s. 222(3), gives priority during *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.

115 Section 11 [1] of the *CCAA* stated:

> **11**. (1) 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.

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

> **222 (3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
>
> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
>
> (b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest
>
> and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

116 Century Services argued that the *CCAA's* general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

> **18.3** (1) ... [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

117 As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

118 By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following comments of MacPherson J.A. in *Ottawa Senators*:

> The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act* .... The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

119 MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA*. Section 18.3(1) was not amended.

120 The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent with those

in the *BIA*. In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71, at pp. 37-38). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

121 Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA*. Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision. I see this lack of response as relevant in this case, as it was in *R. v. Tele-Mobile Co.*, 2008 SCC 12, [2008] 1 S.C.R. 305 (S.C.C.), where this Court stated:

> While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be reimbursed for the reasonable costs of complying with evidence-gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

122 All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

123 Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

> I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators*, it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA*. [para. 37]

124 Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails; and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogani*).

125 The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre-André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

126 The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be construed as affecting an earlier, special provision" (Côté,

at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.)).

127 The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

> [T]he overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, ... at p. 239 ...:
>
> > The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat, *Interprétation des lois* (4th ed. 2009), at para. 1335.)

128 I accept the Crown's argument that the "later in time" principle is conclusive in this case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant).* But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA.* Section 18.3(1) of the *CCAA*, is thereby rendered inoperative for purposes of s. 222(3).

129 It is true that when the *CCAA* was amended in 2005, [2] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005, c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(f) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Canada (Attorney General) v. Canada (Public Service Staff Relations Board)*, [1977] 2 F.C. 663 (Fed. C.A.), dealing with the predecessor provision to s. 44(f)). It directs that new enactments not be construed as "new law" unless they differ in substance from the repealed provision:

> **44.** Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,
>
> > ...
> >
> > (f) except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an enactment as "an Act or regulation or *any portion of an Act or regulation*".

130 Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

> **37.**(1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

131 The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to reorder the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

> On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*] makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive reworking of the CCAA.
>
> (*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

132 Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

133 This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA*.

134 While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act*. That includes the *ETA*. The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA*. Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

135 Given this conclusion, it is unnecessary to consider whether there was an express trust.

136 I would dismiss the appeal.

Appeal allowed.

Pourvoi accueilli.

Appendix

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (as at December 13, 2007)

> **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.
>
> ...
>
> **(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 (i);

(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.

...

(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.

11.4 (1) Her Majesty affected — An order made under section 11 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or arrangement,

(iv) the default by the company on any term of a compromise or arrangement, or

(v) the performance of a compromise or arrangement in respect of the company; and\

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) When order ceases to be in effect — An order referred to in subsection (1) ceases to be in effect if

(a) the company defaults on payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) Deemed trusts — Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) Status of Crown claims — In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

...

(3) Operation of similar legislation — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

...

20. [Act to be applied conjointly with other Acts] — The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at September 18, 2009)**

11. General power of court — 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.

...

11.02 (1) Stays, etc. — initial application — 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 30 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.

(2) Stays, etc. — other than initial application — 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.

(3) Burden of proof on application — 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.

...

11.09 (1) Stay — Her Majesty — An order made under section 11.02 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or an arrangement,

(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may apply.

(2) When order ceases to be in effect — The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(a) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) Deemed trusts — Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

***Excise Tax Act*, R.S.C. 1985, c. E-15 (as at December 13, 2007)**

222. (1) [Deemed] Trust for amounts collected — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) Amounts collected before bankruptcy — Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act)*, to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

...

(3) Extension of trust — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

***Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (as at December 13, 2007)**

67. (1) Property of bankrupt — The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person,

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(b.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and

(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) Deemed trusts — Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) Exceptions — Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) Status of Crown claims — In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

...

(3) Exceptions — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Footnotes

1 Section 11 was amended, effective September 18, 2009, and now states:

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.

2 The amendments did not come into force until September 18, 2009.

2010 SCC 60, 2010 CarswellBC 3419, 2010 CarswellBC 3420, [2010] 3 S.C.R. 379...

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TAB 16

Most Negative Treatment: Distinguished
Most Recent Distinguished: Shermag Inc., Re | 2009 QCCS 537, 2009 CarswellQue 2487, [2009] R.J.Q. 1289, EYB 2009-156550, J.E. 2009-897, 51 C.B.R. (5th) 95 | (C.S. Que., Mar 26, 2009)

1996 CarswellOnt 5598
Ontario Court of Justice (General Division) [Commercial List]

Beatrice Foods Inc., Re

1996 CarswellOnt 5598, 43 C.B.R. (4th) 10

In the Matter of Beatrice Foods Inc.

And In the Matter of an application under the Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36 for a compromise and arrangement with respect to Beatrice Foods Inc. and a reorganization of share capital and appointment of directors of Beatrice Foods Inc. under the Canada Business Corporations Act, R.S.C. 1985, c. C-44

Application Under the Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36

Houlden J.A. (ex officio)

Judgment: October 21, 1996
Docket: 295-96

Counsel: *Joseph Groia*, *Barry I. Goldberg* and *Jonathan Stainsby*, for Beatrice Foods Inc. and Beatrice Foods Holdings Corp.
Patricia D.S. Jackson, *David E. Baird* and *Thomas J. Matz*, for Informal Committee of Noteholders
Ronald Walker, *Sheryl Seigel* for the Senior Banks
Malcolm M. Mercer, *Terry Dolan* and *Norma Priday*, for Merrill Lynch Funds

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Cases considered by *Houlden J.A. (ex officio)*:

Central Capital Corp., Re (1996), 38 C.B.R. (3d) 1, 26 B.L.R. (2d) 88, 132 D.L.R. (4th) 223, 27 O.R. (3d) 494, (sub nom. *Royal Bank v. Central Capital Corp.)* 88 O.A.C. 161, 1996 CarswellOnt 316 (Ont. C.A.) — considered

Statutes considered:

Canada Business Corporations Act, R.S.C. 1985, c. C-44
Generally — considered

s. 173 — considered

s. 173(1)(o) — considered

s. 176(1)(b) — considered

s. 191 — considered

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

s. 191(2) — considered

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

s. 4 — considered

s. 5 — considered

s. 20 — considered

APPLICATION for order approving plan of compromise and arrangement and for order amending applicant's articles and appointing directors.

***Houlden J.A. (ex officio)* (orally)::**

1 Beatrice Foods Inc. ("Beatrice") is applying for an order under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*") for approval of a plan of compromise and arrangement and under s. 191 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*") for an order amending the articles of the applicant to effect a concurrent reorganization of share capital of Beatrice and to appoint directors.

2 Beatrice is a corporation under the *CBCA* and operates in the dairy, food products and baked goods businesses in both Canada and the United States. It has some 3,200 employees. Beatrice owes approximately $172,000,000 to a group of senior banks. It defaulted on its obligations to the senior banks in 1995. The senior banks entered into a standstill arrangement with Beatrice, but under the arrangement Beatrice must pay $100,000,000 to the senior banks on October 31, 1996. If the plan is not approved, Beatrice lacks the means to make the payment.

3 Beatrice is also indebted to the holders of 12 % senior subordinated notes. The amount owing to the noteholders, together with interest is approximately $240,000,000.

4 Beatrice Foods Holdings Corp. ("Holdings") holds 100% of Beatrice's issued and outstanding shares. Ninety-eight percent of Holdings is owed by Funds which are represented by Merrill Lynch Capital Partners Inc. The Funds are opposing these applications.

5 The plan in essence, provides for the following:

(a) the repayment in full of indebtedness to the Senior Banks;

(b) the exchange of 12% Senior Subordinated Notes held by Beatrice noteholders for new common shares in Beatrice, rights to buy additional new common shares, new subordinated notes maturing in 30 years bearing interest at 1% and a small amount of cash; and

(c) the cancellation of all issued and outstanding common shares and the issuance to the holder of such shares of:

(1) warrants entitling the holder to purchase new common shares at a specified exercise price; and

(2) a right to purchase all issued new common shares at a fixed price for four weeks after implementation of the Plan.

6 Since Beatrice is a large company with a substantial work force, I propose to say very little about the financial affairs of the company. Detailed information concerning all relevant aspects of Beatrice's finances is contained, however, in the material which has been put before me and I have carefully reviewed it.

7 In January, 1996, Beatrice retained R.B.C. Dominion Securities Inc. for the purpose of exploring all recapitalization, restructuring and disposition alternatives and opportunities available to Beatrice. Although R.B.C. Dominion Securities contacted over 150 prospective investors, only two binding proposals were received and only one proposal was for the purchase of the entire company. The offer received for the whole company would have paid the claims of the senior banks, but the noteholders would have had a substantial deficiency. In the past two weeks, a further offer has been received but this offer again is not sufficient to pay the noteholders in full. I am satisfied that the common shares held by the Funds have no value and that there is no likelihood in the foreseeable future that they will have any value. The 1995 annual review of operations for Merrill Lynch Capital Appreciation Fund II valued the equity in Beatrice at zero as of May 1996.

8 Dealing first with the *CCAA* application, I am satisfied that the statutory requirements have been complied with, that nothing has been done which is not authorized by the *CCAA* and that the plan is fair and reasonable. Mr. Mercer, for the Funds, has requested that the plan be amended to allocate to the Funds seven percent of the new equity including seven percent of the rights (with the resulting capital contribution applied thereby) or to accord dissent and appraisal rights to the existing common shareholders. I have pointed out to Mr. Mercer that, in my opinion, I have no jurisdiction to make such an amendment. In any event, to make either of those amendments would, in my opinion, render the plan unworkable.

9 Mr. Mercer's principal ground of opposition is that s. 191 of the *CBCA* does not confer jurisdiction on the court to amend the articles of Beatrice as requested by the applicant. Section 191 reads as follows:

> 191. (1) In this section, "reorganization" means a court order made under
>
> (a) section 241;
>
> (b) the *Bankruptcy Act* approving a proposal; or
>
> (c) any other Act of Parliament that affects the rights among the corporation, its shareholders and creditors.
>
> (2) If a corporation is subject to an order referred to in subsection (1), its articles may be amended by such order to effect any change that might lawfully be made by an amendment under section 173.
>
> (3) If a court makes an order referred to in subsection (1), the court may also
>
> (a) authorize the issue of debt obligations of the corporation, whether or not convertible into shares of any class or having attached any rights or options to acquire shares of any class, and fix the terms thereof; and
>
> (b) appoint directors in place of or in addition to all or any of the directors then in office.
>
> (4) After an order referred to in subsection (1) has been made, articles of reorganization in prescribed form shall be sent to the Director together with the documents required by sections 19 and 113, if applicable.
>
> (5) On receipt of articles of reorganization, the Director shall issue a certificate of amendment in accordance with section 262.
>
> (6) A reorganization becomes effective on the date shown in the certificate of amendment and the articles of incorporation are amended accordingly.
>
> (7) A shareholder is not entitled to dissent under section 190 if an amendment to the articles of incorporation is effected under this section.

10 For an order to be made under s. 191(1)(c), it is necessary, Mr. Mercer submitted, that the other Act of Parliament affect the rights among the corporation and its shareholders and the *CCAA* is not such an act. Under the *CCAA*, the court can, he submits, sanction a compromise or arrangement between a debtor company and its creditors, but it cannot sanction a compromise or arrangement between a debtor company and shareholders Accordingly, the *CCAA* is not an Act of Parliament that falls within s. 191(1)(c).

11 I have on occasion made orders under the *CCAA* in conjunction with orders under the *CBCA*. Sections 4 and 5 of the *CCAA* contemplates that the court may order a meeting of shareholders. In addition, s. 20 of the *CCAA* provides:

> 20. The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them

12 When discussing the reorganization provisions in the *Proposals for a New Business Corporations Law*, the *Dickerson Report*, which formed the basis for the comprehensive reform of Canada's corporations law, clearly anticipated that s. 191 would permit the elimination of issued shares. The Report (*Proposals for a New Business Corporations Law*, Robert W.V. Dickerson et at., v.1: Commentary, Part 14.00: Fundamental Changes, (Toronto: Information Canada, 1971) states, with reference to the section in the draft bill which became s. 191 (at p. 124):

> To clear up the obscure meaning of "reorganization", subsection (1) of s. 14.18 states that the term includes a court order made under the *Bankruptcy Act*, s. 19.04 [the oppression remedy] and any other federal law. The object of the section is to enable the court to effect any necessary amendment of the articles of the corporation in order to achieve the objective of the reorganization without having to comply with all the formalities of the Draft Act, particularly shareholder approval of the proposed amendment. For example, the reorganization of an insolvent corporation may require the following steps: first, reduction or even elimination of the interest of the common shareholders; second, relegation of the preferred shareholders to the status of common shareholders; and third, relegation of the secured debenture holders to the status of either unsecured note holders or preferred shareholders.
>
> Presumably then the corporation will be in a position to borrow further upon the security of its assets. In addition, the court will have power to reconstitute the board of directors, thus permitting representatives of the creditors of the corporation to take over the administration of the corporation until the corporation is one again solvent.

13 In discussing s. 191 of the *CBCA*, the authors of Fraser & Stewart, *Company Law of Canada*, (6th ed.: 1993), at p. 581, state that:

> A reorganization, for purposes of s. 191, is defined in s. 191(1) to be a court order which is made pursuant either to the oppression remedy powers of s. 241, or an order under the *Bankruptcy and Insolvency Act* approving a proposal in bankruptcy, or any other federal act that affects the rights of a corporation, its shareholders and creditors. An example of such a federal statute would be the *Companies' Creditors Arrangement Act*.

14 In *Central Capital Corp., Re* (1996), 132 D.L.R. (4th) 223 (Ont. C.A.), Weiler J.A. said (at p. 257):

> By virtue of s. 20 of the *CCAA*, arrangements under the Act mesh with the reorganization provisions of the *CBCA* so as to affect the company's relations with its shareholders. Shareholders have no right to dissent to a reorganization: s. 191(7). On a reorganization, among other things, the articles may be amended to alter or remove rights and privileges attached to a class of shares and to create new classes of shares: s. 173, *CBCA*. These statutory provisions provide a clear indication that, on a reorganization, the interests of all shareholders, including shareholders with a right of redemption, are subordinated to the interests of the creditors. Where the debts exceed the assets of the company, a sound commercial result militates in favour of resolving this problem in a manner that allows creditors to obtain repayment of their debt in the manner which is most advantageous to them.

15 I agree with the interpretation of the relevant provisions of the *CCAA* and the *CBCA*. I am of the opinion that a court order under the *CCAA* is an order under an Act of Parliament that affects the rights among the corporation, its shareholders and creditors.

16 Section 191(2) of the *CBCA* gives substantive, not simply procedural, powers to amend the articles of a *CBCA* corporation. The court may amend the articles to effect any change that might lawfully be made by an amendment under s. 173 of the *CBCA*. Section 173(1)(o) provides that:

> 173. (1) Subject to sections 176 and 177, the articles of a corporation may by special resolution be amended to
>
> . . . . .
>
> (o) add, change or remove any other provision that is permitted by this Act to be set out in the articles.

17 Section 173 is supported by s. 176(1)(b) which contemplates amendments to the articles of a corporation to effect a cancellation of all or part of the shares of a class of shares. Section 176(1)(b) provides:

> 176. (1) The holders of shares of a class or, subject to subsection (4), of a series are, unless the articles otherwise provide in the case of an amendment referred to in paragraphs (a), (b) and (e), entitled to vote separately as a class or series on a proposal to amend the articles to
>
> . . . . .
>
> (b) effect an exchange, reclassification or cancellation of all or part of the shares of such class.

18 I have found that the common shares have no value. I agree with the applicant that, in these circumstances, the shareholders have no status to object to the plan. An order will therefore go as requested. In the circumstances, there will be no order as to costs.

Application granted.

End of Document

TAB 17

CITATION: Re Grant Forest Products Inc., 2011 ONSC 7698
Court File No. CV-09-8247-00CL
Date: 20111229

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT,* R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF GRANT FOREST PRODUCTS INC., GRANT ALBERTA INC., GRANT FOREST PRODUCTS SALES INC. and GRANT U.S. HOLDINGS GP	)	*Kevin McElcheran, Geoff Hall, Heather Meredith* for the Toronto-Dominion Bank, Agent for First Lien Lenders *Fred Myers, Joe Pasquariello* for the Second Lien Creditors *Dan Murdoch* for the Monitor *Jane O. Dietrich* for Grant Forest Products Inc., Grant Alberta Inc., Grant Forest Products Sales Inc., Grant U.S. Holdings GP **Heard**: November 16, 2011

C. CAMPBELL J.:

REASONS FOR DECISION

[1] The First Lien Creditors of Grant Forest Products Inc. (G.F.P.) seek determination of their entitlement claim to default interest under its security from funds held by the Monitor.

[2] The Second Lien Creditors of G.F.P. dispute the entitlement of the First Lien Creditors to default interest on the basis that the provision for such default interest becomes unrecoverable by the First Lien Creditors given the restrictions mandated by s. 8 of the *Interest Act* R.S.C. 1985, c. I-15.

[3] In the CCAA process involving G.F.P. following a marketing process, purchasers were selected, and on January 8, 2010, a purchase and sale agreement was signed for the sale of the assets of G.F.P.

[4] The transferred assets are subject to security interests of the First Lien Creditors under the First Lien Credit Agreement, which have priority, and of the Second Lien Creditors under the Second Lien Credit Agreement.

[5] The Applicant borrowers are in default under the First Lien Credit Agreement and the Second Lien Credit Agreement, respectively.

[6] The issue on this motion is whether or not the First Lean Creditors are precluded from relying on the default interest provisions of its security by reason of the provisions of the *Interest Act*.

[7] Section 8 of the *Interest Act* reads:

> **8.** (1) No fine, penalty or rate of interest shall be stipulated for, taken, reserved or exacted on any arrears of principal or interest secured by mortgage on real property or hypothec on immovables that has the effect of increasing the charge on the arrears beyond the rate of interest payable on principal money not in arrears.
>
> (2) Nothing in this section has the effect of prohibiting a contract for the payment of interest on arrears of interest or principal at any rate not greater than the rate payable on principal money not in arrears.

[8] The position of the Second Lien Creditors is that the loan under which the First Lien Creditors now seek further interest is (a) on a loan secured by a mortgage on real property and (b) penalty interest on arrears such that recovery would be regarded as illegal pursuant to s. 8(1).

[9] Some background is required to assess the position of the parties.

[10] There is an inter-creditor agreement between the First Lien Creditors and the Second Lien Creditors (the Inter-Creditor Agreement), which provides, among other things, that the First Lien Creditors are entitled to enforce their rights and exercise their remedies without consultation with the Second Lien Creditors and that, should the First Lien Creditors elect to release their liens over any assets, the liens of the Second Lien Creditors on any such assets are automatically and unconditionally released.

[11] The First Lien Credit Agreement dated October 26, 2005 was a syndicated loan with the borrowers, being various entities incorporated in Canada and the United States related to G.F.P.I. The particulars of the relationship are set out in this court's decision found at 2010 ONSC 1846 (Can LII).

[12] The Transaction and the facts leading to the Transaction are described more completely in the Sixth Report of the Monitor and the motion materials filed by the Applicants on this motion. The First Lien Credit Agreement was amended in March 2007 to allow for the Second Lien Debt to be advanced between the U.S. entity borrowers and the Second Lien Creditors**.**

[13] The security granted pursuant to a General Security Agreement for both the First Lien and the Second Lien Debt included real property and intangible assets both in Canada and the U.S. which included by way of charge on the Mills.

[14] The First Lien Creditors urge that the true purpose of the financing was not an advance with the security of a mortgage over Canadian realty, but rather business financing principally for the construction of the OSB mills in South Carolina.

[15] Part of the argument of the First Lien Creditors with respect to the application of s. 8 of the *Interest Act* was that the Transaction looked at in substance was not related to a mortgage over Canadian realty (although it is acknowledged to be an incidental part) but rather the entire business financing transaction the vast majority of the advance being for the U.S. side of the business.

[16] Mr. McElcheran conceded that while this wasn't enterprise financing, the First Lien Creditors wanted and received security of whatever kind the debtor could provide. The Canadian realty did provide part of the security package that the Creditors in effect sought and obtained.

[17] What is of greater significance with respect to the application of the *Interest Act* to this transaction is the identity of the parties to the current dispute and the nature of their relationship to the transaction and between themselves.

[18] The amendments to the First Lien Creditor Agreement made in 2007 were purposely to accommodate the addition of the Second Lien Creditors and the securities that they sought and obtained. The First Lien and Second Lien Creditors entered into a comprehensive Inter-Creditor Agreement that governs their relationship.

[19] The position of the Second Lien Creditors is simply that the Inter-Creditor Agreement does not apply to this situation since the claim for default interest is illegal under the *Interest Act* and therefore cannot be recovered.

[20] Whatever the precise application of the *Interest Act* might be as between debtor and creditor in this complex contractual circumstance, the same analogy does not apply when it is the Second Lien Creditors seeking to deprive the First Lien Creditors of what they contracted for not only with the debtor but more importantly for the circumstances with the Second Lien Creditors.

[21] Section 4.05 (2) of the First Lien Credit Agreement (which term also appears in precisely the same language in the Second Lien Credit Agreement) reads in part:

> Upon the occurrence, and during the continuance of, and Event of Default, to the full extent permitted by law, the Applicable Margin will be… plus 2% per annum.

[22] The preamble to the First Lien Credit Agreement makes it clear that the accommodation by the First to permit the Second is only on the terms of the Inter-Creditor Agreement.

[23] Section 6.7, entitled Post Petition Interest, contains a covenant on the part of the Second Lien Creditors and agents not to oppose any claim by the First or interest including

> [A]ll amounts owing in respect of post-petition interest, including any additional interest payable pursuant to the First Lien Credit Agreement arising from or related to a default which is disallowed as a claim in any insolvency or Liquidation Proceeding) before any distribution is made in respect of the claims held by the Second Lien Claimholders……

[24] Section 7.1 under the heading Application of Proceeds of Collateral provides that the First Lien Creditors are entitled to the payment of all costs and expenses incurred by the First Lien Agent on any realization upon the collateral in accordance with the terms of the Agreement.

[25] What the Second Lien Creditors seek to do is to extricate themselves from the language and obligations of the Inter-Creditor Agreement by classifying the recovery of the additional interest as "illegal" within the meaning of s. 8 of the *Interest Act*.

[26] It is noteworthy that the same language and same interest provisions are found in the Second Lien Credit Agreement as in the First.

[27] I am of the view that in the factual relationship present in the Loan Agreements and in the Inter-Creditor Agreement, the Second Lien Creditors cannot simply as they urge "step into the shoes of the debtor" to take advantage of what might be applicable under the *Interest Act* to a relationship between debtor and creditor.

[28] In the previous 2010 decision in this matter, the Second Lien Creditors sought to separate the Canadian and U.S. aspects of the sale transaction under the CCAA. I held that the sale was a unified transaction in the same way that the security underlying the loans was over all of the assets.

[29] The vast majority of the cases referred to related to instances in which the *Interest Act* was the issue directly as between debtor and creditor. Counsel on both sides advised that they were not aware of a case in which the factual matrix included a complex commercial transaction in which a second secured creditor sought to rely on a defence that might be available to a debtor as against a first secured creditor who is relying on the same terms that were in the second security.

[30] The meaning and extent of the provision of s. 8(1) of the *Interest Act* have been the subject of numerous court decisions over the years and in particular whether or not accelerated interest on default could be regarded as a pre estimate of damage as opposed to a penalty: see the analysis of Pepall J. in *Place Concorde East Ltd. Partnership v. Shelter Corp. of Canada Ltd.,* [2003] O.J. No. 5437 at paragraphs 288 and 292.

[31] What I take from the decisions referred to, some of which may appear to be inconsistent with a strict interpretation of s. 8, is that they are all contextual and fact-driven.

[32] In *Reliant Capital Ltd. v. Silverdale*, 2006 BCCA 226, the purpose of the section was described at paragraph 56 as being to "protect property owners against abusive lending practices, while recognizing that generally speaking parties are entitled to freedom of contract."

[33] The B.C. Court of Appeal decision *Langley Lo-Cost Builders Ltd. v. 474835 B.C. Ltd.,* 2000 BBCA 365 summarized a number of seemingly conflicting judgments at paragraph 95 as follows:

> In summary, these cases, each one decided on his own particular facts are authority for the view that a change in interest rate upon default, or some other arrangement such as a waiver of interest upon due payment may not offend against the Act.:

[34] I conclude that given its contractual agreement with the First Lien Creditors, the Second Lien Creditors cannot rely on s. 8(1) to defeat the entitlement of the First to the interest that both Creditors agreed the First could have.

[35] I agree that a mortgage over realty was an incidental part of the entire loan Transaction. That said, the relationship between the First Lien Creditors and the Second Lien Creditors was such that each intended that they would be entitled to default interest when the borrower went into default.

[36] I recognize the hardship that falls on the Second Lien Creditors when the First are entitled to recover their principal and as well default interest, while the Second recovers nothing. That is the bargain that was entered into between the First and the Second.

[37] Those contractual provisions would make no sense if the Second Lien Creditors could simply claim as if they were the borrower that the Transaction is "illegal" pursuant to s. 8 of the *Interest Act*. In my view the *Interest Act* properly read does not apply to the Transaction in question.

[38] Having reached the above conclusion, it is not necessary to deal with the number of the other arguments raised, particularly those of the Second Lien Creditors that the First have not provided evidence of default as that term might apply to the provisions of the *Interest Act.*

[39] An Order will issue declaring entitlement to default interest on the part of the First Lien Creditors.

[40] If counsel cannot agree on the disposition of costs, they may make written submissions.

C. CAMPBELL J.

Released: December 29, 2011

CITATION: Re Grant Forest Products Inc., 2011 ONSC 7698
Court File No. CV-09-8247-00CL
Date: 20111229

SUPERIOR COURT OF JUSTICE
ONTARIO
(Commercial List)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF GRANT FOREST PRODUCTS INC., GRANT ALBERTA INC., GRANT FOREST PRODUCTS SALES INC. and GRANT U.S. HOLDINGS GP

REASONS FOR DECISION

C. CAMPBELL J.

Released: December 29, 2011

TAB 18

Most Negative Treatment: Distinguished
Most Recent Distinguished: Hartum Estate v. Loewen | 2006 ABQB 498, 2006 CarswellAlta 849, 405 A.R. 185, 151 A.C.W.S. (3d) 190, [2006] A.W.L.D. 2833, [2006] A.W.L.D. 2834, [2006] A.W.L.D. 2837, [2006] A.W.L.D. 2863, [2006] A.W.L.D. 2864, 27 E.T.R. (3d) 33, 64 Alta. L.R. (4th) 364 | (Alta. Q.B., Jun 30, 2006)

1993 CarswellAlta 250
Supreme Court of Canada

Hongkong Bank of Canada v. Wheeler Holdings Ltd.

1993 CarswellAlta 250, 1993 CarswellAlta 559, [1993] 1 S.C.R. 167, [1993] A.W.L.D. 195, [1993] S.C.J. No. 5, 100 D.L.R. (4th) 40, 135 A.R. 83, 148 N.R. 1, 29 R.P.R. (2d) 1, 33 W.A.C. 83, 37 A.C.W.S. (3d) 1201, 6 Alta. L.R. (3d) 337, J.E. 93-273, EYB 1993-66886

CANADA MORTGAGE AND HOUSING CORPORATION v. HONGKONG BANK OF CANADA and WHEELER HOLDINGS LTD., TOWN HOUSE DEVELOPMENT LTD., WELLINGTON HOUSING DEVELOPMENTS LTD., KATE WHEELER, PAMELA K. WHEELER, GEORGE L. WHEELER, LOIS ANDERSON, PATRICIA MAY KIRK, 375069 ALBERTA LTD., 386360 ALBERTA LTD. and 376491 ALBERTA LTD.; ATTORNEY GENERAL OF QUEBEC (Intervenor)

CANADA MORTGAGE AND HOUSING CORPORATION v. 375069 ALBERTA LTD. and TOWN HOUSE DEVELOPMENT LTD.; ATTORNEY GENERAL OF QUEBEC (Intervenor)

CANADA MORTGAGE AND HOUSING CORPORATION v. 386360 ALBERTA LTD. and WELLINGTON HOUSING DEVELOPMENTS LTD.; ATTORNEY GENERAL OF QUEBEC (Intervenor)

La Forest, L'Heureux-Dubé, Sopinka, Gonthier, Cory, Stevenson [*] and Iacobucci JJ.

Heard: February 4, 1992
Judgment: January 21, 1993
Docket: Doc. 22268

Proceedings: affirmed *Hongkong Bank of Canada v. Wheeler Holdings Ltd.* (1991), 1991 CarswellAlta 20, (sub nom. Canada Mortgage & Housing Corp. v. Hongkong Bank of Canada) 112 A.R. 85, (sub nom. Canada Mortgage & Housing Corp. v. Hongkong Bank of Canada) 78 Alta. L.R. (2d) 236, (sub nom. Canada Mortgage & Housing Corp. v. Hongkong Bank of Canada) 75 D.L.R. (4th) 561, 24 A.C.W.S. (3d) 755, [1991] A.W.L.D. 100 ((Alta. C.A.))

Counsel: *Francis C.R. Price*, *Wesley M. Pedruski* and *Kent N. Bilton*, for appellant.
Dennis F. Pawlowski, and *Douglas L. Kennedy*, for respondent Hongkong Bank of Canada.
Donald J. Boyer, Q.C., and *Michael R. Kinash*, for respondents 375069 Alberta Ltd., 386360 Alberta Ltd. and 376491 Alberta Ltd.
Robert L. Duke, Q.C., and *Lorne A. Smart*, for respondents Town House Development Ltd., Wellington Housing Developments Ltd. and Wheeler Holdings Ltd.
John A. Weir, Q.C., for respondents Kate Wheeler, Pamela K. Wheeler, George L. Wheeler, Lois Anderson and Patricia May Kirk.
Françoise Saint-Martin, for intervenor Attorney General of Quebec.

Subject: Property; Corporate and Commercial

Table of Authorities

Cases considered:

Attorney-General v. Great Eastern Railway Co. (1880), 5 App. Cas. 473 (H.L.) — *considered*

Bahnsen v. Hazelwood, [1960] O.W.N. 155, 23 D.L.R. (2d) 76 (C.A.) — *referred to*

Bell Houses Ltd. v. City Wall Properties Ltd., [1966] 2 Q.B. 656, [1966] 2 All E.R. 674 (C.A.) [affirmed (1967), 205 E.G. 535] — *referred to*

Campbell v. Campbell, 300 N.Y.S. 760 (S.C., 1937) — *referred to*

Canada Permanent Trust Co. v. King's Bridge Apartments Ltd. (1982), 24 R.P.R. 32, 41 Nfld. & P.E.I.R. 265, 119 A.P.R. 265, reversed (1984), 8 D.L.R. (4th) 152, 48 Nfld. & P.E.I.R. 345, 142 A.P.R. 345 (Nfld. C.A.) — *considered*

Chapman v. Michaelson, [1909] 1 Ch. 238 (C.A.) — *considered*

Colonial & Home Fuel Distributors Ltd. v. Skinners' Ltd. (1963), 39 D.L.R. (2d) 579, affirmed (1963), 46 D.L.R. (2d) 695, which was affirmed [1964] S.C.R v — *distinguished*

Communities Economic Development Fund v. Canadian Pickles Corp., [1991] 3 S.C.R. 388, [1992] 1 W.W.R. 193, 8 C.B.R. (3d) 121, 85 D.L.R. (4th) 88, 131 N.R. 81, 76 Man. R. (2d) 1 — *referred to*

Garnet Lane Developments Ltd. v. Webster (1986), 43 R.P.R. 138, 20 O.A.C. 291 (Div. Ct.) [additional reasons (1987), 43 R.P.R. 138 at 172, 20 O.A.C. 291 at 315] — *considered*

General Auction Estate & Monetary Co. v. Smith, [1891] 3 Ch. 432 — *referred to*

Introductions Ltd., Re; Introductions Ltd. v. National Provincial Bank Ltd., [1970] Ch. 199, [1969] 1 All E.R. 887 (C.A.) — *distinguished*

Knightsbridge Estates Trust Ltd. v. Byrne, [1938] 4 All E.R. 618 (C.A.) — *applied*

MacDonald v. Law Society (Manitoba) (1975), 54 D.L.R. (3d) 372 (Man. Q.B.) — *referred to*

Mills v. Mills, 179 A. 5 (Conn. S.C., 1935) — *referred to*

Moody v. Cox, [1917] 2 Ch. 71 (C.A.) — *applied*

Morris v. Morris, [1974] 2 W.W.R. 193, 14 R.F.L. 163, 42 D.L.R. (3d) 550 (Man. C.A.) — *referred to*

New Finance & Mortgage Co., Re, [1975] Ch. 420, [1975] 1 All E.R. 684*referred to*

Patent File Co., Re; Ex parte Birmingham Banking Co. (1870), L.R. 6 Ch. 83 — *referred to*

Paul v. Paul (1921), 50 O.L.R. 211, 64 D.L.R. 269 (C.A.) — *considered*

Sara v. Sara (1962), 40 W.W.R. 257, 36 D.L.R. (2d) 299 (B.C.C.A.) — *considered*

Tito v. Waddell (No. 2); Tito v. Attorney-General, [1977] Ch. 106, [1977] 3 All E.R. 129 — *considered*

Valley Vu Realty (Ottawa) Ltd. v. Victoria & Grey Trust Co. (1984), 44 O.R. (2d) 526, 30 R.P.R. 90, affirmed 47 O.R. (2d) 544n (C.A.) — *distinguished*

Statutes considered:

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

s. 15(1)*referred to*

s. 18*considered*

s. 117(2)*considered*

Chancery Act, 1850 (U.K.) — *referred to*

Companies Act, R.S.A. 1955, c. 53

s. 19(h)*considered*

Companies Act, R.S.A. 1980, c. C-20

s. 20(1)(h)*considered*

Constitution Act, 1867

s. 92*referred to*

Judicature Act, 1873 (U.K.) — *referred to*

Land Titles Act, R.S.A. 1980, c. L-5

s. 62(1)*referred to*

Law of Property Act, R.S.A. 1980, c. L-8

s. 43*referred to*

National Housing Act, 1954, S.C. 1953-54, c. 23

s. 16(3)(k)*considered*

s. 16(4)(g) [re-en. 1968-69, c. 45, s. 7]*considered*

s. 16(4)(h)*considered*

National Housing Act, R.S.C. 1985, c. N-11

s. 2 "limited-dividend housing company"*considered*

s. 26(3)(b)*considered*

Statute of Quia Emptores, 1289 (U.K.), 18 Edw. 1, c. 1 — *considered*

Rules considered:

Alberta Rules of Court

R. 505(3)*considered*

Rules of the Supreme Court of Canada, SOR/83-74

R. 29*referred to*

Appeal from judgment of Alberta Court of Appeal (1990), 77 Alta. L.R. (2d) 149, 111 A.R. 42, 14 R.P.R. (2d) 1, *(sub nom. Canada Mortgage & Housing Corp. v. Hongkong Bank of Canada)* 75 D.L.R. (4th) 307, supplementary reasons 78 Alta. L.R. (2d) 236, 112 A.R. 85, 75 D.L.R. (4th) 561, dismissing appeal from judgment of Veit J. allowing appeal from order of Master Quinn (1989), 67 Alta. L.R. (2d) 337, 99 A.R. 94, 8 R.P.R. (2d) 189, dismissing application by second mortgagee for judicial sale of property.

The judgment of the court was delivered by *Sopinka J.*:

1 The main issue in this appeal is whether the appellant mortgagee can successfully impeach a subsequent mortgage and sale on the basis of statutorily mandated contractual terms prohibiting a sale or disposition of the mortgaged property. An affirmative answer to this question would raise a constitutional issue with respect to the vires of Parliament to legislate this result. The appeal also raises the issues of corporate ultra vires and the validity of covenants in restraint of alienation of real property.

The Facts

2 The respondents Town House Development Ltd. ("Town House") and Wellington Housing Developments Ltd. ("Wellington") are "limited-dividend housing companies", as defined by the *National Housing Act*, R.S.C. 1985, c. N-11, s. 2:

> "limited-dividend housing company" means a company incorporated to construct, hold and manage a low-rental housing project, the dividends payable by which are limited by the terms of its charter or instrument of incorporation to five per cent per annum or less.

3 Town House and Wellington were originally incorporated under *The Companies Act*, R.S.A. 1955, c. 53. The memoranda of association of Town House and Wellington state that the objects of the companies "are subject to the provisions of the National Housing Act, 1954 and amendments thereto".

4 In 1956 and 1958, the appellant Canada Mortgage and Housing Corporation ("CMHC") loaned money to Town House and Wellington to build and operate two low-rental housing projects in Edmonton. The loans were secured by first mortgages at low rates of interest of 3 1/2% and 4 1/4% per annum respectively. The "term of the loan" was defined in the mortgage as being "the period ending forty years after the project completion date, whether or not the loan shall have been earlier repaid, (Which the Corporation [CMHC] hereby declares to be a term not exceeding the useful life of the project)". The Town House mortgage has a prepayment provision, which is available only when the mortgagor is not in default. The Wellington mortgage does not contain a prepayment provision. Both mortgages provide that their terms are "in addition to those granted or implied by statute", and that the mortgages are made pursuant to the *National Housing Act, 1954*, S.C. 1953-54, c. 23.

5 Along with the mortgages, CMHC entered into operating agreements with both Town House and Wellington. The operating agreements include terms mandated by s. 16(4)(*g*) of the *National Housing Act, 1954*:

> 16. ...

(4) A contract with a limited-dividend housing company entered into under this section shall provide that ...

(*g*) except with the consent of the Corporation [CMHC] and on such terms and conditions as the Corporation may approve the project or any part thereof shall not be sold or otherwise disposed of during the term of the loan.

Accordingly, the operating agreements prohibit the mortgage or sale of the projects without the approval of CMHC. The relevant paragraphs of these agreements are as follows:

1. Definitions ...

(iv) "The term of the loan" shall be the period ending forty years after the project completion date, whether or not the loan shall have been earlier repaid, (which the Corporation hereby declares to be a term not exceeding the useful life of the project).

4. Prohibition against encumbrances

The project, or any part thereof, so long as there shall be any part of the loan or interest thereon remaining unpaid, shall not be mortgaged, charged or otherwise encumbered other than by a first mortgage in favour of the Corporation, without the approval of the Corporation.

12. Default

The Corporation shall have the right, in the event of the Borrower failing to maintain the low-rental character of the project or otherwise committing a breach of this agreement, to declare the unpaid principal of the loan due and payable forthwith or to increase the interest payable thereafter on the unpaid balance of the said loan to such rate as the Governor in Council may determine.

16. Sale of project

The project or any part thereof shall not be sold or otherwise disposed of during the term of the loan except with the consent of the Corporation and on such terms and conditions as the Corporation may approve.

6 The mortgages adopt the terms of the operating agreements, providing that the operating agreements form part of the mortgages and that breach of the operating agreements constitutes breach of the mortgages. In other words, sale or encumbrance of the properties without CMHC's consent would constitute both breach of the operating agreements and default of the mortgages.

7 In 1981, the Bank of British Columbia loaned $3 million to Town House and Wellington, along with the respondent Wheeler Holdings Ltd. ("Wheeler"). The loan was secured by second mortgages on the projects and was personally guaranteed by the respondents Pamela K. Wheeler, Lois Anderson, Kate Wheeler, George L. Wheeler and Patricia May Kirk (all of whom are related). CMHC did not consent to the second mortgages. This mortgage was among the assets purchased by the respondent Hongkong Bank of Canada ("Hongkong") from the Bank of British Columbia in 1986.

8 In February 1982, Alberta adopted a new corporate law regime when the Alberta *Business Corporations Act*, S.A. 1981, c. B-15, was proclaimed in force. The new regime required companies incorporated under the *Companies Act*, R.S.A. 1980, c. C-20, to obtain continuances under the Alberta *Business Corporations Act* within prescribed times. Pursuant to these requirements, Wellington was continued under the Alberta *Business Corporations Act* in June 1985. Town House was continued in February 1986.

9 In 1988, Town House and Wellington agreed to sell the projects ("1988 sales") to the respondents 375069 Alberta Ltd. and 386360 Alberta Ltd. ("1988 purchasers"). The 1988 purchasers are owned and controlled by one person, John Ryan ("Ryan"). Ryan is married to the respondent Pamela K. Wheeler who is one of the guarantors of the Bank of British Columbia mortgage

and a sister to the two directors of Town House and Wellington, George L. Wheeler and Patricia May Kirk. CMHC did not consent to these sales. The 1988 sale agreements provided that title would be given to the 1988 purchasers free and clear of obligations under the CMHC operating agreements, and provided for liquidated damages if such title could not be given. These sale agreements also contained a provision expressly negating and rejecting the covenants implied by s. 62(1) of the Alberta *Land Titles Act*, R.S.A. 1980, c. L-5, with the result that the transferees did not assume the obligations under the mortgage.

10 In 1989, Hongkong began an action to foreclose on its second mortgages. Hongkong proposed a judicial sale of the projects ("1989 sale") to yet another numbered company owned by Ryan, namely the respondent 376491 Alberta Ltd. ("1989 purchaser"). The 1989 sale agreements provided that the 1989 purchaser would get title subject to the CMHC mortgages but free and clear of the terms of the CMHC operating agreements.

11 Hongkong sought approval of the 1989 sale from the Alberta Court of Queen's Bench, but on June 20, 1989 a Master refused this approval: 67 Alta. L.R. (2d) 337, 99 A.R. 94, 8 R.P.R. (2d) 189. Hongkong appealed this finding to a chambers judge, and the 1988 purchasers commenced an action seeking a declaration that they were owners of the projects under the 1988 sale agreements and that they were not bound by the CMHC operating agreements. The appeal and the actions were heard together by the chambers judge. On December 13, 1989, the 1989 sale was approved by the chambers judge and the 1988 purchasers were granted the declaration they requested. Appeals were launched by CMHC in respect of each proceeding.

12 CMHC's appeal to the Alberta Court of Appeal was dismissed on November 15, 1990: 77 Alta. L.R. (2d) 149, 111 A.R. 42, 14 R.P.R. (2d) 1, 75 D.L.R. (4th) 307. A further order as to costs was made on January 4, 1991, in which the court awarded solicitor-and-client costs to CMHC and Hongkong: 78 Alta. L.R. (2d) 236, 112 A.R. 85, 75 D.L.R. (4th) 561.

Lower Court Judgments

Alberta Court of Queen's Bench (Master Quinn)

13 After a review of the facts, the Master noted that the effect of granting the order sought by Hongkong, which included a declaration that the provisions of the operating agreements preventing sale and encumbrance were unenforceable and void, would be that the 1989 purchaser would no longer be obliged to operate the projects as low-rental housing. The submissions in support of the desired order relied on *Canada Permanent Trust Co. v. King's Bridge Apartments Ltd.* (1982), 24 R.P.R. 32 (Nfld. T.D.), which held that a covenant in a mortgage prohibiting dealing with the property without consent of the mortgagee was void as a restraint on alienation. The *Statute of Quia Emptores* of 1289 had established that fee simple is alienable property. The Master cited several authors for the proposition that restraint on alienation means a limitation on the free use of property by the new owner of property.

14 The Master reviewed several cases where restraints which were held to be invalid were contained in the document which conveyed fee simple, not in some other contract to which the landowner was a party. He stated that he was not convinced that *King's Bridge* was correct and he refused to follow it. The Master distinguished another case in which the restraints had been contained in the sale agreement and not in a mortgage. The Master also rejected an argument that the provisions in the CMHC mortgages should be held void as clogs on the equity of redemption, holding that these arguments were premature.

15 As a result, the Master dismissed the application. The Master ordered Hongkong to pay CMHC's costs, but refused to award costs to any other parties.

Alberta Court of Queen's Bench (Veit J.)

16 The chambers judge rendered judgment orally. After reviewing the facts and the parties' submissions, which for the first time raised the issue of the constitutional validity of the *National Housing Act*, the chambers judge stated that she generally accepted the arguments of those opposing the restrictions and rejected CMHC's arguments. Turning first to statutory interpretation, it was noted that the competent legislature can change the common law. However, there is a presumption that the legislature does not intend to make a substantial alteration of law beyond that which it explicitly declares. In addition, there is a presumption that a legislature does not intend to take away private property rights unless it does so explicitly. Given that the

relevant concepts of free alienation and the equity of redemption are so fundamental, these presumptions were held to apply. Parliament did not change the common law explicitly. Therefore, "worthwhile as they may be, the objectives of the National Housing Act have to be met within the confines of the common law."

17 The chambers judge then turned to the constitutional issue. She stated that, in general, property law is within provincial jurisdiction. No argument in support of federal jurisdiction had been made under the peace, order and good government power, and there was some provincial legislation in Alberta regarding the effect of the *National Housing Act* in Alberta, indicating that there was no federal jurisdiction to affect property rights in a province. Thus even if she were wrong with respect to the statutory interpretation issue, the chambers judge would hold that there was no statutory authority to enforce the CMHC mortgages because of the constitutional impediment to federal jurisdiction.

18 The chambers judge then held that the provisions of the operating agreements which stated that the agreements would remain in force for the term of the loan (40 years) should be struck down as clogs on the equity of redemption. The chambers judge then commented on CMHC's allegations that there was a deliberate attempt to evade the terms of the mortgages, stating that the parties' motives were irrelevant to the legal validity of the clauses in question. CMHC's own motives of providing cheap housing were not enough to resolve the dispute in its favour. CMHC had to achieve its objectives within the "common law structures of real property entitlements".

19 The chambers judge rejected an argument that the Crown should not be bound by common law when pursuing its purposes. The *Statute of Quia Emptores* was a derogation from the Crown's right to control real property, and the Crown could not revert to the pre-*Statute* position without clear language. The chambers judge also rejected an argument that the sales were ultra vires the corporate objects of Town House and Wellington.

20 As a result, the chambers judge allowed the appeal, granted an order approving the 1989 sale of the properties and granted a declaration that the impugned provisions of the CMHC mortgages were invalid and that the 1988 purchasers were entitled to redeem. Hongkong was awarded solicitor-and-client costs from the other parties, and CMHC was ordered to indemnify other parties for costs payable to Hongkong.

Alberta Court of Appeal (1989), 77 Alta. L.R. (2d) 149 (Lieberman, Haddad and Irving JJ.A.)

21 The reasons of the court were delivered by Lieberman J.A. The court began with a review of the facts. The first issue was whether the *National Housing Act* creates a statutory restraint on alienation running with the land. The court held that the issue was settled by the presumption that a legislature does not intend to make any substantial alteration of the law beyond what is explicitly declared. "[I]f Parliament had intended to create a statutory restraint of alienation it would have done so explicitly" (p. 158). In addition, existing law should not be altered except to the extent necessary to implement the statutory language. "The right to freely alienate land is fundamental to fee simple ownership. There can be no change to this proposition without clear legislative mandate. That mandate is absent in the legislation relevant to these appeals" (p. 158). Given the conclusion on the statutory interpretation issue, the court found it unnecessary to deal with the constitutional issue.

22 The court noted that CMHC relied on three cases for its position that the operating agreements created valid restrictive covenants restraining alienation of the land, but the court distinguished all three cases. The court therefore concluded that unless CMHC could bring itself within the Crown immunity exception or the restrictive covenant exception, the impugned provisions were either personal covenants or void conditions in restraint of alienation. With respect to the Crown immunity exception, the court agreed with CMHC that the *Statute of Quia Emptores* never bound the Crown. However, a 1327 statute had altered Crown immunity by providing that even tenants holding land directly from the Crown could alienate their land. The proposition that the Crown is not immune from the rule against restraints on alienation had also been confirmed by the courts.

23 With respect to the argument that the operating agreement created a restrictive covenant, the court noted that a restrictive covenant requires three conditions. First, the restriction must be negative. Second, one plot of land must bear a burden and another must receive the benefit (that is, there must be a dominant and a recessive tenement). Third, the defendant cannot set up the overriding defence in equity of purchase of legal estate for resale without notice. The restriction in question was negative

in nature. However, in Alberta a mortgage is only a charge against land. The mortgagee does not hold the legal estate. Thus the rule that a covenant not involving a grant does not run with the land except as between landlord and tenant is particularly important where the issue is a restrictive covenant. As a result, the second requirement for a restrictive covenant was not met and the court concluded that the covenants in question did not run with the land. In addition, there was no benefit to the land because the mortgagee's objects were benefitted but there was no benefit to the mortgage interest itself. With respect to the third requirement, annexing the covenants to mortgages which were registered against title was sufficient notice to subsequent purchasers or encumbrancers. Thus the court concluded that "the requirements of the restrictive covenant creating a right in rem that runs with the land are not met" (p. 164).

24 Given its finding that the covenants were not restrictive covenants, the court held that it was unnecessary to determine whether the restrictive covenants would be unenforceable as clogs on the equity of redemption. The court also reviewed the objects of Town House and Wellington, concluding that the second mortgages were not ultra vires their corporate objects. The court relied upon s. 19(*h*) of *The Companies Act*, R.S.A. 1955, c. 53, which provided that a company may raise money by any means unless its objects expressly restrict such a power. In addition, the *National Housing Act* did not bar the second mortgages, as it merely provided that mortgagors must contract not to enter into subsequent mortgages. It did not provide that mortgagors could not enter into subsequent mortgages.

25 The court then turned to CMHC's submission that the respondents should be precluded from profiting from their own wrong. The court concluded that the second mortgages were not illegal contracts because the *National Housing Act* was not a statutory prohibition on sale or disposition of the properties. The court distinguished several cases which had held that the court would not assist in profiting from one's own wrong. The court found no evidence of an intention to circumvent the contractual liability of the Town House and Wellington, and therefore it was not an appropriate case to pierce the corporate veil.

26 As a result, the appeal was dismissed. On January 4, 1991, the court issued supplementary reasons with respect to costs. The court allowed CMHC's appeal of the costs order made by the chambers judge. The court found that the respondents knowingly breached the operating agreements. Despite their success in the appeal, they did not have clean hands. As a result, Town House and Wellington were ordered to pay costs to CMHC and Hongkong on a solicitor-and-client basis. No other parties were awarded costs.

The Issues

1. Clean Hands:

27 It was submitted that the action for a declaration and the application for a judicial sale are claims for equitable relief to which the respondents have disentitled themselves.

2. Illegality:

28 The appellant submits that by virtue of s. 16(4)(*g*) of the *National Housing Act, 1954* the second mortgages and the 1988 and 1989 sales are illegal as either prohibited by statute or the policy underlying it. If the appellant is correct, the respondents raise a constitutional question as to whether the section is ultra vires. I have concluded that the appellant fails in respect of this submission and it will not be necessary to answer the constitutional question.

3. Corporate Ultra Vires:

29 The appellant submits that the second mortgages and the agreements of sale are beyond the corporate powers of the respondents Town House and Wellington.

4. Prepayment of Mortgages:

30 The appellant asks that the declaration that the respondents, the 1988 purchasers, are entitled to redeem the properties upon payment of the amounts outstanding under the first mortgages be set aside. The respondents, except Hongkong, have

served and filed a motion under R. 29 of the *Rules of the Supreme Court of Canada*, SOR/83-74, to vary the judgment of the Court of Appeal to declare that the clauses prohibiting sale or mortgage are void and not merely unenforceable. In order to decide these issues it is necessary to consider whether these provisions must be struck down as void restraints on alienation or are valid as personal covenants. If they are the latter, then it is further necessary to decide whether their breach is a default under the mortgage disentitling the 1988 purchasers to prepay. This in turn raises the issue as to whether in this event the provisions in the mortgage are a clog on the equity of redemption and, therefore, void.

5. Costs:

31 The respondents, except Hongkong, have moved pursuant to our R. 29 to vary the order as to costs made by the Court of Appeal.

Analysis

1. Clean Hands

32 CMHC argues that the respondents should be denied the relief they seek because they are guilty of misconduct such as to disentitle them from equitable relief. Assuming for the moment that Town House and Wellington were legally capable of granting the second mortgage to the Bank of British Columbia (Hongkong Bank) and of disposing of the projects via the agreements for sale, it is evident that they have committed a flagrant breach of their contracts with CMHC. However, it is not Town House and Wellington who seek relief from the court in this action. With respect to the parties who are seeking relief from the court, I am not convinced that the remedies sought constitute equitable relief in every case or that there is in any event sufficient evidence before the court to conclude that these respondents have unclean hands. There is accordingly no equitable ground upon which to deny relief to the respondents.

33 In determining whether the respondents are entitled to equitable relief, it is important not to paint all the respondents with the same brush. As was noted in *Moody v. Cox*, [1917] 2 Ch. 71 (C.A.), at pp. 87-88, "equity will not apply the principle about clean hands unless the depravity, the dirt in question on the hand, has an immediate and necessary relation to the equity sued for." CMHC seeks to paint all respondents with the same brush, arguing that equity should deny all relief in this case because Town House and Wellington are seeking to escape obligations to CMHC. However, an entire transaction does not become tainted merely because certain parties to the transaction may have unclean hands. Town House and Wellington may be seeking to escape obligations to CMHC, but this does not taint all transactions involving properties subject to those obligations. It is necessary to show that the respondents actually seeking relief from the court are in fact seeking equitable relief and are guilty of wrongdoing amounting to unclean hands.

34 The two numbered companies who are the purchasers under the 1988 sale agreements seek a declaration that they are the beneficial owners of the properties in question pursuant to these agreements. There has been significant debate in the literature and jurisprudence as to whether a declaration constitutes equitable relief or is a sui generis remedy and, if it is the latter, whether equitable principles should bar relief. The Chancery Courts of England had long exercised a limited jurisdiction to grant declaratory judgments, which power was expanded by the *Chancery Act* of 1850. With the merging of the two court systems under the *Judicature Act, 1873*, declaratory jurisdiction was also assumed by the courts of common law. If one categorizes remedies by virtue of their origin in the Court of Chancery or the courts of common law, then, the declaratory judgment would seem to be an equitable remedy.

