Clerk's Stamp

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JUDICIAL CENTRE	CALGARY
APPLICANT	RS TECHNOLOGIES INC.
DOCUMENT	**BRIEF OF LAW**

Brief of Law Filed by Armor Utility Structures Pty Limited

Re: Application to set aside disclaimer of application

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II. INTRODUCTION

1. Armor Utility Structures Pty Limited ("**Armor**") is a counterparty to a distribution agreement with the applicant, RS Technologies Inc. ("**RS Poles**"), that has been in place since 2005, and most recently renegotiated in March, 2012 (the "**Distribution Agreement**"), pursuant to which Armor is the exclusive distributor of the RS Poles "Product" (utility poles) within the areas of Australia and New Zealand.

2. RS Poles has disclaimed the Distribution Agreement pursuant to s. 32(1) of the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36 ("**CCAA**").

3. Armor seeks an Order under s. 32(2) prohibiting the disclaimer on the basis that the minimal potential benefit to RS Poles (namely increased profit) does not outweigh the significant prejudice and financial hardship that Armor, and its sister company, Australia Pty Limited ("**AAP**"), will experience if the disclaimer is upheld.

4. For the most part, the evidence in support of the disclaimer itself is that there is a potential for more profit to go directly to RS Poles (or the purchaser of its shares or assets) if the Distribution Agreement is disclaimed. On that basis alone, it is asserted by RS Poles that it enhances its value, and therefore its prospect of making a viable plan or arrangement.

5. It is trite that, as simple business concept, disclaiming a distribution agreement which, to use the vernacular, "cuts out the middle man", provides a financial upside and benefit to both the supplier and the customer. Thus, to take the position of RS Poles' to its natural conclusion, every distribution agreement ought to be disclaimed in a CCAA restructuring as it will enhance the value of the company if the company can sell directly to the customer base developed (in this case, for approximately 8 years).

6. However, a bare assertion that the a plan or arrangement may be "enhanced" is not sufficient.

7. Rather, RS Poles must satisfy this honourable court that the benefit resulting from the disclaimer not only enhances the prospects of presenting a viable plan, but that it outweighs the financial prejudice to Armor.

8. Armor submits that, in the circumstances, RS Poles fails in this regard, as it cannot be said that either:

   (a) Any plan will fail or survive on the basis of this disclaimer. Quite simply, this Honourable court has already approved a SISP and Credit Bid Purchase Agreement. As summarized by the Monitor in its Second Report dated April 10, 2013 (para 48 to 52) there are a number of conditions that determine if the credit bid will be as an asset purchase or a share purchase. However, the formula for calculating the purchase price regardless of that has already been determined (para 53) and, notably, is based upon either converting or paying out those debts set out therein (para 55). Thus, it cannot be said that the purchase price, or basis of the plan, will be affected by the Distribution Agreement in any way whatsoever, or that the plan can possibly be enhanced as a result.

   or that

   (b) The minimal benefit of potential increased profit (without admitting that that possibility has even been established) does not outweigh the financial prejudice of the cessation of business of Armor, and reduction of approximately 24% of the work force of its parent company as a result.

9. Accordingly, Armor submits that this Honourable Court ought to exercise its discretion under s. 32(2) to prohibit the disclaimer, for the reasons set out herein.

III. BACKGROUND AND FACTUAL SUMMARY

10. As noted, Armor is a sister company of AAP, which is a composite materials engineering and manufacturing company specializing in composite moulding armour panel applications. AAP works within a variety of industries providing

engineered composite solutions from design and prototyping through to providing fully designed and operational production cells.

11. In May 2005, Armor was incorporated because the Australian electrical energy and transmission industry was interested in investigating the use of fibre composites to meet the industry's growing need for replacement of its utility pole structures. Given AAP's work with composite materials, it believed that the composite pole market was one that would fit with AAP's knowledge base, through a new company specific to servicing the utility market.

12. After conducting significant research and investigating the industry, in or around May 2005, RS Poles agreed to appoint and did so appoint Armor as the sole distributor and exclusive representative to market and sell RS' composite modular pole technology known as RStandard® and related accessories (the "**Product**"), in the areas of Australia and New Zealand (the "**Territory**").

13. The first shipment of Product from RS to Armor occurred in or around September, 2005. In the course of developing its rights as a distributor and a market for the Product from 2005 to date, Armor invested a great deal of time and money in establishing itself and the Product within the market, including organizing and marketing a trial for the Energy Networks Association ("ENA"), members of which make up 95% of the potential pole purchases within the Territory, the cost outlay for which was approximately $600,000. During the trials, an issue arose in that the RS Poles failed bush fire tests, as a result of which the potential market decreased by about 80%. However, Armor was still able to capture the remaining market, where the bush fire risk was not a concern.

Affidavit #1 of H. Oldfield, para 5 - 6

14. In addition, Armor obtained an agreement with ActewAGL ("**Actew**"), a multi-utility company located in Canberra, Australia, that provides a range of services including electricity, natural gas, green energy, water and wastewater, and has been supplying poles to them since 2006. The contract with Actew is one that is central to the issues raised herein, and is discussion in further detail below.

15. In March 2012, a new written distribution agreement dated March 30, 2012 (the "**Distribution Agreement**") was entered into between Armor and RS, the terms of which included, in addition to granting Armor the sole and exclusive rights to distribute the Product for a period of 3 years, that RS would:

    (c) be precluded from, among other things, selling or marketing the Product within the Territory;

    (d) Support sales by Armor of the Product to end users or contractors within the Territory; and

    (e) Provide reasonable brochures, manuals and technical documentation regarding the Product and would assist Armor in the preparation of technical and commercial proposals, bids and quotations for the Product.

Distribution Agreement, Exhibit "A" Aff #1 of H. Oldfield

16. By the terms of the Distribution Agreement, among other things:

    (a) Armor was to order a minimum of $600,000 of Product per year from RS for the year 2012, $800,000 for the year 2013, and $1,100,000 for the year 2014; and

    (b) the price to be paid by Armor for the Product was to be RS' MSRP as set out therein, less a fixed discount of 30%.

17. Armor has exceeded its target under the Distribution Agreement by more than 156%. This has not been disputed by the Applicant.

Affidavit #1 of H. Oldfield, para 10

RS' Disclaimer and Evidence of Effect of that on RS Poles

18. On or about April 5, 2013, counsel for RS delivered to Armor a letter with a notice of disclaimer of the Distribution Agreement, pursuant to s. 32(1) of the CCAA (the "**Notice of Disclaimer**").

19. The majority of the reasons for issuing the Notice of Disclaimer related to the supply of Product Actew and the desire of RS Poles to "increase its margin and provide a discount to [Actew] from its current pricing". Included in the reasons is that RS has stated that there is a risk of losing the Actew supply contract. Armor disputes that there is any cause for such concern, having regard to commercial reasonableness, and says that the risk is being fabricated, likely by Actew who is seeking to get a benefit from RS Poles restructuring, but buying direct to avoid the mark up on the Product.

Affidavit #1 of H. Oldfield, para 14(h), 16, and para 27

20. In this respect, the totality of the evidence of RS Poles which goes to the issues in dispute can be summarized as follows:

(a) Armor has failed to adequately market the RS Poles, having developed only one customer, Actew, resulting in direct inquiries being made to them from potential customers.

Affidavit of G. Fecht, para 8(a), 11

(b) Armor has applied an extremely high mark-up, the quantum of which is substantial given that Armor fails to provide local inventory.

Affidavit of G. Fecht, para 8(b)

(c) RS has been informed that Armor has failed to provide adequate customer support.

Affidavit of G. Fecht, para 8(c)

(d) The occurrence of (b) and (c) has caused Actew to conclude that it would like to purchase RS Poles directly from RS Poles.

Affidavit of G. Fecht, para 8(d)

(e) RS has been contacted directly by potential customers on a number of occasions and put them in contact with Armor.

Affidavit of G. Fecht, para 12

(f) Actew had advised that if RS did not submit a direct bid as part of its recent tender process, Actew would seek an alternative to the RS Poles. RS Poles points to an email in support of that conversation (however, the email does not reference such a statement being made *in any way*). In any event, Actew then advised that they wanted to enter into an arrangement for the supply of RS Poles and were initiating a tender process in accordance with their policy. Notably, in the emails from Actew exhibited by RS Poles, nothing indicates that the contract would not ultimately be given to Armor or that there was any risk of that happening.

Affidavit of G. Fecht, para 17, 18, Exh "B" "C"

21. On the basis of those statements, RS concludes that:

(a) Armor has failed to adequately market the RS Poles or establish a sufficient presence in the Territory. As a result, RS and its stakeholders have not benefitted from increased sales of RS Poles as was expected under the Distribution Agreement.

Affidavit of G. Fecht, para 14

(b) If the Distribution Agreement is not disclaimed, it is likely that potential customers will continue to seek out alternatives to RS Poles as "Armor has demonstrated a general lack of involvement in the Australian utility community", which would be alleviated by them selling directly to the customer base.

Affidavit of G. Fecht, para 32 -33

(c) Additional sales would assist RS Poles in its efforts to continue as going concern, become profitable, and to continue the employment of its 53 current employees and 3 contractors and provide additional revenue and value to stakeholders.

Affidavit of G. Fecht, para 34

(d) Accordingly, disclaiming the Distribution Agreement would enhance the prospect of a viable compromise or arrangement being made in respect of the Company and enhance the value of the Company for the benefit of the Stakeholders.

Affidavit of G. Fecht, para 35

22. Thus, the best evidence that RS Poles has provided is a combination of bare assertions and hearsay evidence, with nothing objective in support of the statements and conclusions drawn as based upon them.

23. In particular, there is no evidence on the following points:

(a) What other sales are available;

(b) That the Distribution Agreement is not profitable;

(c) That any particular sale has been lost;

(d) That any particular customer has not been pursued;

(e) That if the disclaimer is not upheld, employees will in fact be terminated; or

(f) How the existence of the Distribution Agreement affects the plan in any way, given that the purchase price has already been established.

24. In contrast, there is either direct (or undisputed) evidence as follows:

(g) Armor that has exceeded all sales milestones under the Distribution Agreement by more than 156%, which would support that the market is being fully serviced and captured by Armor.

Affidavit #1 of H. Oldfield, para 10

(h) Armor is not aware of any situation in which a lack of inventory has resulted in a lost contract. Further, Armor was present at every container unloading and no issue was ever raised about requiring local inventory.

Affidavit #1 of H. Oldfield, para 26(b)
Affidavit #1 of D. Oldfield, para 3(b)

(i) As noted above, ENA is undergoing trials that commenced in 2008. Those trials are just coming to fruition, as the trials were intended to be a 4 to 5 year process. Thus, the timing of this disclaimer is of note, in that it has been done just as the efforts of Armor are starting to result in customer interest. At least two customers that took part in the ENA trial have recently approached Armor for further supply. The majority of others are still in the assessment phase.

Affidavit #1 of H. Oldfield, para 27(c)

Affidavit #1 of D. Oldfield, para 5, Exh "A", para 10(c)

(j) In addition, as these contacts are just now coming to fruition, the assertion that Actew is the only significant customer is misleading. Efforts to develop (and reach) agreements with Ausgrid and Essential Energy are detailed in the Affidavit #1 of D. Oldfield, para 10. That those agreements are in their infancy in terms of sales levels is not the same as saying that they are not significant customers, who have been fully developed by Armor.

Affidavit #1 of D. Oldfield, para 10

(k) Despite site visits and hundreds of phone calls, no issue has been raised by RS Poles or Actew, either verbally or in writing to indicate that there was any concern whatsoever as to the performance of Armor, prior to these proceedings being commenced, specifically as it pertains to customer support or the issues raised herein

Affidavit #1 of H. Oldfield, para 29
Affidavit #1 of D. Oldfield, para 3(d)

(l) To the extent that there is any market available for the Product, Armor has been open to developing a relationship with any interested party. It has specifically sought out and answered each of the inquiries referenced by RS Poles as being directed to them.

Affidavit #1 of D. Oldfield, para 7-9

(m) But for the restructuring of RS Poles, and opportunity that it presented for Actew to seek an advantage, Armor has been consistently led to believe by Actew that Actew would be continuing to buy from them, and wished for Armor to participate in the tender process. There are a number of commercially reasonable reasons why Actew will accept Armor's tender if the contract is not disclaimed, causing no loss to RS Poles and suggesting that the conclusion that there is a risk is unfounded. These are fully detailed by Mr. Hugh Oldfield (para 28) and Mr. Doug Oldfied (Para 11-13). In addition, recent email exchanges between Actew and Armor support that Actew is pursuing Armor's tender. In fact, Armor has recently confirmed that it has been successful in its audit and accreditation (a pre-requisite for the tender).

Affidavit #1 of H. Oldfield, para 28 and 30
Affidavit #1 of D. Oldfield, para 11 to 13, Exh "C"

Financial Hardship caused by Disclaimer

25. Notwithstanding the above, the disclaimer of the Distribution Agreement is likely to cause significant financial hardship to Armor. In particular, Armor's profit from the Distribution Agreement represents 100% of the company's profit. Thus, the disclaimer will result in Armor shutting its doors and ceasing to do business

altogether. It will result in AAP operating at a shortfall and losing its profit altogether.

Affidavit #1 of H. Oldfield, para 31 – 33, 43

26. The effect of a shut down of Armor's business will also cause a financial burden upon AAP and, more importantly, 6 full time employees (that being approximately 24% of its workforce), will likely be terminated as AAP will no longer be required to provide management and office services for Armor.

Affidavit #1 of H. Oldfield, para 39

IV. ARGUMENT

27. Pursuant to section 32(1) of the CCAA, a debtor company, on notice in the prescribed form, may disclaim any agreement to which they are a party on the day on which the proceedings were commenced under the Act. However, such a counterparty is entitled to then apply to court for an order that the agreement not be disclaimed or resiliated.

28. Section 32(4) sets out the factors to be considered upon such an application:

> 32(4) **Factors to be considered** – In deciding whether to make the order, the court is to consider, among other things,
>
> (a) Whether the monitor approved the proposed disclaimer;
>
> (b) Whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> (c) Whether the disclaimer or resiliation would likely cause significant financing hardship to a party to the agreement.

