COURT FILE NUMBER:	2101-05019
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
	IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c C-36, AS AMENDED AND IN THE MATTER OF THE COMPROMISE OR ARRANGEMENT OF COALSPUR MINES (OPERATIONS) LTD.
DOCUMENT:	**BRIEF OF ARGUMENT OF COALSPUR MINES (OPERATIONS) LTD.** **Applications before the Honourable Madam Justice Romaine – July 9, 2021**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**OSLER, HOSKIN & HARCOURT LLP** Barristers & Solicitors Brookfield Place, Suite 2700 225 6 Ave SW Calgary, AB T2P 1N2 Solicitors: Randal Van de Mosselaer / Emily Paplawski Telephone: (403) 260-7000 Facsimile: (403) 260-7024 Email: RVandemosselaer@osler.com / EPaplawski@osler.com File Number: 1217428

PART I - INTRODUCTION

1. This Brief of Argument is filed: (a) in support of an application by Coalspur Mines (Operations) Ltd. ("**Coalspur**", or the "**Applicant**") for, among other things, a declaration that Coalspur is not compelled to perform the Terminal Services Agreement dated January 1, 2018 (as amended, the "**Ridley Agreement**") between Coalspur and Ridley Terminals Inc. ("**Ridley**"); and (b) in opposition to an application by Ridley seeking a declaration that the Ridley Agreement is not to be disclaimed or resiliated by Coalspur.

2. Coalspur is an Alberta coal development company that owns and operates a coal mining project (the "**Vista Project**") near Hinton, Alberta. Coalspur was required to seek CCAA protection in April 2021 after the Vista Project was abruptly shut down because of a permitting issue, and all remaining coal inventory was seized and sold by Coalspur's senior securityholder. While the Vista Project has resumed operations as Coalspur works to restructure, production rates continue to gradually increase and the Visa Project is expected to reach full operating capacity during the second half of 2021.

3. In addition to the Ridley Agreement, Coalspur is party to an agreement with Westshore Terminals Limited Partnership (the "**Amended Westshore Agreement**", and together with the Ridley Agreement, the "**Terminal Services Agreements**"). The Terminal Services Agreements allow Coalspur to ship its coal production to its primary markets in Asia.

4. The Ridley Agreement contains terms that are off-market and not commercially reasonable, including demanding minimum "take or pay" obligations which require Coalspur to make shortfall payments if minimum shipment payments are not met. By contrast, the Amended Westshore Agreement provides substantially identical services but on much more advantageous

terms, including significantly lower minimum shipment thresholds, which Coalspur anticipates no issue in meeting on a go forward basis.

5. Coalspur made significant, good-faith efforts to negotiate amendments to the uneconomic Ridley Agreement to make its commercial terms more competitive, both in late 2020 and immediately before these CCAA proceedings. Ridley unilaterally terminated negotiations on April 23, 2021 without providing any subsequent overture or counteroffer to reopen discussions. After filing for CCAA protection, Coalspur exercised its business judgment and, with the approval of the Monitor, sent Ridley a notice of its intent to disclaim the Ridley Agreement on May 7, 2021. Coalspur immediately stopped performing its obligations under the Ridley Agreement.

6. That same day, in a letter with a reference line reading "Post Filing Breach of Contract", Ridley advised Coalspur that it was of the view that Coalspur had an "obligation to honour [the Ridley Agreement] unless and until [the Ridley Agreement is] disclaimed in accordance with the CCAA."[1]

7. Ridley now seeks an order prohibiting Coalspur from disclaiming the Ridley Agreement and declaring that Coalspur is "bound" by the terms of the Ridley Agreement. In essence, Ridley appears to be seeking a disguised order of specific performance without invoking the test for this exceptional relief and without regard for the impact of such an order on Coalspur's restructuring efforts and other stakeholders.

8. Ridley's attempt to compel Coalspur to continue performing the uneconomic Ridley Agreement is contrary to law, and, in any event, not supported by any evidence before this Court.

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[1] Affidavit of Robert Booker, sworn May 21, 2021 (the "**Booker Affidavit**"), Exhibit 6: letter dated May 7, 2021 from David E. Gruber on behalf of Ridley to Randal Van de Mosselaer on behalf of Coalspur, page 1.

As this Court has recently confirmed in the *Bellatrix Exploration Ltd (Re)*,[2] Coalspur was entitled at any time to determine that it could no longer perform the Ridley Agreement. Like any other contracting party, Coalspur retains the freedom to stop performing a contract, as long as it is prepared to address the resulting damages, if any, in a plan or by some other means.

9. Coalspur submits that its disclaimer of the Ridley Agreement is entirely appropriate and furthers the objectives of the CCAA and of this restructuring. Coalspur has not acted in bad faith, and has not sought to improperly ambush Ridley or deprive it of rights to which it is entitled. Ridley's suggestions to this effect have no merit and have been directly and repeatedly refuted by Coalspur in its evidence and on cross-examination.

10. There is no basis for this Court to second-guess Coalspur's determination that the Ridley Agreement is uneconomic, as Ridley has invited this Court to do. As the Monitor has confirmed, Coalspur will realize significant savings and operational efficiencies by disclaiming the Ridley Agreement, all of which will materially advance Coalspur's efforts to restructure. Ridley has adduced no evidence that it will suffer significant financial hardship - one of the key factors in successfully objecting to a disclaimer under s 32 of the CCAA. In fact, Ridley has chosen not to lead any financial evidence at all, even though the onus is on Ridley to demonstrate such financial hardship.