35 However, starting with the English case of *Chapman v. Michaelson*, [1909] 1 Ch. 238 (C.A.), a number of courts have held that the declaratory judgment does not constitute equitable relief. In *Chapman*, the Court of Appeal distinguished the granting of a declaration that security documents were invalid from the more common equitable remedy of delivering up of the unenforceable security documents. In the latter situation, relief was always made subject to equitable conditions of repayment being imposed on the borrower, but the court refused to impose similar conditions on a borrower granted a declaratory remedy on the grounds that the declaration "is not equitable relief" (p. 242). Although some English decisions have taken a different approach in the intervening years, the *Chapman* approach was reiterated in *Tito v. Waddell (No. 2); Tito v. Attorney General*,

[1977] Ch. 106, [1977] 3 All E.R. 129, in which Megarry V.-C. stated that the remedy is "neither a legal nor an equitable remedy, but statutory" (p. 259).

36 This view as to the nature of the declaratory remedy has largely prevailed in Australia and New Zealand. Similarly, the consensus in Canada seems to be that the remedy is sui generis rather than wholly equitable. Sarna in *The Law of Declaratory Judgments*, 2nd ed. (1988), for example, states at p. 216 that "the development of Canadian case law has seen little or no reference to the equitable nature of the remedy".

37 However, a number of Canadian judgments at the lower levels have applied equitable principles to those who seek a declaration. For example, in *Sara v. Sara* (1962), 40 W.W.R. 257, 36 D.L.R. (2d) 499, the British Columbia Court of Appeal refused to grant a declaration that a marriage was void to a man who had polygamously married his Canadian wife in order to be admitted to the country, and then been supported by her for a number of years after his arrival, on the basis inter alia that the husband had unclean hands. *Morris v. Morris*, [1974] 2 W.W.R. 193, 14 R.F.L. 163, 42 D.L.R. (3d) 550 (Man. C.A.), and *MacDonald v. Law Society (Manitoba)* (1975), 54 D.L.R. (3d) 372 (Man. Q.B.), also take the view that the declaratory remedy is an equitable one. At least some American decisions are to the same effect, such as *Campbell v. Campbell*, 300 N.Y.S. 760 (S.C., 1937), and *Mills v. Mills*, 179 A. 5 (Conn. S.C., 1935), in which the plaintiffs were held to be disentitled to declaratory relief on the basis of unclean hands and laches, respectively.

38 While the above decisions all seem to have been based, expressly or impliedly, on the view that declaratory relief was equitable in nature, it appears that even if the remedy is seen to be sui generis, equitable principles such as clean hands can play a role in the exercise of the court's discretion whether or not to grant the remedy. As Zamir states in *The Declaratory Judgment* (1986), at p. 191:

> This discretion is employed, as discretion was originally employed in respect of all equitable remedies, primarily to do justice in the particular case before the court. It is wide enough to allow the court to take into account virtually all objections and defences possible in equitable proceedings.

Zamir goes on to cite various English cases in which the motives of the plaintiff were taken into account, the claim was dismissed on the basis of laches, and inequitable behaviour on the part of the plaintiff was considered to be a defence to a declaratory judgment.

39 Some other authors take a different approach. In *Equity — Doctrines and Remedies*, 2nd ed. (1984), at p. 466, Meagher, Gummow and Lehane review a number of decisions and conclude that on both authority and principle, the traditional equitable barriers to relief do not apply to declaratory relief. Likewise, Sarna, at p. 216, states that "there has yet to appear a serious proposal that the exercise of discretion on declaratory proceedings be confined to the general principles governing equity".

40 While it may be that certain equitable restrictions such as the requirement that legal remedies be insufficient and that there be a probability of irreparable or at least very serious damage should not be applied to declaratory remedies, I would conclude that in the exercise of the discretion whether or not to grant a declaration, the court may take into account certain equitable principles such as the conduct of the party seeking the relief. In the context of this case, then, the allegation that the 1988 purchasers have unclean hands should be addressed.

41 The only real evidence before this Court with regard to the alleged misconduct of the 1988 purchasers is that they knew that the 1988 sale agreements constituted a breach of the CMHC mortgages and in fact agreed to pay a higher price for the land if the Operating Agreements could be successfully breached. As well, there is the fact that shortly after the execution of the sale agreements, the sole director and shareholder of the numbered companies married the sister of the directors of Town House and Wellington. In my view, this evidence is too tenuous a foundation for the application of the principle. Absent a finding of collusion, knowledge by a purchaser that the vendor is breaching a contractual provision would be insufficient to disentitle the purchaser to equitable relief. This conclusion applies with greater force to the exercise of discretion to refuse declaratory relief in which the "unclean hands" doctrine is applied in a less structured manner and is but one of the factors to be considered. With

respect to the family connection, no finding was made by the courts below with respect to any scheme between the parties to defeat the rights of CMHC. Without such a finding, this fact alone is of little importance.

42 The only party unquestionably seeking equitable relief in this case is Hongkong, which is seeking a judicial sale in its mortgage foreclosure action. There is no evidence that Hongkong was guilty of any misconduct. Hongkong seems particularly free of suspicion of misconduct because it was not even the original mortgagee. It purchased a mortgage acquired by its predecessor in title. If Hongkong were the original mortgagee, there might be suspicion that the second mortgages had been made with the intention of intentionally defaulting in order to escape obligations to CMHC. Here there can be no such suspicion because Hongkong purchased the mortgages some five years after they were first made. There is no evidence of a plot to enter into second mortgages as part of a scheme to escape obligations to CMHC, but even if there was such a scheme Hongkong could not have been a participant. The mere fact that the relationship among the numbered companies, Town House and Wel ington may arouse suspicions is not a sufficient basis upon which to deny an equitable remedy to Hongkong.

43 With respect to the numbered company which seeks to purchase under the judicial sale in the foreclosure action, CMHC argues that all participants in a foreclosure action, including the prospective purchasers at a court-conducted sale, must be governed by equitable principles. In this case, it is evident that the 1989 purchaser knew of the provisions of the Operating Agreement, and in fact the Offer to Purchase is expressly stated to be contingent on a declaration by the court that the terms, conditions and obligations in the Operating Agreement will not be binding on the purchaser. Nonetheless, aside from the relationship of the 1989 purchaser to the other numbered companies and to Town House and Wellington, which will be discussed below, there does not appear to be evidence of wrongdoing on the part of the 1989 purchaser which would warrant a finding of unclean hands. As is the case with the 1988 purchasers, mere knowledge that one is participating in a transaction which constitutes a breach of a contract to which one is not a party does not seem to me to be sufficient to constitute unclean hands. Further, a review of the jurisprudence in this area fails to reveal any cases in which a judicial sale has been disallowed on the basis of the unclean hands of the proposed purchaser, which may well be a result of the fact that, as here, it is not the purchaser but the mortgagee who seeks relief from the court, even though the purchaser stands to benefit from the relief.

44 CMHC relied on *Valley Vu Realty (Ottawa) Ltd. v. Victoria & Grey Trust Co.* (1984), 44 O.R. (2d) 526, 30 R.P.R. 90 (H.C.), affirmed (1984), 47 O.R. (2d) 544n (C.A.), and *Colonial & Home Fuel Distributors Ltd. v. Skinners' Ltd.* (1963), 39 D.L.R. (2d) 579 (Man. Q.B.), affirmed (1963), 46 D.L.R. (2d) 695 (Man. C.A.), which was affirmed [1964] S.C.R. v, in support of its contention that relief should be denied on equitable grounds. In my view, both cases are distinguishable because in both cases there was direct evidence that the very parties who were seeking equitable relief were guilty of misconduct in that they were parties to a breach of contract.

45 In *Valley Vu*, supra, the court refused to assist a mortgagor in obtaining a discharge of a mortgage through prepayment because the mortgagor had intentionally breached the terms of the mortgage, including a provision restraining alienation. In this case, neither Hongkong nor the numbered companies is party to a breach of contract. The only parties in breach are Town House and Wellington. In *Colonial*, the court refused to allow a party to use a company which was his alter ego to circumvent a restrictive covenant. In this case, there is no clear evidence and no finding that either Hongkong or any of the numbered companies were the alter egos of Town House and Wellington. I agree with Lieberman J.A.'s assessment of the respondents' relationship (at p. 168):

> One can, of course, speculate about the motivation behind the parties entering into the agreements for sale and its connection or otherwise with the relationship of those parties, but without evidence to substantiate such a speculation the appellant's submission falls far short of establishing a common operating mind behind the respondent companies. There is in my view no direct evidence to establish an intention to circumvent the contractual liability of the original mortgagors, and I cannot infer such an intention. This is not a case justifying the piercing of the corporate veil.

The relationship between the numbered companies and Town House and Wellington is undoubtedly suspicious, but without direct evidence it is impossible to conclude that they jointly acted to free Town House and Wellington of their obligations towards CMHC.

46 The numbered companies do seek to avoid the CMHC operating agreement but insofar as the terms of the operating agreement are incorporated into the mortgages, which is the extent the statute contemplates, CMHC retains the right to accelerate the loan or increase the interest rates. Thus even if Hongkong is granted the equitable relief which it seeks, CMHC is not left without a remedy for breach of its operating agreements.

47 I therefore conclude that there is no basis for refusing equitable relief or declaratory relief to the respondents on the "clean hands" principle.

2. Illegality

48 CMHC's foremost argument against the transactions was that the second mortgages and the 1988 sale agreements were illegal contracts. CMHC argued that these contracts were contrary to the public policy set out in the *National Housing Act*. In my view, the *National Housing Act* does not prohibit the transactions in question. As a result, this ground of attack fails.

49 At the time of the operating agreements, sale and disposition of mortgaged properties were referred to in s. 16(4)(*g*) of the *National Housing Act, 1954*, which read as follows:

> 16. ...
>
> (4) A contract with a limited-dividend housing company entered into under this section shall provide that ...
>
> (*g*) except with the consent of the Corporation and on such terms and conditions as the Corporation may approve the project or any part thereof shall not be sold or otherwise disposed of during the term of the loan.

This provision was repealed and replaced by the *Act to Amend the National Housing Act, 1954*, S.C. 1968-69, c. 45, s. 7. The replacement to s. 16(4)(*g*) now appears as s. 26(3)(*b*) of the *National Housing Act*, R.S.C. 1985, c. N-11. The wording of s. 26(3)(*b*) differs somewhat from that of s. 16(4)(*g*), but it is not materially different for the purposes of the issue of illegality, and the parties referred in their submissions to s. 16(4)(*g*). For ease of reference, I will therefore refer to s. 16(4)(*g*).

50 CMHC cited *Chesire, Fifoot and Furmston's Law of Contract*, 12th ed. (1991), at p. 349, for the proposition that a contract which is expressly or impliedly prohibited by statute is illegal and therefore void. In my view, s. 16(4)(*g*) neither expressly nor impliedly prohibited the second mortgages and the 1988 sale agreements.

51 The prohibition contained in s. 16(4)(*g*) is not express. Indeed, CMHC did not contend that s. 16(4)(*g*) expressly prohibits the contracts in question. I cannot read s. 16(4)(*g*) as doing anything more than requiring CMHC to obtain contractual restraints on disposition. The whole of s. 16 is directed towards the terms to be incorporated in the contract. It is impossible to read such a provision as an express statutory restraint on disposition.

52 I am also of the opinion that s. 16 does not contain an implied prohibition of the transactions in question. Interpreting s. 16 as creating an implied statutory restraint on disposition would deprive Hongkong of its mortgages and the 1988 purchasers of their title, in the absence of CMHC's consent. Such a deprivation of property rights is not lightly implied.

53 CMHC argued that the second mortgages and the 1988 sale agreements violated the policy of the *National Housing Act*. However, I view the policy of the *National Housing Act* differently. The policy of the *National Housing Act* is to place the governing arrangements in a contract between the mortgagor and mortgagee. CMHC then takes its security and protects itself in accordance with the provincial law applicable to the property. In some instances provincial legislation has been enacted to exclude the general law from applying to projects under the *National Housing Act*. For example, s. 43 of the *Law of Property Act*, R.S.A. 1980, c. L-8, exempts *National Housing Act* mortgages from some of the restrictive provisions of that statute. Moreover, s. 16(4)(*h*) of the *National Housing Act, 1954* stipulates a special remedy for breach, namely acceleration of the loan or increasing the rate of interest. Had Parliament intended the provisions of the Act to have extra-contractual force, it would not have used the contractual mechanism as distinct from simply legislating against alienation.

54 It is common ground that the second mortgages and the 1988 sales are subject to the CMHC mortgages. Hongkong can only dispose of the mortgagor's equity, and the 1988 purchasers take subject to the CMHC mortgages. The fundamental question is whether the contractual provisions can be enforced against strangers to the contract. Section 16 clearly applies to CMHC, directing the conditions under which it must operate. It does not purport to apply to the mortgagors, let alone third parties. In my view CMHC's remedies are contractual, either under the terms of the operating agreements or under the terms of its mortgages. Any sale, judicial or otherwise, can only sell the property subject to the mortgages. The Court of Appeal held that the operating agreement did not create covenants running with the land. CMHC, in its factum, stated that it "did *not* argue that the clauses preventing sale or mortgage 'run with the land', nor that they are 'rights in rem'" (emphasis in original). This is not, therefore, an issue in this appeal.

55 We must remember that the Act contemplated transactions taking place under provincial property law, the granting of a mortgage securing the loan. If CMHC's argument is correct, a federal statute would be imposing real property restraints without regard to the provincial real property regime. One cannot lightly conclude that Parliament, having spoken in terms of contracts and mortgages, intended to create restraints that are inconsistent with the common law and the Torrens system of title holding.

56 Furthermore, the underlying constitutional context suggests that s. 16 should be interpreted so that it does not impliedly prohibit the transactions in question. If s. 16 prohibits the sale or encumbrance of properties mortgaged to CMHC, then it would be a statutory restraint on alienation altering the common law rule that restraints on alienation are void. Under s. 92 of the *Constitution Act, 1867*, Parliament has no jurisdiction to legislate with respect to property and civil rights in a province. Without deciding the point, there would at least be a serious question about the validity of a federal statute creating a restraint on alienation. By requiring the arrangements to be created by contract, Parliament avoided any doubts about the validity of s. 16. Since the express words of Parliament appear to have been employed to avoid any constitutional challenge, it would be unwise to adopt an interpretation of those words which is not only strained but also creates the difficulty which Parliament avoided.

57 For these reasons, I conclude that s. 16 does not prohibit the second mortgages and the 1988 sales, either expressly or impliedly. Section 16 does not create a statutory restraint on alienation. Accordingly, the constitutional question does not arise and need not be answered.

3. Corporate Ultra Vires

58 CMHC's next argument against the transactions was that the second mortgages were ultra vires the corporate powers of Town House and Wellington. In my view, the second mortgages were not ultra vires and accordingly this ground of attack fails.

59 At first glance, it seems somewhat surprising that a corporate ultra vires argument is raised in this appeal, given that the corporate ultra vires doctrine has now all but disappeared. The ultra vires argument arises because Town House and Wellington were incorporated under the *Companies Act* which was still in force at the time of the second mortgages. Town House and Wellington were accordingly still subject to the corporate ultra vires doctrine at that time.

60 The appellant did not argue the ultra vires issue with respect to the 1988 sales in its factum, but by a letter to the Court after the hearing, counsel for CMHC suggested that these transactions could still be analyzed in light of the ultra vires doctrine as this doctrine had not been abolished by the Alberta *Business Corporations Act*, and that, further, the actions of the officers of Town House and Wellington in making the 1988 sale agreements were ultra vires the officers as not being in furtherance of objectives set out in the Articles of Continuance. However, it has been well-established that the doctrine of ultra vires as it stood under the *Companies Act* was abolished by s. 15(1) of the Alberta *Business Corporations Act* (see, for example, the recent decision of Iacobucci J. in *Communities Economic Development Fund v. Canadian Pickles Corp.*, [1991] 3 S.C.R. 388, [1992] 1 W.W.R. 193, 8 C.B.R. (3d) 121, 85 D.L.R. (4th) 88). As will be discussed more fully below, the fact that the Articles of Continuance state that the businesses to be carried on by the corporations are subject to the provisions of the *National Housing Act* is not sufficient to find the sale agreements or mortgages ultra vires according to the doctrine as it existed under the *Companies Act*, much less under the *Business Corporations Act*.

61 It was also submitted that the combined effect of s. 117(2) and s. 18 of the *Business Corporations Act*, which require that the directors and officers comply with the Act, articles and by-laws but protect third parties without notice from the consequence of non-compliance, rendered the transactions ultra vires. These provisions are simply a statutory indoor management rule and do not, as the appellant suggests, govern the situation where a third party such as CMHC claims that a transaction between the corporation and another party should be held void on the basis of non-compliance with the articles. There is therefore no basis upon which to find the 1988 sale agreements to be ultra vires Town House and Wellington.

62 The objects of Town House and Wellington are identical and read as follows:

> To acquire land for building purposes and to lay out building lots and to clear and improve the same in any manner, to construct, purchase, hold, enjoy and manage low rental housing projects consisting of two or more one-family dwellings or one or more multiple family dwellings or a combination of one family or multiple family dwellings; and in connection with the foregoing to purchase, lease, construct, develop, hold, enjoy, manage, improve and assist in improving any and all properties owned or controlled by the Company, recreational and educational facilities, commercial space or buildings including retail stores, shops, offices and other community services in connection with low rental housing projects.
>
> (b) In connection with the foregoing to deal in building material of all kinds and description and carry on business as general contractors.

Thus the objects of Town House and Wellington do not expressly authorize them to grant second mortgages. However, the power to encumber a company's property would normally fall within the scope of s. 20(1)(*h*) of the *Companies Act*, R.S.A. 1980, c. C-20:

> 20 (1) For the purpose of carrying out its objects, a company other than a specially limited company has the following powers, except those of them expressly excluded by the memorandum ...
>
> (*h*) the power to borrow or raise or secure the payment of money in any manner the company thinks fit ...

63 CMHC argued that the second mortgages do not fall within s. 20(1)(*h*) because of the following restriction contained in the memoranda of association of Town House and Wellington: "The objects for which the Company is established are subject to the provisions of the National Housing Act, 1954, and amendments thereto ..."

64 CMHC noted that there is a distinction between a company's objects, contained in the memorandum of association, and its powers, granted by s. 20 of the *Companies Act*. A company's powers can only be used to achieve its objects. *Re Introductions Ltd.; Introductions Ltd. v. National Provincial Bank Ltd.*, [1970] Ch. 199, [1969] 1 All E.R. 887 (C.A.), established that the power to borrow money is not an independent object. Thus the power in s. 20(1)(*h*) can only be used to achieve objects contained in the memoranda of association.

65 It has long been recognized that the ultra vires doctrine should not be applied restrictively. *Attorney-General v. Great Eastern Railway Co.* (1880), 5 App. Cas. 473 (H.L.), stated at p. 478 that the ultra vires doctrine:

> ought to be reasonably, and not unreasonably, understood and applied, and that whatever may fairly be regarded as incidental to, or consequential upon, those things which the Legislature has authorized, ought not (unless expressly prohibited) to be held, by judicial construction, to *ultra vires*.

As is noted in *Palmer's Company Law*, 24th ed. (1987), vol. I, at pp. 143-44, "in modern law the courts are unlikely to hold a contract to be *ultra vires* the company unless, on a reasonable construction of the objects clause and the other clauses of the memorandum and articles, there are compelling grounds to arrive at that result." Such an approach is amply demonstrated by such cases as *Bell Houses Ltd. v. City Wall Properties Ltd.*, [1966] 2 Q.B. 656, [1966] 2 All E.R. 674 (C.A.), and *Re New Finance & Mortgage Co.*, [1975] Ch. 420, [1975] 1 All E.R. 684.

66 In Canada it is particularly important not to interpret corporate capacity restrictively, since, as discussed above, the ultra vires doctrine has been abolished in most Canadian jurisdictions, including Alberta. It would be anachronistic for the courts to interpret corporate powers narrowly when most Canadian legislatures have indicated that companies should have all the legal powers of natural persons.

67 Furthermore, it has long been recognized that companies generally require the ability to mortgage their property in order to undertake their ordinary business operations: see *Re Patent File Co.; Ex parte Birmingham Banking Co.* (1870), L.R. 6 Ch. 83, and *General Auction Estate & Monetary Co. v. Smith*, [1891] 3 Ch. 432. Even without a statutory power such as the one contained in s. 20(1)(*h*), the power to mortgage is a power exercisable by most companies unless that power is expressly excluded in the memorandum of association.

68 Following this general approach to the ultra vires doctrine, I cannot conclude that the second mortgages were ultra vires. The corporate objects of Town House and Wellington include the ability to "purchase, lease, construct, develop, hold, enjoy, manage, improve and assist in improving any and all properties owned or controlled by the Company". The ability to raise funds by making second mortgages on the company's property is sufficiently incidental to these objects. It is difficult to imagine how a company whose objects include the ownership and development of real estate could reasonably function without the incidental ability to finance its operations by mortgaging its property. Furthermore, as Lieberman J.A. noted, "there is no evidence that the mortgage loan was not applied to accomplish a corporate object" (p. 167). Thus *Re Introductions Ltd.*, supra, can be distinguished from this case. *Re Introductions Ltd.* involved a loan which violated an express object of the company. In this case, the loan does not violate an express object of Town House or Wellington. By mortgaging their properties, Town House and Wellington were exercising their powers under s. 20(1)(*h*) in furtherance of corporate objects.

69 Similarly, I cannot conclude that the memoranda of association of Town House and Wellington exclude the power granted to them by s. 20(1)(*h*). Companies have all the powers set out in s. 20, "except those of them expressly excluded by the memorandum". It is important to note that the powers in s. 20 must be excluded expressly. Excluding the power in s. 20(1)(*h*) would require far more express language than the phrase "[t]he objects for which the Company is established are subject to the provisions of the National Housing Act, 1954, and amendments thereto".

70 In addition, the argument that this proviso excludes the power to mortgage depends to a large extent upon the argument I have already rejected, namely that s. 16 of the *National Housing Act, 1954* prohibits or makes illegal the granting of second mortgages. The Act does not provide that a company cannot be incorporated with other objects or powers. It requires CMHC to make loans to companies whose objects satisfy the definition of a limited-dividend housing company. One of its objects must be to construct and operate such a company and there must be a restriction on the dividends. Again, in my view, the remedy for breach (for example, paying out excessive dividends) is the contractual one. Section 16(3)(*k*) makes it clear that CMHC was to satisfy itself, and there is no suggestion of interfering with provincial corporate law:

> 16. ...
>
> (3) A loan may be made under this section only to a limited-dividend housing company that has entered into a contract with the Corporation on the terms set out in subsection (4), to construct a low-rental housing project or to convert existing buildings into a low-rental housing project if ...
>
> (*k*) the powers given to the company and activities or transactions that are permitted by its charter or other instrument of incorporation are satisfactory to the Corporation.

71 The conclusion that the second mortgages are not ultra vires is strengthened by considering the purpose of the ultra vires doctrine. Gower, *Gower's Principles of Modern Company Law*, 4th ed. (1979), at p. 161, describes the ultra vires doctrine as follows:

> Its purpose was two-fold. First to protect investors in the company so that they might know the objects for which their money was to be employed: and secondly to protect creditors of the company by ensuring that its funds, to which alone they could look for payment in the case of a limited company, were not dissipated in unauthorised activities. [Footnote omitted.]

The application of the ultra vires doctrine to invalidate the second mortgages would not further this purpose. CMHC is a creditor of Town House and Wellington and thus is entitled to use the ultra vires doctrine to protect its loan from unauthorized use. However, CMHC's complaint is not that its loan is endangered but rather that it simply does not want Town House and Wellington to make the second mortgages. Thus CMHC is not seeking to use the ultra vires doctrine for the purpose of protecting its position as a creditor, but rather is seeking to use it to maintain control over Town House and Wellington. This is an improper use of the ultra vires doctrine. The ultra vires doctrine is not designed to give creditors the power to control their debtors, even where such control is to be exercised for a beneficial public purpose.

72 As a result, I conclude that neither the 1988 sale agreements nor the second mortgages were ultra vires the corporate powers of Town House and Wellington.

4. Prepayment of Mortgages

73 The appellant seeks deletion of the declaration contained in para. 6 of the chamber judge's formal judgment relating to each of Town House and Wellington and confirmed by the Court of Appeal. The declaration entitles 1988 purchasers to pay off the first mortgages and redeem. The Court of Appeal found that the provisions of the agreements which prohibited sale or other disposition were unenforceable because they were not restrictive covenants running with the land. The Court of Appeal also appears to have concluded that therefore they could not be conditions in restraint of alienation in that they created in personam rights only and not rights in rem. The Court of Appeal declined to decide whether the provisions were a clog on the equity of redemption because in view of the finding that these provisions were not restrictive covenants, the issue was academic. The respondents seek to have the provisions declared void presumably to ensure that the right to redeem is not affected.

74 In my opinion, having characterized these provisions as in personam rights, the Court of Appeal could not affirm the declaration entitling the 1988 purchasers to redeem unless it also concluded that breach of these covenants did not create a default under the mortgages that disentitled these respondents to prepay the amount owing. Whether or not a breach of these covenants had this effect depends largely on the interpretation of any prepayment provision contained in the mortgage. This is a matter not addressed by the Court of Appeal. I propose to first consider whether the Court of Appeal was right in concluding that the impugned provisions created in personam rights and then whether enforcement of in personam rights precludes prepayment and consequent redemption of the mortgages. Finally I will consider whether, if redemption is precluded by reason of the enforcement of the in personam rights, this constitutes a clog on the equity of redemption.

75 To the extent that the policy against restraints on alienation applies to contractual provisions that are not annexed to the land so as to run with the land, it does not render such provisions unenforceable for all purposes. Contractual provisions are simply ineffective to prevent the owner of land from conveying a good title to a purchaser but other in personam remedies remain available. I agree with the Court of Appeal that the Crown is not immune from the rule against restraints on alienation and therefore is in the same position as other parties in this regard. Accordingly, it has been held that breach of such an agreement can constitute an event of default under a mortgage which entitles the mortgagee to accelerate payment at his option. In *Canada Permanent Trust Co. v. King's Bridge Apartments Ltd.* (1984), 8 D.L.R. (4th) 152, the Newfoundland Court of Appeal held that a covenant not to alienate could not restrict the mortgagor's right to sell or otherwise dispose of the property but "none the less a proviso permitting an acceleration of the repayment of the principal sum and other moneys payable under the indenture of mortgage is valid and is enforceable at the option of the mortgagee" (p. 155). Similarly, in *Valley Vu*, supra, a mortgagor who sold contrary to such a covenant was denied an order permitting prepayment of the mortgage and a discharge. In *Paul v. Paul* (1921), 50 O.L.R. 211, 64 D.L.R. 269, the Ontario Court of Appeal held that a provision in a conveyance of land which prohibited sale or mortgage without consent did not render a sale without consent void but that an action for damages lay for breach of the covenant. See also *Bahnsen v. Hazelwood*, [1960] O.W.N. 155, 23 D.L.R. (2d) 76 (C.A.) . In my opinion, the principle applied in these cases strikes the proper balance between two conflicting policies. On the one hand there is a

policy against restraints on alienation which permits real property to circulate freely in commerce and preserves the right of the owner to dispose of it and on the other the law favours that bargains be kept and not breached with impunity. Accordingly, notwithstanding that the impugned provisions are not enforceable to prevent the transfer of a good title to the purchasers, non-compliance with their terms constitutes a breach of the agreement for the purpose of triggering other remedies which the mortgagee has under the mortgage. Clause 12 of the operating agreements, which is headed "Default" and which is incorporated into the mortgages, provides for the acceleration of the loan and increase of interest payments "in the event of the Borrower ... otherwise committing a breach of this agreement ..." This is a remedy that is available to the appellant by reason of the breach occasioned by the dispositions made in 1988 and 1989. I will now consider whether this constitutes an act of default for the purpose of the prepayment provisions.

76 At the outset, I note that the Wellington mortgage does not provide for any right of prepayment. The mortgage by its terms can only be repaid by payments that span the loan period of 40 years. The respondents submit, however, that the court has a discretion to allow prepayment in the absence of a prepayment clause, citing *Garnet Lane Developments Ltd. v. Webster* (1986), 43 R.P.R. 138, 20 O.A.C. 291 (Div. Ct.). This case does not decide that the court has a discretion to allow prepayment absent a prepayment clause in the mortgage. In any event, if the court has such a discretion I would not exercise it in favour of this respondent in the circumstances of this case.

77 The Town House prepayment clause applies only when the mortgagor is not in default. In selling the properties the mortgagor has committed an act of default under cl. 12 of the agreement which is also part of the mortgage. The mortgagor is, therefore, in default under the mortgage. Does that preclude the 1988 purchasers from availing themselves of the provisions of this mortgage? In order to prepay, these purchasers, while not bound by the agreements, must comply with the preconditions for prepayment. One of the preconditions is that the mortgage is not in default. Notwithstanding that the default is not that of the purchasers, this precondition disentitles anyone who seeks to repay the mortgage while the default continues. I would, therefore, set aside the declaration relating to prepayment unless the argument succeeds that in the circumstances the agreement constitutes a clog on the equity of redemption.

78 The foundation for the argument that the operation of the agreements constitutes a clog on the equity of redemption is that notwithstanding the payment of the mortgage debt the equity cannot be redeemed by reason of an impediment imposed by the terms of the mortgage instrument. The contractual postponement of the right to redeem by virtue of the fact that the mortgagor is given a long period within which to pay and the absence of a prepayment clause cannot be characterized as a clog on the equity of redemption. In *Knightsbridge Estates Trust Ltd. v. Byrne*, [1938] 4 All E.R. 618, the English Court of Appeal held that the postponement of redemption for 40 years by reason of contractual provisions in the mortgage which provided for the principal to be repayable by instalments over that period with no right of prepayment or redemption before that time did not constitute a clog on the equity of redemption. Since I have found that there is no right of prepayment here by virtue of the terms of the mortgage, the mortgage is repayable at the end of the loan period of 40 years. This postponement of the right to redeem does not, however, create a clog on the equity of redemption.

5. Costs

79 While CMHC has been unsuccessful except with respect to the right of prepayment, the other parties are able to defeat an operating agreement of which they had notice. In those circumstances there will be no order as to costs in this Court.

80 We were asked to vary the order below on costs.

81 The guarantors argue that, having decided against CMHC on the merits, the Court of Appeal could not interfere with the chambers judge's order because of the provisions of R. 505(3) of the *Alberta Rules of Court*, which require leave to appeal a costs order. There are two plausible interpretations of this rule. It could be interpreted to mean that leave is required if the appellant intends to contest the order as to costs as a separate issue regardless of whether the judgment appealed from is set aside on other grounds. Or it can be interpreted to mean that leave is only required when only the order as to costs is appealed. There does not appear to be a settled practice in this regard in Alberta. See Stevenson and Coté, *Civil Procedure Guide* (1989), at pp.

986-90. Apparently, the Court of Appeal accepted the latter interpretation. In my opinion, it is the preferable interpretation and the costs were properly before the Court of Appeal when the orders as a whole were appealed.

82 In my opinion, the Court of Appeal made no reversible error in the disposition it made which resulted in the mortgagors bearing the brunt of the costs. The mortgagors and their purchasers seek to turn the property to commercial account freed of the restrictions of the operating agreement. The guarantors cannot be in a better position. The new owners also knew the state of the title and may properly be visited with costs subject to any contractual right over they may have against their vendors, the original mortgagors. Accordingly, I would not disturb the Court of Appeal's order as to costs.

Disposition

83 The appeal is allowed in part. The orders made by Veit J. dated December 13, 1989 are varied by deleting from each para. 6 thereof. In other respects the appeal is dismissed. The constitutional question does not arise. There will be no order as to costs in this Court.

Appeal allowed in part.

Footnotes

* Stevenson J. took no part in the judgment.

TAB 19

CITATION: Gillespie v. Gillespie, 2014 ONSC 3755
COURT FILE NO.: FS-503-13
DATE: 2014-07-03

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: Michelle Gillespie, Applicant/Responding Party

AND:

Robert Gillespie, Respondent/Moving Party

BEFORE: The Honourable Mr. Justice G. A Campbell

COUNSEL: Brian R. Kelly, for the Applicant/Responding Party

Robert Gillespie, Self-represented Respondent/Moving Party

COSTS ENDORSEMENT

[1] Mr. Gillespie's latest motion was unsuccessful for the reasons I set out in my Endorsement of June 19, 2014. As a result, Ms. Gillespie is presumed to be entitled to her costs for successfully resisting that motion: Rule 24(1). Her counsel seeks an Order for costs of $8520.20, inclusive of tax for research, preparation and attendance to argue the motion which consumed under three hours of counsel's time that day.

[2] Rule 24(11) sets out the six factors that I am to consider in order to arrive at my costs decision. Those factors are:

a) The importance, complexity or difficulty of the issues;

b) The reasonableness or unreasonableness of each party's behaviour in the case;

c) The lawyer's rates;

d) The time properly spent on the case, including conversations between the lawyer and party or witnesses, drafting documents and correspondence, attempts to settle, preparation, hearing, argument, and preparation and signature of the order;

e) Expenses properly paid or payable; and

f) Any other relevant matter. (my emphasis added)

[3] As well, Mr. Kelly served Mr. Gillespie with a Rule 18 Offer to Settle on May 27, 2014, well before the motion was argued and only one day after Mr. Gillespie e-mailed Mr. Kelly a copy of this Motion to Change.

[4] According to the dockets submitted with the Costs Outline, Mr. Bernard spend six hours and forty minutes on May 26, 2014 on this matter including preparing the Offer to Settle served on 27 of May. Had Mr. Gillespie accepted that Offer on the 27th of May, Ms. Gillespie's law firm would have avoided investing almost 17 more hours on the motion (ten more by Mr. Bernard and 6.3 by Mr. Kelly at rates of $225 and $350/hour). Those extra hours of effort generated fees of $4455 of the total $8322.45 in fees sought. Mr. Kelly's preparation and attendance on June 19 cost Ms. Gillespie $1661.10 and is part of that total.

[5] Mr. Gillespie's "Hail Mary" attempt to set aside Sloan, J.'s order of November 5, 2013 in the face of my Order of June 10, 2013 and his intransigence in (still) not serving or filing any financial disclosure at all, was, according to the *Rules*, doomed from the outset: see Rule 19(10):

> Failure to Follow Rule or Obey Order
>
> If a party does not follow this rule or obey an order made under this rule, the court may, on a motion, do one or more of the following:
>
> 1. Order the party to give another party an affidavit, let the other party examine a document or supply the other party with a copy free of charge;
> 2. Order that a document favourable to the party's case may not be used except with the court's permission; or
> 3. Order that the party is not entitled to obtain disclosure under these rules until the party follows the rule or obeys the order.
> 4. Dismiss the party's case or strike out the party's answer.

5. Order the party to pay the other party's costs for the steps taken under this rule, and decide the amount of the costs.

6. Make a contempt order against the party.

7. Make any other order that is appropriate. (my emphasis added)

[6] Mr. Kelly also correctly reminds me in his submission of the provision of Rule 18(14) as follows:

> Costs Consequences of Failure to Accept Offer
>
> A party who makes an offer is, unless the court orders otherwise, entitled to costs to the date the offer was served and full recovery of costs from that date, if the following conditions are met:
>
> 1. If the offer relates to a motion, it is made at least one date before the motion date.
> 2. If the offer relates to a trial or the hearing of a step other than a motion, it is made at least seven days before the trial or hearing date.
> 3. The offer does not expire and is not withdrawn before the hearing starts.
> 4. The offer is not accepted.
> 5. The party who made the offer obtains an order that is as favourable as or more favourable than the offer. (my emphasis added)

[7] Although I am surprised by the extent of the effort invested by Mr. Bernard and Mr. Kelly (almost ten hours on the Factum and almost five hours legal research) to respond to what appears to be a quixotic attempt by Mr. Gillespie to set aside a valid court order in the face of his continued non-compliance with a previous court order for disclosure of June 10, 2013, the *Rules* are both clear and emphatic. Courts will not respond positively to litigants who seek discretionary relief when they do not first rectify their non-compliance and come to the court with "clean hands".

[8] Mr. Gillespie is the author of his own dilemma. Having created the problem, he cannot now plead his alleged (but not proven) impecuniosity. His "failing to provide the most basic financial disclosure, is litigation conduct deserving the censure of the court" : see paragraph 4 of *Westendorp v. Westendorp* (2000) CanLii 22538, MacKinnon, J. (ONSC).

[9] Once served, Ms. Gillespie had no option available to her other than to oppose the motion. It ill-behooves Mr. Gillespie to now seek to deprive her of repayment for any of the legal expenses that she apparently now faces.

[10] Normally, I would follow the principles enunciated in the cases of *Pagnotta v. Brown* (2002) CarswellOnt 1666 (ONSC); *Gale v. Gale* (2006), CarswellOnt 6328; *Hackett v. Leung* (2005) CanLii 42254 (ONSC); and *Zesta Engineering Ltd. V. Cloutier* [2002] O.J. No. 4495 (OCA) that a costs award should represent a fair and reasonable amount rather than any exact measure of the actual costs for Ms. Gillespie; and should reflect some form of proportionality to the actual issues argued, rather than an unquestioned reliance on billable hours and documents created; and should use a flexible approach to costs rather than a rigid adherence to hours-billed-times-the-hourly-rate-charged approach.

[11] However, in this case, given Mr. Gillespie's unreasonable and intractable resistance to make <u>any</u> financial disclosure at all, I find that the "fair-and-reasonable-amount" approach to deciding a costs award that responds to these particular circumstances "justly" (see *Boucher v. Public Accountants Counsel* [2004] O.J. No. 2634 (OCA)) requires the court to allow the <u>full</u> amount of costs sought by Ms. Gillespie in order that Mr. Gillespie's actions are indeed "censured" (*Westendorp*)

[12] Accordingly, Mr. Gillespie is ordered to forthwith pay Ms. Gillespie $8520.20 including disbursements properly incurred and applicable taxes.

[13] Although Mr. Gillespie based much of his claim and spent much of his time at the return of his motion focussed on the impact of the Sloan, J. order of November 5, 2013 on his relationship with his children, a significant part of his motivation to set aside that order relates to his child support obligation.

[14] Accordingly, I find that 75 percent of these costs ordered were incurred with respect to that portion of the Sloan, J. order that addresses child support issues. These costs are "legal fees or other expenses arising in relation to support or maintenance" and as such, should be enforceable by the Director of F.R.O. (see s. 1(1)(g) of the *Family Law Responsibility and Support Arrears Enforcement Act* 1996, S.O. 1996, C.31 (as amended) and *Wildman v. Wildman* (2006), 82 O.R. (3d) 401 (C.A.)). I so order.

G. A. Campbell J.

Date: July 3, 2014

TAB 20

Immigration and
Refugee Board
Immigration Appeal Division

Commission de l'immigration
et du statut de réfugié
Section d'appel de l'immigration

IAD File No. / N° Dossier de la SAI : MA9-02824
Client ID No. / N° ID Client : 6063-8679

AMENDED

Reasons and Decision – Motifs et décision
Sponsorship Appeal

Appellant(s) / **Appelant(s)**

Nadia ZANCHETTA

Respondent / **Intimé**

Minister of Citizenship and Immigration
Ministre de la Citoyenneté et de l'Immigration

Date(s) of Hearing / **Date(s) de l'audience**

October 12th, 2011 / June 29th, 2012

Place of Hearing / **Lieu de l'audience**

Montréal, Québec

Date of decision / **Date de la décision**

June 29th, 2012
Date of signature: July 12, 2012

Panel / **Tribunal**

Me Dana Kean

Appellant's Counsel / **Conseil de l'appelant(s)**

Richard Serour

Minister's Counsel / **Conseil de l'intimé**

Catherine Raymond

Oral Reasons for Decision

[1] The appellant in this case, **Nadia ZANCHETTA** appealed from a refusal to grant a permanent resident visa to her husband **Michael BORUTA** (the applicant).

[2] In a letter sent to the applicant on February 2nd, 2009, the immigration officer concluded that the applicant, Mr Boruta, was inadmissible to Canada under section 36(1)(b) and 36(2)(b) on grounds of serious criminality for having committed an offense outside Canada, that if committed in Canada would constitute an offence under an Act of Parliament punishable by a maximum term of imprisonment of at least 10 years, that's 36(1)(b) and 36(2)(b) was for having been convicted of an offence outside Canada that, if committed in Canada, would constitute an offence under an Act of Parliament punishable by a maximum term of imprisonment not to exceed 5 years.

[3] The two offences in question: the applicant was convicted in the state of New Jersey of burglary (July 19th, 1995) and of possession of a weapon (November 21st, 1996). The officer concluded that if these offenses would have been committed in Canada, both offenses would be punishable under an Act of Parliament. Burglary conviction equates to subsection 348 of the Canadian Criminal code and the possession conviction equates to section 92 of the Criminal code of Canada.

[4] Additionally, another ground of refusal was added at today's hearing, that of misrepresentation under section 40(1)a) of the *Immigration and Refugee Protection Act*,[1] (the *Act*) in particular that the applicant committed a misrepresentation and/or omission of a material fact which did or could have induced an error in the administration of the *Act*.

[5] The tribunal has reviewed the documentary evidence and concludes that all the grounds of refusal are well founded valid in law.

[6] The appellant asks this tribunal to grant her appeal on the basis of humanitarian and compassionate considerations.

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1 *Immigration and Refugee Protection Act*, S.C. 2001, c.27, as amended.

[7] The appellant in this case was born on March 25th, 1968 and is Canadian citizen. She married the applicant, a United States citizen, on June 9th, 2001. They have three children together: Michael (10), Jonathan (6) and Maria (3). All the children are Canadian citizens.

[8] It would appear that the appellant lived for a time in the United States with her husband but according to the testimony before this tribunal today, it would appear that the appellant and the applicant have both been living in Canada on a permanent basis since 2005.

[9] The applicant entered Canada as a visitor in 2005 and has been living here illegally since that time, in other words for the last seven years.

[10] The tribunal has first considered the applicant's criminality. Counsel for the applicant submitted the crimes for which the applicant was convicted were not serious in nature. The applicant claims that with regard to his conviction for possession of a dangerous weapon it was only a novelty item consisting of a dart pen.

[11] As pointed out during the hearing[2], the list of weapons which constitute prohibited weapons and devices doesn't include a dart pen. The only evidence before this tribunal that this in fact the weapon in question is the applicant's own testimony.

[12] The tribunal cannot conclude based evidence before the tribunal that the offences committed were not serious in nature, but the tribunal would have been inclined towards leniency if the inadmissibility based on criminality was the only grounds of refusal in this case, given that the applicant has a wife and three children in Canada.

[13] The issue before this tribunal is that the applicant added insult to injury when he committed a number of misrepresentations and omissions in the documentary evidence that was put before this panel.

[14] In the view of the tribunal, in order to invoke humanitarian and compassionate considerations and thereby seek discretionary relief, the applicant must, at a minimum, come before the tribunal with

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2 Appeal record, p. 44.

clean hands. Unfortunately, the inverse is true of the applicant who has, in the view of this tribunal, demonstrated a blatant disregard for the law, both Canadian as well as American and furthermore has deliberately and intentionally sought to mislead Canadian immigration authorities.

[15] The list is long. The tribunal refers to page 7 of the Appeal record where the applicant lists his mailing address as being that of his counsel on St-Jacques street, counsel being the present counsel and lists his residential address as being 208 Fairfield Road, Mocksville, North Carolina.

[16] Confronted with this obvious misrepresentation the applicant claims that he misunderstood the question. Unfortunately, the tribunal does not find this credible in the least and does not find residential vs. mailing address to be subject to misinterpretation when one is fluent in the English language.

[17] The tribunal is furthermore not convinced of the applicant's credibility as especially, when confronted with his lack of truthfulness on the Form which appears in page 7, the applicant acknowledged that he couldn't put down his real address because he didn't want to acknowledge that he was living in Canada, thereby confirming that he committed a deliberate misrepresentation.

[18] At page 10 of the Appeal record, we have the applicant's employment history. This Form is signed in 2008, the applicant states that from 2005 until the present date, which date of signature was June 26th, 2008, he is unemployed. Given his testimony at this hearing we know this to be another misrepresentation as the applicant acknowledged he was working in Canada illegally over the last several years.

[19] Page 12 of the Appeal record, question 15: the applicant is asked "to list all addresses where you have lived since your 18th birthday". The applicant indicates that from 2000 until present –again that would be 2008-, he lives in North Carolina, USA, thereby omitting to list his Canadian address where he has been living since 2005 with his wife. Again, I note that this Form was signed at page 13 in 2008.

[20] At page 28 of the Appeal record: the appellant gives the dates of cohabitation with her husband as being June 5th, 1998, September 20th, 1998 and again from July 1st, 1999 to December 20th, 1999. This is, once again, incorrect information as apparently the couple have been cohabiting in

Canada since 2005. Asked if he is currently living with the sponsor, in other words this is the applicant stating or being questioned rather, whether he is currently living with his wife, indicates NO and indicates that the appellant returned to Canada in 1999.

[21] There are additional misrepresentations that were committed if I look at page 87 of the Appeal record, which is a statement signed by the applicant. He indicates:

> "I confirm that between 1999 and 2009 I have lived with my wife and have travelled back and forth from the USA where I stayed part of the time at my brother's and part of the time at my parent's". This contradicts part of his own testimony, and contradicts the documentary evidence.

[22] The applicant testified that he is working in Canada since 2005, despite the fact that he doesn't have a work permit. Consequently he is working illegally in Canada. To add insult to injury, the applicant testified he doesn't pay taxes in Canada, nor in the USA for that matter, thereby, once again, demonstrating a blatant disregard for Canadian and American laws.

[23] The tribunal has also considered the fact that the applicant never sought to regularize his immigration status in Canada prior to 2009.

[24] The applicant consequently chose to remain in Canada illegally for four years before seeking to apply for status. Furthermore, since his application was refused in February 2009, the applicant is aware that he was obliged to leave Canada and yet he has chosen to remain in Canada thereby, yet again, demonstrating a disregard for Canadian immigration law.

[25] Confronted with his misrepresentation, the applicant chose to minimize and rationalize his actions. He claimed that most of his answers were "mistakes". Unfortunately, the tribunal cannot deem this to be credible. It is clear for the tribunal that these were not mistakes, but rather deliberate attempts to mislead.

Conclusion

[26] The tribunal concludes that the applicant, not only committed deliberate misrepresentations, but furthermore he's demonstrated not one iota of remorse for his actions. The tribunal concludes that the applicant has not been of good faith, on the contrary.

[27] The appellant invokes humanitarian and compassionate considerations and the tribunal has considered that the applicant has a wife and three young children living in Canada, all of whom are Canadian citizens. The tribunal notes that according to the *Digilov* decision, the best interest of any child directly affected by a decision, is a factor to be considered in a serious manner, but it is not the predominant factor.

[28] The tribunal has no doubt that the appellant's children would benefit from the continued presence of their father in Canada and has no doubt that the family would be prejudiced by the applicant's removal from Canada. But the tribunal concludes that in the circumstances of this case, this factor in and of itself, is an insufficient humanitarian and compassionate consideration, so as to warrant the exercise of discretionary relief.

[29] The applicant, who is a US citizen, can continue to provide for his family from the USA where he is legally entitled to live and to work. No evidence was put before this tribunal that the appellant and her children could not live with the applicant in the USA and the tribunal has considered that the appellant and her children can continue to visit the applicant until such time as they choose to reunite with the applicant in the USA, or until such time as he is able to legally regularize his immigration status in Canada.

[30] For the foregoing reasons, the tribunal concludes that the refusals in this case, both the inadmissibility as well as the misrepresentation are well founded in law and concludes that the appellant has not met the onus that was incumbent upon her today, of establishing the existence of sufficient humanitarian and compassionate considerations, taking into account the best interest of any child affected by this decision and in light of all the circumstances of this case, so as to warrant the exercise of discretionary relief.

[31] Consequently, this appeal is dismissed and a deportation order as well as an exclusion order are rendered as of this state against the applicant.

NOTICE OF DECISION

This appeal is **dismissed**.

Dana Kean

M^e^ Dana Kean

July 12, 2012
Date

/sb/gg

NOTE - Judicial review - Under section 72 of the *Immigration and Refugee Protection Act*, you may make an application to the Federal Court for judicial review of this decision, with leave of that Court. You may wish to get advice from counsel as soon as possible, since there are time limits for this application.

TAB 21

1999 CarswellOnt 2249
Ontario Superior Court of Justice

Tatarchenko v. Tatarchenko

1999 CarswellOnt 2249, [1999] O.J. No. 2776, 104 O.T.C. 72, 89 A.C.W.S. (3d) 1205

Yevgen Tatarchenko v. Nataliya Tatarchenko

G. Campbell J.

Judgment: July 21, 1999
Docket: F1397/98

Counsel: *Edward J. Mann*, for Moving Party.
Victor Mitrow, for Responding Party.

Subject: Family

Table of Authorities

Cases considered by *G. Campbell J.*:

McRae v. McRae (June 18, 1990), Doc. 15928/87 (Ont. Dist. Ct.) — applied

Poirier v. Poirier (1988), 16 R.F.L. (3d) 384 (Man. Q.B.) — referred to

Rivers v. Hribar (November 21, 1995), Doc. Ottawa 21093/93 (Ont. Gen. Div.) — referred to

Ronson v. Ronson (1989), 21 R.F.L. (3d) 132 (Ont. H.C.) — referred to

Ventura v. Domingos (November 12, 1993), Doc. 92-FC-268 (Ont. Gen. Div.) — applied

Statutes considered:

Canadian Charter of Rights and Freedoms, Part I of the Constitution Act, 1982, being Schedule B to the Canada Act, 1982 (U.K.), 1982, c. 11
Generally — referred to

Children's Law Reform Act, R.S.O. 1990, c. C.12
Generally — referred to

Divorce Act, R.S.C. 1985, c. 3 (2nd Supp.)
Generally — referred to

Family Law Act, R.S.O. 1990, c. F.3
Generally — referred to

s. 34(1)(k) — referred to

s. 43(1) — considered

Rules considered:

Family Court Rules, R.R.O. 1990, Reg. 202
R. 23 — considered

MOTION by husband for relief from term of interim order that he deposit passport with court.

***G. Campbell J.*:**

Endorsement

1 Mr. Tatarchenko brings a motion seeking the court's discretionary relief from the 'passport deposit' term only of an extensive interim order made by Vogelsang J. of October 30, 1998. That order, *inter alia*, ordered him to pay child and spousal support, costs of $2,500 plus G.S.T. and deposit his passport and travel documentation with the court. The latter term was included to thwart the possibility of him removing the children from the responding party's care and absconding with them out of the country.

2 It is common ground that Mr. Tatarchenko has not paid *any* support whatsoever, nor has he paid the costs plus G.S.T. ordered. When this motion was argued on July 14, 1999, the arrears of support had accumulated to $4,486 and the costs plus G.S.T. were $2,675, for a total owing by him of $7,161, plus accumulated interest.

3 Rule 23 of this court provides that:

> Where a party fails to comply with an order for interim relief and the Court is satisfied that the party is able to comply with the order, the Court may postpone the hearing or strike out the application, the answer or any affidavit of the party that failed to comply.

4 According to the findings of Vogelsang J. in his endorsement of October 30, 1998, Mr. Tatarchenko came to Canada from the Ukraine on a student visa as a doctoral student in biology. He was employed by the University of Western Ontario, presumably as a teaching assistant, at $22,000 per year. Within two and-a-half months of later sponsoring his wife and her two children to come to Canada (as visitors only), he separated from her. For several months thereafter, he, his sister and her husband prevented the responding party from any contact with their child. He also unilaterally withdrew from his studies and his employment at the University without any reasonable explanation.

5 Marshman J. ordered interim care and custody of both children to the responding party and initiated the 'deposit passport with the court' order. She also allowed *only* supervised access by Mr. Tatarchenko to the children.

6 In the reasons of his later interim order, Vogelsang J. made some very strong observations with regard to Mr. Tatarchenko's (and his family's) tactics; his "bizarre" allegations made against his wife; his "obvious exaggerations and overstatements; his "tone of ... control, domination and obsession"; the responding party's isolation and complete "vulnerability in this country"; as well as "something quite dark and foreboding about the evidence on this motion". Vogelsang J. imputed an income at the same annual rate as Mr. Tatarchenko had been earning and based the support amounts on that finding.

7 Mr. Tatarchenko now seeks to leave the jurisdiction to return to the Ukraine. His view is that the responding party, having now been abandoned by him, may remain in Canada "as a refugee". He is "happy to see his wife and children supported in Canada". She cannot afford the fares for her and the children to return to the Ukraine and may not work nor receive social assistance, due to her 'visitor' status. She finds herself in an absolutely untenable position.

8 When asked on July 7, 1999 to offer proof of his intention to return to the Ukraine (until then he had only "proposed" to return there), Mr. Tatarchenko, on July 14th, produced a fully paid, one-way ticket to the Ukraine for August 16, 1999,

(presumably paid for by his sister and her husband, upon whom he has been relying for food, lodging and money since the fall of 1998). The ticket cost over $2,500.

9 Mr. Tatarchenko pleads that he has no money to pay support or the costs ordered, due to his inability to find work in Ontario or return to the University. He is, however, able to locate and spend over $2,500 on one week's notice, for his own latest planned egocentric excursion. Mr. Tatarchenko was able to raise significant money for himself, for his own wishes, but has totally ignored his obligations to those others to whom he is obliged.

10 Counsel for Mr. Tatarchenko argued vigorously for the release of Mr. Tatarchenko's passport and travel documentation without which he cannot board the 'Aeroflot' flight on which he is presently booked. He cited the' *Canadian Charter of Rights and Freedoms*' the 'Liberty of the Subject' (as if Mr. Tatarchenko were being imprisoned or his freedom of movement is somehow presently prohibited by the present interim order), and an individual's right to "personal mobility". He also argues that the original reason for the deposit of the documents was to prevent Mr. Tatarchenko from abducting the children from Ontario. Now the responding party seeks to keep them for a different purpose, namely to force him to meet his court-ordered obligations to his wife and the children. Apparently, this causes Mr. Tatarchenko great distress, consternation and affront.