29. Thus, as is the case for most CCAA applications, in considering whether the disclaimer ought to be prohibited, the court is required to weigh competing interests and prejudices to determine what is fair and reasonable.

30. Since the 2009 amendments to the CCAA were made and s. 32 as it now exists brought into force, there has not been a great deal of case law deciding these points. Unfortunately, the cases that have been decided are entirely

distinguishable on their facts, the most notable of which was that there was no argument whatsoever of financial hardship by the counterparty.

31. *Aveos Fleet Performance Inc.* 2012 QCCS 6799 involved the restructuring of Air Canada's maintenance department, following the Air Canada CCAA restructuring, which had resulted in Aveos' outsourcing of its human resources and payroll departments pursuant to a master services agreement with "NGA". There were a number of serious issues with NGA which lead to the conclusion that the "business relationship" had in fact failed prior to the CCAA. Further, Aveos sought to disclaim the contract under s. 32, because the services that Aveos required from NGA were changed dramatically or not required at all because Aveos' operations had ceased.

32. As noted, NGA's argument did not raise any evidence as to financial hardship. Rather, the argument rested merely on whether a plan would be filed, as the matter was a liquidating CCAA. The Court confirmed that the disclaimer does not have to be essential to a plan, but merely advantageous. As such, there is no need of "certainty" that there will be plan, only that the cancellation will be beneficial (at para 49).

33. In any event, the court was content to "rid Aveos of an expensive contract for a system that never functioned in a completely satisfactory manner and that, under the best of circumstances was inappropriate for a company... as the disclaimer could only enhance the possibility of an arrangement" (at par 48).

34. Armor does not dispute this conclusion, although does submit that where there is a liquidating plan, what "enhances" the plan must be looked at more critically. In balancing interests, it is likely more difficult to establish that a liquidating plan can be enhanced solely on the basis of a contract being disclaimed. In short, that conclusion ought to be based on more than a bare assertion being made by the company when the assets or shares of that company are being sold off, as there is then the inevitable question as to "who" will ultimately benefit from the contract's disclaimer, as it will likely be the purchaser, not the company.

35. Similarly, in *Timinco Ltd.,* 2012 ONSC 4471, the court considered the disclaimer of what was characterized as a "consulting agreement", but was found to be more in the nature of an agreement for "termination and/or retirement benefits" (at par 40). Mr. Timmins was the former CEO of the company who had entered an agreement after he retired, by which he was to receive a monthly amount of $29,166.66 over what he would have otherwise been entitled to on retirement, until his death, in exchange for being available for consultation. Timinco defaulted under the agreement immediately prior to the granting of the Initial Order. It was clear that Mr. Timmins did not provide any services after the date of the Initial Order. Thus, the court concluded that it was a pre-filing debt obligation that was compromised under the CCAA. The court then went on to consider the alternative argument related to the disclaimer in *obiter dicta* only (noting specifically that the comments were for the "assistance of the parties"). In any event, Mr. Timmins had in fact acknowledged that the disclaimer would not cause significant financial hardship to him, on a subjective basis.

36. As such, in both cases which have considered s. 32, the court was not actually required to balance the parties' competing interests, as financial prejudice was not alleged by the party whose contract was being disclaimed.

37. That is not the case at bar as the evidence above illustrates.

38. The British Columbia Supreme Court has considered a disclaimer based on similar evidence in *Doman Industries Ltd.* 2004 BCSC 733, a case decided prior to the 2009 amendments.

39. In *Doman* the company sought to disclaim replaceable timber licenses. In considering the approach to such disclaimers, the court preferred the rational adopted by Farley, J. in *Dylex Ltd.* [1995] O.J. No. 595 which "involves the court weighing the competing interests and prejudices in deciding what is fair and reasonable", noting that in most cases a company could establish the need to "downsize" by terminating contracts when an insolvency had been caused by

over-extension or continual losses, in which case the company may wish to "bring an end to the losing aspects of the business" (at para 33).

40. Armor submits that such a balancing is what was intended by the legislators in including the factors specifically set out s. 32(4)(b) and 32(4)(c), but that the question of whether the disclaimer enhances the viability of the plan, and the determination of whether or not the benefit of a disclaimer outweighs the prejudice, both must be viewed through the lens of the overriding objective of a restructuring to "bring an end to the losing aspects of the business" as noted by the Court.

41. Under that lens, as noted by Tysoe, C.J.:

> 35. ... there will be circumstances where it will not be appropriate to authorize the debtor company to terminate contracts. For example, suppose that a debtor company became insolvent because its business had been operating at a loss but market conditions had changed, and with a financial restructuring of its existing debt would be profitable in the future. Suppose further that the debtor company was party to a contract which did not cause the company to operate the relevant aspect of its business at a loss but the contract was not as favourable as the market would permit the company to obtain if it could divest itself of the existing contract. If the company could terminate the contract and enter into a new one with different rates, it could become substantially more profitable into the future. In these circumstances, it may well be inappropriate for the court to authorize the termination of the contract....
>
> [emphasis added]

42. In *Doman*, the court concluded that while Doman would be able to reduce costs (which logically means that a viable plan would be enhanced), that was not sufficient to justify the termination, noting that there was no evidence before the court to establish, among other things, the following:

(a) Whether the existing contracts had produced a loss or were expected to produce a loss;

(b) Whether other operations produced a greater loss;

(c) Whether other aspects of the business created a loss and what consideration had been given to rationalizing that loss in comparison to the termination of the contracts in question; and

(d) What parts of the constituency of stakeholders would benefit from the termination in questions.

43. The court concluded as follows:

> 38. In my opinion, therefore there is insufficient evidence for me to conclude that the proposed contract terminations are fair and reasonable in all of the circumstances. All that the evidence available to me supports is a conclusion that the restructured company will have an opportunity of being more profitable if the contracts are terminated. It has not been demonstrated that the loss of this opportunity will outweigh the prejudice will be suffered by Hayes and Strathcona if the contracts are terminated. In

44. The same can be said in the case at bar. Further to the comments at paragraph 23 above, there is no evidence that:

(a) The Distribution Agreement produces a loss to RS Poles. To the contrary, it appears on the evidence to be a profitable contract, generating sales of over 2000 poles.

(b) Whether other operations produced a greater loss, although that appears to be the logical conclusion given the financial status of RS Poles and that this contract is in fact profitable;

(c) What the rationalization is in disclaiming this profitable contract, rather than other non-profitable aspects of the operations; and

(d) What stakeholders will in fact benefit from the disclaimer, if any.

45. Instead, RS Poles relies simply on its conclusion that disclaiming this profitable contract may allow it to increase profit more, on the basis of speculation of what the market is in the Territory contemplated, and therefore may enhance the possibility of a viable plan.

46. Armor submits that the Notice of Disclaimer was likely issued at the suggestion of Actew who seeks to benefit financially from the lower pricing which can be obtained by buying directly from RS, and that RS is in agreement as it does provide a financial benefit to the stakeholders who will ultimately purchase the shares or assets under a credit bit. There is no evidence, however, that it will result in a benefit to the other creditors, as the purchase price is based upon a credit bid, on a formula already agreed to.

47. Providing benefits to parties that will be realized outside of the restructuring process is not in keeping with the purpose and intention of the disclaimer provisions of the CCAA.

48. Armor respectively submits that in these circumstances, RS Poles' speculation as to making itself more profitable as a basis to conclude that the possibility of a viable plan is enhanced, is not sufficient to overcome the significant prejudice to Armor, namely that:

(a) its business will cease entirely,

(b) its parent will lose significant revenue, resulting in the termination of approximately 24% of its workforce, and

(c) it otherwise, would be just reaching the point that it can capitalize on its 8 year marketing plan as implemented on behalf of RS Poles;

in respect of a contract for which there is no evidence to suggest is not otherwise profitable to RS Poles.

V. RELIEF SOUGHT

49. For the above reasons, armor seeks the following Orders:

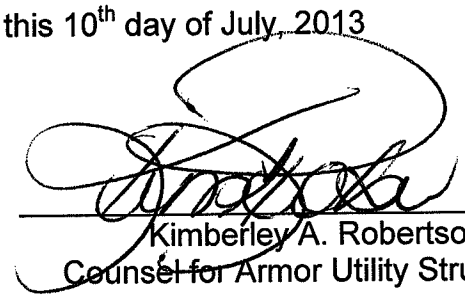
(a) An Order that the Distribution Agreement between RS Technologies Inc. and Armor Utility Structures Pty Limited (the "Distribution Agreement") is not to be disclaimed or resiliated.

(b) An Order that RS Technologies Inc. is precluded from entering into any supply or sale agreement directly with any customer located within the Territory covered by the Distribution Agreement.

(c) Such further and other relief as this counsel may request as ancillary to the relief sought herein, and this Honourable Court may deem appropriate.

(d) Costs of this application.

All of which is respectfully submitted this 10th day of July, 2013



Kimberley A. Robertson / Trevor Ference
Counsel for Armor Utility Structures Pty Limited

I. LIST OF AUTHORITIES

Tab	Description
Statutes Referenced	
1.	*Companies' Creditors Arrangement Act,* R.S.C. 1985 c. C-36, s. 32
Cases Referenced	
2.	*Aveos Fleet Performance Inc.* 2012 QCCS 6799
3.	*Doman Industries Ltd.* 2004 BCSC 733
4.	*Timinco Ltd.,* 2012 ONSC 4471

TAB 1

Companies' Creditors Arrangement Act (R.S.C., 1985, c. C-36)
Full Document: HTML | XML [230 KB] | PDF [518 KB]
Act current to 2013-06-10 and last amended on 2013-04-01. Previous Versions

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Delegation

31. (1) The Superintendent of Bankruptcy may, in writing, authorize any person to exercise or perform, subject to any terms and conditions that he or she may specify in the authorization, any of the powers, duties or functions of the Superintendent of Bankruptcy under sections 29 and 30.

Notification to monitor

(2) If the Superintendent of Bankruptcy delegates in accordance with subsection (1), the Superintendent or the delegate must give notice of the delegation in the prescribed manner to any monitor who may be affected by the delegation.

2005, c. 47, s. 131.

AGREEMENTS

Disclaimer or resiliation of agreements

32. (1) Subject to subsections (2) and (3), a debtor company may — on notice given in the prescribed form and manner to the other parties to the agreement and the monitor — disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer or resiliation.

Court may prohibit disclaimer or resiliation

(2) Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.

Court-ordered disclaimer or resiliation

(3) If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement be disclaimed or resiliated.

Factors to be considered

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

(*a*) whether the monitor approved the proposed disclaimer or resiliation;

(*b*) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and

(*c*) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

Date of disclaimer or resiliation

(5) An agreement is disclaimed or resiliated

(*a*) if no application is made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1);

(*b*) if the court dismisses the application made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1) or on any later day fixed by the court; or

(*c*) if the court orders that the agreement is disclaimed or resiliated under subsection (3), on the day that is 30 days after the day on which the company gives notice or on any later day fixed by the court.

Intellectual property

(6) If the company has granted a right to use intellectual property to a party to an agreement, the disclaimer or resiliation does not affect the party's right to use the intellectual property — including the party's right to enforce an exclusive use — during the term of the agreement, including any period for which the party extends the agreement as of right, as long as the party continues to perform its obligations under the agreement in relation to the use of the intellectual property.

Loss related to disclaimer or resiliation

(7) If an agreement is disclaimed or resiliated, a party to the agreement who suffers a loss in relation to the disclaimer or resiliation is considered to have a provable claim.

Reasons for disclaimer or resiliation

(8) A company shall, on request by a party to the agreement, provide in writing the reasons for the proposed disclaimer or resiliation within five days after the day on which the party requests them.

Exceptions

(9) This section does not apply in respect of

(*a*) an eligible financial contract;

(*b*) a collective agreement;

(*c*) a financing agreement if the company is the borrower; or

(*d*) a lease of real property or of an immovable if the company is the lessor.

2005, c. 47, s. 131; 2007, c. 29, s. 108, c. 36, ss. 76, 112.

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Date modified: 2013-06-27

TAB 2

2012 QCCS 6796

SUPERIOR COURT

Commercial Division

CANADA
PROVINCE OF QUÉBEC
DISTRICT OF MONTRÉAL
N°: 500-11-042345-120

DATE : November 20, 2012

PRESIDING : THE HONOURABLE MARK SCHRAGER, J.S.C.

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

AVEOS FLEET PERFORMANCE INC. /
AVEOS FLEET PERFORMANCE AÉRONAUTIQUE INC.
Insolvent Debtor/Petitioner

and

AERO TECHNICAL US, INC.
Insolvent Debtor

and

FTI CONSULTING CANADA INC.
Monitor

and

NORTHGATEARINSO CANADA INC.
Petitioner

and

CREDIT SUISSE AG CAYMAN ISLANDS BRANCH
Secured creditor

JS 1319

JUDGMENT

INTRODUCTION

[1] Aveos Fleet Performance Inc. ("Aveos") is subject to an order under the *Companies' Creditors Arrangement Act* ("C.C.A.A.")[1] It has sold or seeks to sell all of its assets and is not operating its business. Can it invoke Section 32 C.C.A.A. to cancel an executory contract? This is the principal issue before this Court.

FACTS

[2] Aveos and its related entity, Aero Technical US, Inc. (collectively, the "debtors") applied for and this Court issued an initial order under the C.C.A.A. on March 19, 2012. A stay was issued until April 5, 2012, at that time and has subsequently been extended. F.T.I. Consulting Canada Inc. was named monitor. The record of the Court and particularly the orders and reasons of the undersigned indicate that in the hours following the initial order, the entire board of directors (but one) of Aveos resigned. Most of the remaining employees (i.e. those who had not been laid off prior to the C.C.A.A. filing) were laid off immediately following the initial order and the day-to-day operations of Aveos were shut down.

[3] The remaining director signed the affidavit in support of a Motion Seeking the Appointment of a Chief Restructuring Officer ("C.R.O."), in virtue of which Mr. Jonathan Solursh of the firm R.e.l. Consulting Group, an independent consultant, was named C.R.O. and has acted in such capacity since then. The remaining director resigned following such appointment.

[4] Much time and effort were spent in the month following the filing with the emergency situations of a company not having sufficient cash to operate in the normal course, being in possession of property claimed by third parties and having 2800 former or present employees owed millions of dollars in the aggregate. Nevertheless, the C.R.O. quickly concluded with the support of the Monitor that Aveos had to be sold.

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[1] R.S.C. 1985, c. C-25

[5] On April 29, 2012, this Court issued an order approving the "Divestiture Process" put forward by the C.R.O. in virtue of which Aveos was offered for sale. The C.R.O. determined that Aveos' three (3) divisions (i.e. engines, components and air frames) should be marketed with a view to separate sales as it was unlikely that anyone would purchase all three (3) divisions. The C.R.O. believed that the value could be maximized by seeking to split Aveos into three (3) enterprises although there was no impediment to any one person acquiring all three (3) divisions. It was certainly hoped that all three (3) divisions would be sold on a going concern basis and would recommence operations and this in the interest of all stakeholders.

[6] As the Court record indicates, at no time did any party bring a motion to end the stay period with a view to petitioning Aveos into bankruptcy.

[7] The C.R.O. and Monitor have reported on an ongoing basis and also gave evidence in the present matter before the undersigned. The Divestiture Process has given rise to over 10 transactions. Unfortunately, only one sale (for the components division) has been made on a going concern basis where approximately 200 jobs should be conserved. However, and significantly, although the process of seeking bids has ended, the C.R.O. and the Monitor testified before the undersigned that a "latecomer" has appeared, and is performing a due diligence investigation with a view to making an offer to acquire the engine maintenance division of Aveos. The engine maintenance equipment remains in the hands of a liquidator but the scheduled auction has now been postponed. The interested party is in the same type of business, so that the tax losses of Aveos may have value as part of the transaction and this could potentially lead to the filing of a plan of arrangement with some benefit for unsecured creditors. Though the engine maintenance contract with Air Canada was sold as part of the Divestiture Process, it represented approximately 55 % of the engine maintenance business. Accordingly, there is a potential value in the business enterprise beyond the liquidation value of the tangible assets.

[8] Against this status update of the C.C.A.A. file is the dispute between Aveos and the present Petitioner, Northgatearinso Canada Inc. ("N.G.A.").

[9] Aveos was created as a result of the C.C.A.A. restructuring of Air Canada. It was the former maintenance department of Air Canada. Initially, it depended on Air Canada's support for payroll and human resources. As part of the process of separating Aveos from Air Canada, Aveos sought to outsource its human resources and payroll departments. To this end, a process to select a service provider was put in place. The goal of Aveos

was to have a completely outsourced human resources and payroll system that would include computer access for employees through a portal where they could access their files and view their status (e.g. benefit accruals) and even input information (e.g. change beneficiaries in insurance plans). The service would include a call center to handle employee questions.

[10] The establishment of the system had many challenges and complicating factors, such as the fact that some Aveos' personnel were Air Canada's employees that had been seconded to Aveos.

[11] Originally, an operating system completely independent from Air Canada and its services providers was targeted for autumn 2010. This date was extended due to extraneous considerations to July 14, 2011, which was fortunate given all of the developmental problems experienced as will be addressed below.

[12] The "Global Master Services Agreement" ("G.M.S.A.") with N.G.A. was signed between Aveos and N.G.A. in January 2011. By the time of the C.C.A.A. filing in March 2012 not all outstanding operational issues had been resolved. The relationship was fraught with frustration on both sides. Aveos felt that N.G.A. took too long to install systems and was unable to provide certain services altogether. Costs ran over those stipulated in the G.M.S.A. for services not covered under the agreement. All of this caused Aveos to lose confidence in N.G.A.

[13] N.G.A. was frustrated by the ongoing changes in Aveos management personnel charged with the implementation of the system, so that from N.G.A.'s point of view, once it finally "educated" one member of the Aveos team he she was replaced so that Aveos throughout did not fully understand what the system was designed to do, and by extension, what the system could not do.

[14] Aveos felt that N.G.A. as the expert should tell it not merely what was needed, but what was missing in the system to address Aveos' needs. Instead, the Aveos' personnel in charge learned piecemeal that features that they wanted or needed were not available or at least not included in the contract price. This situation was severe enough to cause Aveos to engage the services of Deloitte at the beginning of 2012 as a consultant to help Aveos resolve the continuing issues arising during implementation of the services to be provided by N.G.A. under the G.M.S.A.

[15] N.G.A. felt not only did Aveos fail to understand the system, but it provided incomplete or incorrect data to N.G.A. for input and thus further complicated matters.

[16] The problems with N.G.A. were such that Aveos has sought cancellation of the G.M.S.A. not only under Section 32 C.C.A.A. but also Aveos seeks resiliation for cause pursuant to the law of contracts generally based on N.G.A.'s alleged faulty execution of its obligations.

[17] The level of frustration existing between N.G.A. and Aveos continued after the C.C.A.A. filing. The lay-offs and the shut down of day-to-day operations required services not contemplated by the G.M.S.A. Obtaining such services in a timely manner from N.G.A. was the subject of ongoing extensive and tense negotiations over a period of approximately one month. Aveos was now represented by the C.R.O. and his staff with the support of the Monitor.

[18] Before the undersigned, the representative of the Monitor diplomatically described the situation between N.G.A. and Aveos prior to the C.C.A.A. filing as a "failed business relationship". Unfortunately, the situation did not improve during the post-filing period.

[19] Upon learning of the initial filing under the C.C.A.A., N.G.A. communicated with Aveos. The thrust of N.G.A.'s written and verbal communications were either a refusal to continue services under the existing contract and seeking assurance of payment going forward (according to Aveos) or a request as to what would be required given the change of operations and personnel as described above (according to N.G.A). There followed a series of exchanges including numerous conference calls which gave rise, in succession, to three Memoranda of Understanding dated March 26, April 10 and April 13, 2012 which outlined the services to be provided by N.G.A. to Aveos and the pricing in respect thereof.

[20] Aveos had payroll needs because 120 employees had been recalled. Also payroll periods which fell on both sides of the C.C.A.A. filing date required special attention. Certain "claw-back" amounts previously set off against amounts due to employees had to be paid post-filing. Records of employment had to be issued in order for employees to be able to claim benefits from the government unemployment insurance program.

[21] Other ongoing services under the G.M.S.A. were obviously not required as Aveos' operations were not continuing as had been the case prior to the C.C.A.A. filing.

[22] From N.G.A.'s point of view, the demands being made by Aveos were exorbitant mainly because the time delays were extremely aggressive. Many of the services requested were not what the system was designed to do. For example, records of employment resulting from mass layoffs were

not designed into the system, nor were reversing deductions from past pay periods and ledgering these reversals in the former pay period already closed for purposes of data entry. The system had to be (re-)designed to accommodate these needs.

[23] From the C.R.O's point of view, N.G.A.'s performance failures experienced by Aveos pre-filing now continued into the post-filing period. N.G.A.'s difficulty to meet tight time deadlines imposed by the C.C.A.A. circumstances and the exorbitant pricing made it such that Aveos, through the C.R.O., sought and engaged an alternate payroll service provider as of May 1st, 2012. The price for a one-year contract albeit encompassing far less extensive services than those under the G.M.S.A., is one-half of N.G.A.'s monthly fee. Indeed, the representative of the C.R.O. testified that the exorbitant pricing under the three (3) Memoranda of Agreement was only accepted because there was no alternative at that time. As such, $240,000.00 was paid by Aveos to N.G.A. for the 4-week period between the end of March and the end of April 2012.

[24] In one instance, where the payroll included the reversal of amounts previously set off, N.G.A. could not produce the work product at all or at least on time such that the C.R.O. organized staff to produce 800 pay cheques manually. Moreover, the data in question was entered into the database by N.G.A. in the current as opposed to the old, pre-filing period in consideration of which the payments were being made. This caused Services Canada to question whether the employees were indeed eligible for Unemployment Insurance ("UIC") benefits. Apparently, much energy was expended in order to correct this situation and the results were additional delays for employees to receive their UIC benefits.

[25] Effective May 1st, 2012, Aveos gave notice to N.G.A. that it was cancelling the G.M.S.A. and the three (3) Memoranda of Agreement for faulty performances both pre and post-filing. Alternatively, Aveos took the position that it was cancelling and repudiating the agreements pursuant to its rights to do so under Section 32 C.C.A.A. N.G.A. claims $501,381.00 which is the indemnity provided by the G.M.S.A. where cancellation is for "convenience", i.e. without cause. N.G.A. also claims the sum of $91,377.00 for unpaid services rendered under the three (3) Memoranda of Agreement.

[26] Crédit Suisse, the secured creditor, has taken the position that whatever sums might be due to N.G.A., they fall within the definition of "claim" in Sections 2 and 19 C.C.A.A. and are not post-filing claims as postulated by N.G.A. Thus, any payment would be subordinate to the rights of Crédit Suisse.

ISSUES

[27] Is Section 32 C.C.A.A. available to Aveos as a means to resiliate or cancel the G.M.S.A.?

[28] Aside from Section 32 C.C.A.A., does Aveos have the right to resiliate the G.M.S.A. because of the alleged faulty execution by N.G.A. of its obligations there under?

[29] Does N.G.A. have the right to claim the cancellation indemnity of $501,381.00 foreseen by the G.M.S.A.? If so, is the amount due immediately by Aveos as a claim arising after the C.C.A.A. filing, and as such not subject to the stay of proceedings? In the alternative, is the amount due but subject to be treated as a (pre-filing) ordinary or unsecured claim to be dealt with under an arrangement, if any, or a bankruptcy?

[30] Is the sum of $91,377.00 due immediately for services rendered by N.G.A. to Aveos after the C.C.A.A. filing?

POSITION OF N.G.A.

[31] N.G.A. contends that Section 32 C.C.A.A. does not apply in the circumstances where Aveos ceased to carry on business, is being liquidated and as such will not propose an arrangement to its creditors. N.G.A. argues that Section 32(1)(b) C.C.A.A. does not apply to such a scenario. The purpose of Section 32 C.C.A.A. is to allow a debtor company to rid itself of contractual obligations which are an impediment to an arrangement. Where no arrangement will be filed, Section 32 C.C.A.A. should not apply according to N.G.A.

[32] Moreover, since the G.M.S.A. contains a provision allowing for cancellation without cause, such recourse must be used before reverting to a statutory mechanism to seek cancellation of the contract. In other words, according to N.G.A., Aveos must pay the stipulated cancellation penalty of $501,381.00 to achieve cancellation in such manner rather than having recourse to Section 32 C.C.A.A.

[33] The resiliation of the G.M.S.A. for faulty execution is not available to Aveos because on the facts of the case, N.G.A. is not at fault having fulfilled its contractual obligations at all relevant times.

[34] The $501,381.00 cancellation penalty is not a claim provable within the meaning of the C.C.A.A., but rather is a post-filing claim. This claim arises from the unilateral cancellation of the G.M.S.A. by Aveos after the

C.C.A.A. filing. N.G.A. continued to render services after the filing albeit in a modified manner, at Aveos' request and in order to respond to Aveos' needs in the situation as it unfolded after the C.C.A.A. filing. On or about May 1st, 2012, approximately five (5) weeks after the C.C.A.A. filing, Aveos cancelled the G.M.S.A. and as such the obligation of Aveos to pay the penalty of $501,381.00.00 arose after the filing. Consequently, it is not a provable claim, but rather an amount arising and payable after the C.C.A.A. filing.

[35] Similarly, the $91,377.00 representing charges for services rendered after the filing, and at the request of and as agreed with Aveos, are currently due. This is not a claim provable to be dealt with under an arrangement, according to N.G.A. As such, it should be paid by Aveos immediately, as were the other amounts for services rendered after the C.C.A.A. filing, the whole as pleaded by N.G.A.

DISCUSSION

[36] Section 32 C.C.A.A. provides a mechanism for a debtor company to "disclaim or resiliate" agreements to which it is a party at the time of the initial C.C.A.A. filing. This disclaimer is achieved by notice given by the debtor to the co-contracting party.

[37] The debtor company's notice to disclaim may be contested by the other party to the contract as N.G.A. has done in the present case. It then falls upon the Court to make (or not) an order of disclaimer :

[38] Section 32(4) C.C.A.A. provides as follows :

> "Factors to be considered
>
> In deciding whether to make the order, the court is to consider, among other things,
>
> a) whether the monitor approved the proposed disclaimer or resiliation;
>
> b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement."

[39] On the face of the drafting of Section 32(4) C.C.A.A., the matters listed are not an exhaustive enumeration of the matters that this Court may consider in deciding whether to approve the cancellation of a contract where the notice is contested.

[40] Section 37(4)(c) C.C.A.A. is not in issue in these proceedings because N.G.A. did not allege nor prove any financial hardship arising from the G.M.S.A. There is the obvious lack of revenue stream when the contract is cancelled (approximately $80,000.00 per month), but it was not contended that the loss of this, *per se* constituted, in this particular case, the "financial hardship" to which subparagraph (c) refers.

[41] Section 32(4)(b) C.C.A.A. addresses the issue of whether the cancellation of the contract would "enhance the prospects of a viable" arrangement being made.

[42] The Monitor filed a report and its representative, Ms. Toni Vanderlaan, testified before the undersigned.

[43] The Monitor confirmed that it had approved the proposed cancellation of the G.M.S.A. as foreseen by Section 32(4)(a) C.C.A.A. In so doing, the Monitor considered the cost of continuing the G.M.S.A., which as indicated above represents approximately $80,000.00 per month prior to the C.C.A.A. filing. The alternate provider engaged by Aveos after May 1st (Ceridian), was considerably cheaper at $40,000.00 per year albeit that the scope of the service under the G.M.S.A. provided by N.G.A. was much broader than those provided by Ceridian. In any event, the Monitor determined that the G.M.S.A. was far too expensive given the cash position of Aveos and its payroll and human resources needs in any scenario post C.C.A.A. filing.