11 The application is brought under the *Divorce Act*, the *Family Law Act* and the *Children's Law Reform Act*. Counsel for the responding party reminds the court of section 43(1) of the *Family Law Act* (absconding debtor) that allows the court, by warrant, to prevent a person from leaving the province, if it is satisfied that (s)he intends to evade their responsibilities under that Act. Clearly, Mr. Tatarchenko falls within that category.

12 Additionally, there are many decisions in this province that clearly require any litigant, who seeks discretionary relief from the court, to come before it with "clean hands". See *McRae v. McRae* (June 18, 1990), Doc. 15928/87 (Ont. Dist. Ct.), where Houston J. cites Misener J. in *Ronson v. Ronson* (1989), 21 R.F.L. (3d) 132 (Ont. H.C.) and Mullally J. in *Poirier v. Poirier* (1988), 16 R.F.L. (3d) 384 (Man. Q.B.), and states at p. 6:

> It should be made crystal clear to husbands and fathers who are attempting to escape the arrears under Orders such as in this case, that they should come to court with clean hands and not, as in this case, present a picture of constantly changing positions.

13 Also, see Greer J.'s comments in *Ventura v. Domingos* (November 12, 1993), Doc. 92-FC-268 (Ont. Gen. Div.) at p.5:

> ... Litigants must come before the court with clean hands. To allow the husband to proceed with litigation to strike down Master Donkin's Order when he was, at that time, one year in arrears of the Order, and when his wife of 35 years had received no support, would simply fly in the face of justice.

14 The 'clean hands' principle was also reiterated by Desmarais J. in *Rivers v. Hribar* (November 21, 1995), Doc. Ottawa 21093/93 (Ont. Gen. Div.).

15 It is incumbent upon the court to uphold the integrity of the court process and of the orders that emanate from it, regardless of whether those orders are interim or final in nature. Mr. Tatarchenko's consistently self-focussed behaviour since separation is clear and is easily predictable. There is absolute certainty that if he is prevented from removing these children from the respondent (as he has been), he has no intention whatsoever of meeting *any* future responsibility to them and the respondent. His past behaviour bodes ominously of his future behaviour. He has little respect, if any, for the institution of marriage as it applies to him (as evidenced by his outrageous and spurious allegations made against his wife in his earlier affidavits) and the institutions of this country.

16 The arguments made on behalf of Mr. Tatarchenko are not persuasive. His motion for relief is stayed, pursuant to Rule 23, until:

- all of the outstanding arrears of support and existing costs plus G.S.T. (previously totalling $7,161) and accumulated interest thereon that are owing at the time of payment, are paid to Mrs. Tatarchenko; and

• a deposit of $5,000 cash (or a bond of a similar amount, with two sureties who pledge property, an available investment or other equally viable security), pursuant to section 34 (1)(k) of the *Family Law Act*, is deposited with the court, to the credit of the responding party for future child and spousal support; and

• costs of these motions, as agreed by counsel or as determined by this court after receiving their brief written submissions within five days of the release of these reasons.

17 When Mr. Tatarchenko has completed all of the above, his passport and travel documentation may be released by the court to his counsel, Edward J. Mann. Mr. Mann is ordered, as an officer of this court, to retain same until five (5) hours before the time of Mr. Tatarchenko's flight to the Ukraine on August 16, 1999, when he may make them available only to Mr. Tatarchenko, in person.

18 Should Mr. Tatarchenko cancel that ticket or rebook a flight to *any* other destination, the passport and travel documentation are not to be released by Mr. Mann to Mr. Tatarchenko (or anyone on his behalf). If that happens, the passport and travel documents are to be re-deposited forthwith with the court. Notice, in writing of the re-deposit of the documents is to be served on counsel for the responding party by Mr. Mann.

Order accordingly.

TAB 22

Federal Court of Appeal | Cour d'appel fédérale

Date: 20150609

Docket: A-455-14

Citation: 2015 FCA 141

CORAM: **STRATAS J.A.**
SCOTT J.A.
BOIVIN J.A.

BETWEEN:

OWAIS AHMED ASAD
RAHIM AHMED

Appellants

and

THE MINISTER OF CITIZENSHIP AND IMMIGRATION

Respondent

Heard at Winnipeg, Manitoba, on May 6, 2015.

Judgment delivered at Ottawa, Ontario, on June 9, 2015.

REASONS FOR JUDGMENT BY: BOIVIN J.A.

CONCURRED IN BY: STRATAS J.A.
SCOTT J.A.

Federal Court of Appeal | Cour d'appel fédérale

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REASONS FOR JUDGMENT

BOIVIN J.A.

I. Background

[1] This is an appeal from a decision of Mr. Justice Russell of the Federal Court (the Judge) dated September 26, 2014 (2014 FC 921). The Judge dismissed the application for judicial review from the decision of an Officer at the Canadian High Commission in Islamabad, Pakistan

(the Officer). The Officer refused the application of Mr. Owais Ahmed Asad (the adult appellant) for citizenship of his adopted son Rahim Ahmed (the child appellant) (collectively, the appellants) made under subsection 5.1(1) of the *Citizenship Act*, R.S.C. 1985, c. C-29 (the Act).

[2] The adult appellant and his wife are Canadian citizens who, after a number of years of marriage, had no children. The adult appellant signed an "Irrevocable Deed of Adoption" (Deed of Adoption) for the child appellant, who was born in Pakistan on October 22, 2008. The said Deed of Adoption was executed on April 18, 2009 and notarized on June 23, 2009. Pursuant to the Guardian and Wards Act, 1890 in force in Pakistan, the Court of Civil/Family Judge & Judicial Magistrate of Hyderabad Sindh (the Family Court) issued a Guardianship Certificate to the adult appellant and his wife, also on June 23, 2009.

[3] In March 2011, the adult appellant applied for Canadian citizenship for the child appellant under section 5.1 of the Act, which provides that a non-Canadian child, adopted by Canadian parents and meeting the requirements of the Act, can directly be granted citizenship without the requirement of first becoming a permanent resident.

[4] The Deed of Adoption and the Guardianship Certificate issued by the Family Court were submitted in support of the application.

[5] By letter dated October 2, 2013, the Officer refused the grant of citizenship. The main ground for refusal was that the *Muslim Family Laws Ordinance, 1961* (the Ordinance 1961) only allows for the sharia law practice of kafala, which is akin to the concept of guardianship. Kafala,

noted the Officer, does not create a permanent parent-child relationship. Although the Officer did not reference it explicitly, section 5.1 of the *Citizenship Regulations*, SOR/93-246 (the Regulations) mandates that a valid adoption includes full severance of the legal relationship between the child and his or her biological parents. The Officer's conclusion was expressed as follows:

> […] no adoption as it is understood in Canada or under the framework provided by *Hague Convention on Protection of Children and Co-operation in Respect of Intercountry Adoption* has taken place. Therefore the application for Canadian Citizenship for a person under the guardianship of a Canadian Citizen to be adopted cannot be processed.
>
> (Appeal book at page 127)

[6] In reviewing the Officer's decision, the Judge found that the standard of review was reasonableness. He upheld the Officer's decision on the basis that there was no evidence as to whether an adoption had taken place in accordance to the laws of Pakistan. In so doing, the Judge made the following observations at paragraphs 41 and 60 of his reasons:

> [41] In attacking the Officer's reasons and conclusions by way of judicial review, the Applicants have attempted to suggest various ways in which the Officer is either wrong or unreasonable. In the end, however, it has to be acknowledged that they chose not to provide the Officer with direct evidence on point such as, for example, an opinion by a qualified expert on the law or laws of adoption in Pakistan and how they had complied with those laws. If adoption is possible in Pakistan as it is understood under the *Hague Convention on Protection of Children and Co-operation in Respect of Interlocutory* [sic] *Adoption* [*Hague Convention*], the Applicants could easily have settled this point with appropriate evidence. Instead they have chosen to challenge the Decision after the fact by suggesting in various indirect ways why the Officer was either wrong or unreasonable.
>
> …
>
> [60] In my view, the adoption deed and related documentation do not establish that, under the law of Pakistan, a severance has occurred in this case. We do not know whether these parties could, by agreement, sever the biological relationship as a matter of law. The Applicants have not established that the Officer was either

wrong or unreasonable when he found that the adoption deed establishes a form of guardianship, which is not an adoption as required by Canadian law.

II. Legislation and Regulation

[7] Section 5.1 of the *Citizenship Act* provides, in relevant portions:

5.1(1) Subject to subsections (3) and (4), the Minister shall, on application, grant citizenship to a person who was adopted by a citizen on or after January 1, 1947 while the person was a minor child if the adoption	**5.1 (1)** Sous réserve des paragraphes (3) et (4), le ministre attribue, sur demande, la citoyenneté à la personne adoptée par un citoyen le 1er janvier 1947 ou subséquemment lorsqu'elle était un enfant mineur. L'adoption doit par ailleurs satisfaire aux conditions suivantes :
(*a*) was in the best interests of the child;	*a*) elle a été faite dans l'intérêt supérieur de l'enfant;
(*b*) created a genuine relationship of parent and child;	*b*) elle a créé un véritable lien affectif parent-enfant entre l'adoptant et l'adopté;
(*c*) was in accordance with the laws of the place where the adoption took place and the laws of the country of residence of the adopting citizen; and	*c*) elle a été faite conformément au droit du lieu de l'adoption et du pays de résidence de l'adoptant;
(*d*) was not entered into primarily for the purpose of acquiring a status or privilege in relation to immigration or citizenship.	*d*) elle ne visait pas principalement l'acquisition d'un statut ou d'un privilège relatifs à l'immigration ou à la citoyenneté.

[8] Subsection 5.1(3) of the *Citizenship Regulations* provides as follows:

5.1(3) The following factors	**5.1(3)** Les facteurs ci-après

are to be considered in determining whether the requirements of subsection 5.1(1) of the Act have been met in respect of the adoption of a person referred to in subsection (1):

sont considérés pour établir si les conditions prévues au paragraphe 5.1(1) de la Loi sont remplies à l'égard de l'adoption de la personne visée au paragraphe (1) :

(*a*) whether, in the case of a person who has been adopted by a citizen who resided in Canada at the time of the adoption,

a) dans le cas où la personne a été adoptée par un citoyen qui résidait au Canada au moment de l'adoption :

(i) a competent authority of the province in which the citizen resided at the time of the adoption has stated in writing that it does not object to the adoption, and

(i) le fait que les autorités compétentes de la province de résidence du citoyen au moment de l'adoption ont déclaré par écrit qu'elles ne s'opposent pas à celle-ci,

(ii) the pre-existing legal parent-child relationship was permanently severed by the adoption;

(ii) le fait que l'adoption a définitivement rompu tout lien de filiation préexistant;

(*b*) whether, in the case of a person who has been adopted outside Canada in a country that is a party to the Hague Convention on Adoption and whose intended destination at the time of the adoption is a province,

b) dans le cas où la personne a été adoptée à l'étranger dans un pays qui est partie à la Convention sur l'adoption et dont la destination prévue au moment de l'adoption est une province :

(i) the competent authority of the country and of the province of the person's intended destination have stated in writing that they approve the adoption as conforming to that Convention,

(i) le fait que les autorités compétentes de ce pays et celles de la province de destination de la personne ont déclaré par écrit que l'adoption était conforme à cette convention,

(ii) a competent authority of the province — in which the citizen who is a parent of the

(ii) le fait que les autorités compétentes de la province de résidence, au moment de

person resided at the time of the adoption — has stated in writing that it does not object to the adoption, and	l'adoption, du citoyen qui est le parent de la personne ont déclaré par écrit qu'elles ne s'opposent pas à l'adoption
(iii) the pre-existing legal parent-child relationship was permanently severed by the adoption; and	(iii) le fait que l'adoption a définitivement rompu tout lien de filiation préexistant;
(*c*) whether, in all other cases,	*c*) dans les autres cas :
(i) a competent authority has conducted or approved a home study of the parent or parents, as the case may be,	(i) le fait qu'une étude du milieu familial a été faite ou approuvée par les autorités compétentes,
(ii) before the adoption, the person's parent or parents, as the case may be, gave their free and informed consent to the adoption,	(ii) le fait que le ou les parents, selon le cas, ont, avant l'adoption, donné un consentement véritable et éclairé à l'adoption,
(iii) the pre-existing legal parent-child relationship was permanently severed by the adoption, and	(iii) le fait que l'adoption a définitivement rompu tout lien de filiation préexistant,
(iv) there is no evidence that the adoption was for the purpose of child trafficking or undue gain within the meaning of the Hague Convention on Adoption.	(iv) le fait que rien n'indique que l'adoption avait pour objet la traite de la personne ou la réalisation d'un gain indu au sens de la Convention sur l'adoption.

III. The Issues

[9] In my view, the issues to be resolved in this appeal are the following:

a) What is the appropriate standard of review?

b) Was the appropriate standard of review applied properly in the present case?

IV. The Appropriate Standard of Review

[10] On an appeal from an application for judicial review, the task of our Court is to first determine whether the judge identified the proper standard of review and, second, whether he or she properly applied it to each of the issues raised. This Court must thus "step into the shoes" of the Federal Court and focus on the administrative decision at issue (*Agraira v. Canada (Public Safety and Emergency Preparedness)*, 2013 SCC 36, [2013] 2 S.C.R. 559 at paras. 45-47).

[11] The parties disagree as to the applicable standard of review.

[12] While the appellants agree that the content of foreign law is a question of fact and findings on such content should attract the standard of review of reasonableness, they submit that the determination as to the content of foreign law in this case is not just a finding of fact on the part of the Officer. Rather, it is a question of general importance to the legal system attracting the correctness standard. As such, the appellants argue, the Federal Court is better placed than the Officer to interpret foreign law. In the alternative, they argue that if the standard of review is reasonableness, the level of deference owed to the Officer is lower and he should be granted only a narrow margin of appreciation.

[13] For its part, the respondent argues that the standard of review is reasonableness and that the Officer is entitled to considerable deference.

[14] For a number of decades, it has been established that in the context of foreign law and citizenship, the Federal Court applies the standard of review of reasonableness. But recently, jurisprudence has emerged resulting in contradictory decisions with some applying the reasonableness standard, and others, correctness.

[15] The case according to which reasonableness has become the applicable standard of review can be traced back to *Canada (Minister of Citizenship and Immigration) v. Saini*, 2001 FCA 311, [2002] 1 F.C. 200 [*Saini*].

[16] In that case, our Court determined that a finding of foreign law was one of fact (*Saini* at para. 26). While *Saini* concerned the review of a Federal Court decision and not one of an administrative decision-maker, subsequent citizenship decisions have applied the standard of reasonableness to findings of foreign law (because it is one of fact) and have found that, as such, officers are entitled to considerable deference: *e.g. Canada (Minister of Citizenship and Immigration) v. Sharma*, 2004 FC 1069, [2004] F.C.J. No. 1313; *Lakhani v. Canada (Citizenship and Immigration)*, 2007 FC 674, [2007] F.C.J. No. 914; *Lai v. Canada (Minister of Citizenship and Immigration)*, 2007 FC 361, [2008] 2 F.C.R. 3; *Tindungan v. Canada (Citizenship and Immigration)*, 2013 FC 115, [2014] 3 F.C.R. 275.

[17] Likewise, in the particular context of assessing whether an adoption has occurred in accordance with foreign law, the Federal Court has applied the reasonableness standard. It has consistently afforded deference to the officers' determinations, as to whether a foreign adoption complies with the laws of the country in which it took place (see *Boachie v. Canada (Citizenship*

and Immigration), 2010 FC 672, [2010] F.C.J. No. 821; *Bhagria v. Canada (Citizenship and Immigration)*, 2012 FC 1015, [2012] F.C.J. No. 1118; *Cheshenchuk v. Canada (Citizenship and Immigration)*, 2014 FC 33, [2014] F.C.J. No. 20; *Vasquez v. Canada (Citizenship and Immigration)*, 2014 FC 782, [2014] F.C.J. No. 819; *Dolker v. Canada (Citizenship and Immigration)*, 2015 FC 124, [2015] F.C.J. No. 174).

[18] However, in two recent decisions, the Federal Court has ruled that determinations regarding the content of foreign law are to be reviewed not on the reasonableness standard but correctness: *Kim v. Canada (Citizenship and Immigration)*, 2010 FC 720, [2010] F.C.J. No. 870 and *Dufour v. Canada (Citizenship and Immigration)*, 2013 FC 340, [2013] F.C.J. No. 393 [*Dufour*]. The appellants in the present case rely on these two Federal Court decisions in support of their argument that correctness should be the standard here. It is to be recalled that the Federal Court's decision in *Dufour* was appealed to the Federal Court of Appeal. In confirming the Federal Court's *Dufour* decision, our Court ruled that it did not need to decide the issue of the standard of review because the issue did not arise (*Canada (Citizenship and Immigration) v. Dufour*, 2014 FCA 81, [2014] F.C.J. No. 324 at para. 27).

[19] Seizing upon the unsettled jurisprudence, the appellants submit that clarification is needed. Echoing *Dunsmuir v. New Brunswick*, 2008 SCC 9, [2008] 1 S.C.R. 190 at paragraph 62 [*Dunsmuir*], the appellants further contend that the applicable standard of review in the context of foreign law and citizenship has yet to be determined in a satisfactory manner because going as far back as *Saini*, a fulsome analysis has never been undertaken in this regard. The appellants

thus strongly invite our Court to "address the issue head on through reasoning", and that a standard of review analysis as per *Dunsmuir* is appropriate in the present case.

[20] For the benefit of future cases, I agree.

[21] As set forth by the Supreme Court of Canada in *Dunsmuir*, the standard of review analysis for purposes of determining whether to apply the reasonableness or the correctness standard is dependent on the following relevant factors:

1. the presence or absence of a privative clause;
2. the purpose of the tribunal as determined by interpretation of enabling legislation;
3. the nature of the question at issue; and
4. the expertise of the tribunal.

[22] Turning to the first factor, I note that although decisions such as the one at issue, which are rendered in the context of citizenship, can only be judicially reviewed upon leave, the Act does not contain any privative clause. As observed by the respondent, the "privative clause" factor is "typically assessed as being neutral" and I agree that it is so in the circumstances.

[23] With respect to the second factor, which goes to the "purpose of the decision-making process regarding citizenship", a reading of section 5.1 of the Act, shows that a determination as to whether the requirements for a grant of citizenship are met do not involve obvious

determinative policy or polycentric considerations. As such, this can be considered an *indicium* for deference favouring the standard of reasonableness.

[24] The third factor concerns the nature of the question at issue. Here, it is undoubtedly fact-driven because the Officer will render a decision based on the evidence adduced and the facts of the case. In addition, foreign law is a question of fact (*Saini*) and must be proven by evidence. This too attracts deference, again favouring the standard of reasonableness.

[25] Finally, in terms of the expertise factor, it is trite to note that an officer posted overseas will have developed a significant degree of expertise in the field as well as expertise in assessing foreign law. Here, factual interpretation and specialized understanding predominate. I accordingly have no difficulty finding that an officer's expertise in this context is greater than that of the courts. Again, this attracts deference and hence the standard of reasonableness.

[26] A review of the foregoing *Dunsmuir* factors convinces me that, as found by the Judge in the present case, the applicable standard of review is reasonableness. Deference is owed to officers who consider foreign law, including when they do so in the context of alleged adoptions under section 5.1 of the Act.

[27] However, the level of deference to be afforded to an officer is not unfettered nor set in stone.

[28] When applying the reasonableness standard to an officer's decision, the reviewing court must decide whether it "falls within a range of possible, acceptable outcomes, which are defensible in respect of the facts and law" (*Dunsmuir* at para. 47). In other words, the court must determine whether the decision at issue is within the decision-maker's margin or range of appreciation (*Delios v. Canada (Attorney General)*, 2015 FCA 117, [2015] F.C.J. No. 549). This margin or range of appreciation can be narrow or wide depending on the nature of the question at issue and circumstances before the administrative decision-maker (*Catalyst Paper Corp. v. North Cowichan (District)*, 2012 SCC 2, [2012] 1 S.C.R. 5; *Halifax (Regional Municipality) v. Nova Scotia (Human Rights Commission)*, 2012 SCC 10, [2012] 1 S.C.R. 364; *McLean v. British Columbia (Securities Commission)*, 2013 SCC 67, [2013] 3 S.C.R. 895).

[29] Applying these principles to decisions of officers who consider foreign law when deciding citizenship applications, the breadth of the margin or range of reasonableness will very much depend on the circumstances of each case.

[30] More specifically, in cases where no evidence of foreign law is adduced, as in the present matter, the nature of the officer's task, as to whether the statutory standards set forth by section 5.1 of the Act are met, allows a wide margin of appreciation to the officer and a hence a wider range of possible and acceptable outcomes (*Canada (Minister of Transport, Infrastructure and Communities) v. Jagjit Singh Farwaha*, 2014 FCA 56, [2014] F.C.J. No. 227).

[31] For completeness, I would add that it necessarily follows from the above analysis that the two cases relied upon by the appellants in support of the correctness standard - i.e. the *Kim* and

Dufour decisions of the Federal Court - are not to be considered good law and should not be followed in circumstances such as the ones at issue in the present case.

[32] One last word on the standard of review before moving to the next portion of these reasons. At hearing before this Court, reference was made by the parties to *Kent Trade and Finance Inc. v. JP Morgan Chase Bank*, 2008 FCA 399, [2009] 4 F.C.R. 109 and *General Motors Acceptance Corp. of Canada Ltd. v. Town and Country Chrysler Ltd.*, 2007 ONCA 904, [2007] O.J. No. 5046. Those cases were rendered in the context of an appellate review, not in the context of an administrative review. They have strictly no application in the present matter.

V. Application of the Reasonableness Standard

[33] In the present case, the appellants essentially contend that the Ordinance 1961 does not bar secular adoption, and hence the Deed of Adoption was made in accordance with the laws of Pakistan as required by paragraph 5.1(1)(*c*) of the Act. Moreover, according to the appellants, this Deed of Adoption effects the necessary legal severance to fulfill the requirements of adoption under Canadian law. These contentions were rejected by the Officer who determined that the appellants had failed to demonstrate that an adoption had taken place for purposes of the Act. The Judge found that this decision was reasonable.

[34] As part of their challenge, the appellants very much rely on the decision of the Immigration Appeal Division of the Immigration and Refugee Board of Canada [IAD] in *Massey*

v. Canada (Citizenship and Immigration), [2010] I.A.D.D. No. 820, No. VA7-00874 [*Massey*]. In that case, the IAD accepted a deed of adoption as proof of adoption and allowed the appeal from the visa office in Pakistan.

[35] However, this decision does not assist the appellants. Contrary to *Massey*, the appellants in this case have failed to adduce relevant evidence in support of their contentions. For instance, the Officer was not provided with expert evidence regarding the laws of Pakistan or whether the appellants complied with those laws. Nor did the appellants adduce evidence to the effect that the Deed of Adoption resulted in an adoption in Pakistan as understood in Canadian law. Similarly, there was no evidence that the said deed is the same - or a similar - deed than the one adduced in *Massey*. While I agree with the appellants that the Deed of Adoption evidences a strong intention to take care of the child at issue, its legal effects remain unknown, more particularly as it relates to severance of ties with the child's biological parents (Section 5.1 of the Regulations and decision of the Family Court in Pakistan). The *Massey* decision was also rendered in a different context and by a different tribunal. In the circumstance, I find that *Massey* is entirely distinguishable and the Officer was in no way bound to follow it.

[36] The appellants also resort to the conflict of laws principle of *lex fori* to advance their position. They submit that, in the absence of any evidence of foreign law, there is a legal presumption that foreign law is the same as Canadian law. As there is no evidence that the Ordinance 1961, which is a religious law, supersedes secular Pakistani law, the appellants maintain that the Court must apply Canadian law, which allows for secular adoption and give full effect to the Deed of Adoption.

[37] This argument is without merit. As is readily apparent from subsection 5.1(1) of the Act, Parliament has set a statutory standard pursuant to which an adoption must notably be shown to have occurred "in accordance with the laws of the place where the adoption took place and the laws of the country of residence of the adopting citizen" (paragraph 5.1(1)(c)). The language of the Act creates an obligation to adduce evidence of foreign law and the Officer's decision has to be measured according to this standard.

[38] As observed by both the Officer and the Judge, the difficulty for the appellants in the present case stems from the total lack of evidence on record regarding the laws of Pakistan, which would support their position. As such, I can only agree with the respondent that "the appellants have not identified any "secular" law, which supports the proposition that the adoption of Muslims in Pakistan is legal, nor have they established that there is a difference between "secular" law and "religious" law in Pakistan" (Memorandum of the respondent at para. 57). The appellants also relied upon the UN Report entitled *United Nations Committee on the Rights of the Child: Second Periodic Reports of States Parties Due in 1997, Pakistan*, 11 April 2003, CRC/C/65/Add.21, online: Refworld http://www.refworld.org/docid/45377e700.html ; Affidavit of Raymond Gillis, appeal book, page 68 at paragraph 7. However, it does not contain findings that could undercut the Officer's decision.

[39] In the end, I am of the view that the Judge did not err in selecting the reasonableness as the standard of review for all issues before him, including the Officer's determinations regarding the laws of Pakistan. Nor did he err in applying the reasonableness standard.

[40] Accordingly, I would dismiss the appeal. As the parties did not request costs, none shall be awarded.

"Richard Boivin"

J.A.

"I agree
David Stratas J.A."

"I agree
A.F. Scott J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-455-14
STYLE OF CAUSE:	OWAIS AHMED ASAD, RAHIM AHMED v. THE MINISTER OF CITIZENSHIP AND IMMIGRATION
PLACE OF HEARING:	WINNIPEG, MANITOBA
DATE OF HEARING:	MAY 6, 2015
REASONS FOR JUDGMENT BY:	BOIVIN J.A.
CONCURRED IN BY:	STRATAS J.A. SCOTT J.A.
DATED:	JUNE 9, 2015

APPEARANCES:

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Nalini Reddy Brendan Friesen	FOR THE RESPONDENT THE MINISTER OF CITIZENSHIP AND IMMIGRATION

SOLICITORS OF RECORD:

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William F. Pentney Deputy Attorney General of Canada	FOR THE RESPONDENT THE MINISTER OF CITIZENSHIP AND IMMIGRATION

TAB 23

COURT OF APPEAL FOR BRITISH COLUMBIA

Citation: *Friedl v. Friedl,*
2009 BCCA 314

Date: 20090707
Docket: CA036496

Between:

Carola Heide Friedl

Respondent
(Plaintiff)

And

Hans Peter Friedl

Appellant
(Defendant)

Before: The Honourable Madam Justice Newbury
The Honourable Madam Justice Levine
The Honourable Mr. Justice Groberman

Corrected Judgment:
Counsel for the appellant has been corrected to ready M.B. Gehlen

On appeal from the Supreme Court of British Columbia, Kamloops Registry,
2008 BCSC 1222, Docket No. 38294

Counsel for the Appellant:	P.R. Albi M.B. Gehlen
Counsel for the Respondent:	M.J. Keim
Place and Date of Hearing:	Vancouver, British Columbia June 23, 2009
Place and Date of Judgment:	Vancouver, British Columbia July 7, 2009

Written Reasons by:
The Honourable Madam Justice Levine

Concurred in by:
The Honourable Madam Justice Newbury
The Honourable Mr. Justice Groberman

Reasons for Judgment of the Honourable Madam Justice Levine:

Introduction

[1] Dr. Hans Peter Friedl appeals from the order of a justice of the Supreme Court dividing the parties' assets in accordance with s. 65 of the *Family Relations Act*, R.S.B.C. 1996, c. 128 ("*FRA*"). The principle question on the appeal is whether the trial judge erred in interpreting and applying expert evidence of German law in finding that the parties' pre-nuptial agreement made in Germany before their marriage (the "Agreement") was invalid.

[2] The trial judge's reasons for judgment may be found at 2008 BCSC 1222.

[3] In my opinion, the trial judge made no error in interpreting the expert evidence of German law, or in applying it in finding the Agreement was invalid. It is therefore not necessary to address other arguments raised by the appellant concerning the application of British Columbia law to the Agreement and the division of the parties' assets on the breakdown of their marriage. It follows that I would dismiss the appeal.

Background

[4] The parties entered into the Agreement immediately before their marriage, when Ms. Friedl was four months pregnant with their first child. The Agreement was executed before Dr. Jung-Heiliger, a notar in Liepzig, Germany. The Agreement provided for "the marital property regime of the separation of property", and that it would be interpreted pursuant to German law. Under the "default" matrimonial property regime provided in German statute law, the net gain from assets acquired by either spouse during the marriage is evenly divided on marriage breakdown. Thus, under the Agreement, these provisions of German law were excluded. The Agreement also dealt with inheritances, pensions and spousal support, which were not in issue at trial and about which no issue is raised on the appeal.

[5] The parties were married in Michigan in 1997, and lived in Germany until 2001, when they moved to Kamloops. They have two children, a daughter born in 1997, and a son born in 1999. They separated in 2006.

[6] The appellant had practised as an orthopaedic surgeon in Germany, but did not practise in Canada. Prior to the marriage, he had acquired property in Germany, Switzerland, and Michigan. After the marriage, he purchased additional property in Michigan, homes in Germany and Kamloops, a ranch at Hyas Lake, near Kamloops, registered in Friedl Development Ltd., property at Clearwater, BC, and an interest in a business, “Proair”, purchased through Friedl Holdings Inc.

[7] The respondent was a physiotherapist before the marriage. She stopped working shortly after, and by agreement of the parties, did not work outside the home throughout the marriage but looked after the children and the household. Her credentials as a physiotherapist in Germany were not recognized in Canada. When the parties separated, she owned no property in her name.

[8] The respondent commenced divorce proceedings in British Columbia Supreme Court in February 2006, claiming reapportionment of the family assets under s. 65 of the *FRA*. In his statement of defence and counterclaim, the appellant claimed that the Agreement governed the division of the parties’ assets, and that German law applied. In her defence to the counterclaim, the respondent took the position that the Agreement was void or voidable on the grounds of duress, undue influence, unconscionability, and unfairness.

[9] The appellant commenced a divorce action in Germany in March 2006. In March 2007, Judge Lips of the Family Court, District Court of Schoneberg, Germany, held that the BC Supreme Court had undisputed jurisdiction over the divorce proceedings. The appellant’s appeal from that decision was dismissed by the German Court of Appeal in December 2007.

Trial Judge's Reasons for Judgment

[10] The 16-day trial covered a wide range of issues between the parties. The parties' evidence concerning the circumstances surrounding the creation of the Agreement varied significantly. The trial judge made strong credibility findings against the appellant generally, and approached his assessment of the validity of the Agreement from that perspective (at para. 30).

[11] Because the Agreement provided that it was governed by German law, the trial judge referred to the evidence, in the form of two reports of a German law professor, Professor Dieter Henrich, concerning the manner in which a German court would review a marriage agreement, and the role of a German notar under German law generally and in relation to the execution of marriage agreements. The reports had been obtained by the appellant, but were put in evidence by the respondent.

[12] On the appeal, the appellant questions whether the first report was properly admitted into evidence. From the record, there can be no doubt that it was, and it is not necessary to deal with that issue further.

[13] After reviewing the evidence of Prof. Henrich, the trial judge concluded that, despite the role of the notar, the respondent had not received independent legal advice (at para. 39), and that the process that would be undertaken by a German court in assessing the circumstances surrounding the execution of a marriage agreement where one of the parties claimed it was unenforceable appeared to be similar to the approach that would be followed in British Columbia (at para. 48).

[14] He found the following circumstances to have been proved by the respondent, which bore on the validity of the Agreement (at para. 49):

> (a) that Ms. Friedl did not see the proposed Marriage Agreement until she attended the notar's office in Leipzig on December 23, 2006;
>
> (b) that Ms. Friedl did not have the opportunity to review the proposed Marriage Agreement with her father or brother or both;
>
> (c) that Ms. Friedl lacked the opportunity to review the terms of the proposed Marriage Agreement with a lawyer of her own choosing and

did not receive independent legal advice as to the ramifications of her entering into the Marriage Agreement;

(d) that Dr. Friedl was more sophisticated in business, investments and property dealings than Ms. Friedl and that she would have benefited from receiving independent legal advice before signing the Marriage Agreement;

(e) that Dr. Friedl directed the preparation of the Marriage Agreement with legal advice he received from his counsel, Mr. Schoning and his sister, Ms. Friedl-Schoning;

(f) that Dr. Friedl scheduled an appointment with the notar during a brief visit by the parties to Leipzig with the time constraints precluding Ms. Friedl from fully reviewing and discussing the Marriage Agreement to assist her in understanding its terms;

(g) that although the notar read the Marriage Agreement to Ms. Friedl I accept Ms. Friedl's testimony that she did not comprehend the implications of the terms of the Marriage Agreement;

(h) that the Marriage Agreement was signed at a time when Ms. Friedl was stressed from having to fly from Zurich to Leipzig and back to Zurich to sign the Marriage Agreement on December 23 before she and Dr. Friedl flew to Michigan on December 25 where they anticipated being married before the end of December, although the marriage did not actually occur until January 3, 1997;

(i) that in December 1996 Ms. Friedl was pregnant, although no mention of her pregnancy appears in the Marriage Agreement, nor is there any evidence that the notar was aware of her pregnancy, a condition that is a significant but not conclusive factor for a German court when assessing the validity of a Marriage Agreement according to Prof. Henrich;

(j) that at the time of signing the proposed Marriage Agreement Ms. Friedl was in the fifth month of her pregnancy and suffering the stresses of pregnancy including tiredness;

(k) that Dr. Friedl told Ms. Friedl that he would not marry her unless she signed the Marriage Agreement, a factor which is particularly relevant when considering the arrangements in place for the marriage to occur soon after in the U.S.;

(l) that Ms. Friedl did not want her child to be born out of wedlock;

(m) that Dr. Friedl knew of Ms. Friedl's pregnancy when the Marriage Agreement was being drafted and later signed;

(n) that if the marriage foundered the Marriage Agreement, according to Prof. Henrich provides for Dr. Friedl, whose income at the time was approximately $750,000 a year, to pay minimal but not unconscionable support provisions to Ms. Friedl, but excluded any responsibility to pay sickness and old-age support;

(o) that throughout the parties' relationship, Dr. Friedl controlled and dominated Ms. Friedl, particularly in an economic sense because

> soon after their marriage Ms. Friedl terminated her employment due to her pregnancy, thereby losing the financial independence provided by that employment; and
>
> (p) that the Marriage Agreement provided Ms. Friedl would receive 10,000 Deutsche Marks, worth approximately $6,880 for every year of the marriage, a total of $62,000, a pittance given Dr. Friedl's 1996 income of $750,000 a year and the fact that Ms. Friedl would be precluded from pursuing her own career and earning her own income as she was to be out of the work force while she raised the parties' two children and managed the family's home.

[15] The trial judge held (at para. 52) that in light of these factors the respondent had established on a balance of probabilities that the appellant had obtained her signature on the Agreement by duress, coercion or undue influence, rendering its terms invalid and unenforceable. He held that the Agreement was null and void whether the situation is considered under the law of Germany or that of British Columbia.

[16] He went on to hold (at para. 53) that because the Agreement was null and void, this also included the choice of law clause which stated German law would govern the parties' termination of marriage. He held that it was therefore appropriate to apply the law of British Columbia given the family's substantial property ties and other links to the Province, and applied Part 5 of the *FRA* to the division of their assets.

Issues on Appeal

[17] The appellant claims that the trial judge erred in setting aside the Agreement. He argues that the trial judge misapprehended the expert evidence of German law concerning the process that would be undertaken by a German court in reviewing a marriage agreement, and misunderstood the function of a notar in German law.

[18] The appellant argues further that the trial judge erred in concluding on the facts that the respondent had established duress, coercion, or undue influence.

Analysis

Application of German Law

[19] The Agreement provided that German law was to be applied "[f]or our marriage as well as in case of its termination". The parties' agreement that German law applied required that the validity of the Agreement be determined in accordance with German law: see *Tezcan v. Tezcan* (1992), 38 R.F.L. (3d) 142 at paras. 65-66, 62 B.C.L.R. (2d) 344 (C.A.).

[20] For the purpose of applying foreign law, a BC court must rely on the evidence of an expert competent to explain and interpret the foreign law, and the judge's conclusion on the foreign law is a finding of fact: see *Buerger v. New York Life Assurance Co.* (1927), 96 L.J.K.B. 930 at 939-943 (C.A.); *Tezcan*, at paras. 61-62.

[21] Despite these well-established principles for the application of foreign law, there is authority that in certain circumstances a court must make its own decision as to that law by examining the statutes and cases relied on by the foreign experts (see *Sarabia v. Oceanic Mindoro (The)* (1996), 26 B.C.L.R. (3d) 143 at para. 11 (C.A.), where the experts gave conflicting opinions as to the foreign law), and that the proper standard of appellate review of a trial judge's decision as to the foreign law is correctness, not palpable and overriding error (see *General Motors Acceptance Corp. of Canada, Ltd. v. Town and Country Chrysler Ltd.* (2007), 88 O.R. (3d) 666 at paras. 28-35 (C.A.) ["*GMAC*"], where the trial judge did not rely on the expert evidence but came to his own conclusion concerning the foreign (Quebec) law).

Fresh Evidence

[22] The cases that suggest that a court deciding a question of foreign law may go beyond the expert opinion evidence and examine the foreign sources of law are relevant to the respondent's application to admit fresh evidence. She seeks to have the Court review a decision of the German Federal Court of Justice pronounced on July 9, 2008, after the trial in this case. The respondent argues that the analysis of

the validity of a marriage agreement undertaken by the German Federal Court confirms the trial judge's approach to the validity of the Agreement.

[23] There is no dispute that the tests for the admission of fresh evidence on an appeal are as set out in *Palmer v. The Queen*, [1980] 1 S.C.R. 759 at 775-776. They may be summarized as:

> (a) the evidence should generally not be admitted if, by due diligence, it could have been adduced at trial;
>
> (b) the evidence must be relevant in the sense that it bears upon a decisive or potentially decisive issue in the trial;
>
> (c) the evidence must be credible in the sense that it is reasonably capable of belief;
>
> (d) the evidence must be such that if believed it could reasonably, when taken with the other evidence adduced at trial, be expected to have affected the result.

[24] The appellant maintains that the decision of the German Federal Court does not bear on the issue before the trial judge, and therefore does not satisfy the tests for the admission of fresh evidence. Further, he argues that the decision may not be put before the Court except as part of an expert's opinion on German law.

[25] In my opinion, the evidence meets the first three tests for admission of fresh evidence: due diligence, relevance, and credibility. However, because the expert evidence that was before the trial judge dealt with the question of the process of review of a marriage agreement in the same way as the decision of the German Federal Court, that decision, standing on its own, would not have affected the result.

[26] Furthermore, while there is authority for the Court to examine the sources of foreign law, those cases appear to deal with circumstances where there is conflicting expert evidence, and the sources are those that have been referred to by the experts. In this case, while the appellant maintains there was some difference

between Prof. Henrich's first and second reports, there was no conflicting expert evidence that the trial judge found he had to resolve, and no reason to refer to other sources of German law.

[27] I would therefore not admit the fresh evidence.

Standard of Review

[28] It is well-established in Canadian law that the findings of fact of a trial judge are entitled to deference, and that in the absence of a palpable and overriding error, an appellate court should not interfere with the trial judge's decision: see *Housen v. Nikolaisen*, 2002 SCC 33, [2002] 2 S.C.R. 235 at para. 1. The Ontario Court of Appeal took a different view in *GMAC*; however, in that case, the trial judge had erred in law in failing to make a finding of fact based on the expert evidence of foreign law. Thus, the Court of Appeal applied the standard of correctness to the legal error, and substituted its own interpretation of the expert evidence.

[29] That is not the case here. The trial judge based his decision on Prof. Henrich's two reports, and found that a German court would review the Agreement for validity in a manner similar to that of a BC court. That is a finding of fact resulting from the assessment and interpretation of the evidence, and I see no reason not to apply the normal standard of appellate review of findings of fact; that is, palpable and overriding error.

Review of the Agreement

[30] Prof. Henrich's two reports addressed the process a German court would undertake in reviewing a marriage agreement. The parties are in agreement that, in both of his reports, he spoke of a "two-stage process", the first concerning the validity or effectiveness of the agreement, and, if the agreement is determined to be valid, the second being an examination of whether a party acts unconscionably in relying on the agreement at the time of the divorce. The parties also agree that at the first stage, the court reviews the various terms of the agreement to determine if any of them is "unethical"; the court will review more strictly the "core areas of the

consequences of divorce"; the "core areas of the consequences of divorce" include support and pension rights but do not include marital property; a separation of property regime will not, by itself, be considered illegal, and therefore will not be the basis for finding an agreement to be invalid; and the first stage includes an "overall assessment" of the circumstances of each of the spouses at the time of execution of the agreement.

[31] The appellant says that the trial judge erred in three ways in considering the factors that a German court would consider at the first stage of the review, and that the error resulted from a misunderstanding or misapprehension of the differences between Prof. Henrich's first and second reports.

[32] First, the appellant says that while in the first report Prof. Henrich, in addressing review generally, may have indicated that in considering the validity or effectiveness of the agreement at the first stage, a German court will consider the marital property regime as well as the other provisions of the agreement, he made it clear in his second report that the German court will only review those provisions that fall within one of the "core areas of the consequences of divorce". Thus, the appellant says, when the trial judge (at para. 41) referred to "marital property" as one of the "core areas", he was not only mistaken, but demonstrated his misunderstanding of Prof. Henrich's evidence.

[33] Second, the appellant argues that the trial judge erred in taking into account the respondent's pregnancy in assessing the validity of the marital property provisions of the Agreement, as Prof. Henrich's second report made it clear that a woman's pregnancy at the time of execution of a marriage agreement is only relevant in assessing the effectiveness of the provisions concerning the "core areas".

[34] Third, the appellant takes issue with the trial judge's reference to the judgment of Judge Lips of the German Family Court in the litigation between these parties, as it was not referred to in the expert evidence. The trial judge quoted from the translation of Judge Lips' judgment in the portion of his reasons for judgment in which he discussed the jurisdiction of the BC Supreme Court (at para. 14). He

underlined Judge Lips' reference to marriage agreements bearing "close examination as regards content ... according to prevailing German case law". Later in his reasons for judgment, after reviewing Prof. Henrich's evidence, the trial judge stated (at para. 47):

> ... However, as I interpret Prof. Henrich's opinion, together with District Judge Lips' March 9, 2007 decision, it is open for a German court, and thus this court, to consider the circumstances surrounding the making of a Marriage Agreement to determine its validity and enforceability. I construe from the remarks of both Prof. Henrich and Judge Lips that if the circumstances include coercion, duress or undue influence by one party to the agreement over the other party, such as to leave the former in an advantageous position and the latter in a disadvantageous position, then it is open for the court to determine whether the agreement is valid and enforceable.

[35] The question for this Court is whether the trial judge made a palpable and overriding error in interpreting Prof. Henrich's reports, leading him to err in concluding (at para. 47) that it was open to him to consider the circumstances surrounding the making of the Agreement, and if the circumstances include coercion, duress or undue influence, that it was open to him to determine whether the agreement was valid and enforceable.

[36] The trial judge's errors in referring to marital property as one of the "core areas of the consequences of divorce", and to Judge Lips' decision as authority for German law on the review of marriage agreements, are not "palpable and overriding errors", in that they did not play a material role in his interpretation and application of German law as described in Prof. Henrich's reports. The trial judge was clear that what he took from Prof. Henrich's reports was that a German court would "consider the circumstances surrounding the making of a Marriage Agreement to determine its validity and enforceability." Such a review was clearly described by Prof. Henrich in both of his reports as part of the first stage of review, the "overall assessment" of the spouses' individual circumstances at the time of execution of the agreement. Prof. Henrich was clear, and the trial judge's reasons for judgment reflected this, that the "overall assessment" takes place after the German court has reviewed the various terms of a marriage agreement for "effectiveness", and that an agreement will not be set aside only on the basis of the marital property provisions.

[37] In both of his reports, Prof. Henrich described the "individual circumstances at the time of the execution of the agreement" as including the spouses'

> ... income and financial situation, the planned or already implemented set-up of their marriage, as well as the effects on the spouses and their children. The goals intended by the spouses with their agreement and other reasons that motivated the advantaged spouse to call for the respective provision/agreement and that caused the disadvantaged spouse to comply with this request must be taken into account. [citation omitted]

[38] In his first report. Prof. Henrich went on, as part of the same paragraph, to refer to the wife's pregnancy. He said:

> ... In such a context, it might be important whether the wife was in a position of constraint. If, for example, a pregnant woman has only agreed to the execution of a contract that is significantly disadvantageous for her since the husband would have refused to marry her without such a marriage contract, the contract can be assumed to be unconscionable [citation omitted]. However, the wife's pregnancy upon the execution of the agreement alone is not sufficient in order for the contract to become void. However, the pressure to execute the agreement that has been exerted on her which takes advantage of her pregnancy is an indication of the wife's negotiating position being weaker and should be a reason to intensify the legal review. [citation omitted, underlining added]

[39] In the second report, Prof. Henrich discussed the implications of pregnancy in a separate section under the heading "Fairness at the time the prenuptial agreement was entered into". This was in response to specific questions put to him by appellant's Canadian counsel under that heading. Here he said:

> b) The wife's pregnancy at the time of the execution of the contract does not change the existing legal situation. It can, however, be indicative of an unequal negotiation position at the time of the contract execution, which would warrant a closer examination of the contract contents [citations omitted]. Should the husband have taken advantage of the wife's pregnant condition to coerce her into accepting an agreement that either completely or to a significant degree excludes rules falling under the core area of the law on the consequences of the divorce, whereby this disadvantageous position of the wife is neither softened through other advantages nor justified through the spouses' special situation, the type of marriage envisioned or lived by them, nor through other notable needs of the husband, this may be regarded as unethical and can thus result in the agreement being declared nil [*sic*] and void [citations omitted]. The important question in this context is: Would the wife have refrained from entering into this agreement or an agreement with these terms if she had not been pregnant? [underlining added]

[40] In the first report, Prof. Henrich was referring to the "overall assessment" of the circumstances surrounding the execution of the agreement, which the German court engages in as part of the process of determining whether an agreement is valid. In the second report, Prof. Henrich was referring to the fairness of the agreement, not its validity. In either case, however, Prof. Henrich notes that it is a relevant circumstance for the court to consider on review of an agreement for validity that if the wife was pregnant, whether that condition indicates that she was "in a position of constraint" or there was "pressure" exerted on her to execute the agreement, whether the husband took advantage of her condition to "coerce" her to accept the agreement, and whether she would have refrained from entering into the agreement if she had not been pregnant.

[41] The respondent's pregnancy was one of the factors the trial judge considered in reviewing the individual circumstances of the spouses at the time of execution of the Agreement. That was entirely consistent with Prof. Henrich's reports, and the trial judge's interpretation of them.

[42] I would not accede to this ground of appeal.

The Function of a Notar in German Law

[43] The trial judge summarized the evidence of Professor Henrich concerning the role of a notar (at para. 37):

> ... Prof. Henrich described notars as individuals having legal training, are qualified to hold a judicial office, and who are appointed by the state government. Under German law a notar dealing with a Marriage Agreement is obliged to ascertain the parties' intentions, clarify the factual situation, and instruct the parties about the legal implications of the agreement they wish to execute, including making them aware of any legal concerns that the notar may have.

[44] He concluded that the notar's role in the execution of the Agreement did not provide the respondent with independent legal advice. He said (at para. 39):

> The defence [appellant] submits that the notar's involvement in the execution of the parties' Marriage Agreement provides Ms. Friedl with independent legal advice and protection with respect to the fairness of the Marriage

> Agreement's terms. While I give considerable deference to the role of the notar in the execution of marriage agreements as he is a quasi judicial officer appointed by the state, I am not convinced that a notar is necessarily in a position to provide a party such as Ms. Friedl with independent legal advice. A relatively short meeting, attended by both parties without the advantage of speaking separately to each party to ascertain their respective concerns, if any, in the absence of their prospective spouse, would appear to limit the information available to the notar. For example, there is no evidence that the notar was aware that Ms. Friedl was pregnant when she signed the Marriage Agreement and there is no reference to her pregnancy in the Marriage Agreement. Dr. Friedl, on the other hand, did have independent legal advice, from Mr. Schoning and Ms. Friedl-Schoning, who both participated in the preparation of the terms of the Marriage Agreement that were put before the notar.

[45] The appellant says that the trial judge failed to appreciate Prof. Henrich's description of a notar's duties that are mandated by statute and directly relevant to the prevention of coercion, duress or undue influence, including the following:

> The Notar must "ensure that inexperienced and unskilled parties are not put at a disadvantage."
>
> "If the Notar has any doubts regarding the lawfulness of the transaction . . . he has to include his instructions and the respective declarations of the parties in the record."
>
> The Notar "must explain to [the parties] the meaning and implications of the prenuptial agreement . . ."

[46] The appellant argues that it must be presumed that the notar carried out his statutory duties, and that displaces the requirement of BC law for independent legal advice. He suggests that the respondent's evidence that she did not understand the implications of the agreement when it was read to her by the notar amounts to accusing the notar of a "gross dereliction of duty", and that his signature attesting to carrying out his statutory duties was "fraudulent". He also claims that the trial judge's conclusion that the notar's role did not amount to independent legal advice was wrongly based on "forum-centric jurisprudence", and was effectively a finding that "a foreign quasi-judicial official was guilty of serious misconduct in office."

[47] The appellant's arguments are somewhat hyperbolic. The trial judge did not doubt that the notar carried out his statutory duties. He concluded, however, taking into account all of the circumstances surrounding the execution of the Agreement,

including the short duration of the meeting with the notar preceded and followed by flights from Zurich to Leipzig and back, the lack of a meeting between the notar and the respondent separately from the appellant, and the lack of an opportunity for the respondent to review drafts of the Agreement before the meeting, that the notar's functions did not satisfy him that the respondent had been given the equivalent of independent legal advice. It was the appellant who submitted to the trial judge that the notar's function was analogous to the function of independent legal advice in assuring that an agreement is not executed in circumstances of coercion, undue influence, or duress.

[48] I would not accede to this ground of appeal.

Coercion, Duress or Undue Influence

[49] The appellant argues that the trial judge erred in concluding, on the facts as he found them, that the respondent had established coercion, duress or undue influence. He suggests that there was no expert evidence of the application of those concepts in German law, and the respondent therefore failed to meet her burden of proof.

[50] The concepts of coercion, duress, and undue influence were expressly referred to by Prof. Henrich in his reports. He noted that in determining the validity of a marriage agreement, "it might be important whether the wife was in a position of constraint", whether there was "pressure" exerted on her to execute the agreement, whether the husband has "taken advantage of the wife's pregnant condition to coerce her into accepting an agreement" [underlining added]. Thus, the trial judge drew directly from the expert evidence in construing Prof. Henrich's opinions as referring to circumstances of coercion, duress, or undue influence in the making of a marriage agreement (at para. 47).

[51] The appellant takes issue with certain of the facts considered by the trial judge, set out in para. 49 of his reasons for judgment (quoted at para. 14 of these reasons). He notes that the Agreement did not exclude sickness and old-age

support, as stated in para. 49(n), and the matters mentioned in paras. 49(o) and (p), concerning the control exercised by the appellant and the respondent not working outside of the home during the marriage, were not related to the circumstances surrounding the execution of the Agreement.

[52] In my opinion, the minor error in para. 49(n) is immaterial, and the matters mentioned in paras. 49(o) and (p) either existed or were contemplated at the time the Agreement was executed.

[53] In support of his argument, the appellant cites decisions of the BC Supreme Court in which the party seeking to have an agreement declared invalid on the grounds of coercion, duress, or undue influence was unsuccessful. Each of these cases is distinguishable on its facts, which are not necessary to review here.

[54] In my opinion, the appellant has not demonstrated that the trial judge made any palpable or overriding error in interpreting the expert evidence of Prof. Henrich in respect of the concepts of coercion, duress, or undue influence in German law, nor in determining the facts relevant to the conclusion that the respondent's signature on the Agreement had been obtained by coercion, duress or undue influence, and that the Agreement was therefore invalid and unenforceable.

[55] I would not accede to this ground of appeal.

Summary and Conclusion

[56] The trial judge did not misunderstand, or make any palpable and overriding error, in interpreting and applying the expert evidence in respect of the process that would be undertaken by a German court in reviewing a marriage agreement, the function of a notar in German law, or the application of the concepts of coercion, duress, and undue influence in determining the validity of a marriage agreement under German law. There is therefore no basis for this Court to interfere with his conclusion that the Agreement was invalid and unenforceable.

[57] It follows that I would dismiss the appeal.

"The Honourable Madam Justice Levine"

I Agree:

"The Honourable Madam Justice Newbury"

I Agree:

"The Honourable Mr. Justice Groberman"

TAB 24

CITATION: JPMORGAN CHASE BANK *v. LANNER* (THE), 2008 FCA 399, [2009] 4 F.C.R. 109 A-191-06

Kent Trade and Finance Inc. and **Praxis Energy Agents S.A.** and **CP3500 International Ltd.** (*Appellants*)

v.

JPMorgan Chase Bank and **J.P. Morgan Europe Ltd.** (*Respondents*)

INDEXED AS: JPMORGAN CHASE BANK v. LANNER (THE) (F.C.A.)

Federal Court of Appeal, Richard C.J., Pelletier and Ryer JJ.A.—Ottawa, October 8 and December 12, 2008.

Maritime Law — Liens and Mortgages — Appellants, non-U.S. corporations, suppliers of necessaries to foreign vessel in foreign ports — Two contracts expressly subject to U.S. law — Third containing arbitration clause providing law of State of Washington to govern — Ranking of creditors for distribution of proceeds of judicial sale of vessel — Whether appellants entitled to maritime liens under U.S. Commercial Instruments and Maritime Liens Act or statutory right in rem under Canadian law — Nature of maritime liens reviewed — Conflict of laws rules reviewed — Divergence of opinion in U.S. District Courts, Circuit Courts of Appeal as to whether maritime lien established in circumstances — Majority herein applying latest expression of law from U.S. appellate court; granting maritime liens to appellants — Pelletier J.A. (dissenting) holding foreign law not proved; applying Canadian law which does not recognize maritime liens for supplies of necessaries to vessel.