[44] In addition to cost, the Monitor concluded that cancelling the G.M.S.A. would enhance the prospect of filing an arrangement. The Monitor underlined that not merely was the G.M.S.A. expensive, but it was undesirable. As stated above, Ms. Vanderlaan summarized the relations between N.G.A. and Aveos at the time of the C.C.A.A. filing as a "failed business relationship". It is clear to the Court that the systems provided by N.G.A. either did not do what they were supposed to do or if they did do what they were supposed to do, then there was a breakdown in communication between N.G.A. as service provider and Aveos as consumer as to what the requirements of Aveos were.

[45] The representative of N.G.A., Mr. Latulippe, referred on a number of occasions to the fact that the representatives of Aveos responsible for the negotiation and implementation of the G.M.S.A. with N.G.A. did not properly

understand what the system was designed to do. This may have been so, but it became evident during the hearing before the undersigned that N.G.A. was lacking in its ability both before and after the C.C.A.A. filing to understand its client's needs and to address them adequately or where that was not possible to explain such inability in a timely and comprehensible fashion. It was therefore not conceivable that Aveos could use the G.M.S.A. going forward because of all of the problems associated with it.

[46] Moreover, the system described in the G.M.S.A. was designed for a company with approximately 3,000 employees. After the C.C.A.A. filing, Aveos only had a fraction of that number on a descending basis. Since the Divestiture Process was based on the premise that no one acquirerer would seek to purchase all three (3) divisions of Aveos, then any possible purchasers would not want the contract based purely on the number of employees. Aside from such consideration, the system did not work very well and the likelihood was that any acquirerer would be an operator in the industry and already have its own payroll and human resources systems in place. The sale or assignment of the G.M.S.A. as part of a sale of assets was not an alternative in the view of the Monitor even absent all the problems experienced by Aveos with the system. Thus, in any possible scenario, the G.M.S.A. was of no use to Aveos and could not enhance, in any scenario, the making of an arrangement.

[47] However, and as stated above, N.G.A. contends that cancellation under Section 32 C.C.A.A. is not available because Section 32(4)(b) C.C.A.A. does not apply. According to N.G.A., there is no discussion to be had about the prospect of an arrangement since early on in the C.C.A.A. process, Aveos shut down its normal operations and went into liquidation mode. Thus, no plan of arrangement will be made, so that an essential element for the application of Section 32 C.C.A.A. is not met according to N.G.A.

[48] The text of Section 32(4)(b) C.C.A.A. does not impose as a condition for resiliation that there be a plan of arrangement or even the certainty that there will be a plan of arrangement filed. Rather 32(4)(b) C.C.A.A. requires that the cancellation of the G.M.S.A. enhance the prospects of a viable arrangement. It is clear from the Monitor's analysis referred to above that the cancellation would rid Aveos of an expensive contract for a system which never functioned in a completely satisfactory manner, and that under the best of circumstances was inappropriate for a company with less than 2,800 employees, and where the relationship with the service provider (both pre and post C.C.A.A. filing) had failed. Viewed in this way, the disclaimer could only enhance the possibility of an arrangement.

[49] It is accepted by the case law that the disclaimer need not be essential but merely advantageous to a plan [2]. There need not be any certainty that there will be a plan of arrangement but just that cancellation of the contract in question would be beneficial to the making of a plan.

[50] Section 32 C.C.A.A. applies even where there is a sales process in place as is the situation with Aveos [3]. Prior to Section 36 C.C.A.A. coming into force in 2009, it was broadly accepted that liquidating while under C.C.A.A. protection was not contrary to the Act.[4] Now, Section 36 C.C.A.A. explicitly provides for sales out of the ordinary course of business, with Court approval.

[51] A sales process, particularly when assets are offered on a going concern basis together with intangible property (e.g. customer contracts) can lead to a result where one or several operating business entities similar to those operated by the debtor pre C.C.A.A. filing, continues after the C.C.A.A. process is completed. The ability to file an arrangement can largely be a function of the sales proceeds received and the amounts available to different stakeholders, particularly secured creditors. The point is that the existence of a sales process or "liquidation" does not *per se* mean that an arrangement is not a possibility. The fact that Aveos ceased operations was a function of cash (or the lack thereof), but the sales process was specifically designed to enhance the possibility of going-concern sales. Indeed, the timetable was short, specifically so as to limit the deterioration of critical mass of such things as customer base and labour pool. Despite the fact that only one division (components) of Aveos was sold on a going concern basis through the process, the C.R.O. testified at the hearing that a new prospective purchaser had come forward to possibly purchase the engine maintenance center together with tax losses arising from Aveos' operations. This could result in a plan of arrangement being filed with benefit for unsecured creditors.

[52] Accordingly, in the view of this Court, the shutdown of Aveos' normal operations and the implementation of a sales process does not in itself, eliminate the application of Section 32 C.C.A.A. as argued by N.G.A.

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[2] *Timminco Limited (Re)*, 2012 ONSC 4471 at par. 52 to 57; *Boutique Jacob inc. (Arrangement relatif à)*, 2011 QCCS 276 at par. 38 to 41 and 46; *Homburg Invest inc. (Re)*, 2011 QCCS 6376 at par. 103-106; *9145-7978 Québec inc. (arrangement relatif à)*, 2007 QCCA 768 at par. 26 to 29.

[3] *Timminco Limited* (Re), op.cit, at par. 52-27

[4] *Sproule vs. Nortel Networks Corporation 2009 ONCA 833; First Leaside Wealth Management Inc. (Re)*, 2012 ONSC 1299; *PCAS Patient Care Automation Services Inc. (Re)*, 2012 ONSC 3367; *Brainhunter Inc. (Re)*, (2009) 62 C.B.R. (5th) 41 (ONSC); *Anvil Range Mining Corp. (Re)*, (2002) 34 C.B.R. (4th) (ONCA)

[53] As indicated above, the undersigned has considered the evidence of the C.R.O. with respect to the late bidder. C.C.A.A. issues generally must be decided in "real time" if for no other reason so as to achieve the broad remedial purpose of the legislation[5] of providing a means for financially-strapped enterprises to correct problems and continue in business. This is all the more so in a process such as the Aveos Divestiture Process where the parties' business judgment dictates that the debtor be offered for sale but the parties do not know ahead of time what the outcome of such process will be. The situation evolves constantly and rapidly. The Court's decisions along the way cannot be frozen in time lest those decisions be unrealistic and unhelpful to the process. In any event, even if the undersigned only considered the facts as they were at the date of the notice to disclaim the G.M.S.A. as urged by N.G.A., the undersigned would still be of the opinion that Section 32 C.C.A.A. is available to Aveos for the reasons given above pertaining to the interpretation of Section 32 C.C.A.A.

[54] N.G.A. also submitted that since the G.M.S.A. contains a mechanism to cancel where cancellation for cause under the common law of contracts is not available, then Section 32 C.C.A.A. cannot apply. The argument put forward by N.G.A. is based on the decision in the matter of Hart Stores [6] where Mongeon, J.S.C. held that Section 32 C.C.A.A. did not apply to the cancellation or termination of verbal contracts of employment having no fixed term.

[55] The reasoning in that case was that the mechanism in Section 32 C.C.A.A. was inappropriate to cancel a verbal contract of indeterminate term where the law (Article 2091 of the Civil Code of Québec) provided a mechanism for unilateral cancellation. In this Court's opinion that reasoning does not apply to a written service agreement of determinate term such as the G.M.S.A.

[56] Moreover taken to its logical conclusion, the argument is not really of any help to N.G.A. for the following reason. If Aveos could not rely on Section 32 C.C.A.A. and was obliged to rely on the cancellation for convenience clause in the G.M.S.A., the penalty of $501,381.00 would nonetheless constitute a provable claim payable under an eventual plan of arrangement or bankruptcy.

[57] "Claim" is defined in Section 2 of the C.C.A.A. by reference to the *Bankruptcy and Insolvency Act* ("B.I.A.") [7]. Section 19 C.C.A.A. introduced

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[5] *Century Services Inc. vs. Canada (Attorney General),* [2010] 3 S.C.R. 379
[6] Re *Hart Stores Inc.*, 2012 QCCS 1094
[7] R.S.C. *c.* B.-3

in the 2007 amendments which came into force in 2009, includes in claims that can be dealt with under a plan of arrangement the following:

> "19.(1)(*b*) claims that relate to debts or liabilities, present or future, to which the company may become subject before the compromise or arrangement is sanctioned by reason of any obligation incurred by the company before the earlier of the days referred to in subparagraphs (*a*)(i) and (ii)."

This is precisely the situation with the cancellation indemnity claimed by N.G.A. in this case. Though Aveos may have triggered the cancellation penalty after the C.C.A.A. filing, the obligation stems from a contract to which it was bound pre-C.C.A.A. filing.

[58] The claim for the cancellation penalty would also be a claim provable in a bankruptcy (see Section 2 and Section 121 of the *B.I.A.* which are substantially similar to Section 19 C.C.A.A.).

[59] Accordingly, in any and all scenarios, the $501,381.00 claimed by N.G.A. for the cancellation indemnity would be a claim provable and would not have the status of a "post-filing claim" payable immediately, i.e. prior to the claims of other creditors.

[60] The Courts have said on numerous occasions that pre-filing creditors cannot under the guise of making a post-filing claim, obtain a preference over other creditors. [8] This applies even to employees for severance claims arising from termination of employment after the C.C.A.A. filing [9]. The equitable treatment of creditors' demands that claims for contractual damages arising from the termination of contracts after filing under the C.C.A.A. be treated on a par with other provable claims [10].

[61] Consequently, N.G.A.'s argument based on the cancellation of the G.M.S.A. without cause after the C.C.A.A. filing date is not helpful to N.G.A., since even if correct, the argument would give rise to a claim provable only.

[62] Moreover, the parties cannot write out part of the C.C.A.A. from contracts. [11] This is against public policy. Parties to a contract cannot exclude in advance the application of the C.C.A.A. It would be offensive to the wording of Section 32 and the C.C.A.A. in general if Section 32 C.C.A.A. could not achieve its purpose as a result of the drafting of the contract which

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[8] *Pine Valley Mining Corporation (Re),* 2008 B.C.S.C. 368 para. 37-42; *Canwest Global Communications Corp. (Re),* 2010 O.N.S.C. 1746, para. 29-31, 33-35

[9] *Canwest Global Communications Corp. (Re),* op.cit.

[10] *Timminco Limited (Re*), op.cit., para. 44

[11] Section 8 C.C.A.A.

the debtor sought to cancel. This would defeat the rehabilitative purpose of the C.C.A.A. and thus would be contrary to the public policy of the C.C.A.A.

[63] Consequently, Section 32 C.C.A.A. is available to Aveos in order to cancel the G.M.S.A. The appropriate order will issue.

[64] Because of the manner in which the Court has answered the first issue set forth hereinabove (i.e. the application of Section 32 C.C.A.A.) it is not necessary to analyse whether Aveos could cancel the G.M.S.A. for cause because of alleged faulty execution by N.G.A. in virtue of the law of contracts generally.

[65] Regarding the $501,381.00 cancellation indemnity, the following should be added. Section 32(7) C.C.A.A. provides that any loss suffered in relation to the disclaimer is a provable claim. The Court renders no judgment on whether the amount of any such claim is $501,381.00 or any other amount in the circumstances. That will have to be determined at a later date, if necessary.

[66] The final issue requiring determination is the matter of N.G.A.'s claim for $91,377.00 for system maintenance. This amount represents the fee of $10,153.00 per week stipulated in the memorandum of understanding of April 13th. Such an amount was paid for the period up to the end of April 2012. The $91,377.00 represents $10,153.00 per week for the 9-week period commencing April 30, 2012, i.e. the expiry of the term of the last memorandum of understanding.

[67] N.G.A. needed the data maintained in the system to complete the records of employment ("R.O.E.") for each of the employees. It had contracted to make "best efforts" to complete those R.O.E.s by April 28, 2012. Mr. Latulippe, N.G.A.'s representative, testified that N.G.A. completed all of the R.O.Es by April 28th, except for 50 which were problematic and could not be completed until the end of June. Accordingly, N.G.A. required the data to be maintained until that time. He conceded that there was no explicit agreement in place after April 30, 2012 for Aveos to pay such weekly system maintenance fee.

[68] Even though N.G.A. only contracted to make best efforts to complete the R.O.E.s before April 28th, if N.G.A. needed to maintain the data in the system after April 28th, it was not justified, without Aveos' consent, to charge the $10,153.00 per week to maintain the data in the system. The "best efforts" clause may have attenuated N.G.A.'S obligation to complete by April 28th but did not impose an obligation on Aveos after that date without its consent. It had been agreed after the C.C.A.A. filing that the services to be provided by N.G.A. and paid for by Aveos were set

forth in the memoranda of understanding. There was no obligation to pay for system maintenance after April 28th.

[69] The Court adds that the fact that the cancellation of the G.M.S.A. takes effect according to Section 32(5) C.C.A.A. on the 30th day following Aveos' notice of May 7, 2012 does not entitle N.G.A. to charge for services under the M.G.S.A. not provided nor for services not agreed to under the memoranda of understanding. Accordingly, the claim for $91,377.00 will be denied.

FOR ALL OF THE FOREGOING REASONS, THE COURT :

[70] **DISMISSES** Northgatearinso Canada Inc.'s "Amended Motion to Strike *De Bene Esse* Notice by Debtor Company to Disclaim or Resiliate an Agreement and for Payment of Post-filing Obligations", dated July 9, 2012;

[71] **DECLARES** and **ORDERS** resiliated as of June 6, 2012 the following agreement, namely: "Global Master Services Agreement" between Aveos Fleet Performance Inc. and Northgatearinso Canada Inc. dated June 30, 2010 as amended from time to time including, *inter alia*, by subsequent Memoranda of Agreement".

[72] THE WHOLE with costs against Northgatearinso Canada Inc.

Montreal, November 20, 2012

MARK SCHRAGER, J.S.C.