Conflict of Laws — Appellants, non-U.S. corporations, suppliers of necessaries to foreign vessel in foreign ports — Two contracts expressly subject to U.S. law — Third containing arbitration clause providing law of State of Washington to govern —Whether should be granted maritime liens under U.S. law or statutory right in rem under Canadian law — Common law choice of law rules providing choice of law expressed or implied in contract normally governs — However, substantive law of jurisdiction strongly connected to maritime transaction may govern — Proper law of two of contracts American law — Based on arbitration clause in third contract, American law proper law of contract — Majority applying latest statement of law from U.S. appellate court — Pelletier J.A. (dissenting) holding proof of foreign law failed since vessel not arrested within jurisdiction of circuit court which has pronounced itself on issue, no binding U.S. Supreme Court decision on issue — Canadian law not recognizing maritime lien for supply of necessaries to vessel.

This was an appeal from a Federal Court assessment of the entitlement of various claims to the proceeds of the judicial sale of a Liberian-flagged vessel, the *Lanner*, arrested and sold in Halifax at the request of the respondent mortgagees.

The appellant Kent Trade, a British Virgin Islands (BVI) corporation, supplied fuel oil to the vessel in Spain and in Canada. The terms and conditions of sale provided that the agreement was subject to the laws of the United States. The appellant Praxis Energy Agents S.A., also a BVI corporation, supplied the vessel with bunker fuel in Trinidad. The supply contract provided that United States law would govern. CP3500 International Ltd., a Cypriot corporation, provided combustion catalysts to the vessel in Singapore. The terms and conditions of sale included an arbitration clause which provided that the law of the State of Washington would govern. The ranking of claims to the proceeds of a ship's sale is decided by the law of the forum. Under U.S. law a supplier of necessaries is afforded a maritime lien under the *Commercial Instruments and Maritime*

Liens Act. Under Canadian law, a supplier of necessaries is accorded a statutory right *in rem* which ranks below a mortgage, which itself is outranked by any maritime liens. The Federal Court found that the appellants only had statutory rights *in rem*.

The issue was whether the suppliers of necessaries to the vessel should be granted maritime liens which would be ranked in priority over the respondents' mortgage claim.

Held (Pelletier J.A. dissenting), the appeal should be allowed.

Per Richard C.J. (Ryer J.A. concurring): Whenever a Canadian court is asked to apply the substantive law of a foreign jurisdiction, it must apply a "choice of law" analysis using Canadian conflict of laws rules. Absent a statutory and/or treaty provision directing the forum to apply a particular choice of law rule, Canadian common law conflict of laws rules will apply in a proceeding where a court is asked to apply foreign law. The first step in a choice of law analysis is the determination of the legal nature of the questions or issues to be adjudicated. The court must then determine what choice of law rule applies to that particular category and finally apply the appropriate jurisdiction's law to the issue. In general, foreign law must be specifically pleaded and proved to the satisfaction of the court. Otherwise the court will apply the law of the forum.

Prior to characterizing the issue, the nature of maritime liens was reviewed. While a maritime lien is an *in rem* right arising by operation of law, rather than from tort or contract, the choice of law clause in the supply contracts should generally govern maritime transactions, including the rights which may arise from those transactions. The Supreme Court of Canada has suggested that the principles of comity, order and fairness should guide the determination of conflict of laws issues. While the principles of comity and fairness will often be equivocal in the case of maritime transactions, which may involve a multitude of jurisdictions, giving greater weight to proper law of the supply contract would pay respect to the notion of "order". This would encourage certainty and predictability in maritime transactions of a jurisdictionally diverse character.

The common law contractual choice of law rules provide that where there is an express or implied choice of law by the parties to the contract, this law will normally govern the contract and legal rights and obligations generated by the contract. However, as maritime liens are extra-contractual rights the possibility exists that where a maritime transaction is so strongly connected to a jurisdiction, this jurisdiction's substantive law, rather than the choice of law clause in the contract, should govern the transaction.

In assessing the proper law to apply to the transactions at issue, the Federal Court found that the choice of law in the contracts did not dictate that American law applied due to insufficient evidence that the vessel's owner was personally liable under this contract. The Federal Court made a palpable and overriding error in holding that a contractual link between the appellants and the vessel's owner was not established by the evidence. The management agreement and invoices established a contractual link between the vessel's owner and the appellants. Therefore, even if personal liability of the ship owner is a necessary element of the choice of law rule, the proper law of the Kent Trade and Praxis contracts, based on choice of law rules, was American law. As to the CP3500 contract, even where an arbitration clause only selects the forum of the arbitration, British and Canadian courts normally take this clause as indicative of the proper law of the contract. The proper law of the CP3500 supply contract was American law.

There were no other factors indicating another jurisdiction had a closer or more substantial connection to the maritime transactions at hand. Therefore American law was the appropriate law to apply.

The Federal Court held that American law would not grant maritime liens in the circumstances. It was not necessary to determine the appropriate standard of review of a decision determining the content of foreign law since fresh evidence was admitted prior to the appeal. Apparently there is a divergence in the U.S. District Courts and Circuit Courts of Appeal as to whether a maritime lien would be established where a non-U.S. supplier has provided necessaries to a foreign vessel in a foreign port. Based on the affidavits and exhibits

presented, the latest expression of the law from a U.S. appellate court recognized a maritime lien for necessaries where, under a supply contract governed by U.S. law, a foreign supplier provides goods or services to foreign vessels in a foreign port. Even though this decision is not binding on other circuits, the appellants proved to the Court's satisfaction that they each have a maritime lien against the *Lanner*.

Per Pelletier J.A. (dissenting): There were two issues herein: what is the effect to be given to the choice of law clause which appears in a different form in each of the contracts and what is the effect to be given to the *Commercial Instruments and Maritime Liens Act*?

Assuming that the interpretation of the contracts in question is subject to United States law, and that the proper construction of the contracts brings the Act into play, it remains that the application of the Act is a function of the U.S. Court of Appeals circuit in which a vessel is arrested and sold, with differing results. The Ninth Circuit has ruled one way and the Eleventh has ruled another. Since the decision of one circuit of the U.S. Federal Court of Appeals does not overrule the decision of another circuit of the same court, both decisions are good law within the geographical limits of the circuit in which they were decided. The U.S. Supreme Court has not yet considered this question so that there is no decision binding on all U.S. courts on this question. Since the *Lanner* was arrested and sold outside the United States, there was no basis for preferring the case law of one circuit of the U.S. Federal Court of Appeals over another. The state of the law depends on a fact which is absent here, namely the presence of the arrested vessel in a port within the geographical jurisdiction of one or the other of the circuits of the United States Court of Appeals. If they wished to take the benefit of the Act, the parties could have stipulated the place at which U.S. law was to be determined. Therefore the proof of foreign law failed. Where there is no proof of foreign law, the *lex fori*, law of Canada applies. The law of Canada does not recognize a maritime lien for the supply of necessaries to a vessel. The claims of Kent Trade and Finance Ltd. And Praxis Energy Agents S.A. to priority over the claims of the ship's mortgagees should be dismissed. However CP3500 International Ltd.'s appeal should be allowed since its arbitration clause stipulates the law of the State of Washington governs. Since Washington is in the Ninth Circuit, the law to be applied would be the interpretation of the Act adopted by the Ninth Circuit of the U.S. Federal Court of Appeals in *Trans-Tec Asia v. M/V Harmony Container et al.*

STATUTES AND REGULATIONS CITED

Commercial Instruments and Maritime Liens Act, 46 U.S.C. §§ 31301-31343 (2006).

Federal Courts Act, R.S.C., 1985, c. F-7, ss. 1 (as am. by S.C. 2002, c. 8, s. 14), 22(2)(*m*) (as am. *idem*, s. 31), 43(3) (as am. *idem*, s. 40).

Ship Mortgage Act, 41 Stat. 1000 (1920).

CASES CITED

APPLIED:

Trans-Tec Asia v. M/V Harmony Container et al.,
518 F.3d 1120 (9th Cir. 2008); petition for a writ of *certiorari* denied by U.S. Sup. Ct., December 1, 2008.

CONSIDERED:

Imperial Oil Ltd. v. Petromar Inc., [2002] 3 F.C. 190; (2001), 209 D.L.R. (4th) 158; 283 N.R. 182; 2001

FCA 391; *Holt Cargo Systems Inc. v. ABC Containerline N.V. (Trustees of)*, [2001] 3 S.C.R. 907; (2001), 207 D.L.R. (4th) 577; 30 C.B.R. (4th) 6; 2001 SCC 90; *Prakasho v. Singh*, [1967] 1 All E.R. 737; *General Medical Council v. Meadow*, [2006] EWCA Civ 1390; *Trinidad Foundry and Fabricating, Ltd. v. M/V K.A.S. Camilla*, 966 F.2d 613 (11th Cir. 1992); *Metron Communications, Inc. v. M/V Tropicana*, [1993] A.M.C. 1264 (S.D. Fla. 1992); *Swedish Telecom Radio v. M/V Discovery I*, 712 F. Supp. 1542 (S.D. Fla. 1988); *Triton Marine Fuels Ltd., S.A. et al. v. M/V Pacific Chukotka, et al.*, 504 F. Supp. 2d 68 (D. Md. 2007); *Sarabia v. Oceanic Mindoro (The)*, [1997] 2 W.W.R. 116; (1996), 84 B.C.A.C. 8; 26 B.C.L.R. (3d) 143 (B.C.C.A.).

REFERRED TO:

Todd Shipyards Corp. v. Altema Compania Maritima S.A., [1974] S.C.R. 1248; (1972), 32 D.L.R. (3d) 571; *Strandhill, The v. Walter W. Hodder Co.*, [1926] S.C.R. 680; [1926] 4 D.L.R. 801; *Dell Computer Corp. v. Union des consommateurs*, [2007] 2 S.C.R. 801; (2007), 284 D.L.R. (4th) 577; 34 B.L.R. (4th) 155; 2007 SCC 34; *Ontario Bus Industries Inc. v. Federal Calumet (The)*, [1992] 1 F.C. 245 (T.D.); affd (1992), 150 N.R. 149 (F.C.A.); *Ventura Packers, Inc. v. F/V Jeanine Kathleen*, 305 F.3d 913 (9th Cir. 2002); *Spar Aerospace Ltd. v. American Mobile Satellite Corp.*, [2002] 4 S.C.R. 205; (2002), 220 D.L.R. (4th) 54; 28 C.P.C. (5th) 201; 2002 SCC 78; *Drew Brown Ltd. v. The "Orient Trader"*, [1974] S.C.R. 1286; (1972), 34 D.L.R. (3d) 339; *Richardson International, Ltd. v. Mys Chikhacheva (The)*, [2002] 4 F.C. 80; (2002), 288 N.R. 96; 2002 FCA 97; *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443; (1967), 62 D.L.R. (2d) 138; [1967] I.L.R. 180; *Compagnie Tunisienne de Navigation S.A. v. Compagnie d'Armement Maritime S.A.*, [1970] 2 Lloyd's Rep. 99 (H.L.); *Hunt v. T&N PLC*, [1993] 4 S.C.R. 289; (1993), 109 D.L.R. (4th) 16; [1994] 1 W.W.R. 129; *Bumper Development Corp. Ltd. v. Commissioner of Police of the Metropolis and others*, [1991] 4 All E.R. 638 (C.A.); *General Motors Acceptance Corp. of Canada Ltd. v. Town and Country Chrysler Ltd.* (2007), 88 O.R. (3d) 666; 2007 ONCA 904; *Wellington, In re Duke of*, [1947] Ch. 506; *Breen v. Breen*, [1961] 3 All E.R. 225.

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APPEAL from the Federal Court's decision ([2007] 1 F.C.R. 289; (2006), 289 F.T.R. 165; 2006 FC 409; revg in part *sub nom. JP Morgan Chase Bank v. Mystras Maritime Corp.* (2005), 275 F.T.R. 159; 2005 FC 864) that U.S. law did not apply to give maritime liens to the appellants, non-U.S. suppliers of necessaries to a foreign ship in foreign ports arrested and sold in Canada. Appeal allowed (Pelletier J.A. dissenting).

APPEARANCES

Peter G. Pamel and *Jean-Marie Fontaine* for appellants.

James E. Gould, Q.C., for respondents.

SOLICITORS OF RECORD

Borden Ladner Gervais LLP, Montréal, for appellants.

McInnes Cooper, Halifax, for respondents.

The following are the reasons for judgment rendered in English by

[1] RICHARD C.J.: This is an appeal from the decision of Gauthier J. [[2007] 1 F.C.R. 289 (F.C.)] (the priorities appeal Judge) which assessed the entitlement of various claims to the proceeds of the judicial sale of a ship, the *Lanner* (the vessel). This decision was itself an appeal of the priorities hearing before Morneau P. [*sub nom. JP Morgan Chase Bank v. Mystras Maritime Corp.* (2005), 275 F.T.R. 159 (F.C.)] who held that the claim of the vessel's mortgagee prevailed over the claims of various necessaries suppliers.

[2] The issue in this case is whether the appellants, which are suppliers of necessaries to the vessel, should be granted maritime liens which would rank in priority over the mortgage claim held by the respondent mortgagees.

Background

[3] The facts in this appeal are uncontroverted.

[4] At the request of the respondent mortgagees, JPMorgan Chase Bank and J.P. Morgan Europe Ltd., the Liberian-flagged vessel was arrested in Halifax and sold by the Federal Court in an admiralty action *in rem*. At all times relevant to the claims of the appellants, the vessel was owned by a Liberian corporation, Mystras Maritime Corporation and was managed by Arrow Co. Ltd. (Arrow) of Greece.

The Four Claims

Kent Trade and Finance Inc. – Cartagena

[5] The appellant, Kent Trade and Finance Inc. (Kent Trade), incorporated under the laws of the British Virgin Islands, supplied fuel oil to the vessel at the port of Cartagena, Spain via an unknown supplier. Kent Trade also supplied fuel oil to the vessel while docked in Halifax, Nova Scotia via a Canadian supplier. The total amount of Kent Trade's claim for fuel provision is C$415 688.70. In the terms and conditions of sale, the following provision was included:

This agreement is subject to the laws of the United States of America.

Praxis Energy Agents S.A.

[6] The second appellant, Praxis Energy Agents S.A. (Praxis), is also a British Virgin Islands corporation. Through an English company, Praxis supplied the vessel with bunker fuel at the port of Pointe à Pierre, Trinidad. The amount of the claim is C$225 599.23. The supply contract included the following clause:

> APPLICABLE LAW The Law governing any and all disputes and all other matters/issues between the Company and the Buyer and/or the Vessel shall be the U.S.A. Law. Such Law shall also govern, but without limitation, all issues concerning the enforcement and the application and status of maritime liens.

CP3500 International Ltd.

[7] The final claim at issue in this appeal is asserted by CP3500 International Ltd. (CP3500), incorporated under the laws of Cyprus. CP3500 arranged for a Singaporean supplier to provide combustion catalysts to the vessel while in Singapore in the amount of C$6 257.25. The terms and conditions of sale included the following arbitration clause:

> ARBITRATION All disputes which may arise between us concerning this transaction of the invoiced goods shall be submitted to binding arbitrators . . . all in accordance with Washington State law.

[8] Under Canadian law, a supplier of necessaries to ships is accorded a statutory right *in rem* (paragraph 25 of *Imperial Oil Ltd. v. Petromar Inc.*, [2002] 3 F.C. 190 (C.A.) (*Imperial Oil*) and see paragraph 22(2)(*m*) [as am. by S.C. 2002, c. 8, s. 31] and subsection 43(3) [as am. *idem*, s. 40] of the *Federal Courts Act*, R.S.C., 1985, c. F-7 [s. 1 (as am. *idem*, s. 14)]). The ranking of claims to the proceeds of a ship's sale is decided by the law of the forum (*Todd Shipyards Corp. v. Altema Compania Maritima S.A.*, [1974] S.C.R. 1248, at page 1254 (*Todd Shipyards*)). A statutory right *in rem* ranks below a mortgage, which is itself outranked by any maritime liens asserted against the vessel (*Todd Shipyards*, at page 1259).

[9] Under U.S. law, a necessaries supplier is afforded a maritime lien, by virtue of the *Commercial Instruments and Maritime Liens Act*, 46 U.S.C. § 31342 (2006):

> § 31342. Establishing maritime liens
>
> (a) Except as provided in subsection (b) of this section, a person providing necessaries to a vessel on the order of the owner or a person authorized by the owner—
>
> (1) has a maritime lien on the vessel;
>
> (2) may bring a civil action in rem to enforce the lien; and
>
> (3) is not required to allege or prove in the action that credit was given to the vessel.
>
> (b) This section does not apply to a public vessel.

As noted by Justice Binnie in *Holt Cargo Systems Inc. v. ABC Containerline N.V. (Trustees of)*, [2001] 3 S.C.R. 907 (*Holt Cargo*), foreign maritime liens, including those arising under the U.S. statute, "will be recognized and given the same priority in Canada as would be given to a maritime lien created in Canada under Canadian maritime law 'unless opposed to some rule of domestic

policy or procedure which prevents the recognition of the right'" (at paragraph 41, citing *Strandhill, The v. Walter W. Hodder Co.*, [1926] S.C.R. 680, at page 685 (*The Strandhill*)).

[10] The appellants, all necessaries suppliers, claim that they enjoy maritime liens by virtue of the U.S. choice of law provisions in the supply contracts and thus, their claims to the vessel's judicial sale proceeds should be satisfied ahead of the respondents' mortgage. The respondent mortgagees, contend that American law is not the proper law to apply and, even if it did govern, U.S. law does not provide for a maritime lien in the circumstances at bar.

Judicial History

Priorities Hearing, (2005), 275 F.T.R. 159 (F.C.)

[11] Morneau P. did not accord maritime lien status to the claims of the suppliers and ranked these claims behind that of the mortgagees. He decided that, because the mortgagees were not parties to the supply contracts, the choice of law clauses did not dictate which jurisdiction's substantive law applied (at paragraph 59).

[12] Morneau P. then applied a conflict of laws analysis to each supply transaction in order to determine if the United States was the jurisdiction to which it had the closest and most substantial connection. Looking at various factors including the vessel's flag state, the location of supply, and the base of operations of the vessel, he concluded that U.S. law was not applicable to these transactions (at paragraph 61). Since no other law had been proved, he applied the law of the forum, i.e. Canadian law. Consequently, he found that each supply transaction only gave rise to a statutory right *in rem*, which was below the mortgage in priority.

Priorities Appeal, [2007] 1 F.C.R. 289 (F.C.)

[13] Justice Gauthier also found that the appellants only had statutory rights *in rem*, rather than maritime liens. She held that the choice of law clauses in the supply contracts would only be determinative of the applicable law if the vessel's owner was personally liable under the contract. She found that there was insufficient evidence to prove that the vessel's manager had the authority to bind the vessel's owner since the contract between the two parties was not before the Court. Therefore, she applied the closest and most substantial connection test to the transactions and agreed with Morneau P. that U.S. law did not apply to the transactions.

[14] Although it was unnecessary to decide whether maritime liens would arise under American law, Justice Gauthier decided that they would not. She found that the respondent mortgagees' expert witness was able to provide more specific evidence that U.S. law would not provide a lien where the necessaries were supplied by a foreign supplier to a foreign ship in a foreign country (at paragraph 94).

Analysis

[15] Whenever a Canadian court is asked to apply the substantive law of a foreign jurisdiction, it must apply a "choice of law" analysis, using Canadian conflict of laws rules (*Dell Computer Corp. v.*

Union des consommateurs, [2007] 2 S.C.R. 801, at paragraph 29; *Ontario Bus Industries Inc. v. Federal Calumet (The)*, [1992] 1 F.C. 245 (T.D.), at page 252 (*The Federal Calumet*), affd (1992), 150 N.R. 149 (F.C.A.)).

General Approach to "Conflict of Laws" Analysis

[16] Absent a statutory and/or treaty provision that directs the forum to apply a particular choice of law rule, Canadian common law conflict of laws rules will apply in a proceeding where the court is asked to apply foreign law. The first step in such an analysis is the determination of the legal nature of the questions or issues to be adjudicated (*Castel & Walker: Canadian Conflict of Laws*, 6th ed. looseleaf, Vol. 1 (Markham, Ont.: LexisNexis/Butterworths, 2005), at §§ 3.1-3.2; *Dicey, Morris and Collins on the Conflict of Laws*, 14th ed. Vol. 1 (London: Sweet & Maxwell, 2006), at paragraphs 2-001 to 2-045). This characterization must be performed since different choice of law rules have been developed for different legal categories. For example, characterization of the issue as tortious versus contractual will result in the application of a different conflicts rule and may result in a different outcome as to which jurisdiction's substantive law governs.

[17] Once the issue is characterized as belonging to a particular legal category, the court must then determine what choice of law rule applies to that particular category (Castel & Walker, at § 3.1). Application of the choice of law rule should indicate which jurisdiction's law should apply to this particular matter.

[18] After the appropriate law is selected using Canadian choice of law rules, the court will then apply that law to the issue. In general, foreign law must be specifically pleaded and proved to the satisfaction of the court (Castel & Walker, at § 7.1; Dicey, Morris and Collins, at Rule 18(1)). If the foreign law is not pleaded or is insufficiently proved, the court will apply the law of the forum (Castel & Walker, at § 7.4).

Characterization of the issue and choice of law in the *Lanner* transactions

[19] Since there is no statutory or treaty rule mandating a particular choice of law rule, I first must characterize the issue at bar. Prior to doing this, it is helpful to review the nature of maritime liens.

[20] The maritime lien is "a true, substantive right in the property of another . . ., a subtraction from the ship owner's absolute ownership" (W. Tetley, *International Maritime and Admiralty Law* (Cowansville, Quebec: Yvon Blais, 2002), at page 482). It is an ancient creature of the *lex maritima* and has no equivalent in the common law (W. Tetley, *Maritime Liens and Claims*, 2nd ed. (Cowansville, Quebec: Yvon Blais, 1998), at page 60). This secured, *in rem* right against the vessel (*Holt Cargo*, at paragraph 26):

> . . . arises without registration or other formality when debts of a specific nature are incurred by or on behalf of a ship. The lien creates a charge which "goes with the ship everywhere, even in the hands of a purchaser for value without notice, and has a certain ranking with other maritime liens, all of which take precedence over mortgages" (*The Tolten*, [1946] P. 135 (C.A.), *per* Scott L.J., at p. 150). It may be described, in that sense, as a "secret lien".

Furthermore, a maritime lien arises by operation of law, rather than from tort or contract (*Imperial*

Oil, at paragraph 26; see also *Ventura Packers, Inc. v. F/V Jeanine Kathleen*, 305 F.3d 913 (9th Cir. 2002)).

[21] As noted by Justice Binnie in *Holt Cargo*, the reason for the privileged status of maritime liens is practical (at paragraph 27):

> The ship may sail under a flag of convenience. Its owners may be difficult to ascertain in a web of corporate relationships. . . . Merchant seamen will not work the vessel unless their wages constitute a high priority against the ship. The same is true of others whose work or supplies are essential to the continued voyage. The Master may be embarrassed for lack of funds, but the ship itself is assumed to be worth something and is readily available to provide a measure of security. Reliance on that security was and is vital to maritime commerce. Uncertainty would undermine confidence.

[22] While Canadian law does not afford a maritime lien for the supply of necessaries, other jurisdictions do, including the United States and France (Tetley, *Maritime Liens and Claims*, at page 551). "Necessaries" include repairs, supplies, towage and the use of dry docks and marine railways (Tetley, *International Maritime and Admiralty Law*, at page 483).

[23] The United States has statutorily recognized a general maritime lien for necessaries since the adoption of the *Ship Mortgage Act* in 1920 [41 Stat. 1000 (1920)] (Tetley, *Maritime Liens and Claims*, at page 77). As mentioned above, the current legislation governing necessaries liens is the U.S. *Commercial Instruments and Maritime Liens Act*, 46 U.S.C. §§ 31301-31343 (2006). These liens arise at the moment of supply to the vessel (Tetley, *Maritime Liens and Claims*, at page 596).

[24] One need only look at the facts of this case to see that maritime transactions may involve a multitude of jurisdictions. As acknowledged by Justice Stone in *Imperial Oil*, "it is not unusual in the marine shipping industry for fuel to be supplied to a vessel under a contract between parties located in several countries, negotiated in one country and performed in another sometimes by a person who was not a party to the original contract" (at paragraph 22). While I recognize that maritime liens are *in rem* rights, which arise by operation of law and not from contract, I believe that the choice of law clause in the supply contracts should generally govern maritime transactions, including the rights which may arise from these transactions. The Supreme Court of Canada has suggested that the principles of comity, order, and fairness should guide the determination of conflict of laws issues (*Spar Aerospace Ltd. v. American Mobile Satellite Corp.*, [2002] 4 S.C.R. 205, at paragraph 21). While the principles of comity and fairness will often be equivocal in the case of maritime transactions, giving greater weight to proper law of the supply contract would pay respect to the notion of "order". This would encourage certainty and predictability in maritime transactions of a jurisdictionally diverse character.

[25] The common law contractual choice of law rules provide that where there is an express or implied choice of law by the parties to the contract, this law will normally govern the contract and legal rights and obligations generated by the contract (*Drew Brown Ltd. v. The "Orient Trader"*, [1974] S.C.R. 1286, at pages 1288, 1314 and 1318; *The Federal Calumet*, at page 253; *Richardson* [*Richardson International, Ltd. v. Mys Chikhacheva (The)*, [2002] 4 F.C. 80 (C.A.)], at paragraph 28). Absent an express or implied choice of law by the parties, the proper law of the contract is determined by assessing which jurisdiction has the closest and most substantial connection (*The Federal Calumet*, at page 253; *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R.

443, at page 448 (*Imperial Life*)).

[26] While the contractual choice of law clause in the contract should dictate the proper law of the maritime transaction, I acknowledge that maritime liens are
extra-contractual rights. Therefore, I do not foreclose the possibility that, where a maritime transaction is so strongly connected to a jurisdiction, this jurisdiction's substantive law, rather than the choice of law clause in the contract, should govern the transaction. In *Imperial Oil*, Justice Stone held that the U.S. choice of law clause in the supply contract did not govern the transaction since the place of vessel registration, the residences of the ship owner and charterer, and the place of supply delivery were all in Canada. Justice Stone also suggested that the flag state of the vessel and the residence of the supplier were significant factors in determining which jurisdiction had the closest and most substantial connection to the transaction.

[27] In assessing the proper law to apply to the transactions at issue, Prothonotary Morneau [at paragraph 60] summarized the relevant connecting factors in a table. I reproduce this table, with some modifications, below. In all cases, the vessel's flag state and the vessel owner's country of residence is Liberia. The vessel's base of operations and the vessel manager's country of residence is Greece.

APPELLANT	APPELLANT'S COUNTRY OF RESIDENCE	SUPPLIER'S COUNTRY OF RESIDENCE	LOCATION OF SUPPLY	CHOICE OF LAW IN SUPPLY CONTRACT
Kent Trade	British Virgin Islands	Canada	Canada	U.S.A.
		Unknown	Spain	U.S.A.
Praxis Energy	British Virgin Islands	England	Pointe à Pierre, Trinidad	U.S.A.
CP3500	Cyprus	Singapore	Singapore	Washington State (arbitration agreement)

[28] It is evident that U.S. law has been explicitly chosen to govern the Kent Trade and Praxis Energy supply contracts. However, the priorities appeal Judge found that the choice of law in the contracts did not dictate that American law applied due to insufficient evidence that the vessel's owner was personally liable under this contract.

[29] Without deciding whether personal liability of the owner is necessary for the choice of law clause to be determinative of the proper law, I find that the priorities appeal Judge made a palpable

and overriding error in holding that a contractual link between the appellants and the vessel's owner was not established by the evidence. It is uncontested by the respondents that the management agreement between the vessel's owner and its manager was part of the record at the priorities appeal. This agreement states that the manager, Arrow, had the authority on behalf of the owner to do all things necessary for the management of the vessel, including the arrangement of bunker fuel and lubrication oil contracts. Furthermore, all invoices of the appellants were addressed directly to Arrow, as manager of the vessel. As a result, a contractual link has been established between the owner and the appellants.

[30] Therefore, even if personal liability of the ship owner is a necessary element of the choice of law rule, the proper law of the Kent Trade and Praxis contracts, based on choice of law rules, is American law.

[31] In the CP3500 contract, there is no explicit choice of law clause; however, there is an arbitration clause stating that any arbitration between the parties is to be decided in accordance with the law of the State of Washington. Even where an arbitration clause only selects the forum of the arbitration, British and Canadian courts normally take this clause as indicative of the proper law of the contract (see e.g. *Richardson*, at paragraphs 34-35; *Compagnie Tunisienne de Navigation S.A. v. Compagnie d'Armement Maritime S.A.*, [1970] 2 Lloyd's Rep. 99 (H.L.)). On this basis, I find that the proper law of the CP3500 supply contract is American law.

[32] Since the contractual choice of law clause should normally govern and there are no other factors, or combinations of factors, which indicate that another jurisdiction has a closer or more substantial connection to the maritime transactions at hand, I disagree with the decisions below and conclude that American law is the appropriate law to apply in this case.

Application of American law

[33] While Justice Gauthier did not believe American law governed the transactions at issue, she proceeded on the basis that it did and found that, based on the expert testimony, American law would not grant maritime liens in the circumstances of this case. The appellants and the respondents differ as to the appropriate standard of review to apply where the trial judge has determined the content of foreign law. It is not contested by either party that foreign law is treated as a question of fact (*Hunt v. T&N PLC*, [1993] 4 S.C.R. 289, at page 306) which must be specifically pleaded by the party relying upon it and proved to the satisfaction of the court (Castel & Walker, at § 7.1). However, as noted by the English Divisional Court in *Prakasho v. Singh*, [1967] 1 All E.R. 737, at page 746 (approved by the English Court of Appeal in *Bumper Development Corp. Ltd. v. Commissioner of Police of the Metropolis and others*, [1991] 4 All E.R. 638, at page 645 (*Bumper Development*)), findings of foreign law are "a question of fact of a peculiar kind". The Ontario Court of Appeal has recently recognized the unique position of an appellate court in reviewing these findings of fact and held that they were reviewable on a standard of correctness (*General Motors Acceptance Corp. of Canada Ltd. v. Town and Country Chrysler Ltd.* (2007), 88 O.R. (3d) 666, at paragraphs 35–36).

[34] This issue does not have to be resolved in the present case since fresh evidence has been admitted in the way of supplemental affidavits from the appellants' and respondents' expert witnesses (order of Décary J., November 6, 2007; order of Noël J., July 10, 2008). In light of the

new evidence submitted prior to this appeal, I must assess whether U.S. law would grant a maritime lien for necessaries in any or all of the four transactions at issue.

[35] Before discussing the expert testimony as to the content of U.S. law, it is helpful to discuss the role of expert witnesses, both in general and in the context of proving foreign law. As recognized by the English Court of Appeal in *General Medical Council v. Meadow*, [2006] EWCA Civ 1390, the duties and responsibilities of expert witnesses in civil cases include the following (citations omitted) [at paragraph 21]:

> 1. Expert evidence presented to the court should be, and should be seen to be, the independent product of the expert uninfluenced as to form or content by the exigencies of litigation. . . . 2. An expert witness should provide independent assistance to the court by way of objective unbiased opinion in relation to matters within his expertise. . . . An expert witness . . . should never assume the role of an advocate. 3. An expert witness should state the facts or assumption upon which his opinion is based. He should not omit to consider material facts which could detract from his concluded opinion. . . . 4. An expert witness should make it clear when a particular question or issue falls outside his expertise. . . .
> 6. If, after exchange of reports, an expert witness changes his view on a material matter having read the other side's expert's report or for any other reason, such change of view should be communicated (through legal representatives) to the other side without delay and when appropriate to the court.

[36] While, in general, both Mr. de Klerk (the expert witness for the appellants) and Mr. Juska (the expert witness for the respondents) provided helpful evidence, I feel it necessary to express my disapproval at the speculative and argumentative nature of some of the testimony given by Mr. de Klerk. An expert witness is entitled to give his opinion as to whether a judicial decision is inconsistent with binding authority or the general state of the law; however, it will generally be inappropriate for expert witnesses to comment on the likelihood of a decision being upheld or reversed on appeal.

[37] As for the substance of the expert testimony, it appears that there is a divergence in the U.S. District Courts and Circuit Courts of Appeal as to whether a maritime lien would be established where a non-U.S. supplier has provided necessaries to a foreign vessel in a foreign port. The English Court of Appeal has suggested that it is "the duty of the judge when faced with conflicting evidence from witnesses about a foreign law to resolve those differences in the same way as he must in the case of other conflicting evidence as to facts" (*Bumper Development*, at page 644). This is also the approach taken in *Wellington, In re Duke of*, [1947] Ch. 506 and *Breen v. Breen*, [1961] 3 All E.R. 225. Determining the law of a foreign jurisdiction when such law is unsettled presents a difficult task for a court. Therefore, I note that my findings on U.S. law are based only on the affidavits and exhibits presented before the Court, since it is generally inappropriate for a court to conduct its own investigation into the foreign law (see *Bumper Development*, at page 644; Castel & Walker, at § 7.3; Dicey, Morris and Collins, at page 262).

[38] Very few decisions were presented that addressed similar circumstances to those at issue in this case: namely, would U.S. courts recognize a maritime lien where a foreign supplier provided necessaries to a foreign ship in a foreign port?

[39] For the proposition that the U.S. Maritime Liens Act does not apply to foreign suppliers providing necessaries to foreign vessels in a foreign port, Mr. Juska cites the decision from the Court

of Appeals for the 11th Circuit in *Trinidad Foundry and Fabricating, Ltd. v. M/V K.A.S. Camilla*, 966 F.2d 613 (11th Cir. 1992). In this case, a Trinidad corporation had provided a Norwegian-flagged ship with certain necessaries and performed repairs on the foreign-owned vessel while docked at Trinidad. The repair contract provided that English law would govern all aspects of the supply and repair agreement. After the vessel's owners failed to pay the outstanding balance on the repair contract, the supplier brought an action *in rem* against the vessel and *in personam* against the ship's owners. The issue before the District Court and at appeal was whether the Court had jurisdiction over the matter. U.S. courts have *in rem* jurisdiction to enforce a maritime lien or whenever a U.S. statute provides for a maritime action *in rem* or analogous proceeding. The supplier argued, *inter alia*, that § 31342 of the U.S. Maritime Liens Act recognized a maritime lien in the circumstances and thus allowed the court to have *in rem* jurisdiction. The Court rejected that argument on two bases: firstly, it held that § 31342 does not provide for a lien for supplies provided by a foreign supplier to foreign flag vessels in foreign ports (at page 617); and secondly, that § 31342 is not even applicable to this case since the contract had stipulated that English law governs.

[40] Similar holdings were made in two other cases cited by Mr. Juska. In *Metron Communications, Inc. v. M/V Tropicana*, [1993] A.M.C. 1264 (S.D. Fla. 1992), the Court declined to recognize the existence of a lien where a Danish corporation provided various services to a Bahamian-registered vessel docked in a foreign port. Furthermore, in *Swedish Telecom Radio v. M/V Discovery I*, 712 F. Supp. 1542 (S.D. Fla. 1988), the District Court commented that (at page 1545):

> On its face, the statute appears to apply to any person or entity regardless of nationality or the location at which the goods were supplied or the services performed. However, the courts interpreting the statute have provided a narrower scope. *See Tramp Oil and Marine Ltd. v. M/V Mermaid I*, 805 F.2d 42 (1st Cir. 1986); *Gulf Trading*, 658 F.2d at 367. "The primary concern of the Federal Maritime Lien Act is the protection of American suppliers of goods and services." *Tramp Oil*, 805 F.2d at 46 (citing the Congressional reports which accompanied the enactment of 1971 amendments to the Act).

[41] The first supplemental affidavit of Mr. Juska referenced a more recent case that was decided by the District Court of Maryland. In *Triton Marine Fuels Ltd., S.A. et al. v. M/V Pacific Chukotka, et al.*, 504 F. Supp. 2d 68 (D. Md. 2007) (*Triton*), a Maltese-registered vessel was owned by a Norwegian corporation, bareboat chartered to a Russian company, and sub-chartered to a U.S.-owned Cayman Islands corporation that had its principal place of business in Seattle. The claimant, a Panamanian corporation, arranged through its Canadian agent to supply the vessel with fuel in the Ukraine. The supply contract contained a clause stating that the law of the United States governed the agreement. The vessel's owner moved for summary judgment on the basis that, even if the choice of law provision was enforceable, the U.S. legislation would not create a maritime lien in the circumstances at issue. The District Court agreed that, as a matter of law, no maritime lien for necessaries existed. In coming to its decision, the court found that there were no policy reasons that would justify "the assertion of United States law against the commandments of the laws of other nations that do not recognize maritime liens for necessaries" (at page 73).

[42] Following the decision in *Triton*, the Court of Appeals for the Ninth Circuit released its decision in *Trans-Tec Asia v. M/V Harmony Container et al.*, 518 F.3d 1120 (9th Cir. 2008) (*Trans-Tec*). The District Court's decision in this case had been cited by Mr. Juska in his first supplemental affidavit for the proposition that, even where the supply contract stipulated the application of American law, a foreign supplier would not obtain a lien for necessaries provided to a foreign vessel

in a foreign port. However, following the submission of this affidavit, the Court of Appeals reversed the District Court's decision. This was brought to the attention of this Court in the second supplemental affidavit of Mr. de Klerk.

[43] In *Trans-Tec*, a Malaysian-owned and flagged vessel, which was chartered to a Taiwanese corporation, was provided with fuel bunkers by a Singaporean corporation while docked in Korea. There was a provision in the supply contract that indicated U.S. law was to govern the transaction. After the supplier did not receive full payment for the bunkers, it filed suit in California, asserting a maritime lien against the vessel. The Court of Appeals relied on the plain language of the statute to find that there was no restriction on the nationality of the supplier or vessel, or on the location of the port of supply. The Court also looked at the Congressional history to support that the Maritime Liens Act was not restricted to American suppliers.

[44] The respondent in *Trans-Tec* argued that there is a presumption against extraterritoriality in Congressional legislation. The Court of Appeals disagreed, holding that admiralty law is extraterritorial by nature and since the parties to the supply contract had chosen American law, the application of American law would not interfere with the sovereignty of other nations. Addressing the decision in *Trinidad*, the Court noted that its analysis of the Maritime Liens Act was skeletal, since the Eleventh Circuit had already decided that English law applied to the transaction. Furthermore, since American law did not apply in this case, the Court's pronouncement that the Maritime Liens Act did not grant a lien where the ship, port, and supplier were foreign was mere *dicta*. The Court also found *Swedish Telecom* to be unpersuasive on this basis, since the Court had determined that Swedish law applied to the transaction.

[45] It is Mr. Juska's opinion that *Trans-Tec* was wrongly decided and he states that he has been advised by counsel for the vessel owner that the Court of Appeals decision will be appealed to the U.S. Supreme Court.[i] *Trans-Tec* is the only U.S. Court of Appeals case decided on much the same facts as the four transactions at issue; namely, a foreign-flagged vessel, owned and operated by non-American entities, docked at a non-U.S. port, being provided with supplies by a non-U.S. company under a supply contract governed by U.S. law. I acknowledge Mr. Juska's assertion, supported by several U.S. Supreme Court decisions, that *Trans-Tec* contradicts the long-established U.S. legal principle that, absent a contrary intent, Congressional legislation does not apply extraterritorially. However, I also note that the Ninth Circuit dealt with this argument and dismissed it.

[46] Although I recognize that a decision of one circuit's Court of Appeals is not considered binding precedent on the decisions of other circuits, *Trans-Tec* is the latest expression of the law from a U.S. appellate court. Therefore, based on the expert evidence before us, I am satisfied that U.S. law would recognize a maritime lien for necessaries where, under a supply contract governed by U.S. law, a foreign supplier provides goods or services to foreign vessels in a foreign port.

[47] There is no aspect relating to any of the four transactions that would serve to distinguish the circumstances at issue from those related in *Trans-Tec*. Consequently, I conclude that the three appellants have proven to my satisfaction that they each have a maritime lien against the *Lanner*.

Disposition

[48] The appeal will be allowed and the following amounts will be ordered to be paid from the balance of the proceeds of the judicial sale of the vessel:

(1) the sum of $415 688.70 in capital to Kent Trade and Finance Inc. with interest to be calculated at the rate stipulated in the supply contract;

(2) the sum of $225 599.23 in capital to Praxis Energies Agents S.A. with interest to be calculated at the rate stipulated in the supply contract; and

(3) the sum of $6 257.25 in capital to CP3500 International Ltd. with interest to be calculated at the rate stipulated in the supply contract.

[49] Costs will be granted to the appellants both in the Federal Court and in this Court.

RYER J.A.: I agree.

* * *

The following are the reasons for judgment rendered in English by

[50] PELLETIER J.A. (dissenting): I have read the decision of the Chief Justice, and for the reasons which follow, I find that I am unable to agree.

[51] In my view, there are two issues in this appeal. First, what is the effect to be given to the choice of law clause which appears in a different form in each of the contracts in question? Second, what is the effect to be given to *Commercial Instruments and Maritime Liens Act*, 46 U.S.C. § 31342 (1994) (the Act)?

[52] Assuming for the purposes of argument that the interpretation of the contracts in question is subject to United States law, and that the proper construction of the contracts brings the Act into play, one is then left with the fact that the application of the Act is a function of the U.S. Court of Appeals circuit in which a vessel is arrested and sold. If the vessel is arrested and sold within the jurisdiction of the Ninth Circuit, then the effect of the Act is to confer a maritime lien on a foreign supplier of necessaries to a foreign ship in a foreign port: see *Trans-Tec Asia v. M/V Harmony Container et al.*, 518 F.3d 1120 (9th Cir. 2008) (*Trans-Tec*); paragraph 4 of Mr. Juska's second supplemental affidavit, at page 441 of the supplemental appeal book. If, on the other hand, a vessel is seized and sold in a port falling within the jurisdiction of the Eleventh Circuit, a maritime lien will not be found to exist as a result of supply to a foreign ship in a foreign port by a foreign supplier by virtue of that Court's decision in *Trinidad Foundry and Fabricating Ltd. v. M/V K.A.S. Camilla*, 966 F.2d 613 (11th Cir. 1992) (*Trinidad Foundry*). Since the decision of one circuit of the U.S. Federal Court of Appeals does not overrule the decision of another circuit of the same court, both decisions are good law within the geographical limits of the circuit in which they were decided. Both experts agreed that the U.S. Supreme Court has not yet considered this question so that there is no decision binding on all U.S. courts on this question.

[53] The present case involves a ship which was arrested and sold outside the United States, so that

the transaction is not one which falls within the geographical jurisdiction of any of the circuits of the U.S. Federal Court of Appeals. Consequently, in so far as Kent Trade and Finance Inc. and Praxis Energy Agents S.A. are concerned, there is no basis for preferring the jurisprudence of one circuit of the U.S. Federal Court of Appeals over another.

[54] This is not a case of a court being forced to choose between conflicting affidavits as to the state of the law of a foreign jurisdiction. It is clear that, in such a case, the court must reach a conclusion on the state of foreign law in spite of the conflict between the experts (*Sarabia v. Oceanic Mindoro (The)*, [1997] 2 W.W.R. 116 (B.C.C.A.), at paragraph 11):

> It is well settled that a court faced with conflicting opinions as to foreign law is bound to make its own decision as to that law. This is apparent from these passages from two authorities:
>
> (1) It is therefore incumbent upon him to prove the law of the State of Washington. This he must prove as matter of fact by the evidence of persons who are expert in that law. . . . and it is settled law that if the evidence of such witnesses is conflicting or obscure the Court may go a step further and examine and construe the passages cited for itself in order to arrive at a satisfactory conclusion. . . .
>
> *Allen v. Hay* (1922), 64 S.C.R. 76 at 80-81, Duff J.
>
> (2) As I understand the law of England. . . . when you come to statute law itself, although it is right that *prima facie* what must be considered is the evidence of the experts and not the text of the law, when the experts differ as to its meaning an English court is entitled and, if it is to perform its function properly, is, indeed, bound, to apply its own mind, fortified by the opinion of the witnesses and giving what weight it thinks ought to be given to it, to the text itself and to examine it in order to make up its mind on the question of interpretation as between the two sets of witnesses.
>
> *Rouyer Guillet & Cie. v. Royer Guillet & Co.*, [1949] All E.R. 244 (C.A.) at 244, Lord Greene M.R. [Emphasis added.]

[55] In this case, while there is a conflict between the opinions of the experts, there is no dispute between them as to the state of the law within the geographical jurisdiction of those circuits of the United States Court of Appeals which have pronounced themselves on the interpretation of the Act. The Ninth Circuit has ruled one way, the Eleventh Circuit has ruled another. Thus, the law to be applied would normally be a function of the circuit in which it is to be applied. As a result, the state of the law depends upon a fact which is absent here, namely the presence of the arrested vessel in a port within the geographical jurisdiction of one or the other of the circuits of the United States Court of Appeals. Given that *Trinidad Foundry*, which ruled against the availability of a maritime lien in the case of foreign suppliers to a foreign ship in a foreign port, was decided in 1992, the parties who wished to take the benefit of the Act could have stipulated the place at which U.S. law was to be determined, and therefore the governing jurisprudence, as CP3500 International Ltd. did in its contract (see paragraph 14 of Mr. de Klerk's affidavit dated October 28, 2004).

[56] In the result, the proof of foreign law fails, not because of the conflicting opinions of the experts, but because the state of the law with respect to maritime liens is, at present, determined by the circuit in which the arrest and sale of the ship occurs. Had the arrest and sale occurred at a U.S. port, the jurisprudence of the Court of Appeals for that circuit would have been applied and the matter resolved. Where the arrest and sale occur outside the United States, and no tie to any

particular circuit is proven, then the U.S. law applicable to that transaction has not been proven.

[57] Where there is no proof of foreign law, the *lex fori*, the law of Canada, applies: see *Castel & Walker: Canadian Conflict of Laws*, 6th ed. looseleaf, Vol. 1 (Markham, Ont.: LexisNexis/Butterworths, 2005), at § 7.4, where Castel and Walker write:

> If foreign law is not pleaded or, if pleaded, it is not proved or is insufficiently proved, the court will apply the *lex fori*. It was once said that in the absence of proof the court would presume the foreign law to be the same as the *lex fori*, but it is better to say that in all cases where foreign law is not proved, the *lex fori* prevails as it is the only law available. [Emphasis added.]

[58] The law of Canada does not recognize a maritime lien for the supply of necessaries to a vessel so that the claims of Kent Trade and Finance Ltd. and Praxis Energy Agents S.A. to priority over the claims of the ship's mortgagees should be dismissed.

[59] The situation of CP3500 International Ltd. is different in that its choice of law clause provides for arbitration under the laws of the State of Washington. At paragraph 14 of his affidavit dated October 28, 2004, Mr. de Klerk states that Washington State law would include the law of the United States. Since Washington is in the Ninth Circuit, the law to be applied would be the law as stated by the Ninth Circuit of the U.S. Federal Court of Appeals in *Trans-Tec*. Given the connection with the Ninth Circuit, I would apply the interpretation of the Act adopted by the United States Court of Appeals for that circuit and allow CP3500 International Ltd.'s claim for a maritime lien.

[60] In the result, I would dismiss the appeals of Kent Trade and Finance Inc. and Praxis Energy Agents S.A. with costs and allow the appeal of CP3500 International Ltd. with costs.

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[1] The petition for a writ of *certiorari* was denied by the U.S. Supreme Court on December 1, 2008 (*Splendid Shipping Sendirian Berhard, Petitioner v. Trans-Tec Asia*, 2008 U.S. LEXIS 8640).

TAB 25

General Motors Acceptance Corp. of Canada, Ltd. v. Town and Country Chrysler Ltd. et al.

[Indexed as: General Motors Acceptance Corp. of Canada, Ltd. v. Town and Country Chrysler Ltd.]

88 O.R. (3d) 666

Court of Appeal for Ontario,
Armstrong, Juriansz and LaForme JJ.A.
December 28, 2007

Conflict of laws -- Foreign law -- Standard of review on questions of foreign law being correctness -- Trial judge erring in determining Qubec law without reference to expert evidence -- Failure of trial judge to make findings in respect of evidence of foreign law leaving appellate court free to reach its own decision on Qubec law.

Personal property security -- Ontario dealer buying car in Qubec and selling it to Ontario wholesaler -- Finance company's security interest not registered against car under Qubec Civil Code as of day of transactions -- Company registering its security interest 12 days later -- Civil Code providing that registration was retroactive to day before dealer made initial purchase -- Ontario purchasers presumed to have knowledge of finance company's security interest -- Presumption of good faith of Ontario purchasers rebutted by their failure to take steps which prudent purchaser would have taken in circumstances -- Civil Code of Qubec, S.Q. 1991, c. 64, Arts. 932, 1745, 2943.

An Ontario car dealer purchased a car in Qubec and sold it to an Ontario wholesaler. At the time of the transactions, neither of the Ontario purchasers conducted a search under the new Qubec equivalent of the Personal Property Security Act,

R.S.O. 1990, c. P.10. If they had done so on the day of the transactions, they would have found nothing registered against the car. Twelve days later, a finance company registered its security interest in the car under the Qubec [page667] legislation. Under Qubec law, that registration was said to be retroactive to the day before the Ontario dealer made the purchase. In a trial to enforce the finance company's security interest against the Ontario purchasers, evidence of Qubec law was adduced by the parties. The trial judge made no reference to that evidence in his reasons, but held that both Ontario purchasers were presumed to have knowledge of the finance company's security interest, and that their presumed good faith conduct in proceeding as they did was rebutted by their failure to act with due diligence. The purchasers appealed.

Held, the appeal should be dismissed.

The rationale that supports a high degree of deference for findings of fact made by a trial judge does not apply to findings and determinations made in respect of foreign law. The standard of review on questions of foreign law is correctness.

The trial judge erred in determining Qubec law without reference to the expert evidence. Where the trial judge fails to make findings in respect of the evidence of foreign law, the appellate court is free to apply its own mind to the questions of foreign law. Article 932 of the Civil Code of Qubec provides that "A possessor is in good faith if, when his possession begins, he is justified in believing he holds the real right he is exercising". In his testimony at trial, the finance company's expert on Qubec law set out the steps a prudent purchaser would take in a case such as this one. The purchasers' failure to take those simple steps rebutted the presumption of good faith. In the circumstances, they could not be said to be justified in believing they had an unfettered right to the vehicle.

Cases referred to

Bank of Nova Scotia v. Wassef, [2000] O.J. No. 4883, [2000] O.T.C. 954, 11 C.P.C. (5th) 338 (S.C.J.); Banque Nationale du Canada v. Michel et Serge Auto Inc., [1989] R.J.Q. 2905 (C.Q. civ.); Caisse populaire Pointe-Gatineau v. Martel, [2002] J.Q. no 5022, [2002] R.J.Q. 3267 (C.Q. civ.); Honda Canada Finance Inc. v. Guvremont, [2003] J.Q. no 1175, J.E. 2003-639 (C.Q. civ.); Housen v. Nikolaisen, [2002] 2 S.C.R. 235, [2002] S.C.J. No. 31, 219 Sask. R. 1, 211 D.L.R. (4th) 577, 286 N.R. 1, 272 W.A.C. 1, [2002] 7 W.W.R. 1, 30 M.P.L.R. (3d) 1, 2002 SCC 33, 10 C.C.L.T. (3d) 157; Rouyer Guillet et Cie v. Rouyer Guillet & Co., [1949] 1 All E.R. 244 (C.A.); Schwartz v. Canada, [1996] 1 S.C.R. 254, [1996] S.C.J. No. 15, 133 D.L.R. (4th) 289, 193 N.R. 241, 17 C.C.E.L. (2d) 141, 96 D.T.C. 6103 (sub nom. M.N.R. v. Schwartz)

Statutes referred to

Civil Code of Qubec, S.Q. 1991, c. 64, Arts. 932, 1745 [as am.], 2805, 2846, 2847, 2943, 2944, 2969, 2970
Personal Property Security Act, R.S.O. 1990, c. P.10, s. 5(2)

Authorities referred to

Malek, Hodge M. et al., eds., Phipson on Evidence, 16th ed. (London: Sweet & Maxwell, 2005)

APPEAL from the judgment of Forget J., [2005] O.J. No. 1378 (S.C.J.), in an action to enforce security interest.

Ronald G. Slaght, Q.C., and Jennifer King, for appellants.

Rolf M. Piehler, for respondent. [page668]

The judgment of the court was delivered by

ARMSTRONG J.A.: --

Introduction

[1] This appeal raises issues of foreign law. The first issue concerns the standard of appellate review to be applied to questions of foreign law determined by a trial judge. The second issue concerns the application of the personal property security legislation in Qubec to two Ontario car dealers who purchased a car initially located in Montral without knowledge of a finance company's registered security interest.

[2] A Smiths Falls, Ontario, car dealer purchased a Corvette automobile from a wholesaler in Montral. The Smiths Falls dealer in turn sold the car to a Belleville wholesaler. At the time of the transactions, neither of the Ontario purchasers conducted a search under the new Qubec equivalent of the Personal Property Security Act, R.S.O. 1990, c. P.10 of Ontario. If they had done a search on the day of the transactions, they would have found nothing registered against the Corvette. Twelve days later, the finance company registered its security interest (pursuant to a conditional sales contract) in the Corvette under the Qubec legislation which registration was said to be retroactive to the day before the Smiths Falls dealer made the initial purchase.

[3] In a trial to enforce the finance company's security interest against the Ontario purchasers, Justice Forget of the Superior Court of Justice held that both Ontario purchasers were presumed to have knowledge of the finance company's security interest. The trial judge further found that the purchasers' presumed good faith conduct in proceeding as they did was rebutted by their failure to act with due diligence. In the result, the trial judge awarded damages against the purchasers, who now appeal to this court.

[4] For the reasons that follow, I would dismiss the appeal.

The Facts

The purchase and sale of the Corvette

[5] A complex chain of transactions gave rise to this case.

On November 24, 1999, 9069-7368 Qubec Inc. ("9069") of Montral purchased a 1999 Corvette from Wilhelmy Chevrolet Geo Oldsmobile Cadillac Limite ("Wilhelmy") in Repentigny, Qubec. A conditional sales agreement was signed the same day and Wilhelmy assigned it to General Motors Acceptance Corporation of Canada, [page669] Limited ("GMAC"), who financed the purchase by advancing funds to 9069. After delivery, a second numbered company, 9066-1141 ("9066"), took possession of the vehicle.

[6] On November 25, 1999, one of the appellants, Town and Country Chrysler Limited ("T & C") of Smiths Falls, Ontario, purchased the Corvette from 9066 for $60,990. 9066 represented to T & C that there existed no interest in the Corvette other than that of the vendor -- a long-time wholesale vendor of vehicles to T & C. There was no notice of any interest of GMAC.

[7] The same day that T & C purchased the Corvette, it sold the car to the other appellant, Devolin Auto Group Ltd. ("Devolin") of Belleville, Ontario, for $62,274.

[8] On December 9, 1999, Devolin sold the Corvette to Brisbee Motor Sales in Michigan for $44,000 (U.S.). The vehicle has since been sold again.

The security interest of GMAC

[9] Although GMAC advanced the funds for the purchase of the Corvette pursuant to a conditional sales agreement of November 24, 1999, GMAC did not register its security interest in Qubec with the Register of Personal and Movable Real Rights ("RPMRR") until December 7, 1999. The RPMRR was then a new personal property registration system which came into operation in September 1999.

[10] GMAC did not register its security interest in Ontario under the Personal Property Security Act ("PPSA") until January 24, 2000.

[11] On March 17, 2000, GMAC sent a letter to the appellants advising of its security interest in the Corvette and claiming

damages against the appellants.

The action

[12] GMAC sought declaratory relief concerning its security interest in the Corvette and damages in the amount of $50,000 against the appellants. GMAC claimed that when T & C purchased the Corvette from 9066 on November 25, 1999, and when Devolin, in turn, purchased it from T & C, GMAC had a valid registered security interest in the Corvette pursuant to Qubec law. GMAC invoked Art. 1745 of the Civil Code of Qubec, S.Q. 1991, c. 64, which provides that the registration of a security interest has a retroactive effect to the date of sale as long as registration is completed within 15 days of the sale.

[13] In this case, the date of registration (December 7, 1999) is within 15 days of the date of the initial purchase and sale [page670] (November 24, 1999). Therefore, GMAC's security interest was valid on November 24, 1999. GMAC further argued that pursuant to s. 5(2)(a) of the PPSA, its registration in Ontario on January 24, 2000 (within 60 days after the car entered Ontario), perfected its Qubec security in Ontario and entitled it to recovery in the courts of this province.

[14] At trial, the appellants argued that GMAC's security interest was not valid in Qubec because under the Civil Code the presumption of knowledge of registration of a purchaser is rebuttable. T & C and Devolin could not reasonably have been expected to know of GMAC's security interest since no registration existed at the time they dealt with the Corvette. Both appellants were unaware of the RPMRR, which had been established only three months prior to the transactions. In any event, even if searches had been conducted at the relevant times, they would have produced negative results. The appellants submitted that they acted in good faith, which is presumed under Art. 2805 of the Civil Code, and that their good faith rebutted the presumption of knowledge.

[15] The appellants further argued that GMAC's registration in Ontario gave it no greater right in Ontario than it would have had in Qubec. Since there was no valid registration in

Qubec at the time of the transactions, there could be no valid registration of a security interest in Ontario.

The Trial

[16] Central to the case was whether GMAC's security interest in the Corvette had been perfected in the Province of Qubec so as to be binding on third parties, including the appellants. This required calling expert evidence on Qubec law and, in particular, on the legal effect of the RPMRR registration system. Each side called a practising commercial lawyer in Qubec to provide such evidence. Before referring to the expert evidence, I will set out the relevant provisions of the Civil Code and of the PPSA.

[17] The relevant statutory provisions of the RPMRR registration system contained in the Civil Code are as follows:

> 932. A possessor is in good faith if, when his possession begins, he is justified in believing he holds the real right he is exercising. His good faith ceases from the time his lack of title or the defects of his possession or title are notified to him by a civil proceeding.
>
> . . . . .
>
> 1745. An instalment sale is a term sale by which the seller reserves ownership of the property until full payment of the sale price. [page671]
>
> A reservation of ownership in respect of a road vehicle or other movable property determined by regulation, or in respect of any moveable property acquired for the service or operation of an enterprise, has effect against third persons only if it has been published; effect against third persons operates from the date of the sale provided the reservation of ownership is published within 15 days. As well, the transfer of such a reservation has effect against third persons only if it has been published.
>
> . . . . .

2805. Good faith is always presumed, unless the law expressly requires that it be provided.

. . . . .

2846. A presumption is an inference established by law or the court from a known fact to an unknown fact.

2847. A legal presumption is one that is specially attached by law to certain facts; it exempts the person in whose favour it exists from making any other proof.

A presumption concerning presumed facts is simple and may be rebutted by proof to the contrary; a presumption concerning deemed facts is absolute and irrebuttable.

. . . . .

2943. ... [A] right registered in the register of personal and movable real rights...is presumed known by a person acquiring or publishing a right in the same property.

2944. Registration of a right in the register of personal and moveable real rights or the land register carries, in respect of all persons, simple presumption of the existence of that right.

. . . . .

2969. ...a register of personal and movable real rights is kept in the Personal and Moveable Real Rights Registry Office.

2970. ...Rights concerning a movable and any other rights are published by registration in the register of personal and moveable real rights. . .

[18] The relevant provision of the PPSA is s. 5(2):

5(2) A security interest in goods perfected under the law

of the jurisdiction in which the goods are situated at the time the security interest attaches but before the goods are brought into Ontario continues perfected in Ontario if a financing statement is registered in Ontario before the goods are brought in or if it is perfected in Ontario,

(a) within sixty days after the goods are brought in.

I should add here that there is no issue concerning the Ontario Act in this appeal. If the Qubec registration applies to the appellants, the appellants concede that the security was properly perfected in Ontario. [page672]

The expert evidence

[19] The respondent's expert, Stephen Hamilton of the Qubec Bar, gave evidence in respect of two of the Civil Code provisions that are relevant to the RPMRR system. He read into the record Art. 1745 concerning the retroactive effect of publication (registration) within 15 days of the sale. He then made brief reference to the registration in this case. Mr. Hamilton also read into the record the provisions of Art. 2943 concerning the presumption of knowledge by third parties claiming a right in the same property registered in the RPMRR system. Counsel then asked Mr. Hamilton what steps a prudent purchaser would take in a case such as the case at bar. Mr. Hamilton suggested the following steps:

(i) check the RPMRR;

(ii) if there is a registration, deal with the registered party;

(iii) if no registration is shown, then there are different options which include:

(a) wait for the 15-day period to expire;

(b) retain the purchase price until the expiry of 15 days and check the register again; and

(c) inquire more closely as to the chain of title back to the dealer.

Mr. Hamilton was not asked about and he gave no evidence as to what might rebut the presumption of knowledge under Art. 2943. He was also not asked about and gave no evidence in respect of the presumption of good faith in Art. 2805.

[20] Pierre McMartin of the Qubec Bar testified for the appellants. Like Mr. Hamilton, Mr. McMartin also made reference to Arts. 1745 and 2943 concerning retroactive registration and presumed knowledge of third parties. He then explained that the presumption of knowledge is a simple presumption rebuttable by proof to the contrary in accordance with Art. 2847.

[21] Mr. McMartin referred to three Qubec cases -- all three appear distinguishable on their facts from the case at bar. See Honda Canada Finance Inc. v. Guvremont, [2003] J.Q. no 1175, J.E. 2003-639 (C.Q. civ.), Caisse populaire Ponte-Gatineau v. Martel, [2002] J.Q. no 5022, [2002] R.J.Q. 3267 (C.Q. civ.), and Banque Nationale du Canada v. Michel et Serge Auto Inc., [1989] R.J.Q. 2905 (C.Q. civ.). [page673]

[22] In concluding his evidence in examination-in-chief, Mr. McMartin said that for GMAC to succeed in this case, it would have to prove that the appellants were negligent. While his evidence was not a model of clarity, Mr. McMartin appears to have equated negligence with lack of good faith. He went on to opine that the trial judge could consider the following factors as supporting the presumption of good faith in this case:

(i) the warranty from the seller to Town & Country that the vehicle was free of liens;

(ii) the problem-free business relationship for 10 years between Town & Country and 9066;

(iii) the reasonableness of the purchase price; and

(iv) the fact that there was no registration under the RPMRR until December 7, 1999.

[23] Counsel for the respondent at trial cross-examined Mr. McMartin on the differences between the case at bar and the three cases that he had referred to in his examination-in-chief. For the most part, the cross-examination simply established that the three cases from the Qubec courts were distinguishable on their facts.

[24] In re-examination, Mr. McMartin testified, without objection from counsel for the respondent, that in his view, whether or not a search was made, the lack of registration of the Corvette at the time of purchase by T & C was sufficient to rebut the presumption of knowledge.

The trial judge's conclusion re GMAC's security interest in Qubec

[25] The trial judge, without reference to the expert evidence, concluded in respect of GMAC's security interest in Qubec as follows [at para. 50]:

> In my opinion, the Defendants should still be presumed to have known of GMAC's interest in the Corvette, despite their arguments to the contrary, and despite the apparent unfairness of that conclusion. This presumption has not been rebutted, for four reasons:
>
> (a) If the dispute is governed by the current version of Article 2943, the Defendants are precluded from arguing that their "good faith" conduct rebuts the presumption of constructive knowledge.
>
> (b) If the dispute is governed by the former version of Article 2943, and good faith is available to rebut the presumption of constructive knowledge of GMAC's security interest, any alleged good [page674] faith on the part of the Defendants is in turn rebutted by convincing evidence that the Defendants did not act with due diligence. Neither Defendant bothered to make any search or inquiry into the validity of their title to the Corvette. It is immaterial that

any such search or inquiry on November 25, 1999 would not have revealed GMAC's interest; the test is whether, given all the circumstances and adopting an objective standard, the Defendants did all that they reasonably could do in order to inform themselves of the validity of their title to the vehicle. In my opinion, the Defendants' conduct does not appear to have met this standard.

(c) As in Ontario, a property right in Qubec pre-dates and exists independently of the registration and publication of that right. While publication of a right permits the enforcement of a person's rights against third parties, the failure to publish or any delay in publication does not extinguish the existence or effect of the right. Therefore, even if the Defendants could rebut the presumption of constructive knowledge of GMAC's security interest, that interest still exists and is retroactive to November 24, 1999.

(d) Finally, it is clear that GMAC complied with Qubec legislation, and properly registered its security interest in the Corvette within the time limit prescribed by the Civil Code so as to take advantage of a 15-day retroactivity period [that] is a valid part of a legislative provision which is still in force and in effect, and which has yet to be challenged, struck out, read down, or declared inapplicable.

[26] In the result, the trial judge granted the declaratory relief sought by GMAC and awarded damages in favour of GMAC against the appellants in the amount of $49,081.72 plus prejudgment interest.

The Appeal

[27] The appellants raise several grounds of appeal which can be reduced to three:

(i) What is the proper standard of review on questions of

foreign law?

(ii) Did the trial judge err in determining Qubec law without reference to the expert evidence?

(iii) Did the trial judge err in his treatment of the issue of good faith?

(i) What is the proper standard of review on questions of foreign law?

[28] The appellants submit that the standard of review for questions of foreign law is correctness. Although foreign law is a [page675] question of fact, counsel submits that the effect of the proven facts on the rights of the parties is a question of law.

[29] Counsel for the appellant relies upon the following statement of Sedgwick J. of the Superior Court of Justice in Bank of Nova Scotia v. Wassef, [2000] O.J. No. 4883, [2000] O.T.C. 954 (S.C.J.), at para. 20:

> While proof of foreign law is treated in our courts as a question of fact, it is "a question of fact of a peculiar kind". Parkasho v. Singh, [1967] 1 All E.R. 737, 746 per Cairns J. "To describe it as one of fact is no doubt apposite, in the sense that the applicable law must be ascertained according to the evidence of witnesses, yet there can be no doubt that what is involved is at bottom a question of law. That has been recognized by the courts". Cheshire & North's: Private Inter-national Law (11th Ed.), 106. For example, in a jury trial, a question of foreign law is determined by the judge; not by the jury. In appellate proceedings, the same deference will not be shown to a trial judge's findings on a question of foreign law as on findings of other facts. The appellate court will examine the evidence of foreign law which was before the trial judge and, may substitute its own interpretation of the foreign law. And while proof of foreign law is a question of fact, the effect of the proven facts on the rights of the parties is a question of law. Re McDonald, [1935] 4 D.L.R. 342 (NSCA).

[30] On the other hand, counsel for the respondent submits that the standard of review on questions of foreign law is palpable and overriding error. He argues that the trial judge's decision in respect of Qubec law and its application to the facts of this case raises questions of mixed fact and law. Relying on the judgment of the Supreme Court of Canada in Housen v. Nikolaisen, [2002] 2 S.C.R. 235, [2002] S.C.J. No. 31, he submits that the standard of palpable and overriding error governs.

[31] The underlying reasons for applying a palpable and overriding error standard in appellate review of findings of fact and of mixed fact and law were exhaustively reviewed by the majority in Housen. These reasons include:

(i) the trial judge is in the better position to assess witnesses' credibility at trial;

(ii) unlimited intervention by appellate courts would greatly increase the number and length of trials generally;

(iii) substantial resources are allocated to the trial courts' process of assessing facts;

(iv) it is important to preserve the autonomy and integrity of the trial process by deferring to a trial judge's finding of facts.

See Housen at paras. 12 and 13. See also Schwartz v. Canada, [1996] 1 S.C.R. 254, [1996] S.C.J. No. 15, at para. 32.
[page676]

[32] In my view, the rationale that supports a high degree of deference for findings of fact made by a trial judge does not apply to findings and determinations made in respect of foreign law. Those factors, supporting a high degree of deference to a trial judge's findings of fact, are either not present in a trial judge's consideration of foreign law or, if they are present, they are not significant.

[33] The credibility of an expert witness testifying on legal issues is, in my view, just as easily assessed on appellate review as at trial. A witness testifying on questions of law is testifying on issues squarely within the province of an appellate court, which is well accustomed to evaluating the persuasiveness of legal arguments. The question of time and the allocation of judicial resources is simply not a significant issue when it comes to questions of foreign law. While globalization is a fact of life, Ontario courts do not appear taxed by foreign law issues. Similarly, it is highly unlikely that the autonomy or integrity of trial courts will in any way be put at risk if appellate courts do not defer to the trial judge's findings in respect of questions of foreign law.

[34] I also find as relevant the following excerpt from Phipson on Evidence, 16th ed. (London: Sweet & Maxwell, 2005) at para. 1-35, which indicates that English courts view foreign law as a question of law on appeal:

> Thus, in English courts, although the existence of English law is a question of law to be determined by authorities in argument, the existence of Scots, colonial or foreign law is treated as a question of fact to be determined by evidence; so that, in the House of Lords or Privy Council, what was a question of fact in the court below, to be established by evidence, may become on appeal a question of law to be judicially noticed.

[35] I therefore conclude that the appropriate standard of review on questions of foreign law is correctness.

(ii) Did the trial judge err in determining Qubec law without reference to the expert evidence?

[36] I agree with the submission of the appellants that the trial judge erred in determining the issues of Qubec law without reference to the expert evidence. The respondent submits that the trial judge by implication referred to and relied upon the expert evidence.

[37] The trial judge delivered relatively lengthy and

detailed reasons -- some 69 paragraphs in 19 single-spaced, typed pages. Yet, these reasons do not contain a single reference to the expert evidence. The trial judge made no findings in [page677] respect of that evidence. He did not indicate whether he accepts or rejects the opinions expressed by either expert. He appears to decide the case as if he were a judge sitting in a Qubec court.

[38] What is the result of this error? I find guidance in the following words of Lord Greene, M.R., in Rouyer Guillet et Cie v. Rouyer Guillet & Co., [1949] 1 All E.R. 244 (C.A.), at p. 244:

> I would add that when you come to the statute law itself, although it is right that prima facie what must be considered is the evidence of the experts and not the text of the law, when the experts differ as to its meaning an English court is entitled and, if it is to perform its function properly, is, indeed, bound, to apply its own mind, fortified by the opinion of the witnesses and giving what weight it thinks ought to be given to it, to the text itself and to examine it in order to make up its mind on the question of interpretation as between the two sets of witnesses.

Although the situation referred to by Lord Greene (that of conflicting expert evidence) was different from that in the case at bar, I conclude that where the trial judge fails to make findings in respect of the evidence of foreign law, this court is at liberty "to apply its own mind" to the questions of foreign law. This approach also comports with the conclusion that the standard of appellate review is correctness.

(iii) Did the trial judge err in his treatment of the issue of good faith?

[39] The issue of good faith arises in respect of rebutting the appellant's presumed knowledge of GMAC's security interest in the Corvette at the time of its purchase. For convenience, I repeat the definition of good faith found in Art. 932 of the Qubec Civil Code:

> 932. A possessor is in good faith if, when his possession begins, he is justified in believing he holds the real right he is exercising. His good faith ceases from the time his lack of title or the defects of his possession or title are notified to him by a civil proceeding.

[40] The trial judge gave four reasons for concluding that the presumption of knowledge had not been rebutted by good faith.

[41] The trial judge's first reason for concluding that the presumption of the appellant's knowledge of GMAC's security interest had not been rebutted was that the current version of Art. 2943 precludes the appellants from arguing that their good faith conduct rebuts the presumption. The current version of Art. 2943 expressly provides that, "a person who does not consult the appropriate register ... may not invoke good faith to rebut the presumption". [page678]

[42] The problem with this rationale, which the judge appeared to acknowledge in part, is that the new version of Art. 2943 came into effect on October 9, 2001 -- nearly two years after the transactions involving the Corvette. The appellant's expert was asked in cross-examination why the Legislature made the amendment to Art. 2943 and he responded:

> I have not checked that, but I can presume that certain clients such as GMAC or other financing companies must have not been too happy about the way the courts were interpreting section 2493 as it was before, because people could allege -- say in good faith, rebut the presumption.

[43] In his second reason, the trial judge asserted that even if good faith was available to rebut the presumption of constructive knowledge, such "good faith on the part of the [appellants] is in turn rebutted by convincing evidence that the [appellants] did not act with due diligence". As noted above, the trial judge said [at para. 50]:

> Neither Defendant bothered to make any search or inquiry into the validity of their title to the Corvette. It is immaterial

that any such search or inquiry on November 25, 1999 would not have revealed GMAC's interest; the test is whether, given all the circumstances and adopting an objective standard, the Defendants did all that they reasonably could do in order to inform themselves of the validity of their title to the vehicle. In my opinion, the Defendants' conduct does not appear to have met this standard.

[44] I cannot discern exactly what the trial judge had in mind when he said that it was immaterial that a search of the register would have produced negative results on November 25, 1999. However, in the above paragraph, I believe he was likely alluding to the evidence of Mr. Hamilton who said what a prudent purchaser in the position of T & C would have done if such a purchaser had found no registration against the Corvette. Those steps included:

(a) wait for the 15-day period to expire;

(b) retain the purchase price until the expiry of 15 days and check the register again; and

(c) inquire more closely as to the chain of title back to the dealer.

[45] The third reason that the trial judge gave for his conclusion is that "even if the [appellants] could rebut the presumption of constructive knowledge of GMAC's security interest, that interest still exists and is retroactive to November 24, 1999". With all due respect to the learned trial judge, I do not [page679] understand this point. The fact that GMAC still has a security interest in the car has nothing to do with whether a third party purchaser can rebut the presumption of constructive knowledge. If a third party can rebut the presumption, he or she is not fixed with constructive knowledge and is free of the consequences of registration.

[46] Finally, the trial judge asserted that GMAC had complied with the Qubec legislation for registration and was entitled to take advantage of the registration's retro-active effect. I do not believe that this rationale adds to the analysis.

Conclusion

[47] In my view, the evidence of Mr. Hamilton, as to the steps that a prudent purchaser would take in the circumstances of T & C is sufficient to rebut the presumption of good faith of both T & C and Devolin. This evidence was essentially unchallenged in cross-examination and appears on its face to produce a sensible approach. I include Devolin because, although it was one step removed from the Qubec transaction, it was aware of the Qubec purchase. Also counsel for the appellants, quite properly, did not distinguish between their positions. The result of this analysis also fits with the definition of good faith in Art. 932 of the Civil Code: "a possessor is in good faith if, when his possession began, he is justified in believing he holds the real right he is exercising". A purchaser who fails to take the simple steps referred to by Mr. Hamilton cannot be said to be justified in believing he had an unfettered right to the vehicle he/she has purchased. Further, I am not persuaded by the evidence of Mr. McMartin that the factors he referred to as supporting the presumption of good faith (supra, para. 22) changes the analysis. I also do not agree with the evidence of Mr. McMartin that the lack of registration of the Corvette at the time of purchase was sufficient to rebut the presumption of knowledge.

[48] I should add that during the trial and to some extent on the argument of the appeal much was made of the fact that the Qubec registration system was a new system that had only been in force for some two months and it was therefore unfair to fix its retroactive effect on the appellants whose principals had no knowledge of it. It is undoubtedly what the trial judge was referring to when he described his conclusion as apparently unfair. Unfortunately, I see no basis in law and in the circumstances here for accepting the newness of the system as a relevant consideration.

[49] For the above reasons, I would dismiss the appeal.
[page680]

Costs

[50] The respondent is entitled to its costs of the appeal on a partial indemnity scale which I would fix at $10,000 including GST and disbursements.

Appeal dismissed.]

TAB 26

Michael Garfield Lyttle *Appellant*

v.

Her Majesty The Queen *Respondent*

INDEXED AS: R. *v.* LYTTLE

Neutral citation: 2004 SCC 5.

File No.: 29412.

2003: October 17; 2004: February 12.

Present: McLachlin C.J. and Major, Binnie, Arbour, LeBel, Deschamps and Fish JJ.

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Criminal law — Evidence — Witnesses — Cross-examination — Right of accused to cross-examine prosecution witnesses — Whether counsel must provide evidentiary foundation for cross-examination or whether good faith basis sufficient for raising questions.

Criminal law — Procedural unfairness at trial — Curative proviso — Defence counsel obliged to call police investigators as her own witnesses against her wishes and to forfeit statutory right to address jury last — Whether resulting trial unfairness could be saved by applying curative proviso — Criminal Code, R.S.C. 1985, c. C-46, s. 686(1)(b)(iii).

The victim was severely beaten by five men. He claimed that he had been beaten over a gold chain but two police officers stated in separate reports, which were disclosed to the defence, that they believed the attack was related to a drug debt. The victim identified the accused in a photographic line-up. The defence theory was that the beating related to an unpaid drug debt and that the victim had identified the accused as his assailant to protect the real offenders — his associates in a drug ring. The Crown did not intend to call the officers as witnesses. In a *voir dire* and repeatedly at trial, the trial judge stated that defence counsel could only proceed with her proposed cross-examination of the Crown's witnesses if she provided substantive evidence of the drug debt theory. Defence counsel called the officers and the accused lost his statutory right to address the jury last. The defence did not present any other evidence. The accused was convicted of robbery, assault causing bodily

Michael Garfield Lyttle *Appelant*

c.

Sa Majesté la Reine *Intimée*

RÉPERTORIÉ : R. *c.* LYTTLE

Référence neutre : 2004 CSC 5.

N^{o} du greffe : 29412.

2003 : 17 octobre; 2004 : 12 février.

Présents : La juge en chef McLachlin et les juges Major, Binnie, Arbour, LeBel, Deschamps et Fish.

EN APPEL DE LA COUR D'APPEL DE L'ONTARIO

Droit criminel — Preuve — Témoins — Contre-interrogatoire — Droit de l'accusé de contre-interroger les témoins à charge — L'avocat doit-il présenter des éléments de preuve au soutien de son contre-interrogatoire ou est-il suffisant qu'il soit de bonne foi lorsqu'il pose ses questions?

Droit criminel — Iniquité procédurale au procès — Disposition réparatrice — L'avocate de la défense a été obligée d'assigner elle-même les policiers enquêteurs et de renoncer au droit que lui reconnaît la loi de s'adresser au jury en dernier — L'injustice en résultant pouvait-elle être corrigée par l'application de la disposition réparatrice? — Code criminel, L.R.C. 1985, ch. C-46, art. 686(1)b)(iii).

Ayant subi une sévère correction aux mains de cinq hommes, la victime a affirmé avoir été battue au sujet d'une chaîne en or. Toutefois, dans des rapports distincts communiqués à la défense, deux policiers ont dit croire que l'agression était reliée à une dette de drogue. La victime a identifié l'accusé à l'occasion d'une séance d'identification photographique. La thèse de la défense était que l'attaque se rapportait à une dette de drogue impayée et que la victime avait désigné l'accusé comme étant son agresseur afin de protéger les véritables malfaiteurs — ses associés au sein d'un réseau de trafiquants de drogue. Le ministère public n'entendait pas citer les policiers comme témoins. Au cours d'un voir-dire ainsi qu'à plusieurs reprises au cours du procès, le juge a indiqué que l'avocate de la défense ne pourrait contre-interroger les témoins à charge comme elle projetait de le faire que si elle fournissait une preuve de fond étayant sa thèse de la dette de drogue. L'avocate de la défense a

harm, kidnapping and possession of a dangerous weapon. In affirming the convictions, the Court of Appeal held that the trial judge had erred in requiring defence counsel to call evidence in support of her drug debt theory but that the verdict could be saved by resort to s. 686(1)(*b*)(iii) of the *Criminal Code*.

Held: The appeal should be allowed and a new trial ordered.

The trial judge unduly restricted the right of the accused to conduct a full and proper cross-examination of the principal Crown witness. The accused was not required to undertake to call evidence to support his drug debt theory as a condition for permitting the cross-examination. The right of an accused to cross-examine prosecution witnesses without significant and unwarranted constraint is an essential component of the right to make a full answer and defence. The right of cross-examination, which is protected by ss. 7 and 11(*d*) of the *Canadian Charter of Rights and Freedoms*, must be jealously protected and broadly construed. A question can be put to a witness in cross-examination regarding matters that need not be proved independently, provided that counsel has a good faith basis for putting the question. It is not uncommon for counsel to believe what is in fact true without being able to prove it otherwise than by cross-examination. "A good faith basis" is a function of the information available to the cross-examiner, his or her belief in its likely accuracy, and the purpose for which it is used. The information may fall short of admissible evidence and may be incomplete or uncertain, provided the cross-examiner does not put suggestions to the witness recklessly or that he or she knows to be false. The cross-examiner may pursue any hypothesis that is honestly advanced on the strength of reasonable inference, experience or intuition and there is no requirement of an evidentiary foundation for every factual suggestion put to a witness in cross-examination. Where a question implies the existence of a disputed factual predicate that is manifestly tenuous or suspect, a trial judge may seek assurance that a good faith basis exists for the question. If the judge is satisfied in this regard and the question is not otherwise prohibited, counsel should be permitted to put the question to the witness. In this case, the existence of a good faith basis for the defence's drug debt theory had become apparent over the course of the

elle-même assigné les policiers et l'accusé a de ce fait perdu le droit que lui accorde la loi de s'adresser au jury en dernier. La défense n'a présenté aucune autre preuve. L'accusé a été déclaré coupable de vol qualifié, de voies de fait causant des lésions corporelles, d'enlèvement et de possession d'arme dangereuse. Confirmant les déclarations de culpabilité, la Cour d'appel a estimé que le juge du procès avait commis une erreur en exigeant de l'avocate de la défense qu'elle produise des éléments de preuve au soutien de sa thèse de la dette de drogue, mais elle a conclu que le verdict pouvait être maintenu par application du sous-al. 686(1)*b*)(iii) du *Code criminel*.

Arrêt : Le pourvoi est accueilli et un nouveau procès est ordonné.

Le juge du procès a indûment limité le droit de l'accusé de mener un contre-interrogatoire complet et approprié du principal témoin à charge. L'accusé n'était pas tenu de s'engager à présenter des éléments de preuve au soutien de sa thèse de la dette de drogue pour être autorisé à procéder au contre-interrogatoire. Le droit d'un accusé de contre-interroger les témoins à charge, sans se voir imposer d'entraves importantes et injustifiées, est un élément essentiel du droit à une défense pleine et entière. Le droit de contre-interroger, qui est garanti par l'art. 7 et l'al. 11*d*) de la *Charte canadienne des droits et libertés*, doit être protégé jalousement et être interprété généreusement. Il est possible de contre-interroger un témoin sur des points qui n'ont pas besoin d'être prouvés indépendamment, pourvu que l'avocat soit de bonne foi lorsqu'il pose ses questions. Il n'est pas inhabituel qu'un avocat prête foi à un fait qui est effectivement vrai, sans qu'il soit capable d'en faire la preuve autrement que par un contre-interrogatoire. La « bonne foi » est fonction des renseignements dont dispose le contre-interrogateur, de l'opinion de celui-ci sur leur probable exactitude et du but de leur utilisation. Ces renseignements peuvent ne pas être des éléments de preuve admissibles et ils peuvent avoir un caractère incomplet ou incertain, pourvu toutefois que le contre-interrogateur ne soumette pas au témoin des hypothèses qui soient inconsidérées ou qu'il sait être fausses. Le contre-interrogateur peut soulever toute hypothèse qu'il avance honnêtement sur la foi d'inférences raisonnables, de son expérience ou de son intuition et rien ne l'oblige à présenter un fondement de preuve à l'égard de chaque fait soumis à un témoin. Lorsqu'une question implique l'existence d'une assise factuelle contestée et manifestement fragile ou suspecte, le juge du procès peut demander à l'avocat l'assurance qu'il pose la question de bonne foi. Si les assurances données à cet égard satisfont le juge et que la formulation de la question n'est pas prohibée pour une autre raison, l'avocat devrait être autorisé à poser la question au

two *voir dires*. The trial judge erred in law by requiring an evidentiary foundation for the cross-examination.

The trial judge's error cannot be cured by resort to s. 686(1)(*b*)(iii) of the *Code*. The ruling had an intimidating effect on defence counsel, disrupted the rhythm of her cross-examinations, and manifestly constrained their scope. It obliged defence counsel to call police investigators as her own witnesses against her wishes. The Crown was permitted to cross-examine its own officers and the accused was found to have forfeited his statutory right to address the jury last. This had a fatal impact on the fairness of the trial. It cannot be said that in the absence of the trial judge's error, there is no reasonable possibility that the verdict would have been different and it would be wrong in these circumstances to apply the curative proviso.

Cases Cited

Explained: *R. v. Howard*, [1989] 1 S.C.R. 1337; *Browne v. Dunn* (1893), 6 R. 67; **disapproved:** *R. v. Fiqia* (1993), 145 A.R. 241; *R. v. Fickes* (1994), 132 N.S.R. (2d) 314; **referred to:** *R. v. Stinchcombe*, [1991] 3 S.C.R. 326; *R. v. Cook*, [1997] 1 S.C.R. 1113; *R. v. Bencardino* (1973), 15 C.C.C. (2d) 342; *R. v. Krause*, [1986] 2 S.C.R. 466; *R. v. Seaboyer*, [1991] 2 S.C.R. 577; *R. v. Osolin*, [1993] 4 S.C.R. 595; *R. v. Meddoui*, [1991] 3 S.C.R. 320; *R. v. Logiacco* (1984), 11 C.C.C. (3d) 374; *R. v. McLaughlin* (1974), 15 C.C.C. (2d) 562; *United Nurses of Alberta v. Alberta (Attorney General)*, [1992] 1 S.C.R. 901; *R. v. Shearing*, [2002] 3 S.C.R. 33, 2002 SCC 58; *Michelson v. United States*, 335 U.S. 469 (1948); *R. v. Norman* (1993), 16 O.R. (3d) 295; *Palmer v. The Queen*, [1980] 1 S.C.R. 759; *Rondel v. Worsley*, [1969] 1 A.C. 191; *R. v. Bevan*, [1993] 2 S.C.R. 599; *R. v. Anandmalik* (1984), 6 O.A.C. 143; *R. v. Wallick* (1990), 69 Man. R. (2d) 310.

Statutes and Regulations Cited

Canadian Charter of Rights and Freedoms, ss. 7, 11(*d*).
Criminal Code, R.S.C. 1985, c. C-46, ss. 651(3), 686(1)(*b*)(iii).

Authors Cited

Brauti, Peter M. "Improper Cross-Examination" (1998), 40 *Crim. L.Q.* 69.

témoin. En l'espèce, l'existence de la bonne foi requise pour justifier la présentation de la thèse de la dette de drogue était ressortie clairement au cours des deux voir-dires. Le juge du procès a commis une erreur de droit en exigeant, pour la tenue du contre-interrogatoire, la production d'un fondement de preuve.

Il est impossible de remédier à l'erreur du juge du procès en appliquant le sous-al. 686(1)*b*)(iii) du *Code criminel*. La décision contestée du juge du procès a eu un effet inhibiteur sur l'avocate de la défense, elle a perturbé le rythme de ses contre-interrogatoires et elle a clairement limité leur portée. Cette décision a obligé l'avocate de la défense à citer, bien malgré elle, les policiers enquêteurs comme témoins à décharge. Le ministère public a été autorisé à contre-interroger ses propres agents et l'accusé a été considéré comme ayant renoncé au droit que la loi lui accorde de s'adresser au jury en dernier. Cette situation a eu des conséquences fatales sur l'équité du procès. Il est impossible d'affirmer qu'il n'existe aucune possibilité raisonnable que le verdict eût été différent en l'absence de l'erreur du juge du procès. De plus, il serait erroné dans les circonstances d'appliquer la disposition réparatrice.

Jurisprudence

Arrêts expliqués : *R. c. Howard*, [1989] 1 R.C.S. 1337; *Browne c. Dunn* (1893), 6 R. 67; **arrêts critiqués :** *R. c. Fiqia* (1993), 145 A.R. 241; *R. c. Fickes* (1994), 132 N.S.R. (2d) 314; **arrêts mentionnés :** *R. c. Stinchcombe*, [1991] 3 R.C.S. 326; *R. c. Cook*, [1997] 1 R.C.S. 1113; *R. c. Bencardino* (1973), 15 C.C.C. (2d) 342; *R. c. Krause*, [1986] 2 R.C.S. 466; *R. c. Seaboyer*, [1991] 2 R.C.S. 577; *R. c. Osolin*, [1993] 4 R.C.S. 595; *R. c. Meddoui*, [1991] 3 R.C.S. 320; *R. c. Logiacco* (1984), 11 C.C.C. (3d) 374; *R. c. McLaughlin* (1974), 15 C.C.C. (2d) 562; *United Nurses of Alberta c. Alberta (Procureur général)*, [1992] 1 R.C.S. 901; *R. c. Shearing*, [2002] 3 R.C.S. 33, 2002 CSC 58; *Michelson c. United States*, 335 U.S. 469 (1948); *R. c. Norman* (1993), 16 O.R. (3d) 295; *Palmer c. La Reine*, [1980] 1 R.C.S. 759; *Rondel c. Worsley*, [1969] 1 A.C. 191; *R. c. Bevan*, [1993] 2 R.C.S. 599; *R. c. Anandmalik* (1984), 6 O.A.C. 143; *R. c. Wallick* (1990), 69 Man. R. (2d) 310.

Lois et règlements cités

Charte canadienne des droits et libertés, art. 7, 11*d*).
Code criminel, L.R.C. 1985, ch. C-46, art. 651(3), 686(1)*b*)(iii).

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Brauti, Peter M. « Improper Cross-Examination » (1998), 40 *Crim. L.Q.* 69.

Sopinka, John, Sidney N. Lederman and Alan W. Bryant. *The Law of Evidence in Canada*, 2nd ed. Toronto: Butterworths, 1999.

APPEAL from a judgment of the Ontario Court of Appeal (2002), 61 O.R. (3d) 97, 167 C.C.C. (3d) 503, 4 C.R. (6th) 1, 163 O.A.C. 33, [2002] O.J. No. 3308 (QL), affirming a judgment of the Superior Court of Justice. Appeal allowed.

David M. Tanovich, for the appellant.

Shelley Hallett, for the respondent.

The judgment of the Court was delivered by

MAJOR AND FISH JJ. —

I. Introduction

1 Cross-examination may often be futile and sometimes prove fatal, but it remains nonetheless a faithful friend in the pursuit of justice and an indispensable ally in the search for truth. At times, there will be no other way to expose falsehood, to rectify error, to correct distortion or to elicit vital information that would otherwise remain forever concealed.

2 That is why the right of an accused to cross-examine witnesses for the prosecution — without significant and unwarranted constraint — is an essential component of the right to make full answer and defence.

3 The Court of Appeal found in this case that the trial judge had unduly restricted the right of the accused to conduct a full and proper cross-examination of the principal Crown witness. We agree with that finding.

4 We agree as well that the judge's error resulted from his understandable misapplication of this Court's decision in *R. v. Howard*, [1989] 1 S.C.R. 1337. The trial judge considered that he was bound by *Howard* to require the appellant to "follow up with substantive evidence" every factual hypothesis defence counsel intended to put to a Crown witness in cross-examination. As the Court of Appeal made plain, this is not the law: *Howard* did not purport to

Sopinka, John, Sidney N. Lederman and Alan W. Bryant. *The Law of Evidence in Canada*, 2nd ed. Toronto : Butterworths, 1999.

POURVOI contre un arrêt de la Cour d'appel de l'Ontario (2002), 61 O.R. (3d) 97, 167 C.C.C. (3d) 503, 4 C.R. (6th) 1, 163 O.A.C. 33, [2002] O.J. No. 3308 (QL), qui a confirmé un jugement de la Cour supérieure de justice. Pourvoi accueilli.

David M. Tanovich, pour l'appelant.

Shelley Hallett, pour l'intimée.

Version française du jugement de la Cour rendu par

LES JUGES MAJOR ET FISH —

I. Aperçu

Bien que le contre-interrogatoire puisse souvent s'avérer futile et parfois se révéler fatal, il demeure néanmoins un ami fidèle dans la poursuite de la justice ainsi qu'un allié indispensable dans la recherche de la vérité. Dans certains cas, il n'existe en effet aucun autre moyen de mettre au jour des faussetés, de rectifier une erreur, de corriger une distorsion ou de découvrir un renseignement essentiel qui, autrement, resterait dissimulé à jamais.

Voilà pourquoi le droit de l'accusé de contre-interroger les témoins à charge — sans se voir imposer d'entraves importantes et injustifiées — est un élément essentiel du droit à une défense pleine et entière.

En l'espèce, la Cour d'appel a conclu que le juge du procès avait indûment limité le droit de l'accusé de mener un contre-interrogatoire complet et approprié du principal témoin à charge. Nous souscrivons à cette conclusion.

Nous sommes nous aussi d'avis que l'erreur commise par le juge résulte de son application erronée, mais compréhensible, de l'arrêt de notre Cour *R. c. Howard*, [1989] 1 R.C.S. 1337. S'estimant lié par cette décision, le juge du procès a exigé de l'appelant qu'il [TRADUCTION] « étaye par une preuve de fond » chacune des hypothèses factuelles que son avocate avait l'intention de soumettre à un témoin à charge en contre-interrogatoire. Comme l'a

change the well-established rule in this regard, and should not be understood to have added an evidentiary burden to the requirement of good faith that has long been considered the governing standard.

The Court of Appeal nonetheless concluded that the judge's misapplication of *Howard* could be cured by resort to the harmless error proviso of s. 686(1)(*b*)(iii) of the *Criminal Code*, R.S.C. 1985, c. C-46.

With respect, we have reached a different conclusion.

First, because the trial judge's impugned ruling had an intimidating effect on defence counsel, disrupted the rhythm of her cross-examinations, and manifestly constrained their scope.

Second, because the ruling obliged defence counsel, against her wishes, to call police investigators as her own witnesses. The Crown was then permitted to cross-examine its own officers — while the appellant, having been obliged by a mistaken ruling to call them, was found to have thereby forfeited his statutory right to address the jury last.

In this latter regard, we do not think it necessary to consider here afresh whether it is generally an advantage to have the last word. Many able and experienced counsel — and others — certainly take that view. Moreover, the defence, where it calls no witnesses, is given that right by s. 651(3) of the *Criminal Code*. Here, the defence wished to exercise that right and was prevented from doing so by the judge's erroneous ruling in law.

For these reasons and those that follow, we have concluded that the trial judge's misapprehension of the governing principles of cross-examination had a fatal impact on the conduct of the defence and on the fairness of the trial.

clairement indiqué la Cour d'appel, il ne s'agit pas là du droit applicable : l'arrêt *Howard* n'a pas modifié la règle établie à cet égard et il n'a pas eu pour effet d'ajouter un fardeau de preuve à l'obligation de bonne foi qui est depuis longtemps considérée comme la norme applicable.

5 La Cour d'appel a néanmoins jugé qu'il était possible de remédier à l'application erronée de l'arrêt *Howard* par le juge du procès au moyen de l'exception relative aux erreurs sans conséquence prévue au sous-al. 686(1)*b*)(iii) du *Code criminel*, L.R.C. 1985, ch. C-46.

6 En toute déférence, nous arrivons à une conclusion différente, et ce pour les raisons suivantes.

7 Premièrement, la décision contestée du juge du procès a eu un effet inhibiteur sur l'avocate de la défense, elle a perturbé le rythme de ses contre-interrogatoires et elle a clairement limité leur portée.

8 Deuxièmement, la décision a obligé l'avocate de la défense à citer, bien malgré elle, les policiers enquêteurs comme témoins à décharge. Le ministère public a été autorisé à contre-interroger ses propres agents — alors que l'appelant, qui a été contraint de les assigner à cause d'une décision erronée, s'est de ce fait trouvé à renoncer au droit que la loi lui accorde de s'adresser au jury en dernier.

9 Pour ce qui est de ce dernier aspect, nous ne jugeons pas nécessaire, dans le présent pourvoi, de réexaminer la question de savoir s'il est en général avantageux de parler en dernier. Nombre d'avocats compétents et expérimentés — ainsi que d'autres personnes — sont assurément de cet avis. En outre, le par. 651(3) du *Code criminel* reconnaît expressément ce droit à la défense lorsqu'elle n'assigne aucun témoin. En l'espèce, la défense souhaitait exercer ce droit et elle en a été empêchée par la décision erronée en droit du juge.

10 Pour les motifs qui précèdent et pour ceux exposés ci-après, nous estimons que l'interprétation erronée par le juge du procès des principes régissant le contre-interrogatoire a eu des conséquences fatales sur la conduite de la défense et sur l'équité du procès.

11 In our respectful view, the appeal should therefore be allowed and a new trial ordered.

II. Facts

12 On February 19, 1999, Stephen Barnaby was viciously beaten by five men with baseball bats, four of them said to have been masked. He was found outside an apartment building, collapsed, shivering, with broken bones and with other severe injuries to his head and legs. He had no wallet, no house keys and no identification.

13 Barnaby told a uniformed officer, with whom he spoke briefly soon after the attack, that he had been beaten over a gold chain.

14 Detective Sean Lawson, initially assigned to the case, stated in his "Occurrence Report" that the attack was believed to be over a drug debt and the victim was being less than truthful. His suspicion in this regard was based on a conversation with Barnaby at the hospital, on the ferocity of the beating, on the fact that Barnaby had a drug-related conviction, and on other elements of Detective Lawson's own preliminary investigation.

15 On the following morning, referring to the Barnaby attack in his "Daily Major" report summarizing all serious crimes that had occurred during his shift, Detective-Sergeant Ian Ganson wrote: "believed to be [over] a drug debt [. . .] further inquiries". Ganson, it should be noted, never spoke directly with Barnaby. He merely relied, in the usual way, on information he had received from subordinate investigators and uniformed officers.

16 Lawson's "Occurrence Report" and Ganson's "Daily Major" report were disclosed to the defence

À notre humble avis, le pourvoi doit donc être accueilli et un nouveau procès doit être ordonné.

II. Faits

Le 19 février 1999, Stephen Barnaby a été sauvagement battu à coups de bâtons de baseball par cinq hommes, dont quatre étaient, dit-on, masqués. Il a été retrouvé à l'extérieur d'un immeuble d'habitation, inconscient, grelottant et souffrant de fractures et de blessures graves à la tête et aux jambes. Il n'avait sur lui ni portefeuille, ni clés de maison, ni pièces d'identité.

Monsieur Barnaby a dit à un policier en uniforme avec qui il s'est brièvement entretenu peu après l'agression qu'on l'avait battu à propos d'une chaîne en or.

Dans son [TRADUCTION] « Rapport circonstancié » (« *Occurrence Report* »), le détective Sean Lawson, initialement chargé de l'affaire, a écrit que l'attaque était selon lui reliée à une dette de drogue et que la victime ne disait pas toute la vérité. Le détective Lawson fondait ses soupçons à cet égard sur une conversation qu'il avait eue avec M. Barnaby à l'hôpital, sur la brutalité de la râclée, sur la déclaration de culpabilité prononcée antérieurement contre ce dernier pour une infraction liée à la drogue et sur d'autres éléments découverts au cours de ses démarches préliminaires.

Le lendemain matin, faisant état de l'agression commise contre M. Barnaby dans son [TRADUCTION] « Rapport quotidien sur les infractions graves » (« *Daily Major* »), lequel résume tous les crimes graves survenus pendant son quart de travail, le sergent-détective Ian Ganson a écrit ceci : [TRADUCTION] « [s]erait reliée à une dette de drogue [. . .] l'enquête se poursuit ». Il convient de souligner que le sergent-détective Ganson n'a jamais parlé directement à M. Barnaby. Il s'est simplement fié, comme à l'habitude, aux renseignements reçus d'enquêteurs subalternes et de policiers en uniforme.

Le « Rapport circonstancié » du détective Lawson et le « Rapport quotidien sur les infractions graves »

in a timely manner, as required by law. See *R. v. Stinchcombe*, [1991] 3 S.C.R. 326.

Detective Michael Korb and his partner, Detective Martin Ottaway, took over the investigation the day after the attack and obtained a statement from Barnaby at the hospital. Korb and Ottaway were aware of the "drug deal gone bad" theory mentioned by Lawson and Ganson, but both testified that it did not influence their investigation. Unlike Lawson and Ganson, Korb and Ottaway believed Barnaby's version of the assault and the reasons for it.

Barnaby, at a photographic line-up, identified the appellant as the unmasked attacker.

III. Proceedings Below

A. *Ontario Superior Court of Justice*

The appellant's trial commenced, before judge and jury, on October 21, 1999.

Crown counsel was aware, from pre-trial discussions, of the defence theory that Barnaby's beating related to an unpaid drug debt and that he had identified the appellant as his assailant to protect the real offenders — his associates in a drug ring.

Before opening his case, Crown counsel urged the trial judge to prohibit cross-examination along these lines in the absence of the "required" evidentiary foundation. In support of its position, the Crown relied on *Howard*, *supra*, and stated that neither Lawson nor Ganson would be called as Crown witnesses.

Throughout the ensuing *voir dire*, the trial judge made it clear that, on his view of the law, the defence could only proceed with its proposed cross-examination if it provided "substantive evidence"

du sergent-détective Ganson ont, comme l'exige la loi, été communiqués à la défense en temps utile. Voir *R. c. Stinchcombe*, [1991] 3 R.C.S. 326.

17 Le lendemain de l'attaque, le détective Michael Korb et son coéquipier, le détective Martin Ottaway, ont pris l'enquête en main et obtenu une déclaration de M. Barnaby à l'hôpital. Messieurs Korb et Ottaway étaient au courant de la thèse de la [TRADUCTION] « transaction de drogue ayant mal tourné » mentionnée par MM. Lawson et Ganson, mais ils ont tous les deux témoigné que cette thèse n'avait pas influencé leur enquête. Contrairement à leurs collègues, MM. Korb et Ottaway ont prêté foi à la version de M. Barnaby au sujet de l'agression et aux raisons qu'il a données à cet égard.

18 Lors d'une séance d'identification photographique, M. Barnaby a identifié l'appelant comme étant l'agresseur non masqué.

III. Historique des procédures

A. *Cour supérieure de justice de l'Ontario*

19 Le procès de l'appelant devant juge et jury a débuté le 21 octobre 1999.

20 L'avocat du ministère public avait pris connaissance, au cours de discussions préalables au procès, de la thèse de la défense suivant laquelle M. Barnaby aurait été battu à cause d'une dette de drogue et aurait identifié l'appelant comme étant son agresseur afin de protéger les véritables malfaiteurs — ses associés au sein d'un réseau de trafiquants de drogue.

21 Avant de présenter sa preuve, l'avocat du ministère public a demandé au juge du procès d'interdire tout contre-interrogatoire à ce propos, vu l'absence du fondement de preuve [TRADUCTION] « requis ». Au soutien de sa demande, le ministère public a invoqué l'arrêt *Howard*, précité, et déclaré que ni le détective Lawson ni le sergent-détective Ganson ne seraient cités comme témoins à charge.

22 Tout au long du voir-dire ayant suivi cette demande, le juge du procès a clairement indiqué que, suivant son interprétation du droit, la défense ne pouvait procéder au contre-interrogatoire projeté

of its "drug debt" theory. The following exchange is illustrative:

THE COURT: She is under no obligation at this point to advise as to the nature of her defence or what evidence she intends to call, but the law is quite clear that if you are making an allegation of that nature and of that substance, that you are required then to commit to leading some evidence in that regard. Is that your intention, madam, or . . . .

MS. ROBB [Defence counsel]: Your . . . Honour, my friend's well aware of the evidence. I didn't dream this up on my own. The investigating officers, within moments at arriving at the scene, checked CPIC and made notations to the effect that they didn't believe this was over a gold chain. They believed it was over a drug deal gone bad. That's where this came from, from the Crown's disclosure. [Emphasis added.]

23 When defence counsel refused to give an undertaking to present an evidentiary foundation for the proposed cross-examination, the trial judge repeated the constraint he was placing on the cross-examination of Crown witnesses:

MS. ROBB: Well, I mean you have to see my position, Your Honour. I can't investigate, prosecute, and prove Mr. Barnaby's a drug dealer. I'm not in a position to do that. The defence theory is that this man made up Mr. Lyttle as the attacker to protect himself from the people that beat him up because he didn't pay the money for drugs. That's the defence theory.

THE COURT: Well, he can give that evidence, not — you have no obligation to tell us whether you are calling him or not. But I can only tell you the law is that if you are going to make those allegations by cross-examining, in the course of cross-examination of the Crown witnesses, you had better follow up with substantive evidence. That is the law. [Emphasis added.]

24 In his preliminary ruling, later often repeated, the trial judge warned defence counsel that there was a danger of a mistrial if she put the "drug debt" allegations to the Crown witnesses and then failed to provide what he considered to be the necessary evidentiary support:

que si elle fournissait une « preuve de fond » étayant sa thèse de la « dette de drogue ». L'échange suivant illustre la position du juge :

[TRADUCTION] LA COUR : Elle n'a aucune obligation à ce moment-ci de révéler la nature de sa défense ou les éléments de preuve qu'elle entend présenter, mais le droit est très clair, si une allégation de cette nature est formulée, il faut s'engager à produire certains éléments de preuve à cet égard. Est-ce là votre intention, madame, ou . . .

M^ME ROBB [avocate de la défense] : Votre [. . .] Seigneurie, mon confrère est bien au fait de la preuve. Je n'ai rien inventé. Dans les instants qui ont suivi leur arrivée sur les lieux, les enquêteurs ont interrogé le CIPC et ont noté qu'ils ne croyaient pas que l'agression avait pour objet une chaîne en or. Ils estimaient qu'une transaction de drogue ayant mal tourné était à l'origine de l'agression. C'est de là que ça vient, de la preuve communiquée par le ministère public. [Nous soulignons.]

Lorsque l'avocate de la défense a refusé de s'engager à présenter un fondement de preuve au soutien du contre-interrogatoire qu'elle projetait de mener, le juge du procès a réitéré les limites qu'il imposait à l'égard du contre-interrogatoire des témoins à charge :

[TRADUCTION] M^ME ROBB : Bien, vous devez comprendre ma position, votre Seigneurie. Je ne peux enquêter sur M. Barnaby, intenter des poursuites contre lui et prouver qu'il est un trafiquant de drogue. Je ne suis pas en mesure de faire ça. La thèse de la défense est que cet homme a inventé le fait que M. Lyttle soit son agresseur afin de se protéger contre ceux qui l'ont battu parce qu'il n'a pas versé l'argent de drogues. Voilà la thèse de la défense.

LA COUR : Bien il peut fournir cette preuve, non — vous n'êtes pas obligée de nous dire si vous l'assignez ou non. Tout ce que je peux vous dire, c'est que le droit prévoit que si vous êtes pour faire ces allégations en contre-interrogatoire, dans le cours du contre-interrogatoire des témoins à charge, vous avez tout intérêt à les étayer ensuite par une preuve de fond. C'est le droit applicable. [Nous soulignons.]

Dans sa décision préliminaire, ainsi qu'à plusieurs reprises par la suite, le juge du procès a prévenu l'avocate de la défense du risque d'annulation du procès si elle faisait état aux témoins à charge des allégations relatives à la « dette de drogue » et si elle ne fournissait pas ultérieurement le fondement de preuve qu'il estimait nécessaire :

[THE COURT]: The answer is, if you are indicating that the questions are necessary to your defence, and that you will comply with the rule in *R. v. Howard*, and cases going back as far as *Browne* and *Dunn*, then I will certainly allow you to ask them, but there better be the follow-up at some point down the road.

MS. ROBB: All right. At this point when the Crown calls its first witness, regardless of follow-up, am I allowed to ask about the CPIC?

THE COURT: Yes. Certainly.

MS. ROBB: So, the only question you're saying I can't ask is to the victim?

THE COURT: I am not — no, you misunderstood me entirely. I am not saying you can or cannot ask any questions. It is your case, it is your defence, you conduct it as you see fit. I am just saying that there will be strict adherence to the rules of evidence, which require that if you ask a question of the nature we have discussed, that, at some point, you are required to produce some foundation or substantive basis for asking that question. You cannot simply pick out of the air an allegation of that nature and hope that it will persuade the jury. There has to be factual underpinning for it. And that if it comes later in the trial, fine, no problem . . . .