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Mtre. Sylvain Rigaud
Norton Rose Canada LLP
Attorneys for FTI Consulting Canada Inc.
Monitor

Dates of Hearings: September 28, October 18, 19 and 30, 2012

TAB 3

2012 CarswellOnt 10568, 2012 ONSC 4471, 93 C.B.R. (5th) 326, 222 A.C.W.S. (3d) 932

2012 CarswellOnt 10568, 2012 ONSC 4471, 93 C.B.R. (5th) 326, 222 A.C.W.S. (3d) 932

Timminco Ltd., Re

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 Timminco Limited and Bécancour Silicon Inc. (Applicants)

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: June 4, 2012
Judgment: August 3, 2012
Docket: CV-12-9539-00CL

Counsel: Maria Konyukhova for Applicants

Robin B. Schwill for J. Thomas Timmins

Steven J. Weisz for Monitor

Debra McPhail for Superintendent of Financial Services

Thomas McRae for B51 Non-Union Employee Pension Committee and B51 Union Employee Pension Commit- tee

Charles Sinclair for United Steelworkers

James Harnum for Mercer Canada

Subject: Insolvency

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Proceedings subject to stay — Miscellaneous

T resigned from his position as CEO of T Inc. in May 2001 but remained director until mid-2007, at which time he resigned from board and sold all of his remaining equity interests — Pursuant to 1996 consulting agreement, T Inc. was to provide T with monthly payment of $29,166.66 less amount due to T under any pension or retirement plan — At time of T's resignation as CEO, 1996 agreement was amended by letter agreement pursuant to

which T was to receive monthly amount of $20,833.33 — T brought motion for order requiring T Inc. to comply with 1996 agreement — T Inc. brought cross-motion for order that its obligations under 1996 agreement, as amended by letter agreement, were pre-filing obligations stayed by initial order granted in reorganization proceedings — Motion by T was dismissed; cross-motion by T Inc. was granted — Benefits conferred on T were, in substance, termination and/or retirement benefits, and as such were unsecured claims — T Inc. was insolvent and not able to honour its obligations to all creditors — If benefits conferred on T were not stayed, T would, in effect, receive enhanced priority over other unsecured creditors, contrary to scheme and purpose of Companies Creditors Arrangement Act — Overriding objective of CCAA was to ensure that creditors in same classification were treated equitably, which would enhance prospects of viable compromise or arrangement being made in respect of debtor company — Disclaimer of agreement with T, if necessary, was fair, reasonable, advantageous, and beneficial to T Inc. restructuring process — Court could not conclude that disclaimer would likely cause significant financial hardship to T.

Cases considered by *Morawetz J.*:

Fraser Papers Inc., Re (2009), 2009 CarswellOnt 4469, 55 C.B.R. (5th) 217, 2009 C.E.B. & P.G.R. 8350, 76 C.C.P.B. 254 (Ont. S.C.J. [Commercial List]) — referred to

Homburg Invest Inc., Re (2011), 2011 QCCS 6376, 2011 CarswellQue 13411 (Que. Bktcy.) — considered

Indalex Ltd., Re (2009), 2009 CarswellOnt 4465, 55 C.B.R. (5th) 64, 79 C.C.P.B. 104 (Ont. S.C.J. [Commercial List]) — referred to

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 3583, 55 C.B.R. (5th) 68, 75 C.C.P.B. 233 (Ont. S.C.J. [Commercial List]) — referred to

Nortel Networks Corp., Re (2009), 256 O.A.C. 131, 2009 CarswellOnt 7383, 2009 ONCA 833, 59 C.B.R. (5th) 23, 77 C.C.P.B. 161, (sub nom. *Sproule v. Nortel Networks Corp.)* 2010 C.L.L.C. 210-005, (sub nom. *Sproule v. Nortel Networks Corp., Re)* 99 O.R. (3d) 708 (Ont. C.A.) — considered

Statutes considered:

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

Generally — referred to

s. 11 — considered

s. 32 — considered

s. 32(2) — considered

s. 32(4) — considered

s. 32(4)(b) — considered

MOTION for order requiring company to comply with agreement providing retirement benefits towards former CEO; MOTION by company for order that its obligations under agreement were pre-filing obligations stayed by initial order in reorganization proceedings.

Morawetz J.:

Overview

1 Mr. J. Thomas Timmins, a former Chief Executive Officer ("CEO") of Timminco Limited ("Timminco") moves for an order that Timminco be ordered to comply with its obligations under a consulting agreement between Timminco and Mr. Timmins dated September 19, 1996 (the "1996 Agreement") and to remit to Mr. Timmins the monthly amounts that he claims to be entitled to under the 1996 Agreement.

2 In response, Timminco brought a cross-motion for an order declaring that Timminco's obligations under the 1996 Agreement, as amended by letter agreement effective May 28, 2011 (the "Letter Agreement" and, together with the 1996 Agreement, the "Agreement"), constitute pre-filing obligations which are stayed by the Initial Order granted in these proceedings on January 3, 2012.

3 Alternative positions have also been presented by the parties.

4 Timminco puts forth the alternative that, if Mr. Timmins' motion is granted, Timminco seeks an order that the 1996 Agreement be disclaimed in accordance with section 32 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA") and that the effective date of the disclaimer of the Agreement (if such a disclaimer is held to be required) should be April 30, 2012.

5 In response to this alternative position, Mr. Timmins seeks an order that the court deny Timminco's request to have the 1996 Agreement disclaimed and, in any event, if the 1996 Agreement is disclaimed, Timminco should not be relieved of its obligation to pay the monthly fees that have and continue to accrue from the date Timminco commenced CCAA proceedings until the date that any such disclaimer is effective.

6 Mr. Timmins asks that the court deny Timminco's request to have the 1996 Agreement disclaimed in accordance with section 32 of the CCAA as the disclaimer would not necessarily enhance the prospects of a viable arrangement being made in respect of Timminco, and would objectively result in significant financial hardship to Mr. Timmins.

Facts

7 Mr. Timmins resigned from his position as CEO on May 28, 2001, but remained a director of Timminco until mid-2007, at which time he resigned from the board and sold all of his remaining equity interests.

8 The preamble to the 1996 Agreement provides:

> The Consultant is an executive of the Corporation who has gained such a level of knowledge, experience and competence in the Corporation's business that it is in the Corporation's interest, following his retirement from employment, to ensure that the Corporation continues to have access to the Consultant for advice and consultation and the Corporation wishes to ensure that the Consultant shall not engage in activities which are competitive with the Corporation's business.

9 The 1996 Agreement provides that Timminco agreed to pay Mr. Timmins a monthly amount by which $29,166.66 exceeds the monthly amount to which [Mr. Timmins] is entitled on [Mr. Timmins] retirement under any pension or retirement plans of [Timminco].

10 The monthly payments were to commence on the first day of the month following Mr. Timmins retirement and terminate only on Mr. Timmins death (subject to earlier termination due to any breach of obligations by Mr. Timmins). There has been no alleged breach on the part of Mr. Timmins of any such obligations.

11 Under the 1996 Agreement, Mr. Timmins was to consult with Timminco "within the time limits from time to time of his physical and other abilities...; provided, however, that consultation and advice shall never occupy [Mr. Timmins] time to such an extent as shall prevent him from devoting the greater portion of his time to other activities".

12 At the time of his resignation as CEO, the 1996 Agreement was amended by the Letter Agreement.

13 Pursuant to the Letter Agreement, Timminco agreed to pay Mr. Timmins a monthly amount of $20,833.33 without further deduction except as may be required by law, commencing on July 1, 2001.

14 The Letter Agreement also provided that Timminco would terminate various employment benefits of Mr. Timmins (such as car lease and parking) and would cease to provide Mr. Timmins with office space and secretarial assistance after September 30, 2001.

15 In connection with the Letter Agreement, Mr. Timmins executed a release and indemnity which provides, in part, as follows:

> Whereas I have agreed to retire voluntarily as Chief Executive Officer and an employee of Timminco Limited and as a director and/or officer of any subsidiaries of Timminco Limited (hereinafter referred to collectively as "Timminco") effective immediately.
>
> And whereas I have agreed to accept the consideration described in the attached letter to me from Timminco dated May 28, 2001 and in the agreement between Timminco and me dated as of September 19, 1996 (collectively, the "Retirement Agreement"), in full settlement of any and all claims I may have relating to my employment with Timminco or the termination thereof;...I understand and agree that the consideration described above satisfies all obligations of Timminco, arising from or out of my employment with Timminco or the termination of my employment with Timminco, including without limitation obligations pursuant to the *Employment Standards Act (Ontario)* and the *Human Rights Code (Ontario)*. For the said consideration, I covenant that I will not file any claims or complaints under the *Employment Standards Act (Ontario)* or the *Human Rights Code (Ontario)*.

16 Following his retirement in 2001, Mr. Timmins remained a member of Timminco's board of directors until October 2007 and served as a member of several board committees until that time, including the strategic committee of the board from June 2003 until October 2007. He received director fees and was reimbursed for his expenses in connection with his services as a member of the board of directors of Timminco and its various committees.

17 Mr. Timmins states that he has fulfilled all contractual obligations imposed on him by the 1996 Agreement and that he has always been prepared to provide his consulting services to Timminco, as required by the 1996 Agreement, whenever from time to time requested by Timminco.

18 The evidence of Mr. Kalins, President, General Counsel and Corporate Secretary of Timmins, is that Timminco has not sought or received any consulting services from Mr. Timmins following his retirement.

19 Mr. Timmins has a different view. His evidence is that he provided consulting services during the early period of Dr. Schimmelbuch's term as CEO.

20 Since the execution of the Letter Agreement, Timminco has paid Mr. Timmins approximately $2.625 million. Mr. Kalins states that the payments under the Letter Agreement constitute the entirety of Mr. Timmins' entitlements from Timminco following his retirement.

21 Timminco has filed statements of pension, retirement, annuity and other income ("T4A Forms") and/or statements of amounts paid or credited to non-residents of Canada ("NR4 Forms") with the Canada Revenue Agency in connection with payments made by Timminco to Mr. Timmins in each year from 2002 to 2011. The T4A Forms and NR4 Forms filed by Timminco with respect to Mr. Timmins in each of those years list amounts paid to Mr. Timmins under the category of "retiring allowances". Mr. Kalins deposed that Timminco is not aware of any requests from Mr. Timmins to amend or refile any of the T4A Forms or NR4 Forms filed by Timminco since 2002.

22 Timminco complied with its obligations to pay the monthly consulting fee to Mr. Timmins until December 2011.

23 Payment was due on January 1, 2012, which was not made. The Initial Order was granted on Tuesday, January 3, 2012.

24 On February 8, 2012, a debtor-in-possession financing agreement (the "DIP Agreement") between Timminco and QSI Partners Ltd. ("QSI" or the "DIP Lender") was approved. Mr. Timmins was not served with notice of the motion to approve the DIP Agreement.

25 On March 30, 2012, counsel for Timminco sent a letter to counsel for Mr. Timmins enclosing a formal notice of disclaimer of the 1996 Agreement pursuant to section 32 of the CCAA. According to the correspondence, the 1996 Agreement was to be disclaimed effective April 30, 2012.

Analysis

26 Counsel to Mr. Timmins set out four issues:

> (a) Was Timminco entitled to stop paying the monthly consulting fee to Mr. Timmins, notwithstanding Mr. Timmins' position that these payments are post-filing obligations under the 1996 Agreement between the parties?
>
> (b) Should Timminco be entitled to disclaim the 1996 Agreement notwithstanding that:
>
> > (i) the company's ongoing obligations under the 1996 Agreement have not impeded its ability to effect a successful sale of its assets; and
> >
> > (ii) the disclaimer would result in significant financial hardship to Mr. Timmins.
>
> (c) In the event that Timminco was not entitled to stop paying the monthly consulting fee, is Mr. Timmins entitled to payments for the period from January 1, 2012 up to the effective date (if any) of the disclaimer?

(d) In the event that Timminco is entitled to disclaim the 1996 Agreement, what should the effective date of that disclaimer be?

27 Counsel to Timminco set forth the issue as being whether Timminco's obligations under the Agreement constitute pre-filing obligations which are stayed by the Initial Order.

28 In a supplementary factum, counsel to Timminco broadened the issue to read as follows:

(a) Should Mr. Timmins' motion for an order that the 1996 Agreement is not to be disclaimed or resiliated be granted; and

(b) If Mr. Timmins' motion referenced in (a) above be granted, should the effective date of the disclaimer of the 1996 Agreement be extended past April 30, 2012 (the day that was 30 days after the day on which Timminco gave notice of the disclaimer to Mr. Timmins).

29 Counsel to Mr. Timmins submits that the 1996 Agreement is clear and unambiguous and that Timminco's attempts to describe the unpaid monthly consulting fees as a pre-filing claim inappropriately mischaracterizes the nature of the 1996 Agreement. Counsel submits that the unpaid amounts can only be characterized as the pre-filing claim if Mr. Timmins earned the right to be paid an amount during his employment with Timminco (which amount was then to be paid out to him over time after the termination of his employment), without further obligations owing from Mr. Timmins to Timminco. Counsel to Mr. Timmins submits that clearly is not the case as the monthly consulting fees do not constitute compensation deferred from a prior employment agreement between the parties and the fees cannot be said to be owing for employment services previously performed by Mr. Timmins.

30 Mr. Timmins takes the position that, while the Letter Agreement dealt with a number of termination of employment issues, it specifically did not amend the 1996 Agreement other than to fix the monthly consulting fee and, in other respects, the 1996 Agreement was to remain in full force and effect.

31 Specifically, from Mr. Timmins standpoint, there were no pension or retirement benefits to forego at the time he entered into the Letter Agreement as the pension plan in which he had participated prior to his resignation was terminated and wound up in 1998.with a lump sum entitlement having been paid out.

32 Counsel for Mr. Timmins goes on to submit that the purpose and effect of the 1996 Agreement is clear and unambiguous on its face - (i) to ensure that Mr. Timmins advice remains available to Timminco; (ii) to ensure that he or his investment company do not engage in activities which are competitive to Timminco's business; and (iii) to ensure that Mr. Timmins does not disclose or otherwise use confidential information.

33 Counsel submits that Mr. Timmins' and Timminco's obligations under the 1996 Agreement are ongoing post-filing obligations, and as such cannot be stayed and suspended in the CCAA proceedings.

34 In my opinion, the arguments of Mr. Timmins are flawed.

35 It seems to me that the benefits conferred on Mr. Timmins under the 1996 Agreement, as amended by the Letter Agreement are, in substance, termination and/or retirement benefits. These are unsecured claims. Counsel to the Applicant has summarized the following attributes or characteristics of the Agreement in support of the Applicant's position that the claim of Mr. Timmins is, in substance, for termination and/or retirement benefits:

(a) the amount of Mr. Timmins' monthly fee under the 1996 Agreement was essentially a "top up" to any other retirement and pension benefit that Mr. Timmins would receive from Timminco;

(b) the "consulting" term of the 1996 Agreement was to commence the first day of the month following Mr. Timmins' retirement;

(c) under the Agreement, Mr. Timmins is not entitled to any retirement or pension benefits from Timminco following his retirement other than the payments;

(d) neither the 1996 Agreement nor the Letter Agreement provide for any minimum amount of consulting to be provided by Mr. Timmins in order to be entitled to receive the monthly payments;

(e) all other employment benefits and provision of services to enable Mr. Timmins to provide employment services to Timminco were terminated by the Letter Agreement; and

(f) Mr. Timmins has not provided any consulting services to Timminco following his retirement as CEO.

36 From the standpoint of Timminco, for all intents and purposes, the Letter Agreement concluded whatever employment relationship remained between Mr. Timmins and Timminco.

37 In addition, in connection with the Letter Agreement and his retirement, Mr. Timmins also executed a release in indemnity wherein he released any and all claims he may have had relating to his employment with Timminco or the termination thereof and agreed that the consideration described in the Agreement satisfies all of the obligations of Timminco arising from or out of his employment with Timminco or the termination of his employment.

38 It is especially significant that the release and indemnity specifically references both the 1996 Agreement and the Letter Agreement.

39 Further, the filings made by Timminco with the Canada Revenue Agency constitute further evidence of the payments made to Mr. Timmins under the Agreement are, in substance, unsecured termination and/or retirement benefits. Mr. Timmins discounts this point indicating that it is the responsibility of Timminco to issue the tax forms. However, it is the responsibility of Mr. Timmins to file the return and to ensure its accuracy.

40 In my view, the inescapable conclusion is that when the 1996 Agreement is considered together with the amendments set out in the Letter Agreement, in substance, the parties entered into an arrangement that addressed termination and/or retirement benefits.

41 The law in this area is clear. The courts have repeatedly found that termination and/or retirement benefits are pre-filing unsecured obligations of debtor companies undergoing CCAA proceedings. See *Indalex Ltd., Re* (2009), 55 C.B.R. (5th) 64 (Ont. S.C.J. [Commercial List]), *Nortel Networks Corp., Re* [Recommencement of Benefit Motion] (2009), 55 C.B.R. (5th) 68 (Ont. S.C.J. [Commercial List]) [Nortel] and *Fraser Papers Inc., Re* (2009), 55 C.B.R. (5th) 217 (Ont. S.C.J. [Commercial List]).

42 Further, the debtor company's obligation to make retirement, termination, severance and other related payments to unionized and non-unionized employees have been held to be prefiling obligations. See Nortel, paras. 10, 12, 67. At para. 67, I stated:

> ...The exact time of when the payment obligation crystallized is not, in my view, the determining factor under section 11.3 [of the CCAA]. Rather, the key factor is whether the employee performed services after the date of the Initial Order. If so, he or she is entitled to compensation benefits for such current service.

43 It is clear in this case that Mr. Timmins did not provide any services after the date of the Initial Order.

44 The Timminco Entities are insolvent and are not able to honour their obligations to all creditors. If the benefits conferred on Mr. Timmins under the Agreement are not stayed, Mr. Timmins would, in effect, receive an enhanced priority over other unsecured creditors, which would be contrary to the scheme and purpose of the CCAA. In this respect, it is noted that the position of the Applicant on this motion was supported by counsel to FSCO, both the Non-Union and Union Employee Pension Committee, the United Steelworkers and Mercer Canada.

45 The Monitor expressed no view on whether the monthly payment obligations were a prefiling or a post-filing obligation. The Monitor did, however, approve of the proposed disclaimer (see below).

46 In my view, it is necessary to briefly address the submission made by counsel to Mr. Timmins that the CCAA order does not preclude Mr. Timmins' claim for the unpaid monthly consulting fees and the related submission that the CCAA order does not stay pre-filing obligations. Paragraph 11 of the CCAA clearly provides that the Timminco Entities are directed to make no payments of principal, interest or otherwise on account of monies owing by the Timminco Entities to any of their creditors as of January 3, 2012. Having made the determination that the obligation of Timminco to Mr. Timmins under the Agreement constitutes a pre-filing claim, this provision is broad enough to cover any and all pre-filing obligations owing to Mr. Timmins.

47 The foregoing is sufficient to dispose of the issues raised in the motion and cross-motion. However, in the event that I am in error in my conclusion, the secondary issue has to be addressed; namely, whether Timminco should be entitled to disclaim the 1996 Agreement and, if so, what should be the effective date of the disclaimer.

48 Section 32 of the CCAA permits a counter-party to a contract disclaimed by the debtor company to apply to court for an order that the agreement is not to be disclaimed or resiliated.

49 Section 32(4) sets out factors to be considered by the court, among other things, in deciding whether to make the order:

> (a) whether the monitor approved the proposed disclaimer or resiliation;
>
> (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

50 In alternative submissions, counsel to Timminco takes the position that the motion of Mr. Timmins should be dismissed because:

> (a) the Monitor has approved the proposed disclaimer;

(b) the disclaimer will enhance the prospects of a viable compromise or arrangement being made in respect of Timminco;

(c) the disclaimer is expected to benefit the stakeholders of Timminco as a whole in that it will permit Timminco to maximize recoveries to its stakeholders;

(d) the disclaimer will not cause any significant financial hardship to Mr. Timmins; and

(e) prohibiting Timminco from disclaiming the Agreement will result in a windfall to Mr. Timmins at the expense of the other unsecured creditors of the Timminco Entities.

51 In analyzing this aspect of the motion, I accept the submission of counsel to Timminco that the scope of the CCAA and the various protections it affords debtor companies should not be interpreted so narrowly as to apply only in the context of a restructuring process leading to a plan arrangement for a newly restructured entity. The Court of Appeal for Ontario stated in *Nortel Networks Corp., Re*, 2009 ONCA 833 (Ont. C.A.), there is "no reason...why the same analysis cannot apply during a sale process that requires the business to be carried as a going concern".

52 In my view, the section 32 (4)(b) requirement that a disclaimer of an agreement with a debtor company enhance the prospects of a viable compromise or arrangement being made should be interpreted with a view to the expanded scope of the statute.

53 In this particular case, the overriding objective of the CCAA must be to ensure that creditors in the same classification are treated equitably. Such treatment will enhance the prospects of a viable compromise or arrangement being made in respect of the debtor company.

54 Similar views were expressed by the court in *Homburg Invest Inc., Re*, 2011 QCCS 6376 (Que. Bktcy.) where the Quebec Superior Court held, among other things, that it is not necessary to demonstrate that a proposed disclaimer is essential for the restructuring period. It merely has to be advantageous and beneficial.

55 It is also noted that counsel to the Applicants submitted that at the commencement of the CCAA proceedings, the Timminco Entities ceased making payments with respect to many of their pre-filing obligations in order to preserve their ability to continue operating and to implement a successful sale of their assets. The continued existence of the Agreement and of the requirement to make the payments thereunder would have further strained the Timminco Entities already severely constrained cash flows. Further, counsel contends that disclaimer of the Agreement and the cessation of payments to Mr. Timmins thereunder improved the Timminco Entities' cash flows and their ability to continue implementing a sales process with respect to their assets.

56 Counsel to Timminco also points out that under the DIP Agreement, approved on February 8, 2012, the Timminco Entities are restricted to use the proceeds of the DIP Facility for the purpose of funding operating costs, expenses and liabilities in accordance with the cash flow projections. Although the DIP Agreement does not prohibit the payment of amounts akin to the amounts owing under the Agreement, the cash flow projections approved by the DIP Lender do not provide for a payment of the monthly payments under the Agreement; making such payments would accordingly result in an event of default under the DIP Agreement. Further, counsel adds that without access to the DIP Facility, the Timminco Entities would have been unable to implement a sales process designed to maximize the benefits to their stakeholders.

57 I am satisfied that, in the context of this alternative argument, the disclaimer of the Agreement, if necessary, is fair, reasonable, advantageous and beneficial to the Timminco Entities' restructuring process.

58 Counsel to Mr. Timmins also raised the issue that the disclaimer of the 1996 Agreement would objectively result in significant financial hardship to Mr. Timmins.

59 However, Mr. Timmins did acknowledge that, if the test of whether the disclaimer of an agreement that pays a party $250,000 per year will cause "significant financial hardship to that party" depends on the individual characteristics and circumstances of that party, the disclaimer of the 1996 Agreement will not cause significant financial hardship to Mr. Timmins.

60 I am in agreement with the submission of the Timminco Entities that the test of whether a disclaimer of an agreement will cause significant financial hardship to the counter party depends and is centered on an examination of the individual characteristics and circumstances of such counter party. Further, an objective test for "significant financial hardship" would make it difficult to debtor companies to disclaim large contracts regardless of the financial ability of the counter parties to absorb the resultant losses. It seems to me that such a result would be contrary to the purpose of principles of the CCAA.

61 Based on the record, I am unable to conclude that the disclaimer would likely cause significant financial hardship to Mr. Timmins.

62 I have also taken into account that the effect of acceding to the argument put forth by counsel to Mr. Timmins would result in an improvement to his position relative to, and at the expense of, the unsecured creditors and other stakeholders of the Timminco Entities. If the Agreement is disclaimed, however, the monthly amounts that would otherwise be paid to Mr. Timmins would be available for distribution to all of Timminco's unsecured creditors, including Mr. Timmins. This equitable result is dictated by the guiding principles of the CCAA.

63 For the foregoing reasons, the alternative relief sought by Mr. Timmins, to the effect that the Agreement is not to be disclaimed, is denied.

64 The remaining outstanding issue is whether or not the disclaimer of the Agreement should be effective April 30, 2012. Counsel to Mr. Timmins takes the position that the effective date of the disclaimer should be no earlier than the date of the determination of this motion.

65 On March 30, 2012, counsel for Timminco sent a letter to Mr. Timmins' counsel enclosing a formal notice of disclaimer which was to be effective April 30, 2012. In accordance with section 32 (2) of the CCAA, on April 13, 2012, Mr. Timmins filed his motion objecting to the disclaimer. Counsel to Mr. Timmins sought to have the motion heard in advance of April 30, but on account of scheduling issues, the motion did not proceed until June 4, 2012. Counsel to Mr. Timmins takes the position that given that the CCAA Order prohibits Mr. Timmins from ceasing to comply with his obligations under the 1996 Agreement, it is only fair that payment for such obligations should be made up until the date that the court makes its determination on this motion.

66 The contrary position put forth by counsel to Timminco is that the Timminco Entities did not deliver a notice of disclaimer until March 30, 2012 because they were of the view that the obligations under the Agreement constitute Timminco's unsecured pre-filing obligations which were stayed by Initial Order and that Timminco was authorized to stop making the payments under the Agreement without being required to disclaim the

Agreement. Consequently, counsel submits that the Timminco Entities only delivered a notice of disclaimer in response to correspondence with Mr. Timmins' counsel and did so expressly without prejudice to their position that the obligations under the Agreement were pre-filing obligations.

67 Counsel to Timminco acknowledged that, if the court found that Timminco's obligations did not constitute pre-filing obligations and the Agreement needed to be disclaimed prior to Timminco being entitled to cease making payments, Timminco would be obligated to make the payments that became due prior to the effective day of the disclaimer, namely, April 30, 2012.

68 I am satisfied that the delay between the commencement of this motion by Mr. Timmins and its hearing was attributable to scheduling issues and the demands on Timminco's management and counsel's time placed by the Timminco Entities' CCAA Proceedings, including the sales process being undertaken by the Timminco Entities for the benefit of their stakeholders. Given these competing priorities, it seems to me that it would be unfair to extend the effective date of the disclaimer, if necessary, beyond April 30, 2012.

69 As noted, my comments with respect to the disclaimer issue are for the assistance of the parties, in the event that my determination of the pre-filing issue is found to be in error.

Disposition

70 In the result, the motion of Mr. Timmins is dismissed. The relief requested by Timminco in the cross-motion is granted.

Motion by former CEO dismissed; Motion by company granted.

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TAB 4

2004 CarswellBC 1262, 2004 BCSC 733, 45 B.L.R. (3d) 78, 29 B.C.L.R. (4th) 178, 1 C.B.R. (5th) 7

Doman Industries Ltd., Re

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

IN THE MATTER OF THE COMPANY ACT R.S.B.C. 1996, c. 62

IN THE MATTER OF THE CANADA BUSINESS CORPORATIONS ACT R.S.C. 1985, c. C-44

IN THE MATTER OF THE PARTNERSHIP ACT R.S.B.C. 1996, c. 348

IN THE MATTER OF DOMAN INDUSTRIES LIMITED, ALPINE PROJECTS LIMITED, DIAMOND LUMBER SALES LIMITED, DOMAN FOREST PRODUCTS LIMITED, DOMAN'S FREIGHTWAYS LTD., DOMAN HOLDINGS LIMITED, DOMAN INVESTMENTS LIMITED, DOMAN LOG SUPPLY LTD., DOMAN-WESTERN LUMBER LTD., EACOM TIMBER SALES LTD., WESTERN FOREST PRODUCTS LIMITED, WESTERN PULP INC., WESTERN PULP LIMITED PARTNERSHIP, and QUATSINO NAVIGATION COMPANY LIMITED (PETITIONERS)

British Columbia Supreme Court

Tysoe J.

Heard: May 25, 2004
Judgment: May 25, 2004[FN*]
Docket: Vancouver L023489

Counsel: E.J. Harris, Q.C., P.D. McLean for Petitioner, Western Forest Products Ltd.

I.G. Nathanson, Q.C., S.R. Schachter, Q.C. for Hayes Forest Services Ltd.

M.I. Buttery for Tricap Restructuring Fund

S.R. Ross for Strathcona Contracting Ltd.

K. Zych for Committee of Unsecured Noteholders

C.E. Hirst for Petro-Canada Inc.