. . .

. . . you have done your duty.

. . .

But if it does not come, then you are subject to an application by the Crown for a mistrial. [Emphasis added.]

Later that same day, the submissions on the defence theory continued. The trial judge settled the issue by reiterating his previous ruling:

[THE COURT]: All right, we are going to handle this in the same way we are handling the other issue that we discussed at length this morning. You will be permitted to ask those questions. If you fail to follow-up, and under the *R. v. Howard* case you are obligated to, I presume by now you have read it. I will quote, just to deal with that

[TRADUCTION] [LA COUR] : La réponse est que, si vous affirmez que les questions sont nécessaires à votre défense et que vous allez vous conformer à la règle établie dans *R. c. Howard*, et à des décisions remontant aussi loin que l'arrêt *Browne* et *Dunn*, je vais alors certainement vous autoriser à les poser, mais il vaut mieux que la preuve requise suive à un moment donné.

M^ME^ ROBB : D'accord. À ce moment-ci, lorsque le ministère public appellera son premier témoin, indépendamment de la preuve à apporter plus tard, suis-je autorisée à le questionner au sujet du CIPC?

LA COUR : Oui, certainement.

M^ME^ ROBB : Donc, vous dites que la seule question que je ne peux poser s'adresse à la victime?

LA COUR : Je ne — non, vous ne m'avez pas compris du tout. Je ne dis pas que vous pouvez poser des questions ou que vous ne pouvez pas le faire. C'est votre cause, c'est votre défense, vous la menez comme bon vous semble. Je dis simplement qu'il y aura application stricte des règles de preuve, lesquelles exigent que si vous posez une question de la nature de celle dont nous avons discuté, vous êtes tenue, à un moment donné, de produire des éléments de preuve de fond étayant cette question. Vous ne pouvez tout simplement pas soulever comme ça une allégation de cette nature et espérer qu'elle convainque le jury. Cette allégation doit avoir un fondement factuel. Si ce fondement est établi plus tard au cours du procès, alors tout va bien, aucun problème . . .

. . .

. . . vous avez satisfait à votre obligation.

. . .

Mais s'il ne l'est pas, vous vous exposez à une demande d'annulation du procès par le ministère public. [Nous soulignons.]

25

Plus tard le même jour, la présentation des observations sur la thèse de la défense s'est poursuivie. Le juge du procès a tranché la question en réitérant sa décision antérieure :

[TRADUCTION] [LA COUR] : Bon, nous allons régler ça de la même manière que nous avons réglé l'autre question dont nous avons discuté en profondeur ce matin. Vous serez autorisée à poser ces questions. Si vous ne présentez pas les éléments de preuve requis, et suivant l'arrêt *R. c. Howard* vous êtes tenue de le faire, je

issue briefly, from page [1347] of the Judgment by Mr. Justice Lamer where he says quite clearly:

> "It is not open to the examiner or cross-examiner to put as a fact, or even a hypothetical fact, that which is not and will not become part of the case as admissible evidence."

MS. ROBB: Okay, Your Honour . . . .

THE COURT: So, there is your directive. If you fail to abide by that directive, there will be consequences. [i.e., a mistrial] . . . .

26 Near the end of the examination-in-chief of Ottaway, the second Crown witness, defence counsel expressed concern over the trial judge's ruling and raised the issue of a mistrial. In the absence of the jury, Ms. Robb indicated that she intended to pursue the "drug debt" theory in cross-examination and sought reassurance that in the event the Crown did ask for a mistrial, she would be permitted to address the court. The trial judge confirmed that the defence would be given such an opportunity and stated:

THE COURT: . . . You will be permitted to ask whatever questions you think are relevant to the defence of your client, and I will simply apply the rules of evidence, if, at some later [time] in the trial, you do not produce substantive evidence to – which, looking back, would have warranted that question and that suggestion to the witness. Now, we are going to leave it at that. We are going to bring the jury in. Let us get on with the trial.

I ask you, before they come in, Ms. Robb, to simply read the decision of Mr. Justice Darichuk in the Manitoba . . . Queen's Bench [*R. v. Evans* (1994), 93 Man. R. (2d) 77]. . . . He quite clearly says:

> "Does the right of cross-examination encompass the right to assert specific factual suggestions without confirmation from counsel that the matters suggested are or will be part of his or her case, and that evidence will be led on that subject? I think not."

27 The issue of the foundation for the defence theory arose again during the cross-examination of Ottaway. In order to avoid the possibility of a mistrial should defence counsel not abide by his ruling, the trial judge conducted a second *voir dire*, this

présume que vous l'avez lu depuis. Je citerai, juste pour régler rapidement cette question, cet extrait de la page [1347] du jugement du juge Lamer, où celui-ci dit très clairement :

> « Celui qui interroge ou contre-interroge ne peut pas présenter comme un fait, ni même comme un fait hypothétique, ce qui ne fait pas partie et ne fera pas partie des éléments admissibles et mis en preuve. »

M^ME ROBB : D'accord, votre Seigneurie . . .

LA COUR : Voilà donc votre directive. Si vous ne vous y soumettez pas, il y aura des conséquences. [c.-à-d. l'annulation du procès] . . .

Peu avant la fin de l'interrogatoire principal de M. Ottaway, le deuxième témoin à charge, l'avocate de la défense a exprimé certaines inquiétudes à l'égard de la décision du juge du procès et elle a soulevé la question de l'annulation du procès. En l'absence du jury, M^me Robb a précisé qu'elle entendait continuer à parler de la thèse de la dette de drogue lors du contre-interrogatoire et elle a demandé l'assurance que, si le ministère public sollicitait l'annulation du procès, elle serait autorisée à s'adresser au tribunal. Le juge du procès a confirmé que la défense aurait cette possibilité et il a déclaré ceci :

[TRADUCTION] LA COUR : . . . Vous serez autorisée à poser toutes les questions que vous estimez pertinentes pour la défense de votre client, et je ne ferai qu'appliquer les règles de preuve si, plus tard au cours du procès, vous ne présentez pas la preuve de fond afin — qui, avec le recul, aurait justifié cette question et cette suggestion au témoin. Bon nous allons nous arrêter là. Nous allons rappeler le jury. Continuons le procès.

Je vous demande simplement, avant qu'ils n'entrent, M^me Robb, de lire la décision de Monsieur le juge Darichuk, de la Cour du Banc de la Reine du Manitoba [*R. c. Evans* (1994), 93 Man. R. (2d) 77]. [. . .] Il dit très clairement :

> « Le droit de contre-interroger emporte-t-il celui d'avancer des faits précis sans confirmation par l'avocat que les points mentionnés font ou feront partie de sa thèse et que des éléments de preuve seront produits à ce sujet? Je ne crois pas. »

La question du fondement de preuve requis au soutien de la thèse de la défense s'est de nouveau soulevée pendant le contre-interrogatoire de M. Ottaway. Pour éviter que le procès ne soit annulé au cas où l'avocate de la défense ne se conformerait

time to determine the nature of the facts that would in his view warrant defence counsel's proposed cross-examination. Ottaway and Lawson were called to testify.

On the *voir dire*, the trial judge asked who would call Lawson. Obviously resigned to the trial judge's treatment of *Howard*, defence counsel replied, "Well, if my friend is not gonna call Officer Lawson, I will."

The trial judge considered that Lawson's testimony would provide what he saw as the "substantive evidence" requirement. And it was on this basis that he ultimately permitted the defence to cross-examine Crown witnesses with respect to its "drug debt" theory.

After Ottaway's evidence, and once the jury was excused, the trial judge returned to the evidentiary basis for defence counsel's cross-examination:

THE COURT: Just before we leave. Apropos and flowing from my ruling with respect to cross-examination, Ms. Robb, I noticed [on] a number of occasions you put questions to this witness, 1) inquiring as to whether he'd seen a BMW in the driveway; 2) whether he checked the owners of all the cars that they took the license plates from; 3) with respect to whether they saw a Maxima in the driveway; 4) whether Ms. Veta Smith had any outstanding charges for importing and 5) suggesting that there were many other suspects . . . that they investigated. These are all questions of the same nature as the one that you wanted to ask with respect to the drug deal situation. I assume you are going to be leading evidence with regard to these various items or there will be evidence coming out. There was no objection taken by your friend and they are not, of course, as egregious or perhaps as important to your defence as the drug related thing and I've given you the latitude to ask those questions but, you have a tendency to ask questions, take a no answer. We wonder whether there will be evidence down the road to substantiate the finding of a BMW, for instance, in the driveway.

pas à sa décision, le juge du procès a tenu un second voir-dire afin de déterminer cette fois la nature des faits qui justifieraient à son avis le contre-interrogatoire projeté par l'avocate de la défense. MM. Ottaway et Lawson ont été appelés à témoigner.

28 Au cours du voir-dire, le juge du procès a demandé qui assignerait le détective Lawson. Manifestement résignée à la façon dont le juge du procès appliquait l'arrêt *Howard*, l'avocate de la défense a répondu ceci : [TRADUCTION] « Bien, si mon confrère n'assigne pas l'agent Lawson, je le ferai. »

29 Le juge du procès estimait que le témoignage du détective Lawson apporterait ce qu'il considérait comme la « preuve de fond » requise et c'est sur ce fondement qu'il a fini par permettre à la défense de contre-interroger les témoins à charge à propos de sa thèse fondée sur la dette de drogue.

30 Après le témoignage de M. Ottaway et une fois le jury retiré, le juge du procès est revenu sur la question du fondement de preuve requis au soutien du contre-interrogatoire mené par l'avocate de la défense :

[TRADUCTION] LA COUR : Avant de quitter. À propos de ma décision concernant le contre-interrogatoire, M^me^ Robb, j'ai remarqué qu'à de nombreuses occasions vous avez posé à ce témoin des questions 1) lui demandant s'il avait vu une BMW dans l'entrée de l'immeuble, 2) s'il avait vérifié l'identité des propriétaires de tous les véhicules dont ils avaient relevé le numéro d'immatriculation, 3) s'ils avaient vu une Maxima dans l'entrée de l'immeuble, 4) si des accusations d'importation pesaient contre M^me^ Veta Smith et 5) suggérant que beaucoup d'autres suspects [. . .] avaient fait l'objet d'une enquête. Ce sont toutes des questions de la nature de celle que vous vouliez poser au sujet de la [transaction] de drogue. Je présume que vous allez présenter des éléments de preuve concernant ces différents points ou que des éléments de preuve se feront jour. Aucune objection n'a été soulevée par votre confrère et ces points ne sont pas aussi sérieux ou peut-être pas aussi importants pour votre défense que la thèse de la drogue, et je vous ai donné la latitude nécessaire pour poser ces questions, mais vous avez tendance à poser des questions, et à vous contenter d'un non comme réponse. Nous nous demandons si vous présenterez des éléments de preuve qui, par exemple, confirmeront la présence d'une BMW dans l'entrée de l'immeuble.

MS. ROBB: Well, Your Honour, I got . . . [that from the Crown's disclosure].

THE COURT: Technically, under the Rule you can't simply leave that hanging as you have.

31 When defence counsel later advised the court that she wished to address the jury last and did not wish to be forced to forego this right by calling evidence, the trial judge stated:

THE COURT: . . . Madam. I'm going to ask you not to use that terminology again. The Crown is not forcing you to call Lawson. The reason I am suggesting you must call Lawson is because you committed to call Lawson freely during the course of a *voir dire* in which you won the day and your point prevailed to a great extent upon the commitment you made to the court that you would call Lawson so that you would have the opportunity to abide by the *Howard* principle that if you are going to cross-examine in this particular area you have to produce, as the Crown says, "the beef". [Emphasis added.]

32 Defence counsel then asked the trial judge to himself call Lawson as a witness in accordance with *R. v. Cook*, [1997] 1 S.C.R. 1113, but the judge refused to do so.

33 As a result, Lawson and Ganson were called by the defence, and the appellant lost his statutory right to address the jury last. On cross-examination by the Crown, Lawson and Ganson described their "drug debt" suppositions as initial theories or "hunches" which appeared, they said, to have been disproved by further police investigation.

34 The defence did not present any other evidence.

35 The appellant was convicted of robbery, assault causing bodily harm, kidnapping and possession of a dangerous weapon.

B. *Ontario Court of Appeal* (2002), 61 O.R. (3d) 97

36 On appeal to the Ontario Court of Appeal, the court found that the trial judge had erred in applying

M^ME ROBB : Bien, votre Seigneurie, j'ai tiré [. . .] [cela de la preuve communiquée par le ministère public].

LA COUR : Techniquement, suivant la Règle, vous ne pouvez pas simplement laisser cette question en suspens comme vous l'avez fait.

Lorsque, plus tard, l'avocate de la défense a dit au tribunal qu'elle souhaitait s'adresser au jury en dernier et qu'elle ne voulait pas être obligée de renoncer à ce droit en produisant des éléments de preuve, le juge du procès a déclaré ceci :

[TRADUCTION] LA COUR : Madame, je vais vous demander de ne plus utiliser cette terminologie. Le ministère public ne vous oblige pas à assigner Lawson. La raison pour laquelle j'affirme que vous devez assigner Lawson est que vous vous êtes engagée de plein gré à l'assigner au cours d'un voir-dire où vous avez eu gain de cause, et votre argument a prévalu en grande partie parce que vous vous êtes engagée envers le tribunal à assigner Lawson, afin d'être en mesure de vous conformer au principe établi dans l'arrêt *Howard* qui requiert que, si vous entendez contre-interroger sur ce sujet en particulier, vous devez, comme le dit le ministère public, livrer « la marchandise ».

L'avocate de la défense a alors demandé au juge du procès de citer lui-même M. Lawson comme témoin, conformément à l'arrêt *R. c. Cook*, [1997] 1 R.C.S. 1113, mais le juge a refusé.

Par conséquent, MM. Lawson et Ganson ont été assignés par la défense et l'appelant a perdu le droit que lui reconnaît la loi de s'adresser au jury en dernier. Durant le contre-interrogatoire mené par le ministère public, MM. Lawson et Ganson ont présenté leurs hypothèses sur la « dette de drogue » comme étant des théories de départ ou des « intuitions » qui, ont-ils dit, se sont révélées non fondées lorsque la police a poussé son enquête.

La défense n'a présenté aucun autre élément de preuve.

L'appelant a été déclaré coupable de vol qualifié, de voies de fait causant des lésions corporelles, d'enlèvement et de possession d'arme dangereuse.

B. *Cour d'appel de l'Ontario* (2002), 61 O.R. (3d) 97

L'appelant a interjeté appel à la Cour d'appel de l'Ontario, qui a estimé que le juge du procès avait

Howard, but that the verdict could be saved, and the appeal dismissed, by resort to s. 686(1)(*b*)(iii) of the *Criminal Code*.

Delivering the judgment of the court, Carthy J.A. concluded (at para. 11) that the broad rule enunciated by Lamer J. (as he then was) in *Howard* had no application in the circumstances of this case as it was intended to apply only with respect to the cross-examination of expert witnesses:

> Lamer J. could not have been intending to lay down a broad rule encompassing all forms of cross-examination and to be overruling well-established authorities of this court and others without referring to them. The implications of such a strict rule would pervade and restrict all traditional cross-examinations containing any element of speculation.

Carthy J.A. found, correctly in our view, that *Howard* did not overrule *R. v. Bencardino* (1973), 15 C.C.C. (2d) 342 (Ont. C.A.), which stood for the principle that counsel can cross-examine on matters he or she may not be able to prove directly so long as counsel had a good faith basis for asking the question. He also referred to *R. v. Krause*, [1986] 2 S.C.R. 466, and noted, at para. 19, that:

> [T]he general rule is for a broad right of cross-examination unconstrained by direct relevance to issues and then a narrower right, but not a compulsion, to rebut with further evidence if the issue is not collateral.

The Court of Appeal held that the trial judge had erred in requiring defence counsel to undertake to call evidence to support her "drug debt" theory as a condition for permitting cross-examination on that subject.

The court was satisfied, however, that this error had occasioned no substantial wrong or miscarriage of justice within the meaning of s. 686(1)(*b*)(iii) of the *Criminal Code* and dismissed the appeal.

commis une erreur en appliquant l'arrêt *Howard*, mais que le verdict pouvait être maintenu et l'appel pouvait être rejeté en recourant au sous-al. 686(1)*b*)(iii) du *Code criminel*.

37 Prononçant le jugement de la Cour d'appel, le juge Carthy a conclu (au par. 11) que la règle générale énoncée par le juge Lamer (plus tard Juge en chef) dans l'arrêt *Howard* ne s'appliquait pas dans les circonstances de l'espèce, car cette règle ne visait que le contre-interrogatoire des témoins experts :

> [TRADUCTION] Le juge Lamer ne saurait avoir eu l'intention d'établir une règle générale applicable à toutes les formes de contre-interrogatoire et d'écarter les précédents bien établis de notre cour et d'autres tribunaux sans les mentionner. Les incidences d'une règle aussi stricte s'étendraient à tous les contre-interrogatoires traditionnels comportant un élément de spéculation et en restreindraient la portée.

38 Le juge Carthy a estimé, à juste titre selon nous, que l'arrêt *Howard* n'écartait pas l'arrêt *R. c. Bencardino* (1973), 15 C.C.C. (2d) 342 (C.A. Ont.), lequel étaye le principe qu'un avocat peut contre-interroger le témoin sur des points qu'il n'est peut-être pas en mesure de prouver directement, pourvu qu'il pose ses questions en toute bonne foi. Il a aussi fait état de l'arrêt *R. c. Krause*, [1986] 2 R.C.S. 466, et mentionné ceci, au par. 19 :

> [TRADUCTION] [L]a règle générale reconnaît un large droit de contre-interroger qui n'est pas subordonné à une exigence de pertinence directe des questions avec les points en litige, puis un droit plus limité, qui n'est toutefois pas une obligation, de réfuter les dires du témoin par d'autres éléments de preuve s'il ne s'agit pas d'une question incidente.

39 La Cour d'appel a conclu que le juge du procès avait commis une erreur en imposant à l'avocate de la défense, comme préalable au contre-interrogatoire relatif à sa thèse de la « dette de drogue », qu'elle s'engage à présenter des éléments de preuve au soutien de celle-ci.

40 Cependant, convaincue que cette erreur n'avait entraîné aucun tort important ni aucune erreur judiciaire au sens du sous-al. 686(1)*b*)(iii) du *Code criminel*, la Cour d'appel a débouté l'appelant.

IV. Discussion

41 As mentioned at the outset, the right of an accused to cross-examine prosecution witnesses without significant and unwarranted constraint is an essential component of the right to make a full answer and defence. See *R. v. Seaboyer*, [1991] 2 S.C.R. 577, at p. 608, *per* McLachlin J. (as she then was):

> The right of the innocent not to be convicted is dependent on the right to present full answer and defence. This, in turn, depends on being able to call the evidence necessary to establish a defence and to challenge the evidence called by the prosecution. . . . In short, the denial of the right to call and challenge evidence is tantamount to the denial of the right to rely on a defence to which the law says one is entitled. [Emphasis added.]

42 In *R. v. Osolin*, [1993] 4 S.C.R. 595, Cory J. reviewed the relevant authorities and, at p. 663, explained why cross-examination plays such an important role in the adversarial process, particularly, though of course not exclusively, in the context of a criminal trial:

> There can be no question of the importance of cross-examination. It is of essential importance in determining whether a witness is credible. Even with the most honest witness cross-examination can provide the means to explore the frailties of the testimony. For example, it can demonstrate a witness's weakness of sight or hearing. It can establish that the existing weather conditions may have limited the ability of a witness to observe, or that medication taken by the witness would have distorted vision or hearing. Its importance cannot be denied. It is the ultimate means of demonstrating truth and of testing veracity. Cross-examination must be permitted so that an accused can make full answer and defence. The opportunity to cross-examine witnesses is fundamental to providing a fair trial to an accused. This is an old and well-established principle that is closely linked to the presumption of innocence. See *R. v. Anderson* (1938), 70 C.C.C. 275 (Man. C.A.); *R. v. Rewniak* (1949), 93 C.C.C. 142 (Man. C.A.); *Abel v. The Queen* (1955), 115 C.C.C. 119 (Que. Q.B.); *R. v. Lindlau* (1978), 40 C.C.C. (2d) 47 (Ont. C.A.).

43 Commensurate with its importance, the right to cross-examine is now recognized as being protected

IV. Analyse

Comme il a été mentionné au départ, le droit d'un accusé de contre-interroger les témoins à charge, sans se voir imposer d'entraves importantes et injustifiées, est un élément essentiel du droit à une défense pleine et entière. Voir l'arrêt *R. c. Seaboyer*, [1991] 2 R.C.S. 577, p. 608, la juge McLachlin (maintenant Juge en chef) :

> Le droit de l'innocent de ne pas être déclaré coupable est lié à son droit de présenter une défense pleine et entière. Il doit donc pouvoir présenter les éléments de preuve qui lui permettront d'établir sa défense ou de contester la preuve présentée par la poursuite. [. . .] Bref, la dénégation du droit de présenter ou de contester une preuve équivaut à la dénégation du droit d'invoquer un moyen de défense autorisé par la loi. [Nous soulignons.]

Dans l'arrêt *R. c. Osolin*, [1993] 4 R.C.S. 595, le juge Cory a examiné la jurisprudence pertinente et, à la p. 663, il a expliqué pourquoi le contre-interrogatoire joue un rôle aussi important dans le processus de débat contradictoire, particulièrement — mais évidemment pas seulement — dans les procès criminels :

> Le contre-interrogatoire a une importance incontestable. Il remplit un rôle essentiel dans le processus qui permet de déterminer si un témoin est digne de foi. Même lorsqu'il vise le témoin le plus honnête qui soit, il peut permettre de jauger la fragilité des témoignages. Il peut servir, par exemple, à montrer le handicap visuel ou auditif d'un témoin. Il peut permettre d'établir que les conditions météorologiques pertinentes ont pu limiter la capacité d'observation d'un témoin, ou que des médicaments pris par le témoin ont pu avoir un effet sur sa vision ou son ouïe. Son importance ne peut être mise en doute. C'est le moyen par excellence d'établir la vérité et de tester la véracité. Il faut autoriser le contre-interrogatoire pour que l'accusé puisse présenter une défense pleine et entière. La possibilité de contre-interroger les témoins constitue un élément fondamental du procès équitable auquel l'accusé a droit. Il s'agit d'un principe ancien et bien établi qui est lié de près à la présomption d'innocence. Voir les arrêts *R. c. Anderson* (1938), 70 C.C.C. 275 (C.A. Man.); *R. c. Rewniak* (1949), 93 C.C.C. 142 (C.A. Man.); *Abel c. La Reine* (1955), 23 C.R. 163 (B.R. Qué.); et *R. c. Lindlau* (1978), 40 C.C.C. (2d) 47 (C.A. Ont.).

Vu son importance, le droit de contre-interroger est maintenant reconnu comme un droit protégé par

by ss. 7 and 11(*d*) of the *Canadian Charter of Rights and Freedoms*. See *Osolin*, *supra*, at p. 665.

The right of cross-examination must therefore be jealously protected and broadly construed. But it must not be abused. Counsel are bound by the rules of relevancy and barred from resorting to harassment, misrepresentation, repetitiousness or, more generally, from putting questions whose prejudicial effect outweighs their probative value. See *R. v. Meddoui*, [1991] 3 S.C.R. 320; *R. v. Logiacco* (1984), 11 C.C.C. (3d) 374 (Ont. C.A.); *R. v. McLaughlin* (1974), 15 C.C.C. (2d) 562 (Ont. C.A.); *Osolin*, *supra*.

Just as the right of cross-examination itself is not absolute, so too are its limitations. Trial judges enjoy, in this as in other aspects of the conduct of a trial, a broad discretion to ensure fairness and to see that justice is done — and seen to be done. In the exercise of that discretion, they may sometimes think it right to relax the rules of relevancy somewhat, or to tolerate a degree of repetition that would in other circumstances be unacceptable. See *United Nurses of Alberta v. Alberta (Attorney General)*, [1992] 1 S.C.R. 901, at p. 925.

This appeal concerns the constraint on cross-examination arising from the ethical and legal duties of counsel when they allude in their questions to disputed and unproven facts. Is a good faith basis sufficient or is counsel bound, as the trial judge held in this case, to provide an evidentiary foundation for the assertion?

Unlike the trial judge, and with respect, we believe that a question can be put to a witness in cross-examination regarding matters that need not be proved independently, provided that counsel has a good faith basis for putting the question. It is not uncommon for counsel to believe what is in fact true, without being able to prove it otherwise than by cross-examination; nor is it uncommon for

l'art. 7 et l'al. 11*d*) de la *Charte canadienne des droits et libertés*. Voir l'arrêt *Osolin*, précité, p. 665.

44 Le droit de contre-interroger doit donc être protégé jalousement et être interprété généreusement. Il ne doit cependant pas être exercé de manière abusive. Les avocats sont liés par les règles de la pertinence et il leur est interdit de harceler le témoin, de faire des déclarations inexactes, de se répéter inutilement ou, de façon plus générale, de poser des questions dont l'effet préjudiciable excède la valeur probante. Voir *R. c. Meddoui*, [1991] 3 R.C.S. 320; *R. c. Logiacco* (1984), 11 C.C.C. (3d) 374 (C.A. Ont.); *R. c. McLaughlin* (1974), 15 C.C.C. (2d) 562 (C.A. Ont.); *Osolin*, précité.

45 Tout comme le droit de contre-interroger n'est pas lui-même absolu, les limites dont il est assorti ne le sont pas elles non plus. Le juge du procès jouit, à cet égard comme dans d'autres aspects de la conduite d'un procès, d'un large pouvoir discrétionnaire lui permettant d'assurer l'équité de celui-ci et de voir à ce que justice soit rendue — et perçue comme l'ayant été. Il peut arriver que, dans l'exercice de ce pouvoir discrétionnaire, le juge estime approprié d'assouplir quelque peu les règles de la pertinence ou de tolérer un degré de répétition qui serait par ailleurs inacceptable dans d'autres circonstances. Voir *United Nurses of Alberta c. Alberta (Procureur général)*, [1992] 1 R.C.S. 901, p. 925.

46 Le présent pourvoi porte sur les contraintes que doivent respecter les avocats en raison de leurs obligations légales et déontologiques lorsque, en contre-interrogatoire, ils font allusion dans leurs questions à des faits contestés et non prouvés. La bonne foi de l'avocat est-elle suffisante ou ce dernier doit-il, comme a conclu le juge du procès en l'espèce, produire des éléments de preuve au soutien de ses affirmations?

47 En toute déférence, contrairement au juge du procès, nous croyons qu'il est possible de contre-interroger un témoin sur des points qui n'ont pas besoin d'être prouvés indépendamment, pourvu que l'avocat soit de bonne foi lorsqu'il pose ses questions. Il n'est pas inhabituel qu'un avocat prête foi à un fait qui est effectivement vrai, sans qu'il soit capable d'en faire la preuve autrement que par un

reticent witnesses to concede suggested facts — in the mistaken belief that they are already known to the cross-examiner and will therefore, in any event, emerge.

48 In this context, a "good faith basis" is a function of the information available to the cross-examiner, his or her belief in its likely accuracy, and the purpose for which it is used. Information falling short of admissible evidence may be put to the witness. In fact, the information may be incomplete or uncertain, provided the cross-examiner does not put suggestions to the witness recklessly or that he or she knows to be false. The cross-examiner may pursue any hypothesis that is honestly advanced on the strength of reasonable inference, experience or intuition. The purpose of the question must be consistent with the lawyer's role as an officer of the court: to suggest what counsel genuinely thinks possible on known facts or reasonable assumptions is in our view permissible; to assert or to imply in a manner that is calculated to mislead is in our view improper and prohibited.

49 In *Bencardino*, *supra*, at p. 347, Jessup J.A. applied the English rule to this effect:

> . . . whatever may be said about the forensic impropriety of the three incidents in cross-examination, I am unable to say any illegality was involved in them. As Lord Radcliffe said in *Fox v. General Medical Council*, [1960] 1 W.L.R. 1017 at p. 1023:
>
> > An advocate is entitled to use his discretion as to whether to put questions in the course of cross-examination which are based on material which he is not in a position to prove directly. The penalty is that, if he gets a denial or some answer that does not suit him, the answer stands against him for what it is worth.

50 More recently, in *R. v. Shearing*, [2002] 3 S.C.R. 33, 2002 SCC 58, while recognizing the need for exceptional restraint in sexual assault cases,

contre-interrogatoire; il n'est pas non plus inhabituel qu'un témoin récalcitrant admette les faits qu'on lui suggère — croyant erronément que le contre-interrogateur les connaît déjà et que, en conséquence, leur existence va de toute façon être révélée.

Dans ce contexte, la « bonne foi » est fonction des renseignements dont dispose le contre-interrogateur, de l'opinion de celui-ci sur leur probable exactitude et du but de leur utilisation. Des renseignements qui ne constitueraient par ailleurs pas des éléments de preuve admissibles peuvent être présentés aux témoins. En fait, des renseignements peuvent avoir un caractère incomplet ou incertain, pourvu que le contre-interrogateur ne soumette pas au témoin des hypothèses qui soient inconsidérées ou qu'il sait être fausses. Le contre-interrogateur peut soulever toute hypothèse qu'il avance honnêtement sur la foi d'inférences raisonnables, de son expérience ou de son intuition. Le but de la question doit être compatible avec le rôle que joue l'avocat en tant qu'auxiliaire de justice : il est à notre avis permis à l'avocat de suggérer un fait qu'il considère sincèrement possible à la lumière de faits connus ou d'hypothèses raisonnables; il est toutefois inacceptable et interdit selon nous d'énoncer un fait ou de suggérer implicitement son existence dans le but de tromper.

Dans l'arrêt *Bencardino*, précité, p. 347, le juge Jessup de la Cour d'appel de l'Ontario a appliqué la règle anglaise sur la question :

> [TRADUCTION] . . . indépendamment du caractère malséant des trois incidents survenus lors du contre-interrogatoire, il m'est impossible de conclure qu'ils ont quoi que ce soit d'illégal. Comme l'a dit lord Radcliffe dans l'arrêt *Fox c. General Medical Council*, [1960] 1 W.L.R. 1017, p. 1023 :
>
> > Un avocat dispose de la latitude voulue pour poser, en contre-interrogatoire, des questions reposant sur des éléments d'information qu'il n'est pas en mesure de prouver directement. Le prix à payer est que, s'il obtient une dénégation ou une réponse qui ne lui convient pas, cette réponse joue contre lui pour ce qu'elle vaut.

Plus récemment, dans l'arrêt *R. c. Shearing*, [2002] 3 R.C.S. 33, 2002 CSC 58, tout en reconnaissant l'exceptionnelle retenue dont doivent

Binnie J. reaffirmed, at paras. 121-22, the general rule that "in most instances the adversarial process allows wide latitude to cross-examiners to resort to unproven assumptions and innuendo in an effort to crack the untruthful witness . . .". As suggested at the outset, however, wide latitude does not mean unbridled licence, and cross-examination remains subject to the requirements of good faith, professional integrity and the other limitations set out above (paras. 44-45). See also *Seaboyer*, *supra*, at p. 598; *Osolin*, *supra*, at p. 665.

faire montre les avocats dans les affaires d'agression sexuelle, le juge Binnie a réaffirmé, aux par. 121-122, la règle générale établissant « la grande latitude que, dans la plupart des cas, le processus contradictoire laisse aux contre-interrogateurs de recourir à des hypothèses et à des insinuations non prouvées pour tenter de désarçonner le témoin qui ment . . . ». Toutefois, comme il a été mentionné au départ, cette vaste latitude ne saurait être assimilée à la liberté d'action absolue et le contre-interrogatoire reste assujetti aux obligations de bonne foi et d'intégrité professionnelle ainsi qu'aux autres limites précisées plus tôt (par. 44-45). Voir également les arrêts *Seaboyer*, précité, p. 598, et *Osolin*, précité, p. 665.

A trial judge must balance the rights of an accused to receive a fair trial with the need to prevent unethical cross-examination. There will thus be instances where a trial judge will want to ensure that "counsel [is] not merely taking a random shot at a reputation imprudently exposed or asking a groundless question to waft an unwarranted innuendo into the jury box". See *Michelson v. United States*, 335 U.S. 469 (1948), at p. 481, *per* Jackson J.

51 Le juge du procès doit établir un juste équilibre entre le droit de l'accusé à un procès équitable et la nécessité d'empêcher la tenue d'un contre-interrogatoire contraire à l'éthique. Il surviendra en conséquence des cas où le juge du procès voudra s'assurer que [TRADUCTION] « l'avocat ne se contente pas simplement d'attaquer à l'aveuglette une réputation imprudemment compromise ou de poser une question non fondée afin de lancer une insinuation injustifiée à l'intention des jurés ». Voir *Michelson c. United States*, 335 U.S. 469 (1948), p. 481, le juge Jackson.

Where a question implies the existence of a disputed factual predicate that is manifestly tenuous or suspect, a trial judge may properly take appropriate steps, by conducting a *voir dire* or otherwise, to seek and obtain counsel's assurance that a good faith basis exists for putting the question. If the judge is satisfied in this regard and the question is not otherwise prohibited, counsel should be permitted to put the question to the witness.

52 Lorsqu'une question implique l'existence d'une assise factuelle contestée et manifestement fragile ou suspecte, le juge du procès peut à bon droit prendre les mesures qui s'imposent — soit en tenant un voir-dire soit autrement — pour obtenir de l'avocat l'assurance qu'il pose la question de bonne foi. Si les assurances données à cet égard satisfont le juge et que la formulation de la question n'est pas prohibée pour une autre raison, l'avocat devrait être autorisé à poser la question au témoin.

Central to the trial judge's ruling in this case was his understandable but mistaken view of *Howard*.

53 Un aspect central de la décision du juge du procès en l'espèce est l'interprétation, par ailleurs compréhensible mais erronée, qu'il a donnée de l'arrêt *Howard*.

The Court of Appeal distinguished *Howard* on the basis that it applied only to expert witnesses.

54 La Cour d'appel a déclaré l'arrêt *Howard* inapplicable à l'espèce pour le motif que cette décision ne viserait que les témoins experts.

55 In our respectful opinion, the *ratio* of *Howard* has been misunderstood and misapplied. *Howard* dealt essentially with the admissibility of evidence. Unfortunately, the reasons of Lamer J. have been applied beyond their context and the record in this case leaves no doubt that a misapprehension of *Howard* weighed heavily on the trial of the appellant.

56 In *Howard*, the accused and his co-accused had been tried jointly and found guilty of first degree murder. The Court of Appeal concluded that the trial judge had erred in some respects and ordered a new trial. The co-accused pleaded guilty to second degree murder prior to the second trial. At the first trial, both the Crown and defence called footprint experts in order to establish or disprove, respectively, that the footprints found beside the body of the victim were those of the co-accused, a certain Trudel.

57 At the second trial, before the defence expert testified, the Crown sought the court's permission to ask the defence expert on cross-examination whether or not the fact that the co-accused had pleaded guilty to the murder and had accepted a statement of facts that put him at the scene of the crime would change the expert's opinion that the footprints were not those of the co-accused as he had testified at the first trial. The trial judge ruled that the Crown could ask the question. The defence chose not to call the expert.

58 The issue was whether or not the Crown was entitled to refer, in cross-examining the defence expert, to the guilty plea entered by the co-accused. It is in this context that *Howard* must be understood. The *ratio* of *Howard*, at p. 1348, is that counsel should not inject bias into the application of the witness's expertise by being told of, and asked to take into account, a fact that is corroborative of one of the alternatives he is asked to "scientifically determine":

À notre humble avis, la *ratio decidendi* de l'arrêt *Howard* a été mal comprise et mal appliquée. Cet arrêt portait essentiellement sur l'admissibilité de la preuve. Malheureusement, les motifs du juge Lamer ont reçu une application débordant leur contexte et, en l'espèce, il ressort indubitablement du dossier que l'interprétation erronée de l'arrêt *Howard* a pesé lourd au procès de l'appelant.

Dans l'arrêt *Howard*, l'accusé et son coaccusé ont été jugés ensemble et reconnus coupables de meurtre au premier degré. La Cour d'appel a conclu que le juge de première instance avait commis certaines erreurs et elle a ordonné la tenue d'un nouveau procès. Le coaccusé a plaidé coupable à une accusation de meurtre au deuxième degré avant le second procès. Au cours du premier procès, le ministère public et la défense ont tous deux cité des experts en empreintes de pieds, pour déterminer si les empreintes relevées près du corps de la victime étaient celles du coaccusé, un certain Trudel.

Au deuxième procès, avant que l'expert de la défense ne témoigne, le ministère public a sollicité du tribunal l'autorisation de demander à l'expert de la défense, en contre-interrogatoire, si le fait que le coaccusé avait plaidé coupable à l'accusation de meurtre et avait accepté un exposé des faits précisant qu'il se trouvait sur les lieux du crime modifiait l'opinion qu'il avait exprimée au premier procès, à savoir que les empreintes n'étaient pas celles du coaccusé. Le juge du procès a estimé que le ministère public pouvait poser la question. La défense a choisi de ne pas faire témoigner son expert.

Il s'agissait de décider si l'avocat du ministère public avait le droit de parler du plaidoyer de culpabilité du coaccusé au cours du contre-interrogatoire du témoin expert de la défense. C'est dans ce contexte que l'arrêt *Howard* doit être interprété. Selon la *ratio decidendi* de l'arrêt *Howard*, exprimée à la p. 1348, les avocats ne doivent pas influencer l'application par le témoin expert de ses connaissances spécialisées en lui communiquant un fait qui corrobore l'une des possibilités qu'on lui demande d'« établir scientifiquement » et en lui demandant de prendre ce fait en considération :

Experts assist the trier of fact in reaching a conclusion by applying a particular scientific skill not shared by the judge or the jury to a set of facts and then by expressing an opinion as to what conclusions may be drawn as a result. Therefore, an expert cannot take into account facts that are not subject to his professional expert assessment, as they are irrelevant to his expert assessment; *a fortiori*, as injecting bias into the application of his expertise, he should not be told of and asked to take into account such a fact that is corroborative of one of the alternatives he is asked to scientifically determine. If the Crown experts had been told by the police when they were retained that Trudel had in fact confessed and that he acknowledged facts that established that it was his footprint, we would be left in doubt as to whether their conclusion is a genuine scientific conclusion. This is so because their expertise does not extend to Trudel's credibility, and what he admits to is totally irrelevant to what they were asked to do to help the Court, that is apply their scientific knowledge to the relevant "scientific facts", i.e., the moulds, etc.

Les experts aident le juge des faits à arriver à une conclusion en appliquant à un ensemble de faits des connaissances scientifiques particulières, que ne possèdent ni le juge ni le jury, et en exprimant alors une opinion sur les conclusions que l'on peut en tirer. Par conséquent, un expert ne peut pas tenir compte de faits qui ne sont pas soumis à son examen à titre d'expert professionnel, car ils n'ont pas de rapport avec son examen d'expert; à fortiori, on ne devrait pas lui communiquer ni lui demander de prendre en considération un fait qui corrobore l'une des possibilités qu'on lui demande d'établir scientifiquement car cela fausserait l'expertise elle-même. Si les policiers avaient dit aux experts de la poursuite, lorsqu'on avait retenu leurs services, que Trudel avait avoué et qu'il reconnaissait les faits qui établissaient qu'il s'agissait de ses empreintes de pieds, il nous faudrait nous demander si leur conclusion est vraiment scientifique. Il en est ainsi parce que leur domaine d'expertise ne s'étend pas à la crédibilité de Trudel et que ce qu'il a admis n'a absolument rien à voir avec ce qu'on leur a demandé de faire pour aider la Cour, c'est-à-dire d'appliquer leurs connaissances scientifiques aux « faits scientifiques » pertinents, à savoir les moules, etc.

Stated another way, the Crown should not have been authorized to ask the expert to take into account the co-accused's guilty plea or his adoption of the Crown's statement of facts. The Crown had not called the co-accused as a witness and as Lamer J. later pointed out, at p. 1349, "[a]t the next trial Trudel may be called, if the Crown so chooses, to testify to these facts that would tend to prove that [the expert] was wrong in his conclusion."

59 Autrement dit, le ministère public n'aurait pas dû être autorisé à demander à l'expert de prendre en considération le plaidoyer de culpabilité du coaccusé ou le fait que ce dernier avait souscrit à l'exposé des faits du ministère public. Celui-ci n'avait pas cité le coaccusé comme témoin et, comme le juge Lamer l'a ensuite souligné à la p. 1349, « [d]ans le cadre du nouveau procès, le ministère public peut, s'il le souhaite, appeler Trudel à témoigner sur les faits qui tendraient à prouver que [l'expert] s'est trompé dans sa conclusion. »

The source of the confusion in *Howard* may originate in the following remarks by Lamer J., at p. 1347:

60 Les remarques suivantes du juge Lamer, à la p. 1347 de l'arrêt *Howard*, pourraient être à l'origine de la confusion :

The fact that Trudel had pleaded guilty and had acknowledged that the footprint was his was not at the time the question intended to be put to the expert, and was not going to become, a fact adduced in evidence; nor was it a fact that could fairly be inferred from the facts in evidence. It is not open to the examiner or cross-examiner to put as a fact, or even a hypothetical fact, that which is not and will not become part of the case as admissible evidence. [Emphasis added.]

Le fait que Trudel avait plaidé coupable et avait reconnu que les empreintes de pieds étaient les siennes n'était pas un fait présenté en preuve à l'époque où l'on voulait poser la question à l'expert et n'allait pas le devenir par la suite. Ce n'était pas non plus un fait qu'on pouvait vraiment déduire des faits soumis en preuve. Celui qui interroge ou contre-interroge ne peut pas présenter comme un fait, ni même comme un fait hypothétique, ce qui ne fait pas partie et ne fera pas partie des éléments admissibles et mis en preuve. [Nous soulignons.]

The question that the Crown proposed to put to the expert in *Howard* would have circumvented the

61 Dans l'arrêt *Howard*, la question que le ministère public se proposait de poser à l'expert lui aurait

rules of evidence. Trudel had not testified and his guilty plea was not adduced in evidence. The question and answer were irrelevant to the validity of the expert's opinion and therefore inadmissible. There is a crucial difference between questions put on cross-examination that relate to and rely on inadmissible evidence and cross-examination on unproven facts. See P. M. Brauti, "Improper Cross-Examination" (1998), 40 *Crim. L.Q.* 69, at p. 91.

62 Rather than confining *Howard* to the admissibility of evidence as Finlayson J.A. did in *R. v. Norman* (1993), 16 O.R. (3d) 295 (C.A.), at p. 310, trial and appellate courts, as illustrated in this appeal, have not infrequently interpreted *Howard* as standing for a broad proposition that restricts cross-examination to questions based on facts established in evidence. See *R. v. Fiqia* (1993), 145 A.R. 241 (C.A.), at paras. 44-50; *R. v. Fickes* (1994), 132 N.S.R. (2d) 314 (C.A.), at paras. 9-10.

63 The conclusion that *Howard* mandates or authorizes the requirement of an evidentiary foundation for every factual suggestion put to a witness (expert or not) in cross-examination is misplaced. *Howard* cannot be invoked for this purpose. It is unlikely that the Court intended to add an evidentiary requirement to the foundation for cross-examination and thus limit the scope of cross-examination which had been developed by the long history of the common law and accompanying jurisprudence. *Howard* therefore cannot be accepted as an authority beyond the *ratio* of that case which concerned the admissibility of certain evidence.

64 The trial judge also made reference to the case of *Browne v. Dunn* (1893), 6 R. 67 (H.L.), as support for the proposition that an evidentiary foundation is required for questions put in cross-examination. He was mistaken. The rule in *Browne v. Dunn* requires counsel to give notice to those witnesses whom the

permis de contourner les règles de preuve. Trudel n'avait pas témoigné et son plaidoyer de culpabilité n'était pas soumis en preuve. La question et la réponse étaient sans rapport avec la validité de l'opinion de l'expert et elles étaient par conséquent inadmissibles. Il existe une différence fondamentale entre le fait de poser, en contre-interrogatoire, des questions qui portent et reposent sur des éléments de preuve inadmissibles et le fait de contre-interroger un témoin sur des faits non établis. Voir P. M. Brauti, « Improper Cross-Examination » (1998), 40 *Crim. L.Q.* 69, p. 91.

Au lieu de restreindre l'arrêt *Howard* à l'admissibilité de la preuve, ainsi que l'a fait le juge Finlayson dans l'arrêt *R. c. Norman* (1993), 16 O.R. (3d) 295 (C.A.), p. 310, il est arrivé assez fréquemment, comme en témoigne le présent pourvoi, que des tribunaux de première instance et d'appel tirent de cet arrêt la proposition générale voulant que les seules questions autorisées en contre-interrogatoire soient celles portant sur les faits étayés par la preuve. Voir *R. c. Fiqia* (1993), 145 A.R. 241 (C.A.), par. 44-50; *R. c. Fickes* (1994), 132 N.S.R. (2d) 314 (C.A.), par. 9-10.

La conclusion selon laquelle l'arrêt *Howard* a pour effet d'exiger, ou de permettre au tribunal d'exiger, un fondement de preuve à l'égard de chaque fait soumis à un témoin (expert ou non) en contre-interrogatoire est injustifiée. Cet arrêt ne peut être invoqué au soutien d'une telle proposition. Il est peu probable que la Cour ait voulu ajouter un fardeau de preuve aux exigences déjà applicables au contre-interrogatoire et ainsi limiter la portée de celui-ci, portée qui avait évolué au fil de la longue histoire de la common law et de la jurisprudence pertinente. On ne saurait donc accepter que l'arrêt *Howard*, qui portait sur l'admissibilité de certains éléments de preuve, fasse autorité au-delà de sa *ratio decidendi*.

Le juge du procès a aussi invoqué l'arrêt *Browne c. Dunn* (1893), 6 R. 67 (H.L.), pour étayer la proposition selon laquelle il est nécessaire de présenter un fondement de preuve à l'égard des questions posées en contre-interrogatoire. Il a fait erreur. La règle établie dans *Browne c. Dunn* oblige l'avocat à

cross-examiner intends later to impeach. The rationale for the rule was explained by Lord Herschell, at pp. 70-71:

> Now, my Lords, I cannot help saying that it seems to me to be absolutely essential to the proper conduct of a cause, where it is intended to suggest that a witness is not speaking the truth on a particular point, to direct his attention to the fact by some questions put in cross-examination showing that that imputation is intended to be made, and not to take his evidence and pass it by as a matter altogether unchallenged, and then, when it is impossible for him to explain, as perhaps he might have been able to do if such questions had been put to him, the circumstances which it is suggested indicate that the story he tells ought not to be believed, to argue that he is a witness unworthy of credit. My Lords, I have always understood that if you intend to impeach a witness you are bound, whilst he is in the box, to give him an opportunity of making any explanation which is open to him; and, as it seems to me, that is not only a rule of professional practice in the conduct of a case, but is essential to fair play and fair dealing with witnesses. Sometimes reflections have been made upon excessive cross-examination of witnesses, and it has been complained of as undue; but it seems to me that a cross-examination of a witness which errs in the direction of excess may be far more fair to him than to leave him without cross-examination, and afterwards to suggest that he is not a witness of truth, I mean upon a point on which it is not otherwise perfectly clear that he has had full notice beforehand that there is an intention to impeach the credibility of the story which he is telling.

The rule, although designed to provide fairness to witnesses and the parties, is not fixed. The extent of its application is within the discretion of the trial judge after taking into account all the circumstances of the case. See *Palmer v. The Queen*, [1980] 1 S.C.R. 759, at pp. 781-82; J. Sopinka, S. N. Lederman and A. W. Bryant, *The Law of Evidence in Canada* (2nd ed. 1999), at pp. 954-57. In any event, the foregoing rule in *Browne v. Dunn* remains a sound principle of general application, though irrelevant to the issue before the trial judge in this case.

prévenir les témoins dont il entend mettre en doute la crédibilité ultérieurement. La justification de cette règle a été expliquée ainsi par lord Herschell, aux p. 70-71 :

> [TRADUCTION] Bien, vos Seigneuries, je ne peux m'empêcher d'affirmer qu'il m'apparaît absolument essentiel au déroulement régulier d'une instance, lorsqu'un avocat entend suggérer qu'un témoin ne dit pas la vérité sur un point en particulier, d'attirer l'attention de ce témoin sur ce fait en lui posant en contre-interrogatoire certaines questions indiquant qu'on fera cette imputation, et non d'accepter son témoignage et d'en faire abstraction comme s'il était absolument incontesté puis, lorsqu'il lui est impossible d'expliquer — ce qu'il aurait peut-être pu faire si ces questions lui avaient été posées — les circonstances qui, prétend-on, montrent que sa version des faits ne doit pas être retenue, de soutenir qu'il n'est pas un témoin digne de foi. Vos Seigneuries, il m'a toujours semblé que l'avocat qui entend mettre en doute le témoignage d'une personne doit, lorsque cette personne se trouve à la barre des témoins, lui donner l'occasion d'offrir toute explication qu'elle est en mesure de présenter. De plus, il me semble qu'il ne s'agit pas seulement d'une règle de pratique professionnelle dans la conduite d'une affaire, mais également d'une attitude essentielle pour agir de façon loyale envers les témoins. On souligne parfois le caractère excessif du contre-interrogatoire auquel un témoin est soumis, reprochant à ce contre-interrogatoire d'être abusif. Toutefois, il me semble qu'un contre-interrogatoire mené par un avocat péchant par excès de zèle peut se révéler beaucoup plus équitable pour le témoin que le fait de ne pas le contre-interroger puis de suggérer qu'il ne dit pas la vérité, je veux dire sur un point à l'égard duquel il n'est par ailleurs pas clair qu'il a été pleinement informé au préalable qu'on entendait mettre en doute la crédibilité de sa version des faits.

Bien qu'elle vise à faire en sorte que les témoins et les parties soient traités équitablement, cette règle n'a pas un caractère absolu. La mesure dans laquelle elle est appliquée est une décision qui relève du pouvoir discrétionnaire du juge du procès, eu égard à toutes les circonstances de l'affaire. Voir *Palmer c. La Reine*, [1980] 1 R.C.S. 759, p. 781-782; J. Sopinka, S. N. Lederman et A. W. Bryant, *The Law of Evidence in Canada* (2e éd. 1999), p. 954 et 957. Quoi qu'il en soit, la règle susmentionnée établie dans l'arrêt *Browne c. Dunn* demeure un principe valable d'application générale, bien qu'elle ne soit pas pertinente pour la question dont était saisi le juge du procès en l'espèce.

66 As long as counsel has a good faith basis for asking an otherwise permissible question in cross-examination, the question should be allowed. In our view, no distinction need be made between expert and lay witnesses within the broad scope of this general principle. Counsel, however, bear important professional duties and ethical responsibilities, not just at trial, but on appeal as well. This point was emphasized by Lord Reid in *Rondel v. Worsley*, [1969] 1 A.C. 191 (H.L.), at pp. 227-28, when he said:

> Every counsel has a duty to his client fearlessly to raise every issue, advance every argument, and ask every question, however distasteful, which he thinks will help his client's case. But, as an officer of the court concerned in the administration of justice, he has an overriding duty to the court, to the standards of his profession, and to the public, which may and often does lead to a conflict with his client's wishes or with what the client thinks are his personal interests. Counsel must not mislead the court, he must not lend himself to casting aspersions on the other party or witnesses for which there is no sufficient basis in the information in his possession, he must not withhold authorities or documents which may tell against his clients but which the law or the standards of his profession require him to produce. . . . [Emphasis added.]

Pourvu que l'avocat agisse de bonne foi lorsqu'il pose en contre-interrogatoire une question par ailleurs admissible, cette question devrait être autorisée. À notre avis, il n'est pas nécessaire d'établir de distinction entre les témoins experts et les témoins profanes à l'intérieur du vaste cadre de ce principe général. Toutefois, les avocats sont assujettis à d'importantes obligations professionnelles et déontologiques, non seulement au cours du procès mais aussi en appel. Lord Reid a souligné l'importance de ce point dans l'arrêt *Rondel c. Worsley*, [1969] 1 A.C. 191 (H.L.), p. 227-228, lorsqu'il a dit ceci :

> [TRADUCTION] Tout avocat a envers son client l'obligation de ne pas hésiter à soulever tout point, à faire valoir tout argument et à poser toute question — aussi répugnante que puisse être cette intervention — qui selon lui aide la cause de son client. Cependant, en tant qu'officier de justice soucieux de l'intérêt de l'administration de la justice, il a envers le tribunal, les normes de sa profession et le public une obligation primordiale qui peut entrer en conflit et qui dans bien des cas entre effectivement en conflit avec les désirs d'un client ou avec ce que le client estime être ses intérêts personnels. L'avocat ne doit pas induire le tribunal en erreur, il ne doit pas se permettre de lancer des accusations contre l'autre partie ou les témoins sans avoir en sa possession les renseignements suffisants pour les étayer, il ne doit pas cacher de la jurisprudence ou des documents qui pourraient être défavorables à ses clients, mais que le droit ou les normes de sa profession l'obligent à déposer. . . [Nous soulignons.]

67 By requiring an evidentiary foundation on the basis of *Howard*, the trial judge erred in law. Over the course of the two *voir dires* the existence of a good faith basis for the defence's "drug debt" theory had, in any event, become apparent. This basis included, but was not limited to, the police reports, the complainant Barnaby's drug conviction, his admission at the preliminary hearing that he had dealt in drugs, and the drug conviction of the complainant's acquaintance who drove him to the alleged scene of the attack.

Le juge du procès a commis une erreur de droit en exigeant, sur la base de l'arrêt *Howard*, la production d'un fondement de preuve. De toute façon, l'existence de la bonne foi requise pour justifier la présentation de la thèse de la dette de drogue était ressortie clairement au cours des deux voir-dires. Parmi les éléments étayant cette bonne foi, mentionnons les rapports de police, la déclaration de culpabilité figurant au dossier du plaignant Barnaby pour une affaire de drogue et son aveu, à l'enquête préliminaire, qu'il avait vendu de la drogue et la déclaration de culpabilité pour une affaire de drogue prononcée contre la personne — une connaissance du plaignant — qui l'avait conduit sur les lieux présumés de l'agression.

V. Conclusion

In order to determine whether there has been no substantial wrong or miscarriage of justice as a result of a trial judge's error, an appellate court must determine "whether there is any reasonable possibility that the verdict would have been different had the error at issue not been made". See *R. v. Bevan*, [1993] 2 S.C.R. 599, at p. 617.

In *R. v. Anandmalik* (1984), 6 O.A.C. 143, at p. 144, the Ontario Court of Appeal recognized that the importance of cross-examination becomes even more critical when credibility is the central issue in the trial:

> In a case where the guilt or innocence of the [accused] largely turned on credibility, it was a serious error to limit the [accused] of his substantial right to fully cross-examine the principal Crown witness. It would not be appropriate in the circumstances to invoke or apply the curative provisions of s. 613(1)(*b*)(iii) [now s. 686(1)(*b*)(iii)].

The Manitoba Court of Appeal echoed these sentiments in *R. v. Wallick* (1990), 69 Man. R. (2d) 310, at p. 311:

> Cross-examination is a most powerful weapon of the defence, particularly when the entire case turns on credibility of the witnesses. An accused in a criminal case has the right of cross-examination in the fullest and widest sense of the word as long as he does not abuse that right. Any improper interference with the right is an error which will result in the conviction being quashed.

It follows that where, as here, a trial judge improperly interfered with an accused's right to cross-examine, infused a mistrial chill into the proceedings, and placed conditions on a legitimate line of questioning that forfeited the accused's statutory right to address the jury last, a substantial wrong occurred and an unfair trial resulted.

This alone is sufficient to dispose of the appeal in the appellant's favour.

V. Conclusion

68 Afin de déterminer si l'erreur du juge du procès a causé un tort important ou une erreur judiciaire grave, la cour d'appel saisie de la question doit se demander « s'il existe une possibilité raisonnable que le verdict eût été différent en l'absence de l'erreur en question ». Voir *R. c. Bevan*, [1993] 2 R.C.S. 599, p. 617.

69 Dans l'arrêt *R. c. Anandmalik* (1984), 6 O.A.C. 143, p. 144, la Cour d'appel de l'Ontario a reconnu que le contre-interrogatoire revêt une importance plus cruciale encore lorsque la crédibilité est la question centrale du procès :

> [TRADUCTION] Dans une affaire où la culpabilité ou l'innocence de l'[accusé] dépendait largement de la question de la crédibilité, ce fut une grave erreur que de priver l'[accusé] de son droit fondamental de contre-interroger pleinement le principal témoin de la poursuite. Il ne serait pas approprié dans les circonstances d'invoquer ou d'appliquer les dispositions réparatrices du sous-al. 613(1)*b*)(iii) [maintenant le sous-al. 686(1)*b*)(iii)].

70 La Cour d'appel du Manitoba a fait écho à cette opinion dans l'arrêt *R. c. Wallick* (1990), 69 Man. R. (2d) 310, p. 311 :

> [TRADUCTION] Le contre-interrogatoire est un outil très puissant à la disposition de la défense, particulièrement lorsque toute l'affaire repose sur la crédibilité des témoins. Dans un procès criminel, l'accusé a le droit de contre-interroger les témoins, et ce au sens le plus complet et le plus large du terme, pourvu qu'il n'abuse pas de ce droit. Toute limitation irrégulière de ce droit constitue une erreur susceptible d'entraîner l'annulation de la déclaration de culpabilité.

71 Il s'ensuit que dans les cas où, comme en l'espèce, le juge du procès a limité irrégulièrement le droit de l'accusé de contre-interroger, a fait peser la menace d'annulation du procès et a subordonné la présentation d'une série de questions légitimes au respect de conditions qui ont eu pour effet de faire perdre à l'accusé le droit que lui confère la loi de s'adresser au jury en dernier, un tort important a été causé et un procès inéquitable en a résulté.

72 Cette conclusion justifie à elle seule de trancher le pourvoi en faveur de l'appelant.

73 Moreover, we are not convinced that, in the absence of the trial judge's error, there is no "reasonable possibility that the verdict would have been different". See *Bevan*, *supra*, at p. 617.

74 In our respectful view, it would be wrong in these circumstances to apply the curative proviso.

75 We would instead allow the appeal and order a new trial.

Appeal allowed.

Solicitors for the appellant: Pinkofskys, Toronto.

Solicitor for the respondent: Attorney General of Ontario, Toronto.

En outre, nous ne sommes pas convaincus qu'il n'existe aucune « possibilité raisonnable que le verdict eût été différent » en l'absence de l'erreur commise par le juge du procès. Voir l'arrêt *Bevan*, précité, p. 617.

À notre humble avis, il serait erroné dans les circonstances d'appliquer la disposition réparatrice.

Au contraire, nous sommes d'avis d'accueillir le pourvoi et d'ordonner la tenue d'un nouveau procès.

Pourvoi accueilli.

Procureurs de l'appelant : Pinkofskys, Toronto.

Procureur de l'intimée : Procureur général de l'Ontario, Toronto.

TAB 27

Court File No. 13-1003300-CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

THE HONOURABLE	)	**TUESDAY, THE 23RD**
	)	
JUSTICE MORAWETZ	)	**DAY OF APRIL, 2013**

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 AND ARRANGEMENT OF SKYLINK AVIATION INC.

PLAN SANCTION ORDER

THIS MOTION made by SkyLink Aviation Inc. (the "**Applicant**") for an order (the "**Plan Sanction Order**") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**"), sanctioning the plan of compromise and arrangement dated April 18, 2013, which is attached as **Schedule "A"** hereto (and as it may be further amended, varied or supplemented from time to time in accordance with the terms thereof, the "**Plan**"), was heard on April 23, 2013 at 330 University Avenue, Toronto, Ontario.

ON READING the Notice of Motion, the Affidavit of Jan Ottens sworn April 21, 2013 (the "**Ottens Affidavit**"), filed, the second report (the "**Second Report**") of Duff & Phelps Canada Restructuring Inc. in its capacity as monitor of the Applicant (the "**Monitor**"), filed, and the third report of the Monitor (the "**Third Report**"), filed, and on hearing the submissions of counsel for each of the Applicant, the Monitor, the Initial Consenting Noteholders and DIP Lenders, and such other counsel as were present, no one else appearing although duly served as appears from the affidavit of service, filed.

DEFINED TERMS

1. **THIS COURT ORDERS** that any capitalized terms not otherwise defined in this Plan Sanction Order shall have the meanings ascribed to such terms in the Plan and the Meetings Order granted by this Court on March 8, 2013 (the "**Meetings Order**"), as applicable.

SERVICE, NOTICE AND MEETING

2. **THIS COURT ORDERS** that the time for service of the Notice of Motion, the Motion Record in support of this motion, the Second Report and the Third Report be and are hereby abridged and validated so that the motion is properly returnable today and service upon any interested party other than those parties served is hereby dispensed with.

3. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient notice, service and delivery of the Meetings Order and the Information Package (including, without limitation, the Plan) to all Persons upon which notice, service and delivery was required.

4. **THIS COURT ORDERS AND DECLARES** that the Meetings were duly convened and held on April 19, 2013, all in conformity with the CCAA and the Initial Order granted by this Court on March 8, 2013 (the "**Initial Order**"), the Meetings Order, and the Claims Procedure Order granted by this Court on March 8, 2013 (the "**Claims Procedure Order**", and collectively with the Initial Order and the Meetings Order, the "**Orders**").

5. **THIS COURT ORDERS AND DECLARES** that: (i) the hearing of the Plan Sanction Order was open to all of the Affected Creditors and all other Persons with an interest in the Applicant and that such Affected Creditors and all such other Persons were permitted to be heard at the hearing in respect of the Plan Sanction Order; and (ii) prior to the hearing, all of the Affected Creditors and all such other Persons on the service list in respect of the CCAA Proceedings were given notice thereof.

SANCTION OF THE PLAN

6. **THIS COURT DECLARES** that the relevant classes of Affected Creditors of the Applicant for the purpose of voting to approve the Plan are the Secured Noteholders Class and the Affected Unsecured Creditors Class.

7. **THIS COURT DECLARES** that the Plan, and all the terms and conditions thereof, and matters and transactions contemplated thereby, are fair and reasonable.

8. **THIS COURT ORDERS AND DECLARES** that the Plan has been approved by the Required Majorities of Affected Creditors in each Voting Class, as required by the Meetings Order, and in conformity with the CCAA.

9. **THIS COURT ORDERS AND DECLARES** that the activities of the Applicant have been in compliance with the provisions of the CCAA and the Orders of the Court made in the CCAA Proceedings, and the Court is satisfied that the Applicant has not done or purported to do anything that is not authorized by the CCAA.

10. **THIS COURT ORDERS** that the Plan is hereby sanctioned and approved pursuant to section 6 of the CCAA.

PLAN IMPLEMENTATION

11. **THIS COURT ORDERS AND DECLARES** that the Plan and all associated steps, compromises, transactions, arrangements, releases and reorganizations effected thereby are hereby approved and shall be deemed to be implemented, binding and effective in accordance with the provisions of the Plan as of the Plan Implementation Date at the time or times and in the manner set forth in the Plan, and shall inure to the benefit of and be binding upon the Applicant, the Released Parties, the Affected Creditors, the Directors and Officers, any Person with a Director/Officer Claim or a Released Claim, and all other Persons and parties named or referred to in, affected by, or subject to the Plan, including, without limitation, their respective heirs, administrators, executors, legal representatives, successors, and assigns.

12. **THIS COURT ORDERS** that each of the Applicant and the Monitor are authorized and directed to take all steps and actions, and do all things, necessary or appropriate to implement the Plan in accordance with its terms and to enter into, execute, deliver, complete, implement and consummate all of the steps, transactions, distributions, deliveries, allocations, and agreements contemplated by the Plan, and such steps and actions are hereby authorized, ratified and approved. Neither the Applicant nor the Monitor shall incur any liability as a result of acting in accordance with the terms of the Plan and the Plan Sanction Order.

13. **THIS COURT ORDERS** that the Applicant, the Monitor, the First Lien Agent, the Secured Note Indenture Trustee, the New Second Lien Notes Indenture Trustee, CDS, the CDS Participants and any other Person required to make any distributions, deliveries or allocations or take any steps or actions related thereto pursuant to the Plan are hereby authorized and directed to complete such distributions, deliveries or allocations and to take any such related steps or actions, as the case may be, in accordance with the terms of the Plan, and such distributions, deliveries and allocations, and steps and actions related thereto, are hereby approved.

14. **THIS COURT ORDERS** that upon the satisfaction or waiver of the conditions precedent set out in section 9.1 of the Plan in accordance with the terms of the Plan, as confirmed by the Applicant and the Majority Initial Consenting Noteholders (or their respective counsel) in writing, the Monitor is authorized and directed to deliver to the Initial Consenting Noteholders and the Applicant (or their respective counsel) a certificate substantially in the form attached hereto as **Schedule "B"** (the "**Monitor's Certificate**") signed by the Monitor, certifying that the Plan Implementation Date has occurred and that the Plan is effective in accordance with its terms and the terms of the Plan Sanction Order. The Monitor shall file the Monitor's Certificate with this Court promptly following the Plan Implementation Date.

15. **THIS COURT ORDERS** that the Applicant, the Monitor and the Majority Initial Consenting Noteholders are hereby authorized and empowered to exercise all consent

and approval rights provided for in the Plan in the manner set forth in the Plan, whether prior to or after the Plan Implementation Date.

16. **THIS COURT ORDERS** that the steps to be taken and the compromises and releases to be effected on the Plan Implementation Date are and shall be deemed to occur and be effected in the sequential order and at the times contemplated in section 5.4 of the Plan, without any further act or formality, on the Plan Implementation Date, beginning at the Effective Time.

17. **THIS COURT ORDERS** that the New Shareholders' Agreement shall be effective and binding on all holders of the New Common Shares and any Persons entitled to receive New Common Shares pursuant to the Plan immediately upon issuance of the New Common Shares to such Persons, with the same force and effect as if such Persons were signatories to the New Shareholders' Agreement.

18. **THIS COURT ORDERS** that, subject to the payment of any amounts secured by the Charges that remain owing on the Plan Implementation Date, if any, each of the Charges shall be terminated, discharged and released on the Plan Implementation Date.

COMPROMISE OF CLAIMS AND EFFECT OF PLAN

19. **THIS COURT ORDERS** that, pursuant to and in accordance with the terms of the Plan, on the Plan Implementation Date, any and all Affected Claims shall be fully, finally, irrevocably and forever compromised, released, discharged, cancelled and barred, subject only to the right of the applicable Persons to receive the distributions to which they are entitled pursuant to the Plan.

20. **THIS COURT ORDERS AND DECLARES** that on the Plan Implementation Date, pursuant to and in accordance with the Plan, the Applicant shall be forever released and discharged from any and all obligations in respect of the Affected Claims and the ability of any Person to proceed against the Applicant in respect of or relating to any Affected Claims shall be permanently and forever barred, estopped, stayed and enjoined, and all proceedings with respect to, in connection with or relating to such Affected Claims shall

be permanently stayed, subject only to the right of Affected Creditors to receive distributions pursuant to the Plan in respect of their Affected Claims.

21. **THIS COURT ORDERS** that, without limiting the provisions of the Claims Procedure Order or the Meetings Order, any Person that did not file a Proof of Claim, a Notice of Dispute or a Notice of Dispute of Revision or Disallowance, as applicable, by the Claims Bar Date or such other bar date provided for in the Claims Procedure Order, as applicable, whether or not such Affected Creditor received direct notice of the claims process established by the Claims Procedure Order, shall be and is hereby forever barred from making any Claim or any Director/Officer Claim and shall not be entitled to any distribution under the Plan, and such Person's Claim or Director/Officer Claim, as applicable, shall be and is hereby forever barred and extinguished. Nothing in the Plan extends or shall be interpreted as extending or amending the Claims Bar Date or any other bar date provided for in the Claims Procedure Order, or gives or shall be interpreted as giving any rights to any Person in respect of Claims or Director/Officer Claims that have been barred or extinguished pursuant to the Claims Procedure Order, the Plan, this Plan Sanction Order, or the Meetings Order.

22. **THIS COURT ORDERS** that, notwithstanding anything to the contrary in the Plan or paragraphs 21, 23, 24 and 34 hereof, and based on the consent of the Applicant and the Monitor, any Person having a claim that is expressly designated as an "Excluded Claim" in a settlement agreement entered into between the Applicant and such Person after the Filing Date and prior to April 19, 2013 (each a "**CCAA Settlement Agreement**") shall be permitted to file a statement of claim in respect of such Excluded Claim for the purpose of preserving such Person's rights to pursue such Excluded Claim in accordance with, and subject to, the terms, conditions and limitations of such CCAA Settlement Agreement and on the basis that there shall be no recourse whatsoever, directly or indirectly, to the Applicant or any of the SkyLink Subsidiaries or their respective assets or property in respect of such Excluded Claim.

23. **THIS COURT ORDERS** that, pursuant to and in accordance with the terms of the Plan, on the Plan Implementation Date, any and all Released Director/Officer Claims shall be

fully, finally, irrevocably and forever compromised, released, discharged, cancelled and barred, subject to sections 3.7(b) and 7.1(b) of the Plan and subject to paragraph 22 of this Plan Sanction Order.

24. **THIS COURT ORDERS AND DECLARES** that, on the Plan Implementation Date, pursuant to and in accordance with the terms of the Plan, the ability of any Person to proceed against the Released Directors/Officers in respect of or relating to any Released Directors/Officers Claims shall be permanently and forever barred, estopped, stayed and enjoined, and all proceedings with respect to, in connection with or relating to such Released Director/Officer Claims shall be permanently stayed, subject to section 7.3 of the Plan and subject to paragraph 22 of this Plan Sanction Order.

25. **THIS COURT ORDERS** that, on the Plan Implementation Date, each Affected Creditor and any person having a Released Claim shall be deemed to have consented and agreed to all of the provisions of the Plan, in its entirety, and each Affected Creditor and any Person having a Released Claim shall be deemed to have executed and delivered all consents, releases, assignments and waivers, statutory or otherwise, required to implement and carry out the Plan in its entirety.

26. **THIS COURT ORDERS** that, pursuant to section 6(2) of the CCAA, the Articles of the Applicant shall be amended on the Plan Implementation Date in accordance with the Articles of Reorganization.

27. **THIS COURT ORDERS** that (i) in accordance with the Articles of Reorganization, any fractional Class A Shares held by any holder of Class A Shares immediately following the consolidation of the Class A Shares referred to in section 5.4(j) of the Plan shall be cancelled without any liability, payment or other compensation in respect thereof; and (ii) all Equity Interests (for greater certainty, not including any Class A Shares that remain issued and outstanding immediately following the cancellation of fractional interests pursuant to section 5.4(k) of the Plan) and the Shareholder Agreement shall be cancelled without any liability, payment or other compensation in respect thereof.

28. **THIS COURT ORDERS AND DECLARES** that, subject to performance by the Applicant of its obligations under the Plan and except as provided in the Plan, all obligations, agreements or leases to which any of the Applicant or the SkyLink Companies is a party on the Plan Implementation Date shall be and remain in full force and effect, unamended, as at the Plan Implementation Date and no party to any such obligation or agreement shall on or following the Plan Implementation Date, accelerate, terminate, refuse to renew, rescind, refuse to perform or otherwise disclaim or resiliate its obligations thereunder, or enforce or exercise (or purport to enforce or exercise) any right or remedy under or in respect of any such obligation or agreement, by reason: (i) of any event which occurred prior to the Plan Implementation Date, or which is or continues to be suspended or waived under the Plan, which would have entitled any other party thereto to enforce those rights or remedies; (ii) that the Applicant has sought or obtained relief or has taken steps in connection with the Plan or under the CCAA; (iii) of any default or event of default arising as a result of the financial condition or insolvency of the Applicant on or prior to the Plan Implementation Date; (iv) of the effect upon the Applicant of the completion of any of the transactions contemplated under the Plan; or (v) of any compromises, settlements, restructurings, recapitalizations or reorganizations effected pursuant to the Plan.

29. **THIS COURT ORDERS AND DECLARES** that no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any non-competition or non-solicitation agreement or obligation in respect of the Applicant that exists on the Plan Implementation Date, including for greater certainty any non-competition or non-solicitation agreement or obligation that is expressly preserved or continued pursuant to a CCAA Settlement Agreement, provided that any such agreement or obligation shall terminate or expire in accordance with the terms thereof or as otherwise agreed by the Applicant and the applicable Persons.

30. **THIS COURT ORDERS** that, on the Plan Implementation Date, following completion of the steps in the sequence set forth in section 5.4 of the Plan, all debentures, notes, certificates, agreements, invoices and other instruments evidencing Affected Claims (including, for greater certainty, the Secured Notes) shall not entitle any holder thereof to

any compensation or participation and shall be and are hereby deemed to be cancelled and shall be and are hereby deemed to be null and void.

RELEASES AND INJUNCTIONS

31. **THIS COURT ORDERS** that, subject to paragraph 32 of this Plan Sanction Order, on the Plan Implementation Date, in accordance with section 7.1 of the Plan and the sequence set forth in section 5.4 of the Plan, the Released Parties shall be released and discharged from any and all Released Claims, and all Released Claims shall be fully, finally, irrevocably and forever waived, discharged, released, cancelled and barred as against the Released Parties, all to the fullest extent permitted by Applicable Law.

32. **THIS COURT ORDERS** that, notwithstanding paragraph 31 of this Plan Sanction Order, Insured Claims and Director/Officer Wages Claims shall not be compromised, released, discharged, cancelled or barred by this Plan Sanction Order or the Plan, provided that from and after the Plan Implementation Date, any Person having, or claiming any entitlement or compensation relating to, an Insured Claim or a Director/Officer Wages Claim will be irrevocably limited to recovery in respect of such Insured Claim or Director/Officer Wages Claim solely from the proceeds of the applicable Insurance Policies, and Persons with any Insured Claim or Director/Officer Wages Claims will have no right to, and shall not, directly or indirectly, make any claim or seek any recoveries from the Applicant, any SkyLink Subsidiary, any Released Director/Officer or any other Released Party, other than enforcing such Person's rights to be paid by the applicable insurer(s) from the proceeds of the applicable Insurance Policies. Nothing in this Plan Sanction Order prejudices, compromises, releases or otherwise affects any right or defence of any insurer in respect of an Insurance Policy or any insured in respect of an Insured Claim or a Director/Officer Wages Claim.

33. **THIS COURT ORDERS** that on the Plan Implementation Date, all Persons shall be permanently and forever barred, estopped, stayed and enjoined with respect to any and all Released Claims, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral,

administrative or other forum) against the Released Parties; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Released Parties or their property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against one or more of the Released Parties; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Released Parties or their property; or (v) taking any actions to interfere with the implementation or consummation of the Plan; provided, however, that the foregoing shall not apply to the enforcement of any obligations under the Plan.

34. **THIS COURT ORDERS** that on the Plan Implementation Date, all Persons shall be permanently and forever barred, estopped, stayed and enjoined from commencing, taking, applying for or issuing or continuing any and all steps or proceedings, including without limitation, administrative hearings and orders, declarations or assessments, commenced, taken or proceeded with or that may be commenced, taken or proceeded with in respect of any Insured Claim or Director/Officer Wages Claim, except as against the applicable insurer(s) to the extent that rights to enforce such Insured Claims and/or Director/Officer Wages Claims against such insurer(s) in respect of an Insurance Policy are expressly preserved pursuant to sections 3.5(b), 3.7(b) and/or 7.1(b) of the Plan, and provided that, notwithstanding the restrictions on making a claim that are set forth in sections 3.5(b), 3.7(b) and 7.1(b) of the Plan, any claimant in respect of an Insured Claim or a Director/Officer Wages Claim that was duly filed with the Monitor by the Claims Bar Date shall be permitted to file a statement of claim in respect thereof to the extent necessary solely for the purpose of preserving such claimant's ability to pursue such Insured Claim or Director/Officer Wages Claim against an insurer in respect of an Insurance Policy in the manner authorized pursuant to sections 3.5(b), 3.7(b) and/or

7.1(b) of the Plan. For greater certainty, nothing in this paragraph 34 restricts or limits the application of paragraph 22 of this Plan Sanction Order.

THE MONITOR

35. **THIS COURT ORDERS** that the Monitor, in addition to its prescribed rights and obligations under the CCAA and the powers provided to the Monitor herein and in the Plan, shall be and is hereby authorized, directed and empowered to perform its functions and fulfill its obligations under the Plan to facilitate the implementation of the Plan.

36. **THIS COURT ORDERS** that (i) in carrying out the terms of this Plan Sanction Order and the Plan, the Monitor shall have all the protections given to it by the CCAA, the Initial Order, and as an officer of the Court, including the stay of proceedings in its favour; (ii) the Monitor shall incur no liability or obligation as a result of carrying out the provisions of this Plan Sanction Order and/or the Plan, save and except for any gross negligence or wilful misconduct on its part; (iii) the Monitor shall be entitled to rely on the books and records of the Applicant and any information provided by the Applicant without independent investigation; and (iv) the Monitor shall not be liable for any claims or damages resulting from any errors or omissions in such books, records or information.

37. **THIS COURT ORDERS** that upon completion by the Monitor of its duties in respect of the Applicant pursuant to the CCAA, the Plan and the Orders, the Monitor may file with the Court a certificate stating that all of its duties in respect of the Applicant pursuant to the CCAA, the Plan and the Orders have been completed and thereupon, Duff & Phelps Canada Restructuring Inc. shall be deemed to be discharged from its duties as Monitor and released of all claims relating to its activities as Monitor.

BOARD OF DIRECTORS OF SKYLINK AVIATION INC.

38. **THIS COURT ORDERS AND DECLARES** that the Persons to be appointed to the board of directors on the Plan Implementation Date are Harry Green, Rael Nurick, Andrew Hamlin and Philip Hampson or such other persons listed on a certificate filed with the Court by the Applicant prior to the Plan Implementation Date, provided that such certificate and the Persons listed thereon shall be subject to the prior written consent

of the Majority Initial Consenting Noteholders. Concurrently with the appointment of such directors, all directors serving immediately prior to the Plan Implementation Date shall be deemed to resign.

SEALING ORDER

39. **THIS COURT ORDERS** that the Confidential Appendix #1 to the Third Report be sealed, kept confidential and not form part of the public record, but rather shall be placed, separate and apart from all other contents of the Court file, in a sealed envelope attached to a notice which sets out the title of these proceedings and a statement that the contents are subject to a sealing order and shall only be opened upon further Order of the Court.

EXTENSION OF THE STAY OF PROCEEDINGS

40. **THIS COURT ORDERS** that the Stay Period, as such term is defined in and used throughout the Initial Order, be and is hereby extended to and including 11:59 p.m. on May 31, 2013, and that all other terms of the Initial Order shall remain in full force and effect, unamended, except as may be required to give effect to this paragraph or otherwise provided in the Plan or this Plan Sanction Order.

EFFECT, RECOGNITION AND ASSISTANCE

41. **THIS COURT ORDERS** that the Applicant and the Monitor may apply to this Court for advice and direction with respect to any matter arising from or under the Plan or this Plan Sanction Order.

42. **THIS COURT ORDERS** that this Plan Sanction Order shall have full force and effect in all provinces and territories of Canada and abroad as against all persons and parties against whom it may otherwise be enforced.

43. **THIS COURT REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada, the United States, or in any other foreign jurisdiction, to give effect to this Order or to assist the Applicant, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such

orders and to provide such assistance to the Applicant and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Applicant or the Monitor and their respective agents in carrying out the terms of this Order.

GENERAL

44. **THIS COURT ORDERS** that this Plan Sanction Order shall be posted on the Monitor's Website at http://www.duffandphelps.com/services/restructuring/Pages/RestructuringCases.aspx and is only required to be served upon the parties on the Service List and those parties who appeared at the hearing of the motion for this Plan Sanction Order.

45. **THIS COURT ORDERS AND DECLARES** that any conflict or inconsistency between the Plan and this Plan Sanction Order shall be governed by the terms, conditions and provisions of the Plan, which shall take precedence and priority, provided that any provision of this Plan Sanction Order that expressly provides that it supersedes the provisions of the Plan or that it operates notwithstanding anything to the contrary in the Plan shall take precedence and priority over any conflicting provision in the Plan.

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

APR 2 3 2013

Schedule "A"

(Plan of Compromise and Arrangement)

[Omitted due to length]

Schedule "B"

Monitor's Certificate of Plan Implementation

Court File No. 13-1003300-CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT OF SKYLINK AVIATION INC.

CERTIFICATE OF DUFF & PHELPS CANADA RESTRUCTURING INC. AS THE COURT-APPOINTED MONITOR OF SKYLINK AVIATION INC.

(Plan Implementation)

All capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Plan of Compromise and Arrangement concerning, affecting and involving SkyLink Aviation Inc. (the "**Applicant**") dated April 18, 2013 (the "**Plan**"), which is attached as Schedule "A" to the Plan Sanction Order of the Honourable Justice Morawetz made in these proceedings on the ● day of April, 2013 (the "**Plan Sanction Order**"), as the Plan may be further amended, varied or supplemented from time to time in accordance with its terms.

Pursuant to section 9.2 of the Plan and paragraph 14 of the Plan Sanction Order, Duff & Phelps Canada Restructuring Inc. in its capacity as the Court-appointed monitor of the Applicant (the "**Monitor**") delivers this certificate to counsel to the Initial Consenting Noteholders (on behalf of the Initial Consenting Noteholders) and counsel to the Applicant (on behalf of the Applicant) and hereby certifies that:

1. The Monitor has received written confirmation from the Applicant and the Majority Initial Consenting Noteholders (or their respective counsel) that the conditions precedent set out in section 9.1 of the Plan have been satisfied or waived, as applicable.

2. Pursuant to the terms of the Plan, the Plan Implementation Date has occurred.

3. The Plan is effective in accordance with its terms.

4. This Certificate will be filed with the Court.

DATED at the City of Toronto, in the Province of Ontario, this ● day of ●, 2013.

DUFF & PHELPS CANADA RESTRUCTURING INC.,
in its capacity as Court-appointed Monitor of SkyLink Aviation Inc.

By:

_____

Name:

Title:

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 AND ARRANGEMENT OF SKYLINK AVIATION INC.

Court File No.: 13-1003300-CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

PLAN SANCTION ORDER
(returnable April 23, 2013)

Goodmans LLP
Barristers & Solicitors
Bay Adelaide Centre
333 Bay Street, Suite 3400
Toronto, Canada M5H 2S7

Robert J. Chadwick (LSUC# 35165K)
Logan Willis (LSUC# 53894K)

Tel: 416.979.2211
Fax: 416.979.1234

Lawyers for the Applicant

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TAB 28

No. S-105095
Vancouver Registry

IN THE SUPREME COURT OF BRITISH COLUMBIA

IN THE MATTER OF SECTION 192 OF THE *CANADA BUSINESS CORPORATIONS ACT*, R.S.C. 1985, c. C-44, AS AMENDED

AND

IN THE MATTER OF A PROPOSED ARRANGEMENT INVOLVING 7588674 CANADA INC., GATEWAY CASINOS & ENTERTAINMENT INC. AND GATEWAY CASINOS & ENTERTAINMENT LIMITED

Re: 7588674 CANADA INC., GATEWAY CASINOS & ENTERTAINMENT INC. AND GATEWAY CASINOS & ENTERTAINMENT LIMITED

PETITIONERS

ORDER MADE AFTER APPLICATION

FINAL ORDER

BEFORE THE HONOURABLE MR. JUSTICE HARRIS	)	MONDAY THE 16th
	)	
	)	DAY OF AUGUST, 2010

ON THE APPLICATION of the Petitioners, 7588674 Canada Inc. ("**Holdco**"), Gateway Casinos & Entertainment Inc. ("**Gateway Casinos**") and Gateway Casinos & Entertainment Limited ("**New Gateway**") pursuant to section 192 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, as amended ("**CBCA**"), coming on for hearing at Vancouver, British Columbia, on the 16th day of August, 2010,

AND ON HEARING, Bill Kaplan, QC, counsel for Holdco and Gateway Casinos, and S. Richard Orzy and Anthony L. Friend, QC, counsel for New Gateway, AND ON being advised that the Director appointed under the CBCA does not intend to appear at this application,

AND UPON READING the material filed herein, including the Affidavit #1 of Gabriel De Alba sworn on July 9, 2010, the Affidavit #1 of Jason O'Connor sworn on July 13, 2010, the Affidavit #2 of Jason O'Connor sworn on August 13, 2010, and the Order of this Court dated July 14, 2010 (the "**Interim Order**"),

AND UPON BEING ADVISED that New Gateway will rely upon the approval of the Arrangement for purposes of an exemption from the registration requirements under 3(a)(10) of the *United States Securities Act of 1933*, with respect to the New Common Shares to be issued pursuant to the Plan of Arrangement,

THIS COURT ORDERS AND DECLARES THAT:

1. As used in this Order, unless otherwise defined herein, capitalized terms have the respective meanings set out in the Plan of Arrangement (the "**Plan**") attached as Schedule "A" to this Order.

2. The Petitioners have complied with all actions and steps required to be taken by them pursuant to the Interim Order or in connection with documents or acts contemplated by the Interim Order, including, without limitation, that the Meeting Materials as defined in the Interim Order were distributed in compliance with the Interim Order and that the First Lien Claimholders' Meeting and the Second Lien Claimholders' Meeting, each as defined in the Interim Order, were called, held and conducted in compliance with the Interim Order.

3. The arrangement and the terms and conditions thereof, as described in the Plan (the "**Arrangement**"), is an arrangement within the meaning of section 192 of the CBCA.

4. The Arrangement be and is hereby approved, and the terms, provisions and effects of the Arrangement, including all documents, steps, transactions, discharges, cancellations, extinguishments, terminations and releases set out in or contemplated by the Plan, shall be

binding and given full force and effect in the manner and in the sequences and at the times specified therein.

5. The Arrangement and the terms, provisions and effects thereof, including all documents, steps, transactions, discharges, cancellations, extinguishments, terminations and releases set out in or contemplated by the Plan, are fair and reasonable to all Persons affected thereby and shall not be void or voidable by any shareholder or creditor of New Gateway, Gateway Casinos, Holdco, Amalco or any other Person.

6. The Plan and all transactions contemplated thereby or related thereto, including pursuant to the Asset Conveyance, once completed, do not constitute a fraudulent conveyance or preference, transfer at undervalue or reviewable transaction and are not oppressive of or unfairly prejudicial to, or conduct that unduly or unfairly disregards the interest of, any creditor or shareholder of New Gateway, Gateway Casinos, Holdco or Amalco under any applicable law.

7. Upon the execution and delivery of the Asset Conveyance pursuant to Section 4.2(f)(i) of the Plan, all of Amalco's right, title and interest in and to the Acquired Assets, as that term is described in the Asset Conveyance, shall vest absolutely in New Gateway, free and clear of and from any and all security interest (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trust (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise, other than: (i) instruments registered in the applicable land title office against title to the real and immovable property and assets of Amalco as of the date hereof; (ii) instruments registered in the applicable land title office against title to real and immovable property that affect or attach to Amalco's leasehold interests as of the date hereof; (iii) inchoate liens for taxes not yet due and payable; (iv) statutory liens, reservations and exceptions to title to real and immovable property applicable in the jurisdiction in which such real and immovable property is situate; and (v) financing statements registered or filed in the applicable personal property security registry as of the date hereof listing Amalco or Gateway Casinos as debtor; provided, however, that Amalco shall continue to hold legal and registered title to the Beneficially Acquired Assets, as described in the Asset Conveyance, as nominee and bare trustee for and on behalf of New Gateway until

such time as New Gateway determines otherwise. Gateway Casinos and Amalco shall thereby be dispossessed of, and New Gateway shall thereafter carry on, the activities and business previously carried on by Gateway Casinos.

8. Notwithstanding any *Personal Property Security Act* registrations or filings, any registrations against title to real property registered under the *Land Title Act* (British Columbia) or the *Land Titles Act* (Alberta), in each case registered in the name of or against Gateway Casinos, Holdco, Amalco or New Gateway (or any of their respective predecessors), or other registrations and filings that may be effected in respect of or pursuant to the New First Lien Debt Security Agreements, the security interests, mortgages, liens and charges granted pursuant to the New First Lien Debt Security Agreements secure indebtedness, obligations and liabilities effectively exchanged for the First Lien Debt and shall have the same priority and ranking over the Acquired Assets and other real and personal property of New Gateway and Amalco (as against any other competing security interests, mortgages, liens and charges over such assets and property) as the security interests, mortgages, liens and charges with respect to the First Lien Debt had over the Acquired Assets and other real and personal property of Gateway Casinos prior to the making of this Order.

9. The Shareholders' Agreement shall be effective and binding on all holders of New Common Shares and Persons entitled to receive New Common Shares pursuant to the Plan immediately upon the issuance of New Common Shares to such Persons, with the same force and effect as if such Persons were signatories to the Shareholders' Agreement.

10. The New First Lien Debt Credit Agreement shall be deemed to be effective and binding on all holders of the New First Lien Debt pursuant to the Plan at the same time as the New First Lien Debt Credit Agreement becomes effective, with the same force and effect as if such Persons were signatories to the New First Lien Debt Credit Agreement.

11. The Petitioners are authorized and directed to take all steps and actions necessary or appropriate to implement the Arrangement, including the transactions contemplated by the Plan in accordance with the terms of the Plan and such other steps or actions as New Gateway considers necessary or advisable in connection therewith or in furtherance thereof (including

entering into any agreements or other documents which are to come into effect in connection with the Arrangement).

12. BNY Trust Company of Canada, the New First Lien Agent, the First Lien Agents and the Second Lien Agents are authorized and directed to take all steps and actions necessary or appropriate to implement the Arrangement and the transactions contemplated thereby in accordance with the terms of the Plan and to provide the Petitioners with such documents, information and assistance as New Gateway may request in connection therewith or in furtherance thereof.

13. The Existing Gateway Common Shares shall be cancelled upon the Amalgamation without any repayment of capital thereof or any other compensation therefor and all Entitlements that any Person may have that are directly or indirectly related to or are derived from the Existing Gateway Equity shall be released and extinguished in full without any compensation.

14. All Entitlements that any Person may have that are directly or indirectly related to or are derived from the Holdco Equity (other than the rights of holders of Holdco Class A Shares and the rights of holders of Holdco Class B Shares to receive Class A Shares and Class B Shares of Amalco) shall be released and extinguished in full without any compensation.

15. The Priority Portion, the Amalco Priority Debt and the Debt of Holdco shall all be extinguished for no consideration pursuant to the Plan at the times specified therein.

16. The releases set out in the Plan in favour of the Amalco Releasees and the Claimholder Released Parties shall be binding in accordance with their terms and shall be deemed to have been given by each of the Releasors and other Persons contemplated thereby and shall be effective immediately following the completion of the final step of the Arrangement and after giving effect to the provisions thereof.

17. This Court respectfully seeks and requests the aid and recognition of any court or any judicial, regulatory or administrative body constituted pursuant to the Parliament of Canada or the legislature of any province and any court or any judicial, regulatory or administrative body of the United States of America or any other applicable jurisdiction to act in aid of and to assist this Court in carrying out the terms of this Order.

18. New Gateway shall be entitled to seek leave to vary this Order upon such terms and upon the giving of such notice as this Honourable Court may direct, to seek the advice and direction of this Honourable Court as to the implementation of this Order and/or to apply for such further orders as may be appropriate.

THE FOLLOWING PARTIES APPROVE THE FORM OF THIS ORDER AND CONSENT TO EACH OF THE ORDERS, IF ANY, THAT ARE INDICATED ABOVE AS BEING BY CONSENT:

Signature of
[ ] party [x] lawyer for 7588674 Canada Inc. and Gateway Casinos & Entertainment Inc.
Bill Kaplan, QC

Signature of
[ ] party [x] lawyer for Gateway Casinos & Entertainment Limited
S. Richard Orzy
Anthony L. Friend, QC

BY THE COURT.

Registrar

SCHEDULE "A"

PLAN OF ARRANGEMENT

[Omitted due to length]

TAB 29

Court File No. CV-13-10274-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

THE HONOURABLE	)	MONDAY, THE 29TH
	)	
JUSTICE NEWBOULD	)	DAY OF JUNE, 2015

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 8440522 CANADA INC., DATA & AUDIO-VISUAL ENTERPRISES WIRELESS INC., DATA & AUDIO-VISUAL ENTERPRISES HOLDINGS INC. AND 2451608 ONTARIO INC.

Applicants

ORDER
(Vesting)

THIS MOTION made by Data & Audio-Visual Enterprises Holdings Inc. ("**Holdings**"), Data & Audio-Visual Enterprises Wireless Inc. ("**Wireless**"), 8440522 Canada Inc. and 2451608 Ontario Inc. (collectively with Wireless and 8440522 Canada Inc,. the "**Wireless Entities**" and the Wireless Entities collectively with Holdings are the "**Applicants**") for an Order, further to the Order of this Court granted on June 24, 2015 (the "**Sale Order**") approving the sale transaction (the "**Transaction**") contemplated by a share purchase offer letter between Holdings, Wireless and Rogers Communications Inc. ("**Rogers**") dated June 23, 2015 (the "**Sale Agreement**") and attached as Confidential Exhibit "F" to the Affidavit of William E. Aziz, sworn June 23, 2015, *inter alia*:

(a) vesting in Rogers' designated affiliate, Rogers Cable and Data Centres Inc. (the "**Designee**", and collectively with Rogers, the "**Purchaser**") all of Holdings'

right, title and interest in and to the shares of Wireless (the "**Purchased Shares**") and all claims, if any, against Wireless by Holdings to be transferred pursuant to the Sale Agreement (together with the Purchased Shares, the "**Purchased Assets**");

(b) establishing the basis upon which the Cash Amount (as defined in the Sale Agreement) will be held by Ernst & Young Inc., in its capacity as Monitor, of the Applicants (in such capacity, the "**Monitor**");

(c) releasing certain Released Claims against the Released Parties (in each case as defined in Schedule "C"); and

(d) effective upon closing of the Transaction, terminating this proceeding under the CCAA solely in respect of the Wireless Entities and terminating and discharging the engagement of Blue Tree Advisors II Inc., and William E. Aziz on behalf of Blue Tree Advisors II Inc., as Chief Restructuring Officer of the Wireless Entities (in such capacity, the "**CRO**"),

was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Affidavit of William E. Aziz sworn, June 29, 2015 (the "**Aziz Affidavit**"), the Fourteenth Report of the Monitor, dated June 27, 2015, and upon hearing the submissions of counsel for the Applicants, the Monitor, the Ad Hoc Committee of Noteholders, the Purchaser, and Catalyst and such other counsel as were present, no one else appearing although duly served as appears from the affidavit of service of Alexander Schmitt sworn June 27, 2015.

1. **THIS COURT ORDERS AND DECLARES** that the time for service of the Notice of Motion and the Motion Record in support of this Motion and the Fourteenth Report be

and is hereby abridged and validated, such that this Motion is properly returnable today, and that any further service of the Notice of Motion, the Motion Record or the Fourteenth Report is hereby dispensed with.

2. **THIS COURT ORDERS** that capitalized terms used herein and not otherwise defined have the meanings ascribed to them in the Sale Order, the Sale Agreement and the Aziz Affidavit.

3. **THIS COURT ORDERS** that Wireless is authorized and directed to, immediately prior to completion of the Transaction pay to Holdings (or to the Monitor on behalf of Holdings) all cash owned or held by Wireless (the "**Wireless Cash**") as at the date of completion of the Transaction as a dividend, or with the prior consent of the Purchaser, not to be unreasonably withheld, in any other manner as Wireless deems appropriate.

4. **THIS COURT AUTHORIZES AND DIRECTS** the Monitor to hold the Wireless Cash and the Cash Amount in trust for Holdings or Wireless, as the case may be, in accordance with the terms of this Order in an account opened at a Canadian chartered bank for this purpose.

5. **THIS COURT ORDERS AND DECLARES** that upon the delivery of a Monitor's certificate to the Purchaser substantially in the form attached as Schedule A hereto (the "**Monitor's Certificate**"), all of Holdings' right, title and interest in and to the Purchased Assets shall vest absolutely in the Designee, free and clear of and from any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise (collectively, "**Claims**") including, without limiting the generality of the foregoing, the

following (the "**Encumbrances**", which term shall not include the permitted encumbrances, easements and restrictive covenants listed on Schedule "B" hereto (the "**Permitted Liens**")): (i) any encumbrances or charges created by the Initial Order of this Court dated September 30, 2013 (as amended) or the Order of this Court dated January 28, 2015; (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) (the "**PPSA**") or any other personal property registry system; (iii) the shareholders agreements and shareholder declarations to which any of the Wireless Entities may be a party (including, without limitation, those listed on Schedule "D" hereto) and any other shareholders agreements and shareholder declarations that may apply to any of the Wireless Entities in any manner (collectively, the "**Shareholders Agreements**"); (iv) any equity securities, rights, claims, options, warrants, restricted stock units or other securities convertible or exchangeable into equity securities in the capital of any of the Wireless Entities (other than any common shares in the capital of any of the Wireless Entities that have been duly issued and are outstanding and are recorded in the share registers of the Wireless Entities, including the Purchased Shares) (the "**Options**"); and, for greater certainty, this Court orders that the Shareholders Agreements and the Options shall terminate and be of no force or effect with respect to the Purchased Shares or any of the Wireless Entities.

6. **THIS COURT ORDERS** that upon delivery of the Monitor's Certificate to the Purchaser, Equity Financial Trust Company in its capacity as trustee and collateral agent under the DIP Notes, the First Lien Notes and the Second Lien Notes is directed to release the share certificates of the Wireless Entities to the Purchaser.

7. **THIS COURT ORDERS** that upon delivery of the Monitor's Certificate to the Purchaser, all Claims and Encumbrances against the Purchased Assets, Wireless Entities and their assets (with the exception of Permitted Liens) shall be fully and finally released,

discharged, and expunged as against the Wireless Entities and their assets, provided that this paragraph does not affect unsecured recourse for Claims against the Wireless Entities and their assets other than Claims in respect of the DIP Notes, First Lien Notes (other than the Catalyst First Lien Notes), the Second Lien Notes, Shareholder Agreements or Options.

8. **THIS COURT ORDERS** that upon delivery of the Monitor's Certificate to the Purchaser all Claims and Encumbrances against Holdings in connection with obligations of Wireless, including in respect of the Catalyst First Lien Notes, shall be fully and finally released, discharged and expunged as against Holdings.

9. **THIS COURT ORDERS** that Catalyst has waived and released any claim against the Cash Amount (including any portion of the Cash Amount paid under Section 2(b) and 2(c) of the Sale Agreement following completion of the Transaction), provided that, for greater certainty, Catalyst retains its unsecured recourse against Wireless for full payment of all amounts owing in respect of the Catalyst First Lien Notes (which are in the principal amount of CAD$69,765,000), while the holders of any Claims in respect of the DIP Notes, the First Lien Notes (other than the Catalyst First Lien Notes) and the Second Lien Notes cease to have any recourse to the Wireless Entities whatsoever and instead have recourse against the Cash Amount as provided for in paragraph 12 below, and accordingly (a) nothing in this Order limits, lessens or extinguishes any unsecured Claims of Catalyst, following the Closing of the Transaction, against Wireless based upon the Catalyst First Lien Notes (or any related contractual obligations between Rogers and Catalyst in respect thereto), and (b) Wireless shall make any or all payments on account of the Catalyst First Lien Notes or the redemption thereof directly to Catalyst rather than to the Indenture Trustee under the First Lien Notes, and upon such payment

or payments the Catalyst First Lien Notes shall be deemed to be redeemed and extinguished to the extent of such payments.

10. **THIS COURT ORDERS** that upon the delivery of a Monitor's Certificate to the Purchaser, the Monitor (or its counsel or agents) shall forthwith complete all necessary filings and other steps required to discharge all registrations (with the exception of any registrations in respect of Permitted Liens) against the Purchased Assets, the Wireless Entities or their assets pursuant to the PPSA or any other personal property registry system and shall forthwith deliver to the Purchaser evidence that all such discharges have been completed.

11. **THIS COURT ORDERS** that Wireless and Holdings shall direct the Purchaser to pay the Cash Amount (including any portion of the Cash Amount paid under Section 2(b) and 2(c) of the Sale Agreement following completion of the Transaction), to the Monitor (on behalf of Wireless and Holdings) forthwith upon satisfaction of the conditions precedent to payment of the Cash Amount by the Purchaser under the Sale Agreement.

12. **THIS COURT ORDERS** that the Wireless Loan Amount, being the portion of that Cash Amount equal to the total amounts owing under the DIP Notes, the First Lien Notes (other than the Catalyst First Lien Notes), and the Second Lien Notes (such portion being, the "**Wireless Distribution Amount**") shall be held by the Monitor in escrow subject to further Order of the Court authorizing and directing the distribution of the Wireless Distribution Amount and that promptly following such distribution, the Monitor shall provide reasonably detailed particulars thereof to the Purchaser.

13. **THIS COURT ORDERS** that for the purposes of determining the nature and priority of Claims and Encumbrances against Holdings, other than those Claims and Encumbrances paid in full or waived pursuant to paragraphs 6 through 11 hereof, the

Cash Amount (including any portion of the Cash Amount paid under Section 2(b) and 2(c) of the Sale Agreement following completion of the Transaction) less the Wireless Distribution Amount (the "**Remaining Proceeds**") shall stand in the place and stead of the Purchased Assets, and that from and after the delivery of the Monitor's Certificate, all Claims and Encumbrances shall attach to the Remaining Proceeds with the same priority as they had with respect to the Purchased Assets immediately prior to the sale, as if the Purchased Assets had not been sold and remained in the possession or control of the person having that possession or control immediately prior to the sale.

14. **THIS COURT ORDERS AND DIRECTS** the Monitor to file with the Court a copy of the Monitor's Certificate, forthwith after delivery thereof.

15. **THIS COURT ORDERS** that, pursuant to clause 7(3)(c) of the Canada *Personal Information Protection and Electronic Documents Act*, Holdings and Wireless are authorized and permitted to disclose and transfer to the Purchaser all human resources and payroll information in Holdings' and Wireless' records pertaining to Wireless' past and current employees and all personal information in respect of Wireless' past and current customers. The Purchaser shall maintain and protect the privacy of such information and shall be entitled to use the personal information provided to it in a manner which is in all material respects identical to the prior use of such information by Holdings and Wireless.

16. **THIS COURT ORDERS** that, notwithstanding:

    (a) the pendency of these proceedings;

    (b) any applications for a bankruptcy order now or hereafter issued pursuant to the *Bankruptcy and Insolvency Act* (Canada) ("**BIA**") in respect of any of the

Applicants and any bankruptcy order issued pursuant to any such applications; and

(c) any assignment in bankruptcy made in respect of any of the Applicants;

the vesting of the Purchased Assets in the Designee pursuant to this Order and the payment of the Wireless Cash from Wireless to Holdings, shall be binding on any trustee in bankruptcy that may be appointed in respect of any of the Applicants and shall not be void or voidable by creditors of any of the Applicants, nor shall it constitute nor be deemed to be a fraudulent preference, assignment, fraudulent conveyance, transfer at undervalue, or other reviewable transaction under the BIA or any other applicable federal or provincial legislation, nor shall it constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

17. **THIS COURT ORDERS AND DECLARES** that the Transaction is exempt from the application of the *Bulk Sales Act* (Ontario).

18. **THIS COURT ORDERS** that upon delivery of the Monitor's Certificate the Released Parties shall be released and discharged from any and all Released Claims and all Released Claims shall be fully, finally and irrevocably waived, discharged, released, cancelled and barred as against the Released Parties to the fullest extent permitted by applicable law, provided that, for greater certainty, the foregoing shall not prevent QCP CW S.A.R.L ("**QCP**") from advancing any claims or positions of QCP concerning entitlement to and distribution of the Wireless Distribution Amount.

19. **THIS COURT ORDERS** that all persons shall be permanently and forever barred, estopped, stayed and enjoined, from and after delivery of the Monitor's Certificate, with respect to any and all Released Claims, from: (i) commencing, conducting or continuing

in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Released Parties; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Released Parties or their respective property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation by way of contribution or indemnity or other relief, in common law, or in equity, or for breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against one or more of the Released Parties; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Released Parties or their respective property; or (iv) taking any actions to interfere with the implementation or consummation of the Transaction; provided, however, that (i) the foregoing shall not apply to the enforcement of any obligations under the Sale Agreement, any other agreements delivered as part of the Closing under the Sale Agreement (in each case solely among the parties to the Sale Agreement or such other agreements delivered as part of the Closing under the Sale Agreement), or under any Order, including this Order, as the case may be, and (ii) for greater certainty, the foregoing shall not prevent QCP from advancing any claims or positions of QCP concerning entitlement to and distribution of the Wireless Distribution Amount.

20. **THIS COURT ORDERS** that, except as otherwise provided for in this Order, all obligations or agreements to which Wireless is party immediately prior to Closing will be

and remain in full force and effect as at Closing and no Person who is a party to any such obligations or agreements shall, following the Closing, accelerate, terminate, rescind, refuse to renew, refuse to perform or otherwise disclaim or repudiate its obligations thereunder, or enforce or exercise (or purport to enforce or exercise) any right or remedy (including any right of set-off, option, dilution or other remedy) or make any demand under or in respect of any such obligation or agreement, by reason of:

(a) any defaults or events of default arising as a result of the financial condition or insolvency of any of the Applicants on or prior to the Closing, other than a payment default in respect of an obligation falling due in the ordinary course that is not paid within 14 days of Closing;

(b) the fact that any Applicant has sought or obtained relief under the CCAA;

(c) any changes in share ownership of Wireless arising from implementation of the Transaction, provided, however, where a real property lease contains a provision prohibiting a change of control of the tenant by reason of the transfer of the shares of the tenant without landlord consent, then any landlord of such lease(s) (who has not consented to the transfer) may, within 30 days, serve a notice of motion objecting to the application of this provision to the applicable leases in which case the matter shall be dealt with on its merits, and failing timely service of such notice of motion, the landlord shall be permanently bound by this provision;

(d) the effect on Wireless of the completion of the Transaction.

21. **THIS COURT ORDERS** that effective upon delivery of the Monitor's Certificate to the Purchaser, this proceeding under the CCAA shall be and is hereby terminated solely in

respect of the Wireless Entities, provided however that the stay of proceedings contained in paragraphs 15 through 18 of the Initial Order shall remain in effect in respect of the Wireless Entities for 14 days following delivery of the Monitor's Certificate.

22. **THIS COURT ORDERS** that effective upon delivery of the Monitor's Certificate to the Purchaser, the appointment of the CRO in respect of the Wireless Entities shall be automatically terminated and the CRO discharged from any further obligations in respect of the Wireless Entities, both as CRO and as director.

23. **THIS COURT ORDERS** that effective upon delivery of the Monitor's Certificate to the Purchaser, the CRO is hereby released and discharged from any and all liability that the CRO now has or may hereafter have by reason of, or in any way arising out of, the acts or omissions of the CRO while acting in its capacity as CRO or director of the Wireless Entities.

24. **THIS COURT ORDERS** that notwithstanding any provision of this Order, the CRO may carry out such functions and duties as may be incidental to the termination of the proceedings under the CCAA in respect of the Wireless Entities and in carrying out such functions and duties, the CRO shall continue to have the benefit of any and all of the protections granted in the CCAA proceedings of the Wireless Entities.

25. **THIS COURT HEREBY REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States, to give effect to this Order and to assist Holdings, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to Holdings and the Monitor, as an officer of this Court, as may be necessary

or desirable to give effect to this Order or to assist Holdings, the Monitor and/or their respective agents in carrying out the terms of this Order.

26. **THIS COURT ORDERS** that each of the Applicants and the Monitor be at liberty and are hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order.

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

JUN 29 2015

SCHEDULE "A"

FORM OF MONITORS CERTIFICATE

Court File No. CV-13-10274-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

THE HONOURABLE	)	●, THE ●
	)	
JUSTICE NEWBOULD	)	DAY OF JUNE, 2015

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 8440522 CANADA INC., DATA & AUDIO-VISUAL ENTERPRISES WIRELESS INC., DATA & AUDIO-VISUAL ENTERPRISES HOLDINGS INC. AND 2451608 ONTARIO INC.