Subject: Insolvency; Corporate and Commercial

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

Insolvent company was in process of attempting restructuring under Companies' Creditors Arrangement Act — Insolvent company brought application for approval of termination of contracts it had with H Ltd. and S Ltd. — Application dismissed — Insufficient evidence existed to support conclusion that proposed contract terminations were fair and reasonable in all circumstances — Available evidence simply supported conclusion that insolvent company would have opportunity of being more profitable if contracts were terminated — It was not demonstrated that loss of this opportunity to be more profitable would outweigh prejudice that would be suffered by H Ltd. and S Ltd. if contracts were terminated — Termination of contracts as condition precedent of restructuring plan was not contained in initial draft of plan and there was no evidence as to why it was inserted later — It could not be said that condition precedent was result of adversarial negotiation and that restructuring was unlikely to proceed if it was not satisfied — It is not necessary for insolvent company to demonstrate that termination of contract is essential to making of viable plan or arrangement.

Cases considered by *Tysoe J.*:

Blue Range Resource Corp., Re (1999), 1999 CarswellAlta 597, 245 A.R. 154, 1999 ABQB 1038 (Alta. Q.B.) — not followed

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

Repap British Columbia Inc., Re (June 11, 1997), Doc. Vancouver A970588 (B.C. S.C.) — considered

Skeena Cellulose Inc., Re (2002), 43 C.B.R. (4th) 178, 2002 BCSC 1280, 2002 CarswellBC 2032, 5 B.C.L.R. (4th) 193 (B.C. S.C.) — considered

Skeena Cellulose Inc., Re (2003), 43 C.B.R. (4th) 187, 184 B.C.A.C. 54, 302 W.A.C. 54, 2003 BCCA 344, 2003 CarswellBC 1399, 13 B.C.L.R. (4th) 236 (B.C. C.A.) — distinguished

T. Eaton Co., Re (1999), 1999 CarswellOnt 3542, 14 C.B.R. (4th) 288 (Ont. S.C.J. [Commercial List]) — considered

Statutes considered:

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

Generally — referred to

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

Generally — referred to

Forest Act, R.S.B.C. 1996, c. 157

Generally — referred to

Forestry Revitalization Act, S.B.C. 2003, c. 17

Generally — referred to

Regulations considered:

Forest Act, R.S.B.C. 1996, c. 157

Timber Harvesting Contract and Subcontract Regulation, B.C. Reg. 22/96

Generally

APPLICATION by insolvent company for approval of termination of contracts.

***Tysoe J.* (orally):**

1 One of the Petitioners, Western Forest Products Ltd., ("Western") applies, in these proceedings under the *Companies Creditors Arrangement Act* (the "*CCAA*") involving the Doman group of companies, for authorization or approval of the termination of contracts it has with Hayes Forest Services Ltd. ("Hayes") and Strathcona Contracting Ltd. ("Strathcona").

2 The Doman group of companies ("Doman") carry on business in the B.C. forestry industry. Doman encountered financial difficulties and has been in the process of attempting to restructure under the *CCAA* for approximately one and a half years. The liabilities of *Doman* consist of secured term debt in the principal amount of U.S. $160 million, unsecured term notes in the principal amount of U.S. $513 million, unsecured trade debt in excess of $20 million, a secured operating line of credit and other miscellaneous obligations.

3 The restructuring process is nearing completion. A plan of compromise and arrangement (the "Restructuring Plan") has been filed and the meeting of creditors to consider it has been scheduled to be held in approximately two weeks. The deadline for creditors to file proofs of claim is today.

4 In very simple terms, the Restructuring Plan contemplates that the lumber and pulp assets of Doman will be transferred into new corporations and that the unsecured noteholders, trade creditors and other unsecured creditors will have their debt converted into shares in one of the new corporations, which will own the lumber assets and the shares of the other corporation holding the pulp assets. The secured term debt is to be refinanced and the secured operating line of credit will be unaffected. The existing shareholders of Doman are to receive warrants entitling them to purchase a limited number of shares in the new parent corporation.

5 The implementation of the Restructuring Plan is subject to the fulfilment of numerous conditions precedent. One of the conditions is the termination of the contracts with Hayes and Strathcona which are the subject matter of this application.

6 Western holds certain forest tenure, including licenses relating to an area known as the Nootka Region on Vancouver Island and at least one island off the coast of Vancouver Island called Nootka Island. In 1991, the B.C. government decided that logging contractors should have a form of security similar to the tenure enjoyed by license holders and created the concept of replaceable contracts under the *Forest Act*.

7 The attributes of replaceable contracts were discussed at length by the B.C. Court of Appeal in *Skeena Cellulose Inc., Re*, 2003 BCCA 344 (B.C. C.A.) and I will not repeat all of them here. In short, a replaceable contract is a form of evergreen contract which contains statutorily mandated provisions, the most important of which is that the license holder must offer a new or replacement contract to the contractor upon each expiry of the term of the contract as long as the contractor is not in default under the contract. If the parties are not able to

agree on the new rates under the replacement contract, an arbitrator will determine the rates, which are mandated to be competitive within the industry and to permit the contractor to earn a reasonable profit on top of its costs. The contractors with such contracts are known in the industry as Bill 13 contractors. A license holder must have at least 50% of its annual allowable cut harvested by Bill 13 contractors.

8 Western has 7 full-phase Bill 13 logging contracts with 6 contractors for the Nootka Region. Hayes is one of those contractors and it has the full-phase contract for the Plumper Harbour area of the Nootka Region. A full-phase contract includes all aspects of logging ranging from road construction, falling, hauling, sorting and delivery to transportation points. Hayes sold the road construction aspect of its contract, and the replaceable contract for road construction was assigned to Strathcona.

9 When Doman first commenced these *CCAA* proceedings, it was anticipated that the restructuring process would be completed in a relatively short period of time. It was contemplated that all unsecured debt other than the unsecured bondholders would be paid in full and that the unsecured bondholders would take most, but not all, of the equity in Doman in exchange for some of the indebtedness owed to them and would take security for the remainder of their indebtedness. The confirmation or come-back Order of December 6, 2002 authorized a downsizing process for Doman, but it was not instituted in view of the anticipated restructuring.

10 The restructuring initially contemplated by Doman did not take place, in part because I made a ruling that the covenants in the trust deed for the secured term debt could not be overridden into the future. By the beginning of April 2004, the unsecured bondholders were pressing for their own restructuring plan and had made it clear that there should be some downsizing in Doman's operations, particularly the closure of Doman's pulp mill in Port Alice. On April 6, 2004, I declined Doman's application for an extension of the stay for the sole purpose of pursuing refinancing of its debt and the sale of the Port Alice pulp mill, but I also declined an application of the unsecured bondholders to call a meeting of creditors to consider its plan of arrangement. I extended the stay for the purpose of allowing Doman to file its own restructuring plan while still pursuing refinancing and sale alternatives, but I imposed a fairly concrete deadline by directing that the creditors meeting be held on June 7. In my April 6 Order, I authorized Doman to reinstitute its downsizing process with special emphasis on the closure of the Port Alice pulp mill if a purchaser was not located. I also placed a restriction on any downsizing by providing that any termination of a replaceable contract under the *Forest Act* was not to be effective unless authorized by the court.

11 By letters dated April 27, 2004, Western terminated its contracts with Hayes and Strathcona effective upon court approval of the terminations. An affidavit of Mr. Zimmerman, a Western employee, provided the following rationale for the decision to terminate these replaceable contracts:

> As part of the reorganization and "downsizing" processes of [Western], we have looked at methods to rationalize harvesting operations in the Nootka Region so as to reduce costs and improve profitability of [Western]. [Western] has worked in conjunction with representatives of the Bondholder committee who have asked for recommendations so as to increase profitability. [Western] has determined that within the Nootka Region, operational efficiencies can be achieved and significant cost savings can be achieved if the number of contractors is reduced and if that contractor's allocated volume is re-allocated to the remaining contractors. [Western] has recommended this reduction to the Bondholders Committee and the representatives of the Committee have asked that [Western] institute a rationalization and termination of contract, which is subject to Court approval as provided in this Court's Order of April 6, 2004.

The affidavit goes on to state that the rationalization can best be carried out by the termination of the Plumper Harbour contracts, principally because the contractor costs associated with this location are the highest in the Nootka Region. The volume under the contracts would then be re-allocated to other Bill 13 contractors in the Nootka Region. The average contract rate for logging a cubic metre of timber under the Hayes contract for the period from 1998 to 2001, as determined by arbitration, was approximately $4 higher than the average rate under the other contracts for the Nootka Region.

12 Mr. Zimmerman's affidavit indicated that Western did not intend to harvest at Plumper Harbour for the next three years and set out the savings that Western would be able to achieve by terminating the Hayes and Strathcona contracts. These savings were estimated at $5 million over the next three years and $800,000 for each year thereafter. These included annual savings of approximately $165,000 in road building costs, but the main reason Western wants to terminate its contract with Strathcona is that the full-phase contractor replacing Hayes may have its own road building capabilities. Mr. Zimmerman also exhibited to his affidavit a proposal which Hayes had made to Western in 1999 whereby Hayes offered to exchange its rights under its Bill 13 contract for the exclusive right to do helicopter logging in the Nootka Region with an annual minimum guarantee. In the proposal, Hayes stated that the average cut for many of the Bill 13 contractors had been reduced below an efficient economic operating level and that higher costs were being passed on to Western. The proposal was not accepted by Western because it did not want to give exclusive rights for helicopter logging with a guaranteed entitlement.

13 Representatives of Hayes and Strathcona swore affidavits disputing that the savings would be of the magnitude estimated by Mr. Zimmerman. They also set out the prejudice which their companies would suffer if the contracts were terminated, including the loss of employment and the inability to utilize fixed assets. Mr. Hayes deposed that there is no reasonable or rational economic reason for Western to forego harvesting in Plumper Harbour this year because most of the engineering and road construction costs have already been incurred. Mr. Hayes estimated that if Western harvested the timber on its logging plan for this year in Plumper Harbour, it would receive revenue, net of additional harvesting costs, of approximately $2 million.

14 The affidavit of Mr. Hayes also stated that Hayes recognized that the operations of the Bill 13 contractors in the Nootka Region are inefficient, unwieldy and costly. Despite this acknowledgment, Mr. Hayes expressed a view that the termination of its contract will not have a material impact on cost reduction in the Nootka Region when one takes into account that the Province will be taking back approximately 20% of Western's annual allowable cut in the Nootka Region pursuant to the recently enacted *Forestry Revitalization Act* and will thereby cause a reduction in the volumes harvested by all of the Bill 13 contractors. No affidavit was sworn by a Western representative to dispute this statement.

15 Mr. Zimmerman, Mr. Hayes and the deponent on behalf of Strathcona were cross-examined on their affidavits. In his cross-examination, Mr. Zimmerman stated that Western did intend to liquidate the developed timber at Plumper Harbour of approximately 130,000 cubic metres over the next two years before putting the area in abeyance for a three year period. Western has not introduced any evidence with respect to the anticipated costs if this developed timber is harvested or is harvested by other Bill 13 contractors rather than Hayes.

16 In addition to the *Skeena Cellulose Inc.* decision which dealt with the termination of replaceable contracts in *CCAA* proceedings, counsel referred me to several other cases involving the termination of contracts, leases or licenses in *CCAA* proceedings.

17 In *Dylex Ltd., Re*, [1995] O.J. No. 595 (Ont. Gen. Div. [Commercial List]), Farley J. authorized the in-

solvent company to repudiate the leases of three of its stores as part of a program to close 200 of its stores across Canada. The three stores had been a financial drain on Dylex. Although the closures were going to have a detrimental effect on the shopping centres in which the stores were located, Farley J. held that in weighing the balancing of interests in a *CCAA* context, the court's discretion should be exercised in favour of Dylex over the landlord, which was in sound financial condition. Farley J. declined to import into the *CCAA* the requirement applicable to proposals under the *Bankruptcy and Insolvency Act* that the insolvent company has to show that it would not be able to make a viable proposal unless it terminated the leases in question.

18 In *Blue Range Resource Corp., Re*, 1999 ABQB 1038 (Alta. Q.B.), the insolvent company had been authorized by the court under the initial stay order to terminate such of its contracts as it deemed appropriate to permit it to proceed with an orderly restructuring of its business. Blue Range terminated some of its natural gas supply contracts and three of the parties to such contracts sought to challenge the termination of their contracts. One of the issues they raised was that the stay order should be varied to provide that Blue Range would only be permitted to terminate the contracts if it was incapable of performing them or if the termination was essential to the success of their restructuring. Lo Vecchio J. dismissed the application to vary the stay order in this fashion. He made the following comments at paras. 36 through 38, which have been quoted in subsequent cases:

> The purpose of the CCAA proceedings generally and the stay in particular is to permit a company time to reorganize its affairs. This reorganization may take many forms and they need not be listed in this decision. A common denominator in all of them is frequently the variation of existing contractual relationships. Blue Range might, as any person might, breach a contract to which they are a party. They must however bear the consequences. This is essentially what has happened here.
>
> A unilateral termination, as in any case of breach, may or may not give rise to a legitimate claim in damages. Although the Order contemplates and to a certain extent permits unilateral termination, nothing in Section 16.e or in any other part of the Order would suggest that Blue Range is to be relieved of this consequence; indeed Blue Range's liability for damages seems to have been assumed by Duke and Engage in their set-off argument. The application amounts to a request for an order of specific performance or an injunction which ought not to be available indirectly. In my view, an order authorizing the termination of contracts is appropriate in a restructuring, particularly given that it does not affect the creditors' rights to claim for damages.
>
> The Applicants are needless to say not happy about having to look to a frail and struggling company for a potentially significant damages claim. They will be relegated to the ranks of unsecured judgment creditors and may not, indeed likely will not, have their judgments satisfied in full. While I sympathize with the Applicants' positions, they ought not to, in the name of equity, the guide in CCAA proceedings, be able to elevate their claim for damages above the claims of all the other unsecured creditors through this route.

19 Lo Vecchio J. held that the court has the necessary jurisdiction to permit termination of contracts and that the termination of the contracts in question was necessary to the company's survival program.