Applicants

MONITOR'S CERTIFICATE

RECITALS

A. Pursuant to Orders of the Honourable Justice Newbould of the Ontario Superior Court of Justice (Commercial List) (the "Court") dated September 30, 2013 and January 28, 2015, Ernst & Young Inc., was appointed as monitor (in such capacity, the "**Monitor**") of the undertaking, property and assets of Data & Audio-Visual Enterprises Holdings Inc. ("**Holdings**") , Data & Audio-Visual Enterprises Wireless Inc. ("**Wireless**"), 8440522 Canada Inc. and 2451608 Ontario Inc. (collectively with Holdings and Wireless, the "**Applicants**").

B. Pursuant to an Order of the Court dated June 24, 2015, the Court approved the share purchase offer letter made as of June 23, 2015 (the "**Sale Agreement**") between Holdings,

Wireless and Rogers Communications Inc. (the "**Purchaser**") and an Order of the Court dated June ●, 2015 provided for the vesting in Rogers Cable and Data Centres Inc., (as a designated affiliate of the Purchaser) of Holdings' right, title and interest in and to the Purchased Assets, which vesting is to be effective with respect to the Purchased Assets upon the delivery by the Monitor to the Purchaser of a certificate confirming (i) the payment by the Purchaser of the Cash Amount; (ii) that the conditions to Closing set out in Sections 5 through 7 of the Sale Agreement have been satisfied or waived by Holdings and/or the Purchaser, as applicable; and (iii) the Transaction has been completed to the satisfaction of the Monitor.

C. Unless otherwise indicated herein, terms with initial capitals have the meanings set out in the Sale Agreement.

THE MONITOR CERTIFIES the following:

1. The Purchaser has paid and Holdings and Wireless (or the Monitor on behalf of Holdings and Wireless) have received the Cash Amount payable on Closing to each of Holdings and Wireless pursuant to the Sale Agreement;

2. The conditions to Closing as set out in sections 5 through 7 of the Sale Agreement have been satisfied or waived by Holdings and the Purchaser; and

3. The Transaction has been completed to the satisfaction of the Monitor.

4. This Certificate was delivered by the Monitor at _____ [TIME] on _____ [DATE].

ERNST & YOUNG INC., in its capacity as Court-appointed Monitor of Data & Audio-Visual Enterprises Holdings Inc., Data & Audio-Visual Enterprises Wireless Inc., 8445022 Canada Inc. and 2451608 Ontario Inc., and not in its personal capacity

Per: _____

Name:

Title:

Schedule "B"
Permitted Liens

"Permitted Liens" means:

1. Inchoate mechanic's, construction and carrier's liens and other similar liens arising by operation of law or statute in the ordinary course of the Business for obligations which are not delinquent and will be paid or discharged in the ordinary course of business.

2. Any right of expropriation conferred upon, reserved to or vested in Her Majesty The Queen in Right of Canada, Her Majesty The Queen in right of any province of Canada in which the Leased Properties are located, or by any Governmental Authority under any applicable Law which do not, individually or in the aggregate, materially impair the value or use of the Leased Properties for the Business.

3. Zoning restrictions, easements and rights of way or other similar Liens or privileges in respect of real property which do not, individually or in the aggregate, materially impair the value or use of the Leased Properties for the Business and provided the same have been complied with in all material respects.

4. Liens created by others upon other lands over which there are easements, rights-of-way, licenses or other rights of user in favour of the Leased Properties and which do not materially impede the use of the easements, rights-of-way, licenses or other rights of user for the purposes for which they are held.

5. Liens related to the following *Personal Property Security Act* (Ontario) registrations:

Secured Party	**Debtor**	**Reference File No. and Registration Number(s)**
ESI Techologies De L'Information Inc.	Data & Audio Visual Enterprises Wireless Inc.	683247294 20121130 1258 2562 2464
Collateral Classification	**General Collateral Description**	**Comments**
Equipment	F5-BIG-LTM-4200V BIG-IP-Appliance; local traffic manager 4200V (16G Qty 2 F5-SVC-BIG-STD-L1-3 Big-IP Service Std Level 1-3 HWR/Refer to Licensin Qty 2 F5-ADD-BIG DNS BIG-IP Add-on; DNS License Qty 2 F5-SVC-BIG-STD-L1-3 BIG-IP Service Std Level 1-3 HWR/Refer to licensin Qty 2 F5-UPG-AC-400W field upgrade; single 400W AC power (4000 series) QTY2 F5-INST-BIG-LTM BIG-IP installation; local traffic manager impleme Qty 1	Amount: $95,511 No Fixed Maturity Date

Schedule "C"

"**Mobilicity Released Parties**" means (i) Holdings; (ii) the present and former officers, directors, de facto officers or directors, employees, auditors, financial advisors, legal counsel and agents of Holdings, Wireless and their respective affiliates and subsidiaries; (iii) Ernst & Young Inc., in its capacity as court-appointed monitor of Holdings, Wireless and their respective affiliates and subsidiaries, and its legal counsel; and (iv) the chief restructuring officer of Holdings and Wireless and their respective affiliates and subsidiaries.

"**Rogers**" means (i) Rogers Communications Inc., its affiliates and subsidiaries; and (ii) the respective present and former officers, directors, de facto officers or directors, employees, auditors, financial advisors, legal counsel and agents of Rogers Communications Inc. and its affiliates and subsidiaries.

"**Released Claims**" means any and all demands, claims, liabilities, indebtedness, obligations, causes of action, debts, accounts, covenants, damages, executions and other recoveries of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, whether at law or in equity, including by reason of the commission of a tort (intentional or unintentional), by reason of any breach of contract or other agreement (oral or written), by reason of any breach of duty (including, any legal, statutory, equitable or fiduciary duty) or by reason of any equity interest, right of ownership of or title to property or assets or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise), and together with any security enforcement costs or legal costs associated with any such claim, and whether or not any indebtedness, liability or obligation is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, perfected, unperfected, present or future, known or unknown, by guarantee, warranty, surety or otherwise, and whether or not any right or claim is executory or anticipatory in nature, that any Released Party or Wireless may have against any other Released Party, or any right or ability of any Released Party or Wireless to advance against any other Released Party a claim for an accounting, reconciliation, contribution, indemnity, restitution or otherwise with respect to any matter, grievance, action (including any class action or proceeding before an administrative tribunal), cause or chose in action, whether existing at present or commenced in the future, including without limiting the generality of the foregoing, any security interest, charge, mortgage or other encumbrance in connection with any of the foregoing based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Closing and with respect to, relating to, arising out of, or in connection with Wireless or its subsidiaries, or the Released Parties' dealings with Wireless or its subsidiaries, including (without limitation) the transaction contemplated by the Sale Agreement, the proceedings of Holdings and Wireless and their affiliates and subsidiaries under the *Companies' Creditors Arrangement Act* (Canada), any person's financing to, or investment in securities of, Holdings or Wireless or their respective affiliates or subsidiaries, the Catalyst Oppression Application (as defined in the Aziz Affidavit) or events and occurrences directly or indirectly related to the Oppression Action or the facts, circumstances and allegations asserted or raised in the Oppression Action; provided, however, that Released Claims do not extend to (i) any Released Party's rights or obligations under the Sale Agreement, the Catalyst Letter or this Order, (ii) any claims any Mobilicity Released Parties have against any other Mobilicity Released Parties, or (iii) any Remaining Convertible Debenture Claims.

"**Released Parties**" means Securityholders' Released Parties, the Mobilicity Released Parties and Rogers.

"**Remaining Convertible Debenture Claims**" means any demands, claims, liabilities, indebtedness, obligations, causes of action, debts, accounts, covenants, damages, executions and other recoveries of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, against holders of Convertible Debentures in respect of their Claims, rights, obligations or entitlements under the Convertible Debentures.

"**Securityholders Released Parties**" means past and present (ii) indenture trustees and collateral agents under the First Lien Notes, (ii) legal and beneficial holders of First Lien Notes, (iii) legal and beneficial holders of Second Lien Notes, (iv) collateral agents under the Second Lien Notes, (v) legal and beneficial holders of DIP Notes, (vi) collateral agents under the DIP Notes, (vii) indenture trustees under the Unsecured Senior Notes, (viii) legal and beneficial holders of Unsecured Senior Notes, (ix) legal and beneficial holders of Convertible Debentures (except with respect to the Remaining Convertible Debenture Claims), (x) holders of equity securities of any Applicant, and their respective subsidiaries and affiliates, officers, directors, employees, auditors, financial advisors and legal counsel (including legal counsel to the Ad Hoc Committee of Noteholders and the holders of DIP Notes).

Schedule "D"
Shareholders Agreements and Shareholder Declarations

1. Unanimous Shareholder Agreement dated August 1, 2008 among Data & Audio-Visual Enterprises Inc., QCP CW S.A.R.L and Data & Audio-Visual Enterprises Wireless Inc., as amended, supplemented or restated from time to time.

2. Data & Audio-Visual Enterprises Wireless Inc. Unanimous Shareholder Declaration dated August 1, 2008 between Data & Audio-Visual Enterprises Wireless Inc. and Data & Audio-Visual Enterprises Holdings Inc., as amended, supplemented or restated from time to time.

3. Amended and Restated Shareholders Agreement made as of December 17, 2009 among Data & Audio-Visual Enterprises Investments Inc., QCP CW S.A.R.L., Data & Audio-Visual Enterprises Holdings Inc. and Data & Audio-Visual Enterprises Wireless Inc., as amended, supplemented or restated from time to time.

4. Data & Audio-Visual Enterprises Leasing Inc. Unanimous Shareholder Declaration dated February 19, 2010 among Data & Audio-Visual Enterprises Leasing Inc., Data & Audio-Visual Enterprises Holdings Inc. and Data & Audio-Visual Enterprises Wireless Inc., as amended, supplemented or restated from time to time.

5. Second Amended and Restated Shareholders Agreement dated May 14, 2010 among Data & Audio-Visual Enterprises Investments Inc., QCP CW S.A.R.L, Data & Audio-Visual Enterprises Holdings Inc. and Data & Audio-Visual Enterprises Wireless Inc., as amended, supplemented or restated from time to time.

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 8440522 CANADA INC., DATA & AUDIO-VISUAL ENTERPRISES WIRELESS INC., DATA & AUDIO-VISUAL ENTERPRISES HOLDINGS INC. AND 2451608 ONTARIO INC.

Court File No: CV-13-10274-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

ORDER
(VESTING ORDER)

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Lawyers for the Applicants

TAB 30

Court File No. CV-10-8533-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

THE HONOURABLE MADAM	)	MONDAY, THE 17th DAY
	)	
JUSTICE PEPALL	)	OF MAY, 2010

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 AND ARRANGEMENT OF CANWEST PUBLISHING INC. / PUBLICATIONS CANWEST INC., CANWEST BOOKS INC. AND CANWEST (CANADA) INC.

CONDITIONAL CREDIT ACQUISITION SANCTION, APPROVAL AND VESTING ORDER

THIS MOTION, made by Canwest Publishing Inc. / Publications Canwest Inc., Canwest Books Inc. and Canwest (Canada) Inc. (collectively, the "**Applicants**") for an Order approving and conditionally sanctioning the plan of compromise and arrangement dated January 8, 2010 and attached as Schedule "A" to this Order (the "**Plan**") and for ancillary relief associated with the implementation of the Plan, was heard this day, at 330 University Avenue, Toronto, Ontario.

ON READING the Notice of Motion, the seventh report of FTI Consulting Canada Inc. (the "**Monitor**") dated May 11, 2010 (the "**Seventh Report**"), and upon hearing submissions of counsel to the Applicants and Canwest Limited Partnership / Canwest Societe en Commandite ("**Canwest Limited Partnership**"), the Monitor, The Bank of Nova Scotia in its capacity as Administrative Agent for the Senior Lenders to Canwest Limited Partnership (the "**Administrative Agent**"), the ad hoc committee of holders of 9.25% senior subordinated notes issued by the Limited Partnership (the "**Ad Hoc Committee**"), 7535538 Canada Inc., the court-appointed representatives of certain employees and former employees of the LP Entities and others:

DEFINITIONS

1. **THIS COURT ORDERS** that any capitalized terms not otherwise defined in this Order shall have the meanings ascribed thereto in the Plan and/or the initial order (the "**Initial Order**") made by this Court under the *Companies' Creditors Arrangement Act* (the "**CCAA**") dated January 8, 2010.

SERVICE AND MEETING

2. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient service and notice of the Plan to all Senior Lenders.

3. **THIS COURT ORDERS** that there has been good and sufficient service of the Meeting Materials upon all Senior Lenders, and that the Senior Lenders Meeting was duly called, held and conducted in conformity with the CCAA and the Initial Order.

4. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient service and notice of this Sanction Hearing, and that this motion is properly returnable today and further service of the Notice of Motion and the Motion Record upon any interested party is unnecessary and is hereby dispensed with.

PLAN SANCTION

5. **THIS COURT ORDERS AND DECLARES** that:

(a) the Plan has been approved by the requisite majority of Senior Lenders of the Applicants and Canwest Limited Partnership (collectively, the "**LP Entities**") entitled to vote on the Plan in conformity with the CCAA and the terms of the Initial Order;

(b) the LP Entities have acted in good faith and with due diligence and have complied and acted in accordance with the provisions of the CCAA and the Orders of this Honourable Court made in these proceedings in all respects;

(c) this Honourable Court is satisfied that the LP Entities have not done or purported to do anything that is not authorized by the CCAA; and

(d) the Plan and the transactions contemplated thereby are fair and reasonable and are in the best interests of the Senior Lenders and do not unfairly prejudice the interests of any Person.

6. **THIS COURT ORDERS** that the making of this Order in no way limits or lessens or otherwise affects the power of the Court to sanction other plans of arrangement between one or more of the LP Entities and any of their creditors other than the Senior Secured Lenders, including without limitation the CCAA Plan of Arrangement contemplated by the AHC Transaction.

7. **THIS COURT ORDERS** that notwithstanding the making of this Order, any other terms of this Order or of the Plan, and even if all conditions precedent to the effectiveness of the Plan are satisfied or waived, the Plan and the assignment of Contracts and the vesting of assets and claims provided for hereby shall not be effective until and unless the Monitor delivers to counsel for the Administrative Agent, the LP Entities, 7535538 Canada Inc. and the Ad Hoc Committee in accordance with this Order a certificate (the "**Monitor's Credit Bid Sanction Certificate**") in the form attached hereto as Schedule "B". The Monitor shall promptly thereafter file with this Court a copy of the Monitor's Credit Bid Sanction Certificate.

8. **THIS COURT ORDERS** that the Monitor will not deliver the Monitor's Credit Bid Sanction Certificate if the AHC Transaction closes on or before July 29, 2010 and the Administrative Agent receives, or escrow arrangements satisfactory to the Administrative Agent have been made to ensure that it receives on closing, from or on behalf of the LP Entities in immediately available funds an amount sufficient to distribute to the Senior Lenders in indefeasible repayment in full of all amounts owing under the Senior Credit Agreement, Hedging

Agreements and the Collateral Agency Agreement. Subject to paragraph 9 below, the Monitor's Credit Bid Sanction Certificate will not be delivered prior to July 29, 2010.

9. **THIS COURT ORDERS** that, notwithstanding paragraph 8 above, if prior to July 29, 2010, the Monitor determines in its reasonable business judgement that there is no reasonable chance that the AHC Transaction can close, the Monitor may apply to Court on four (4) business days notice for authority to deliver the Monitor's Credit Bid Sanction Certificate prior to July 29, 2010.

10. **THIS COURT ORDERS** that, subject to paragraph 9 above, if the AHC Transaction does not close on or before July 29, 2010, the Monitor is hereby authorized and directed to apply to the Court on July 30, 2010 for advice and direction as to whether it should deliver the Monitor's Credit Bid Sanction Certificate or withhold delivery of the Monitor's Credit Bid Sanction Certificate for such further period of time as directed by the Court.

11. **THIS COURT ORDERS** that, subject to paragraph 7 above, the Plan (including, without limitation, the Credit Acquisition, compromises, arrangements and releases set out therein) is hereby sanctioned and approved as of the date hereof pursuant to Section 6 of the CCAA and that upon delivery of the Monitor's Certificate pursuant to paragraph 14 below and the delivery of the Monitor's Credit Bid Sanction Certificate, the Plan shall be implemented, shall be effective and shall enure to the benefit of and be binding upon the LP Entities and the Senior Lenders, including their respective heirs administrators, executors, legal personal representatives, successors, and assigns but will not affect Unaffected Claims.

12. **THIS COURT ORDERS** that if the AHC Transaction has closed on or before July 29, 2010 (or such later date as is ordered by the Court) in accordance with the Order Approving the AHC Transaction and Amending the Claims Procedure Order and the SISP Procedures made on the date of this Order, then this Order shall be of no force or effect.

APPROVAL AND VESTING

13. **THIS COURT ORDERS AND DECLARES** that, subject to paragraph 7 above, the Acquisition and Assumption Agreement substantially in the form attached as Schedule "1.1(8)" to the Plan (the "**Acquisition Agreement**") and the transaction contemplated thereby (the "**Transactions**") are hereby approved. Upon the delivery of the Monitor's Credit Bid Sanction Certificate, the execution of the Acquisition Agreement by Doug Lamb or Kevin Bent on behalf the LP Entities will be authorized and approved without any requirement of further actions by shareholders, directors or officers of the LP Entities, and the LP Entities and the Monitor will be authorized and directed to take such additional steps and execute such additional documents as may be necessary or desirable for the completion of the Transactions and for the conveyance of the Acquired Assets to 7272049 Canada Inc. ("**Acquireco**") in accordance with the Plan and the Acquisition Agreement.

14. **THIS COURT ORDERS** that, subject to paragraph 7 hereof, upon being provided with evidence satisfactory to the Monitor of the satisfaction (or, where applicable, waiver) of the conditions set out in section 8.2 of the Plan, the Monitor shall deliver to the Administrative Agent and the LP Entities and promptly thereafter file with this Court a certificate stating that all conditions precedent set out in section 8.2 of the Plan have been satisfied (or, where applicable, waived by the LP Entities and/or the Administrative Agent in accordance with the terms of the Plan) (the "**Monitor's Certificate**"), and the date of the delivery of such certificate to the Administrative Agent and the LP Entities shall be the date upon which the Plan shall be and be deemed to have been implemented (the "**Credit Acquisition Plan Implementation Date**").

15. **THIS COURT ORDERS** that upon the filing of a Monitor's Certificate, the following shall take place, in the order in which they appear below and in accordance with the Plan:

(a) all right, title and interest in and to the Canwest Books Assets shall vest absolutely in CPI free and clear of and from any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have

attached or been perfected, registered or filed and whether secured, unsecured or otherwise, including, without limiting the generality of the foregoing: (i) any encumbrances or charges created by the Initial Order of the Honourable Justice Pepall dated January 8, 2010; and (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other applicable federal or other provincial statute, but not including Prior Ranking Secured Claims expressly assumed by Acquireco pursuant to the terms of the Acquisition Agreement (collectively, the "**Canwest Books Encumbrances**") and, for greater certainty, this Court orders that Canwest Books Encumbrances affecting or relating to the Canwest Books Assets are hereby expunged and discharged as against the Canwest Books Assets;

(b) all right, title and interest in and to the Canwest GP Assets shall vest absolutely in CPI free and clear of any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise, including, without limiting the generality of the foregoing: (i) any encumbrances or charges created by the Initial Order of the Honourable Justice Pepall dated January 8, 2010; and (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other applicable federal or other provincial statute, but not including Prior Ranking Secured Claims expressly assumed by Acquireco pursuant to the terms of the Acquisition Agreement (collectively, the "**Canwest GP Encumbrances**") and, for greater certainty, this Court orders that Canwest GP Encumbrances affecting or relating to the Canwest GP Assets are hereby expunged and discharged as against the Canwest GP Assets;

(c) all right, title and interest in and to the CLP Assets shall vest absolutely in CPI free and clear of any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or

monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise, including, without limiting the generality of the foregoing: (i) any encumbrances or charges created by the Initial Order of the Honourable Justice Pepall dated January 8, 2010; and (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other applicable federal or other provincial statute, but not including Prior Ranking Secured Claims expressly assumed by Acquireco pursuant to the terms of the Acquisition Agreement (collectively, the "**CLP Encumbrances**") and, for greater certainty, this Court orders that CLP Encumbrances affecting or relating to the CLP Assets are hereby expunged and discharged as against the CLP Assets;

(d) the right, title and interest in and to the Senior Secured Claims (for greater certainty, net of amounts paid to the Senior Lenders under the terms of the Acquisition Agreement (defined herein) and the Plan on or before the Credit Acquisition Plan Implementation Date that would reduce the outstanding Senior Secured Claims) shall vest absolutely in Acquireco free and clear of and from any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise, including, without limiting the generality of the foregoing all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other applicable federal or other provincial statute (collectively, "**Senior Claim Encumbrances**") and, for greater certainty, this Court orders that Senior Claim Encumbrances affecting or relating to the Senior Secured Claims are hereby expunged and discharged as against the Senior Secured Claims; and

(e) all of the right, title and interest of any Person in and to the Acquired Assets described in the Acquisition Agreement shall vest absolutely in Acquireco, (including without limitation any amounts in the Cash Reserve Account that are

not used by the Monitor in accordance with the Cash Reserve Order to pay Cash Reserve Costs), free and clear of and from any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise (collectively, the "**Encumbrances**") including, without limiting the generality of the foregoing: (i) any encumbrances or charges created by the Initial Order of the Honourable Justice Pepall dated January 8, 2010; and (ii) all charges, security interests or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other applicable federal or other provincial statute, but not including Prior Ranking Secured Claims expressly assumed by Acquireco pursuant to the terms of the Acquisition Agreement and real property permitted encumbrances as set out in Schedule D and, for greater certainty, this Court orders that all of the Encumbrances affecting or relating to the Acquired Assets are hereby expunged and discharged as against the Acquired Assets.

16. **THIS COURT ORDERS** that in accordance with the Plan, the Acquireco Equity and the Acquireco Debt to be distributed in respect of each Senior Lender's Senior Secured Claim (the "**Acquireco Debt/Equity**") shall stand in place and stead of such Senior Secured Claim and all Senior Claim Encumbrances on or against such Senior Secured Claim shall attach to and may be asserted against the Acquireco Debt/Equity with the same priority as they had immediately prior to the implementation of the Plan, as if such Senior Secured Claim had not been transferred to Acquireco and had remained the property of such Senior Lenders immediately prior to the implementation of the Plan.

17. **THIS COURT ORDERS** that, without limiting the other provisions in this Order, on the Credit Acquisition Implementation Date, the license of the LP Entities to use the "Canwest" name and trademarks under a Trademarks License Agreement dated October 13, 2005 (the "**License**") shall be assigned to Acquireco and, following that assignment, Canwest Global Communications Corp. shall not be entitled to exercise any right of termination of the License unless the termination is to take effect after February 28, 2011.

REAL PROPERTY

Ontario

18. **THIS COURT ORDERS** that upon the registration in the Land Registry Office for the Land Titles Division of Toronto (No. 66) (the "**Toronto Land Registry Office**") of an Application for Vesting Order in the form prescribed by the *Land Titles Act* (Ontario) and the *Land Registration Reform Act* (Ontario) with respect to the Toronto Property (as defined in Schedule C), the Land Registrar for the Toronto Land Registry Office is hereby directed to enter Acquireco as the owner of the Toronto Property in fee simple, and is hereby directed to delete and expunge from title to the Toronto Property all of the real property encumbrances relating to the Toronto Property, including but not limited to, the real property encumbrances listed in Schedule D, subject only to the real property permitted encumbrances relating to the Toronto Property listed in Schedule E.

19. **THIS COURT ORDERS** that upon registration in the Land Registry Office for the Land Titles Division of Ottawa-Carleton (No. 4) (the "**Ottawa Land Registry Office**") of an Application for Vesting Order in the form prescribed by the *Land Titles Act* (Ontario) and the *Land Registration Reform Act* (Ontario) with respect to the Ottawa Property (as defined in Schedule B), the Land Registrar for the Ottawa Land Registry Office is hereby directed to enter Acquireco as the owner of the Ottawa Property in fee simple, and is hereby directed to delete and expunge from title to the Ottawa Property all of the real property encumbrances relating to the Ottawa Property, including but not limited to, the real property encumbrances listed in Schedule D, subject only to the real property permitted encumbrances relating to the Ottawa Property listed in Schedule E.

20. **THIS COURT ORDERS** that upon registration in the Land Registry Office for the Land Titles Division of Essex (No. 12) (the "**Windsor Land Registry Office**") of an Application for Vesting Order in the form prescribed by the *Land Titles Act* (Ontario) and the *Land Registration Reform Act* (Ontario) with respect to the Windsor Properties (as defined in Schedule C), the Land Registrar for the Windsor Land Registry Office is hereby directed to enter Acquireco as the owner of the Windsor Properties in fee simple, and is hereby directed to delete and expunge from

title to the Windsor Properties all of the real property encumbrances relating to the Windsor Properties, including but not limited to, the real property encumbrances listed in Schedule D, subject only to the real property permitted encumbrances relating to the Windsor Properties listed in Schedule E.

Alberta

21. **THIS COURT ORDERS** that, upon presentation for registration in either of the North Alberta Land Titles Office or the South Alberta Land Titles Office (collectively, the "**Alberta LTO**"), as the case may be, a certified copy of this Order and an Affidavit of Value as prescribed by the *Land Titles Act* (Alberta), the Alberta LTO be and is hereby authorized and directed to cancel the existing certificates of title to the Alberta Properties as defined in Schedule C and to issue new certificates of title for those Alberta Properties in the name of Acquireco. The Alberta LTO be and is hereby directed to delete and expunge from such new titles to the Alberta Properties all of the real property encumbrances relating to the Alberta Properties, including but not limited to the real property encumbrances listed on Schedule D, subject only to the real property permitted encumbrances relating to the Alberta Property listed in Schedule E being carried forward to the new Alberta Property titles.

22. **THIS COURT ORDERS** that the cancellation of titles and issuance of new titles and discharge of instruments as set out in paragraph 21 shall be registered notwithstanding the requirements of Section 191(1) of the *Land Titles Act* (Alberta).

British Columbia

23. **THIS COURT ORDERS** that, for greater certainty, those lands and premises defined in Schedule C hereto as the BC Properties (the "**BC Properties**") be sold to Acquireco, and that the BC Properties, together with all buildings, fixtures, systems, interests, licences, commons, ways, profits, privileges, rights, easements and appurtenances to the said hereditaments belonging, or with the same or any part thereof, held or enjoyed or appurtenant thereto, do vest in Acquireco in fee simple, free from all encumbrances, subject nevertheless to the reservations, limitations, provisos and conditions expressed in the original grant thereof from the Crown, and subject to

the real property permitted encumbrances relating to the BC Properties listed in Schedule E hereto, upon the filing of the Monitor's Certificate.

24. **THIS COURT ORDERS** that the BC Properties do vest in Acquireco as set out herein, and that all of the encumbrances registered against the titles to the BC Properties, including but not limited to the real property encumbrances relating to the BC Properties and listed in Schedule E hereto, but subject to the real property permitted encumbrances relating to the BC Properties listed in Schedule E hereto, be discharged immediately upon the registration in the appropriate Land Title Offices of a certified copy of the Order made upon this Motion, together with a letter from Bull, Housser & Tupper LLP, permitting registration of the Order made upon this Motion.

Saskatchewan

25. **THIS COURT ORDERS** that, pursuant to the Acquisition Agreement, upon payment of the required registration fee, the Registrar of Titles of the Saskatchewan Land Titles Registry is hereby authorized and directed pursuant to Section 109 of *The Land Titles Act, 2000* S.S. 2000, c. L-5.1 and Section 6.5 of *The Land Titles Conversion Facilitation Regulations*, c. L-5.1, Reg. 2 to cancel the existing titles to the Saskatchewan Properties identified in Schedule C and the new titles to such Saskatchewan Properties shall be issued in the name of Acquireco, free and clear of all real property encumbrances related to the Saskatchewan Properties listed in Schedule D, subject only to the real property permitted encumbrances related to the Saskatchewan Properties listed in Schedule E.

Quebec

26. **THIS COURT ORDERS** AND DIRECTS, in order to give effect to this Order prior to closing of the Transactions, CPI and Acquireco to enter into a deed of transfer with respect to the Quebec Property (as defined in Schedule C), upon the same terms and conditions substantially as those set forth in the draft deed of transfer attached hereto as Schedule F (the "**Deed of Transfer**"), which Deed of Transfer shall be effective upon the delivery of the Monitor's Certificate to Acquireco.

27. **THIS COURT ORDERS** AND DIRECTS, in order to give effect to this Order prior to closing of the Transaction, CIBC Mellon Trust Company to execute a deed of mainlevée with respect to the real property encumbrances listed in Schedule D relating to only the Quebec Property, subject only to the real property permitted encumbrances related to the Quebec Property listed in Schedule E (the "**Deed of Mainlevée**"), which Deed of Mainlevée shall be effective only upon the delivery of the Monitor's Certificate to Acquireco.

28. **THIS COURT ORDERS** that, pursuant to clause 7(3)(c) of the Canada *Personal Information Protection and Electronic Documents Act*, the parties to the Acquisition Agreement are authorized and permitted to disclose and transfer to Acquireco all human resources and payroll information in the LP Entities' records pertaining to the LP Entities' past and current employees. The recipient of such information shall maintain and protect the privacy of such information and shall be entitled to use the personal information provided to it in a manner which is in all material respects identical to the prior use of such information by the applicable party to the Acquisition Agreement.

29. **THIS COURT ORDERS** that, notwithstanding:

(a) the pendency of these proceedings;

(b) any applications for a bankruptcy order now or hereafter issued pursuant to the *Bankruptcy and Insolvency Act* (Canada) in respect of any of the LP Entities or any of the Senior Lenders (herein collectively the "**Vesting Entities**") and any bankruptcy order issued pursuant to any such applications; and

(c) any assignment in bankruptcy made in respect of any of the Vesting Entities;

(i) the entering into of the Acquisition Agreement; (ii) the vesting of rights, titles and interests as set out in paragraph 15 above and (iii) the assignment of the Contracts (as defined below) pursuant to this Order, shall be binding on any trustee in bankruptcy that may be appointed in respect of any of the Vesting Entities and shall not be void or voidable by creditors of any of the Vesting Entities, nor shall any of them constitute nor be deemed to be a settlement, fraudulent

preference, assignment, fraudulent conveyance or transfer at undervalue under the *Bankruptcy and Insolvency Act* (Canada), the CCAA or any other applicable federal or provincial legislation, nor shall any of them constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

30. **THIS COURT ORDERS AND DECLARES** that the Plan, the Credit Acquisition and the other transactions contemplated thereby are exempt from the application of the *Bulk Sales Act* (Ontario) and any equivalent or applicable legislation under any other province or territory in Canada.

PLAN IMPLEMENTATION

31. **THIS COURT ORDERS** that upon delivery of the Monitor's Credit Bid Sanction Certificate, the LP Entities, Acquireco, the Administrative Agent, the Collateral Agent (as defined below) and the Monitor shall be authorized and directed to take all steps and actions and execute such additional documents (and with respect to the LP Entities Doug Lamb or Kevin Bent shall be authorized and directed to execute such additional documents on behalf of the LP Entities) as may be necessary or appropriate (as determined by each party in consultation with the other parties) to implement the Plan, the Credit Acquisition and the Transactions in accordance with and subject to their terms and such steps and actions are hereby approved.

SENIOR SECURED CLAIMS

32. **THIS COURT ORDERS** that, without limiting the Initial Order, for the purposes of the Plan the Principal amount of the Senior Secured Claims shall be determined in accordance with the claims process set out at paragraph 68 of the Initial Order. To the extent that any Senior Lender (the "**Claimant**") asserts a claim in respect of Other Amounts that arose after the Filing Date but prior to the date of this Order (a "**Post-Filing Other Amounts Claim**"):

(a) such Claimant shall within ten (10) Business Days from the making of this Order, send to the Monitor (with a copy to the LP Entities and the Administrative Agent) a notice (the "**Claim Notice**") setting out the amount of its Post-Filing Other

Amounts Claim in the form attached hereto as Schedule "G". If no such notice is received by the Monitor from the Claimant within ten (10) Business Days of the making of this Order, the Claimant's Post-Filing Other Amounts Claim shall be and is hereby for the purposes of the Plan extinguished and forever barred;

(b) if the Monitor, with the consent of the Administrative Agent acting in consultation with the Steering Committee, confirms the Post-Filing Other Amounts Claim set out in the Claim Notice or if the Monitor, with the consent of the Administrative Agent acting in consultation with the Steering Committee, does not deliver a Notice of Dispute, indicating that the Monitor disputes the Post-Filing Other Amounts Claim within five (5) Business Days of receipt of the Claim Notice, then the amount set out in the Claim Notice shall be deemed to be finally determined ("**Finally Determined**") and accepted for the purpose of calculating the Claimant's entitlement to distributions under the Senior Lenders CCAA Plan;

(c) if the Monitor delivers a Notice of Dispute in accordance with subparagraph (b) above, then the Monitor, the Administrative Agent and the particular Senior Lender shall have five (5) Business Days from the date of delivery of the Notice of Dispute to reach an agreement in writing as to the Post-Filing Other Amounts Claim that is subject to the Notice of Dispute, in which case such agreement shall govern and the Post-Filing Other Amounts Claim shall be deemed to be Finally Determined in accordance with the agreement;.

(d) if a Notice of Dispute is unable to be resolved in the manner and within the time period set out in subparagraph (c) above, then the Claim of such Claimant shall for the purposes of the Plan be determined by the Court on a motion for advice and directions brought by the Monitor (the "**Dispute Motion**") on notice to the Administrative Agent and all other interested parties. The Monitor and the Claimant shall each use reasonable efforts to have the Dispute Motion, and any appeals therefrom, disposed of on an expedited basis with a view to having the Post-Filing Other Amounts Claim of the Claimant Finally Determined on a timely basis.

If there are any Senior Secured Claims (including for greater certainty, for Principal or Other Amounts) or any portion thereof that have not been Finally Determined pursuant to the terms of the Initial Order or this Order (an "**Unresolved Senior Claim**"), as of the Credit Acquisition Plan Implementation Date, the Monitor shall establish a Unresolved Senior Claims Reserve. The Unresolved Senior Claims Reserve shall be comprised of Acquireco Debt, Acquireco Equity and cash reserved out of the LP Entity Cash and Cash Equivalents. The aggregate value of the Acquireco Debt and Acquireco Equity to be included in the Unresolved Senior Claims Reserve shall be equal to the value of Acquireco Debt and Acquireco Equity that would have been distributed in respect of the Unresolved Senior Claims if the full amounts of such Unresolved Senior Claims were Proven Senior Secured Claims on the Credit Acquisition Plan Implementation Date. The aggregate amount of the cash to be included in the Unresolved Senior Claims Reserve shall be equal to the amount of all Unpaid Interest on Unresolved Senior Claims as of the Credit Acquisition Plan Implementation Date that would have been paid to the Senior Lenders holding such Unresolved Senior Claims if the full amounts of such Unresolved Senior Claims were Proven Senior Secured Claims on the Credit Acquisition Plan Implementation Date.

33. **THIS COURT ORDERS** that provided that the Monitor receives from the LP Entities and Acquireco, respectively, the cash and Acquireco Debt and Acquireco Equity required for the Monitor to establish the Unresolved Senior Claims Reserve in accordance with the Plan, not later than fifteen days (or such later date as may be specified by Order of the Court) following the Final Determination Date, the Monitor shall distribute from the Unresolved Senior Claims Reserve:

(a) to the Persons entitled in accordance with the Plan and the Acquireco Capitalization Term Sheet, Acquireco Debt and Acquireco Equity in respect of any Senior Secured Claims that were Unresolved Senior Claims on the Credit Acquisition Plan Implementation Date and that subsequently became Proven Senior Secured Claims, together with any interest, dividends, distributions or other payments actually received by the Monitor on account or in respect thereof;

(b) following the distribution referred to in subparagraph (a) above, any balance of Acquireco Debt and Acquireco Equity that forms part of the Unresolved Senior

Claims Reserve shall be distributed to the Persons entitled in accordance with the Plan and the Acquireco Capitalization Term Sheet such that all Acquireco Debt and Acquireco Equity shall have been distributed in accordance with the Plan and the Acquireco Capitalization Term Sheet and any interest, distributions or other payments actually received by the Monitor on account or in respect of the Acquireco Debt and Acquireco Equity referred to in this subparagraph (b) shall be distributed to the Persons receiving the applicable Acquireco Debt or Acquireco Equity pursuant to this subparagraph (b),

(c) to the Persons entitled in accordance with the Plan and the Acquireco Capitalization Term Sheet, cash in an amount equal to the aggregate amount of all Unpaid Interest on Senior Secured Claims that were Unresolved Senior Claims on the Credit Acquisition Plan Implementation Date that subsequently became Proven Senior Secured Claims, together with any interest actually received by the Monitor on account or in respect thereof, and following this distribution, any balance of cash that forms part of the Unresolved Senior Claims Reserve together with any interest actually received by the Monitor on account or in respect thereof shall be paid to Acquireco.

For the purposes of calculating the various distributions to be made pursuant to this paragraph 33, each Senior Lender's Pro Rata Share shall be calculated as if (i) the Senior Secured Claims that became Proven Senior Secured Claims after the Credit Acquisition Plan Implementation Date were Proven Senior Secured Claims and not Unresolved Senior Claims on the Credit Acquisition Plan Implementation Date, (ii) the Unresolved Amount was zero as of the Credit Acquisition Plan Implementation Date, and (iii) Unpaid Interest on Senior Secured Claims that became Proven Senior Secured Claims after the Credit Acquisition Plan Implementation Date was paid on the Credit Acquisition Plan Implementation Date.

EFFECT OF PLAN IMPLEMENTATION

34. **THIS COURT ORDERS** that, effective on the Credit Acquisition Plan Implementation Date each Senior Secured Claim shall be dealt with in accordance with the Plan and the ability of

the holder of a Senior Secured Claim (other than Acquireco) to proceed against the LP Entities or the LP Property (including any amounts now or hereafter held by the Monitor in respect of the LP Entities) in respect of a Senior Secured Claim and all suits, actions, proceedings or other enforcement processes by the holder of a Senior Secured Claim (other than Acquireco) with respect to, in connection with or relating to such Senior Secured Claims are permanently stayed and restrained, subject only to the right of the holder of such a Senior Secured Claim to receive distributions in accordance with the Plan.

35. **THIS COURT ORDERS AND DECLARES** that, effective on the Credit Acquisition Plan Implementation Date, all Senior Secured Claims determined in accordance with the Plan, the Initial Order and this Order are final and binding on the LP Entities, the Monitor and all Senior Lenders and that, as of the Credit Acquisition Plan Implementation Date, the Plan shall enure to the benefit of and be binding upon the Senior Lenders and all other Persons affected thereby and their respective heirs, administrators, executors, legal personal representatives, successors and assigns.

36. **THIS COURT ORDERS** that, upon the delivery of the Monitor's Credit Bid Sanction Certificate and except as provided in the terms of the Plan and subject to the restrictions in Section 11.3 of the CCAA, the LP Entities will be authorized and directed to assign all contracts, leases, agreements and other arrangements of which Acquireco takes an assignment on closing pursuant to the terms of the Acquisition Agreement (the "**Contracts**") and that, subject to Section 11.3 of the CCAA and the giving of notice to the counterparties of such Contracts in accordance with paragraph 47 below, such assignments are hereby approved and are valid and binding upon the counterparties notwithstanding any restriction or prohibition on assignment contained in such Contract.

37. **THIS COURT ORDERS** that from and after the Credit Acquisition Plan Implementation Date, subject to the CCAA, all Persons shall be deemed to have waived all defaults then existing or previously committed by the LP Entities under, or caused by the LP Entities under, and the non-compliance by the LP Entities with, any of the Contracts arising solely by reason of the insolvency of the LP Entities or as a result of any actions taken pursuant to the Plan or in these proceedings, and all notices of default and demands given in connection

with any such defaults under, or non-compliance with, the Contracts shall be deemed to have been rescinded and shall be of no further force or effect.

ROLE OF THE MONITOR

38. **THIS COURT ORDERS** that, notwithstanding any other terms of this Order or of the Plan, the appointment of the Monitor pursuant to the terms of prior Orders made by this Honourable Court shall not expire or terminate on the Credit Acquisition Plan Implementation Date and shall continue for purposes of the following:

(a) the completion by the Monitor of all of its duties in connection with the Plan; and

(b) the completion by the Monitor of all other matters for which it is responsible in these proceedings and pursuant to the Plan, the Initial Order and the CCAA.

39. **THIS COURT ORDERS** that all claims of any Person, whether such claims are direct, indirect, derivative or otherwise, against the Monitor arising from or relating to the services provided by the Monitor in respect of the LP Entities prior to the date of this Order, save and except claims of gross negligence or wilful misconduct, shall be and are hereby forever barred from enforcement and are extinguished.

40. **THIS COURT ORDERS** that the Monitor shall be discharged of its duties and obligations with respect to the LP Entities pursuant to the Plan, this Order and all other Orders made in these proceedings with respect to the LP Entities from time to time upon the filing with this Honourable Court of a certificate of the Monitor certifying that the matters set out in paragraph 38 above are completed to the best of the Monitor's knowledge.

CHARGES

41. **THIS COURT ORDERS** that, on the Credit Acquisition Plan Implementation Date following the making of the Cash Reserve Order and the establishment of the Cash Reserve in

accordance with the Plan, all charges against the LP Entities or the LP Property created by the Initial Order or any subsequent Orders shall be terminated, discharged and released.

42. **THIS COURT ORDERS AND DECLARES** that, notwithstanding any of the terms of the Plan or this Order, the LP Entities shall not be released or discharged from its obligations to pay the fees and expenses of the Monitor, the Monitor's counsel or the LP Entities' counsel in respect of the Plan and the implementation thereof, which obligations shall be in addition to any such obligations under the Plan.

RELEASES, EXCULPATION AND LIMITATION OF LIABILITY

43. **THIS COURT ORDERS** that on the Credit Acquisition Plan Implementation Date, the LP Entities shall be deemed to have released each of the Senior Lenders, each individual, corporation or other entity that was at any time a Senior Lender, each member and former member of the Steering Committee or any other committee of holders of Senior Secured Claims, the Administrative Agent, the DIP Lenders, Acquireco and the Collateral Agent, and their respective agents, affiliates, directors, officers, employees, and representatives, including counsel and its financial advisor (collectively, the "**Indemnitees**") and the Monitor, from any and all claims, obligations, rights, causes of action, and liabilities, of whatever kind or nature, whether based on contract, negligence or other tort, fiduciary duty, common law, equity, statute or otherwise, whether known or unknown, whether foreseen or unforeseen, arising on or before the Credit Acquisition Implementation Date (other than any claims, obligations, rights, causes of action, and liabilities arising from fraud as determined by a final judgment of a court of competent jurisdiction) which such LP Entities may have for, upon or by reason of any matter, cause or thing whatsoever, which are based upon, arise under or are related to the Senior Credit Agreement, Hedging Agreements, Collateral Agency Agreement or Senior Secured Claims.

44. **THIS COURT ORDERS** that on the Credit Acquisition Plan Implementation Date the Senior Lenders shall be deemed to have released the Monitor and the present and former officers and directors of the LP Entities from any and all claims, obligations, rights, causes of action, and liabilities, of whatever kind or nature, whether known or unknown, whether foreseen or unforeseen, arising on or before the Credit Acquisition Plan Implementation Date, which such

Senior Lenders may have for, upon or by reason of any matter, cause or thing whatsoever, which are based upon, arise under or are related to the Senior Credit Agreement, Hedging Agreements, Collateral Agency Agreement or Senior Secured Claims, provided that nothing herein will release any of the present or former officers or directors of the LP Entities in respect of any claim, obligations right, cause of action, or liability referred to in section 5.1(2) of the CCAA.

45. **THIS COURT ORDERS** that none of the LP Entities, the Monitor, the Administrative Agent, the Senior Lenders, Acquireco, any individual, corporation or other entity that was at any time formerly a Senior Lender, the Steering Committee or any other committee of holders of Senior Secured Claims, the DIP Lenders, Collateral Agent, or any of their respective present or former members, officers, directors, employees, direct or indirect advisors, attorneys, or agents, shall have or incur any liability to any holder of a Senior Secured Claim, or any of their respective agents, employees, representatives, financial advisors, attorneys, or affiliates, or any of their successors or assigns, for any act or omission in connection with, relating to, or arising out of, the LP Entities' CCAA proceedings initiated by the Initial Order, formulating, negotiating or implementing the Plan or the Support Agreement, the solicitation of acceptances of the Plan or the Support Agreement, the pursuit of confirmation of the Plan, the confirmation of the Plan, the consummation of the Plan, or the administration of the Plan or the property to be distributed under the Plan, except for their wilful misconduct, and in all respects shall be entitled to rely reasonably upon the advice of counsel with respect to their duties and responsibilities under the Plan.

46. **THIS COURT ORDERS** that the LP Entities hereby jointly and severally fully indemnify each of the Indemnitees against any manner of actions, causes of action, suits, proceedings, liabilities and claims of any nature, costs and expenses (including reasonable legal fees) which may be incurred by such Indemnitee or asserted against such Indemnitee arising out of or during the course of, or otherwise in connection with or in any way related to, the negotiation, preparation, formulation, solicitation, dissemination, implementation, confirmation and consummation of the Plan, other than any liabilities to the extent arising from the gross negligence or willful or intentional misconduct of any Indemnitee or any breach by Acquireco of the terms of the Acquisition Agreement as determined by a final judgment of a court of

competent jurisdiction. If any claim, action or proceeding is brought or asserted against an Indemnitee in respect of which indemnity may be sought from any of the LP Entities, the Indemnitee shall promptly notify the LP Entities in writing, and the LP Entities may assume the defence thereof, including the employment of counsel reasonably satisfactory to the Indemnitee, and the payment of all costs and expenses. The Indemnitee shall have the right to employ separate counsel in any such claim, action or proceeding and to consult with the LP Entities in the defence thereof and the fees and expenses of such counsel shall be at the expense of the LP Entities unless and until the LP Entities shall have assumed the defence of such claim, action or proceeding. If the named parties to any such claim, action or proceeding (including any impleaded parties) include both the Indemnitee and any of the LP Entities, and the Indemnitee reasonably believes that the joint representation of such entity and the Indemnitee may result in a conflict of interest, the Indemnitee may notify the LP Entities in writing that it elects to employ separate counsel at the expense of the LP Entities, and the LP Entities shall not have the right to assume the defence of such action or proceeding on behalf of the Indemnitee. In addition, the LP Entities shall not affect any settlement or release from liability in connection with any matter for which the Indemnitee would have the right to indemnification from the LP Entities, unless such settlement contains a full and unconditional release of the Indemnitee, or a release of the Indemnitee satisfactory in form and substance to the Indemnitee.

COMPLETION OF SCHEDULES AND AMENDMENT OF ORDER

47. **THIS COURT ORDERS** that the LP Entities are authorized and directed to (i) use their commercially reasonable efforts to work cooperatively with the Administrative Agent to complete the Schedules to this Order by not later than June 15, 2010, and (ii) as soon as practicable following the completion of the Schedules to this Order, and in any event not later than June 29, 2010, serve a motion to this Court for an Order amending this Order on notice to the counterparties to the Contracts and any Person that has registered any Canwest Books Encumbrance, Canwest GP Encumbrance, CLP Encumbrance or Encumbrance.

OTHER PROVISIONS

48. **THIS COURT ORDERS** that the AHC Transaction will have priority to management time to close that transaction. However, the LP Entities will also use reasonable efforts to comply with information requests from the Agent in accordance with the email of Alvarez & Marsal Canada ULC to the Monitor dated May 16, 2010 and such other requests in accordance with the LP Support Agreement so long as in each case they do not materially hinder or prejudice the closing of the AHC Transaction within the intended timeline. If any issues arise in relation to access to management time or other closing requirements as between the AHC Transaction and the Credit Acquisition, the parties will consult with the Monitor who will seek to resolve them. If the Monitor is unable to resolve any such issues advice and direction will be sought from the Court.

49. **THIS COURT ORDERS** that, except to the extent that the Initial Order has been varied by or is inconsistent with this Order, the Plan or any other Order in these proceedings, the provisions of Initial Order shall remain in full force and effect until the Credit Acquisition Plan Implementation Date, when all but paragraphs 65-97 of the Initial Order shall terminate. Notwithstanding the termination of certain provisions of the Initial Order, the Monitor shall continue to have the benefit of the provisions of all Orders made in this proceeding, including all approvals, protections and stays of proceedings in its favour, except as varied herein.

50. **THIS COURT ORDERS** that paragraphs 65-97 of the Initial Order and all other Orders made in these CCAA proceedings shall continue in full force and effect in accordance with their respective terms, except to the extent that such Orders are varied by or inconsistent with this Order, subject to paragraph 12 hereof, or any further Order of this Honourable Court.

51. **THIS COURT ORDERS** that this Court shall retain jurisdiction in respect of any matter in dispute arising out of anything relating to the interpretation or implementation of the Plan.

52. **THIS COURT ORDERS** that the LP Entities, the Monitor, Acquireco or the Administrative Agent may apply to this Honourable Court for further advice, directions or assistance as may be necessary to give effect to the terms of the Plan.

53. **THIS COURT ORDERS** that, subject to paragraphs 7 and 12, this Order shall have full force and effect in all provinces and territories in Canada and abroad and as against all other Persons against whom it may otherwise be enforceable.

54. **THIS COURT HEREBY REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States, to give effect to this Order and to assist the LP Entities, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the LP Entities and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the LP Entities and the Monitor and their respective agents in carrying out the terms of this Order.

55. **THIS COURT ORDERS** that each of the LP Entities, the Monitor, Acquireco and the Administrative Agent be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order, and that the Monitor is authorized and empowered to act as a representative in respect of the within proceedings for the purpose of having these proceedings recognized in a jurisdiction outside Canada.

56. **THIS COURT ORDERS** that this Order shall be posted on the website maintained by the Monitor and shall only be required to be served upon those parties who have either formally entered an appearance in these proceedings or those parties who appeared at the hearing of the motion for this Order.

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

MAY 17 2010

PER / PAR:

SCHEDULE "A"

Plan of Compromise and Arrangement

SCHEDULE "B"

Court File No. CV-10-8533-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST PUBLISHING INC./ PUBLICATIONS CANWEST INC., CANWEST BOOKS INC., AND CANWEST (CANADA) INC.

MONITOR'S CREDIT BID SANCTION CERTIFICATE

RECITALS

A. Pursuant to an Order of the Honourable Madam Justice Pepall of the Ontario Superior Court of Justice (the "**Court**") dated January 8, 2010, FTI Consulting Canada Inc. was appointed as the monitor (the "**Monitor**") of Canwest Publishing Inc. / Publications Canwest Inc., Canwest Books Inc., and Canwest (Canada) Inc., and Canwest Limited Partnership / Canwest Societe en Commandite (collectively, the "**LP Entities**") in their proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended.

B. By Order dated May 17, 2010 (the "**Conditional Credit Acquisition Order**"), the Court approved and sanctioned, subject to paragraph 7 of the Conditional Credit Acquisition Order, the plan of compromise and arrangement dated January 8, 2010 attached as Schedule "A" to the Conditional Credit Acquisition Order (the "**Plan**") and ordered that upon, *inter alia*, delivery of the Monitor's Credit Bid Sanction Certificate the Plan shall be implemented, shall be effective and shall enure to the benefit of and be binding upon the LP Entities and the Senior Lenders (as defined in the Conditional Credit Acquisition Agreement).

C. Pursuant to the Conditional Credit Acquisition Order, the Monitor was authorized to apply to Court for authority or directions to deliver the Monitor's Credit Bid Sanction Certificate.

D. Unless otherwise indicated herein, terms with initial capitals have the meanings set out in the Conditional Credit Acquisition Order.

THE MONITOR CERTIFIES the following:

1. By Order dated ●, 2010, the Court directed the Monitor to deliver the Monitor's Credit Bid Sanction Certificate.

2. This Monitor's Credit Bid Sanction Certificate was delivered by the Monitor at _____ on _____ _____, 2010.

FTI Consulting Canada Inc., in its capacity as Court-appointed Monitor of the LP Entities, and not in its personal capacity

Per: _____

Name:

Title:

SCHEDULE "C"

[NTD: List of legal descriptions to be completed in accordance with Paragraph ●]

Toronto Property

Ottawa Property

Windsor Property

Alberta Properties

BC Properties

Saskatchewan Properties

Quebec Properties

SCHEDULE "D"

[NTD: List of Real Properties Encumbrances to be added in accordance with Paragraph 43.]

Toronto Property

Ottawa Property

Windsor Property

Alberta Properties

BC Properties

Saskatchewan Properties

Quebec Properties

SCHEDULE "E"

[NTD: List of Real Properties Permitted Encumbrances to be added in accordance with Paragraph 43.]

Toronto Property

Ottawa Property

Windsor Property

Alberta Properties

BC Properties

Saskatchewan Properties

Quebec Properties

SCHEDULE "F"

[NTD: Insert form of draft deed of transfer for Quebec Property in accordance with Paragraph 43.]

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 CANWEST PUBLISHING INC./PUBLICATIONS CANWEST INC., CANWEST BOOKS INC. AND CANWEST (CANADA) INC.

APPLICANTS

Court File No: CV-10-8533-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

CONDITIONAL CREDIT ACQUISITION SANCTION, APPROVAL AND VESTING ORDER

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Fax: (416) 862-6666

Lawyers for the Applicants

F. 1117119

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON EDUCATION LTD. AND NELSON EDUCATION HOLDINGS LTD.

Applicants

Court File No: CV15-10961-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

BOOK OF AUTHROITIES OF THE FIRST LIEN HOLDERS (Motions Returnable August 13, 2015)

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Lawyers for Wilmington Trust, National Association, as the First Lien Agent, Cortland Capital Market Services LLC, as the Supplemental Agent, and the First Lien Steering Committee