20 In *T. Eaton Co., Re*, [1999] O.J. No. 4216 (Ont. S.C.J. [Commercial List]), Farley J. refused to order specific performance of an exclusive license to provide credit card services that had been repudiated by the insolvent company as part of a sale of its assets which was the foundation of its restructuring plan. He held that the licensee could be adequately compensated in damages and should not have a higher claim than any other unsecured creditor. In the course of his reasons, he quoted the above portions of the *Blue Range Resource Corp.* de-

cision, and said the following at para. 7:

> It is clear that under CCAA proceedings debtor companies are permitted to unilaterally terminate in the sense of repudiate leases, and contracts without regard to the terms of those leases and contracts including any restrictions conferred therein that might ordinarily (i.e. outside CCAA proceedings) prevent the debtor company from so repudiating the agreement. To generally restrict debtor companies would constitute an insurmountable obstacle for most debtor companies attempting to effect compromises and reorganizations under the CCAA. Such a restriction would be contrary to the purposive approach to CCAA proceedings followed by the courts to this date.

Farley J. also spoke about being cognizant of the function of a balancing of prejudices within the general approach to the *CCAA*.

21 The issue of the court's jurisdiction to authorize the termination of replaceable contracts under the *B.C. Forest Act* was first addressed in the predecessor to the *CCAA* proceedings of Skeena Cellulose, *Repap British Columbia Inc., Re* (June 11, 1997), Doc. Vancouver A970588 (B.C. S.C.). Thackray J. held that the court had the jurisdiction under the *CCAA* to authorize the insolvent company to terminate replaceable contracts. None of the replaceable contracts in question were actually terminated until the subsequent Skeena Cellulose proceed- ings.

22 In the Skeena Cellulose proceedings, the come-back order authorized the company to terminate replaceable contracts in order to facilitate the downsizing and consolidation of its business and operations. As part of Skeena Cellulose's plan of compromise and arrangement, a third party agreed to purchase the shares in the company for $8 million, which was to be used for distribution to the creditors having claims in excess of $400 million. It was a condition precedent to the purchase that two of Skeena Cellulose's five replaceable contracts be terminated, and letters of termination were sent. The two contractors applied to the court for a declaration that the terminations were invalid.

23 Brenner C.J.S.C. dismissed the application. In his decision (cited at 2002 BCSC 1280 (B.C. S.C.) [*Skeena Cellulose Inc., Re*]), he said the following at para. 25:

> SCI has no authority to decline to replace the applicants' replaceable contracts under the terms of those contracts, or in accordance with the provisions of the Regulation that deal with when and how a replaceable contract can be terminated. The only authority for SCI to terminate, or indeed, jurisdiction for this court to approve such terminations, must be found in the terms of the Come-back Order, and in the provisions of the CCAA. To be effective, the terminations must:
>
> (a) comply with the procedures and conditions stipulated in the Come-back Order; and,
>
> (b) conform to the broader principles of economic necessity and fairness which underlie the court's discretionary jurisdiction under the CCAA.

Brenner C.J.S.C. expressed the view that the statutory privileges given to the Bill 13 contractors are not sufficient to justify the creation or recognition of a preference in favour of the contractors over other creditors.

24 The appeal from Brenner C.J.S.C.'s decision was dismissed. In its decision, the B.C. Court of Appeal held that the court had an equitable jurisdiction to supplement the *CCAA* by approving a plan of arrangement

which contemplates the termination of contracts by the debtor corporation. Newbury J.A. held that in approving such a plan involving the termination of replaceable contracts, the court was not overriding provincial legislation because nothing in the legislation purported to invalidate a termination of a replaceable contract but that, in any event, the doctrine of paramountcy would result in preference being given to the *CCAA* over the *B.C. Forest Act* in the case of a conflict.

25 The Court of Appeal found no error in the exercise of discretion by Brenner C.J.S.C. Newbury J.A. said the following about the concept of fairness at para. 60:

> I have no difficulty in accepting the appellants' argument that fairness as between them and the other three evergreen contractors and as between the appellants and Skeena was a legitimate consideration in the analysis of this case. (Indeed, I believe the Chief Justice considered this aspect of fairness, even though he did not mention it specifically in this part of his Reasons.) The appellants are obviously part of the "broad constituency" served by the CCAA. But the key to the fairness analysis, in my view, lies in the very breadth of that constituency and wide range of interests that may be properly asserted by individuals, corporations, government entities and communities. Here, it seems to me, is where the flaw in the appellants' case lies: essentially, they wish to limit the scope of the inquiry to fairness as between five evergreen contractors or as between themselves and Skeena, whereas the case-law decided under the CCAA, and its general purposes discussed above, require that the views and interests of the "broad constituency" be considered. In the case at bar, the Court was concerned with the deferral and settlement of more than $400 million in debt, failing which hundreds of Skeena's employees and hundreds of employees of logging and other contractors stood to lose their livelihoods. The only plan suggested at the end of the extended negotiation period to save Skeena from bankruptcy was NWBC's acquisition of its common shares for no consideration and the acceptance by its creditors of very little on the dollar for their claims.

The Court of Appeal concluded that there was a business case for the terminations. Newbury J.A. stated that the situation in *Dylex Ltd.* was no different in principle because, like the leases in *Dylex Ltd.*, the replaceable contracts were too costly for Skeena Cellulose to continue operating under them.

26 Although the Court of Appeal's decision in *Skeena Cellulose Inc.* settles that the court has the necessary jurisdiction to deal with the termination of contracts, none of the above decisions includes any detailed discussion with respect to the basis upon which the court becomes involved in decisions to terminate contracts. Newbury J.A. discussed the jurisdiction in terms of the court approving a plan of arrangement which involves the termination of contracts, but the court will often authorize the termination of contracts prior to the formulation of a plan of arrangement.

27 If a debtor company repudiated a contract prior to commencing *CCAA* proceedings, the court would not have any direct involvement in the termination of the contract unless, possibly, the other party to the contract sought specific performance of the contract (which, as Brenner C.J.S.C. pointed out in *Skeena Cellulose Inc.*, is particularly inappropriate in an insolvency). The other party to the contract would have a claim for damages in respect of the repudiation and would be treated like any other unsecured creditor for the purposes of the plan of arrangement.

28 Once an insolvent company seeks the assistance of the court by commencing *CCAA* proceedings, the company comes under the supervision of the court. The supervision also involves a consideration of the interests of the broad constituency served by the *CCAA* mentioned in *Skeena Cellulose Inc.* by Newbury J.A. These in-

terests, when coupled with the exercise by the court of its equitable jurisdiction, bring into play the requirements for fairness and reasonableness in weighing the interests of affected parties.

29 Generally speaking, the indebtedness compromised in *CCAA* proceedings is the debt which is in existence at the time of the *CCAA* filing, and the debtor company is expected to honour all of its obligations which become owing after the *CCAA* filing. It is common for the initial stay order or the come-back order to provide that the debtor company is to continue carrying on its business and to honour its ongoing obligations unless the court authorizes exceptions.

30 In many reorganizations under the *CCAA*, it is necessary for the insolvent company to restructure its business affairs as well as its financial affairs. Even if the financial affairs are restructured, the company may not be able to survive because portions of the business will continue to incur ongoing losses. In such cases, it is appropriate for the court to authorize the company to restructure its business operations, either during the currency of the *CCAA* proceedings or as part of a plan of arrangement. The process is commonly referred to as a downsizing if it involves certain aspects of the business coming to an end. The liabilities which are incurred as a result of the restructuring of the business operations, for such things as termination of leases and other contracts, are included in the obligations compromised by the plan of arrangement even though the debtor company will have been honouring its ongoing commitments under the leases and other contracts after the commencement of the *CCAA* proceedings. The inclusion of these liabilities in the plan of arrangement is an exception to the general practice of debtor companies paying the full extent of post-filing liabilities and compromising only the pre-filing liabilities.

31 It is within this context that the court is called upon to authorize the termination of contracts which the debtor company could have repudiated without any authorization prior to the commencement of *CCAA* proceedings. The liabilities to be compromised have, in general terms, been crystallized by the filing of the *CCAA* petition, and the affairs of the debtor company are under the supervision of the court, which is required to exercise its equitable jurisdiction fairly and reasonably.

32 I do not approach the matter in the same fashion as Lo Vecchio J. did in *Blue Range Resource Corp.* I do not see the resistance of a party to the termination of a contract with the debtor company to be an attempt to elevate their claim for damages above the claims of all the other unsecured creditors. Apart from any monies which may have been outstanding under the contract at the time of the *CCAA* filing, the party to the contract was not an unsecured creditor who was going to be subjected to a compromise under a plan of arrangement. The party only becomes a creditor in respect of its damage claim if the contract is terminated. Although Lo Vecchio J. could be interpreted as suggesting in the quoted paragraphs 36 to 38 that a debtor company may terminate contractual relations as long as the resulting damage claim is included in its plan of arrangement, I do note that he subsequently commented that the termination of the contracts in that case was necessary to the company's survival program.

33 I prefer the approach of Farley J. in *Dylex Ltd.*, which involves the court weighing the competing interests and prejudices in deciding what is fair and reasonable. I would anticipate that in the majority of cases a debtor company will be able to persuade the court to exercise its discretion in favour of the termination of contracts and other steps required to downsize or rationalize its business affairs. A debtor company must be insolvent to qualify under the *CCAA* and the insolvency may have been caused by over-expansion or continual losses by a part of the business. If the company is to have a reasonable prospect of surviving into the indefinite future, it will be appropriate to downsize its operations or bring an end to the losing aspects of the business. The in-

terests of the broad constituency of stakeholders in taking reasonable steps to ensure the ongoing viability of the business will often outweigh the prejudice caused to parties having their contracts or other arrangements with the debtor company terminated and their consequential damage claim being included in the plan of arrangement. There is no single test for the debtor company to satisfy apart from demonstrating that the termination is fair and reasonable in all of the circumstances. As held in *Dylex Ltd.*, it is not necessary for the debtor company to demonstrate that the termination of the contract is essential to the making of a viable plan of arrangement.

34 An example of this type of situation has already occurred in these proceedings. Doman's pulp mill at Port Alice has been losing money for a significant period of time and causing a financial drain on Doman's resources. At the suggestion of the bondholders, it was decided that the mill should be closed and should not be part of the restructured company. Although the closure of the mill would have had a devastating effect on the employees of the pulp mill and the Village of Port Alice as a whole, I authorized the closure because it would not have been reasonable to require the restructured company to operate a division of its business which was anticipated to continue to lose money. Fortunately, Doman was able to find another party who was willing to take over the pulp mill prior to its closure.

35 On the other hand, there will be circumstances where it will not be appropriate to authorize the debtor company to terminate contracts. For example, suppose that a debtor company became insolvent because its business had been operating at a loss but market conditions had changed and, with a financial restructuring of its existing debt, it was expected to be profitable in the future. Suppose further that the debtor company was party to a contract which did not cause the company to operate the relevant aspect of its business at a loss but the contract was not as favourable as the market would permit the company to obtain if it could divest itself of the existing contract. If the company could terminate the contract and enter into a new one with different rates, it could become substantially more profitable into the future. In these circumstances, it may well be inappropriate for the court to authorize the termination of the contract. The risk of the failure of the debtor company after its restructuring would be relatively low and, depending on the terms of the plan of arrangement, the future benefit of the contract termination may accrue to the shareholders of the company or to the creditors of the company who took risks in exchange for high rates of return.

36 On the present application, all that the evidence establishes is that Doman will likely be able to reduce its costs to some extent at some point in the future if it can terminate the two contracts in question. Mr. Zimmerman's affidavit states that the reason Western made the recommendation to terminate the two contracts was to improve or increase its profitability. There is no evidence on this application with respect to the following points:

(a) whether the logging at Plumper Harbour under the existing contracts has produced a loss in the past or is expected to produce a loss in the future;

(b) whether other logging operations of Doman produce a greater loss;

(c) whether other aspects of Doman's business produce a loss and, if so, what consideration has been given to rationalizing that loss in comparison to the termination of the contracts in question;

(d) whether it is expected that the restructured company will operate at a profit;

(e) what parts of the constituency of stakeholders will benefit from the termination of the contracts in ques-

tion;

(f) whether the developed timber at Plumper Harbour can be harvested in the next two years by other contractors at a cost less than the cost under the contracts in question; and

(g) what is the fallacy, if any, in the assertion of Mr. Hayes that the termination of the contracts will have no material impact on cost reduction after taking into account the 20% government take-back.

37 Some reliance was placed by counsel on the fact that the termination of these contracts is a condition precedent of the Restructuring Plan. In my view, this condition precedent is materially different than the condition precedent in *Skeena Cellulose Inc.* In that case, it was an independent purchaser of the shares in *Skeena Cellulose Inc.* that negotiated the condition on the basis that it was not prepared to purchase the shares unless two of the five replaceable contracts were terminated. The condition resulted from an arm's length negotiation which required the purchaser to put up funds to purchase the shares. In the present case, the bondholder committee produced the initial draft of the Restructuring Plan, which was finalized after a limited negotiation that served to advance the interests of the existing directors and shareholders of Doman. The condition precedent in question was not contained in the initial draft of the Restructuring Plan put forward by the bondholders and there is no evidence as to why the condition was inserted in the Restructuring Plan. I am unable to conclude that the condition precedent was the result of a truly adversarial negotiation and that, unlike the situation in *Skeena Cellulose Inc.*, the restructuring is unlikely to proceed if the condition is not satisfied.

38 In my opinion, therefore, there is insufficient evidence for me to conclude that the proposed contract terminations are fair and reasonable in all of the circumstances. All that the evidence available to me supports is a conclusion that the restructured company will have an opportunity of being more profitable if the contracts are terminated. It has not been demonstrated that the loss of this opportunity will outweigh the prejudice which will be suffered by Hayes and Strathcona if the contracts are terminated. In weighing the competing interests on the evidence before me, it is my conclusion that I should exercise my discretion against approving the contract terminations. I dismiss the application with costs.

Application dismissed.

FN* Leave to appeal refused *Doman Industries Ltd., Re* (2004), 2004 BCCA 382, 2004 CarswellBC 1545 (B.C. C.A. [In Chambers]).

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