11. Ridley's application should be denied and Coalspur's application should be granted.

PART II - FACTS

12. In early 2021, Coalspur experienced an exigent liquidity crisis caused by: (a) the shut down of the mine in February 2021 as a result of a permitting issue (the "**Permitting Issue**") with the

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2 *Bellatrix Exploration Ltd (Re)*, 2020 ABQB 809 [*Bellatrix*], leave to appeal dismissed, 2021 ABCA 85 **[TAB 2]**.

Alberta Energy Regulator ("**AER**"), thereby suspending all coal production and cutting off Coalspur's only source of revenue; and (b) the simultaneous crystallization of an approximately $59.9 million USD hedge obligation to Trafigura Pte. Ltd. ("**Trafigura**") following the rapid escalation in global coal prices in late 2020, and resulting exercise by Trafigura of its right to take title to and sell the entirety of Coalspur's coal inventory.[3] Together, these two factors meant that once the Permitting Issue was resolved, Coalspur lacked the liquidity necessary to resume operations at the Vista Project. Coalspur therefore sought the protection of the CCAA on April 26, 2021 in order to allow it to access the capital necessary to restart its operations at the Vista Project, streamline its cost structure, and restructure its business to protect against similar liquidity issues.[4]

13. After commencement of these CCAA proceedings, Coalspur restarted the Vista Project and recommenced coal production for the benefit of all stakeholders. Coalspur continues to gradually increase production rates at the Vista Project, thereby increasing the tonnage of coal produced.[5] However, the Vista Project is not intended to reach full operating capacity until the second half of 2021.[6]

A. The Terminal Services Agreements

14. Coalspur transports its coal from the Vista Project to two terminals for export: the terminal owned by Ridley and located in Prince Rupert, British Columbia ("**Ridley Terminal**"); and the terminal owned by Westshore and located in Delta, British Columbia ("**Westshore Terminal**").[7] Terminal and shipment services at each of the Ridley Terminal and the Westshore

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3 Affidavit of Michael Beyer, sworn April 19, 2021 (the "**Beyer Affidavit**") at paras 6, 12, 102-129.

4 Beyer Affidavit at paras 130, 137-139.

5 Affidavit #4 of Michael Beyer, sworn June 28, 2021 (the "**Fourth Beyer Affidavit**") at para 6(d).

6 Affidavit of James Bland sworn June 8, 2021 (the "**Bland Affidavit**") at para 7.

7 Beyer Affidavit at para 42.

Terminal are governed by the Ridley Agreement and the Amended Westshore Agreement, respectively.

(a) The Ridley Agreement

15. Under the Ridley Agreement, Ridley agreed to provide Coalspur with terminal services at the Ridley Terminal between January 1, 2019 and December 31, 2028.[8]

16. Ridley and Coalspur entered into the Ridley Agreement on January 1, 2018 – one year before the Vista Project became operational in 2019. With the benefit of operating experience, it became clear to Coalspur that the terms of the Ridley Agreement were not aligned with the practical realities of the Vista Project.[9] In particular, the shipment costs under the Ridley Agreement were in excess of market rates, and the minimum shipment targets under the Ridley Agreement were overly aggressive and unrealistic given average production rates and operating realities at the Vista Project.[10]

17. Under the Ridley Agreement:

(a) shipment costs per tonne of coal are scaled by volume: for example, in 2021, Coalspur pays $12.32 per tonne for the first million tonnes shipped, then $12.06 per tonne for the second million tonnes shipped, and so on;[11] and

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[8] Confidential Affidavit of Donald S. Swartz II, sworn June 8, 2021 (the "**Confidential Swartz Affidavit**") at para 9.

[9] Confidential Swartz Affidavit at para 15.

[10] Confidential Swartz Affidavit at para 15.

[11] Confidential Swartz Affidavit at para 18.

(b) Coalspur is required to deliver a minimum volume of coal to be shipped through the Ridley Terminal (the "**Minimum Throughput Commitment**") or pay a shortfall payment of $6 per tonne, adjusted annually for inflation. The Minimum Throughput Commitment for 2021 under the Ridley Agreement is 6.075 million metric tonnes per year.[12]

18. The Monitor has concluded that "the financial terms of the Ridley Agreements are more onerous than those available to Coalspur through the alternate vendor of Terminal Services."[13]

(b) The Westshore Agreement

19. Coalspur and Westshore were originally party to a terminal services agreement, dated July 23, 2019, pursuant to which Westshore agreed to provide Coalspur with overflow services because Ridley was unable to accommodate Coalspur's then-anticipated volume production needs.[14]

20. In the fall of 2020, as a result of a force majeure event at the Ridley Terminal, Coalspur (with Ridley's knowledge) diverted coal to be shipped through the Westshore Terminal.[15] Shipment through the Westshore Terminal proved more operationally beneficial than shipment through the Ridley Terminal.[16] Moreover, Westshore continually demonstrated willingness to

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12 Confidential Swartz Affidavit at para 19.

13 Third Report of FTI Consulting Canada Inc., in its Capacity as Monitor of Coalspur Mines (Operations) Ltd., dated June 28, 2021 ("**Monitor's Third Report**") at para 27.

14 Confidential Swartz Affidavit at para 10; Questioning on Affidavit of Donald Samuel Swartz II (By Way of Video Conference), dated June 17, 2021 (the "**Swartz Cross**") at pp. 14:18-16:7.

15 Swartz Cross at pp. 18:15-20:17.

16 See, for example, Swartz Cross at p. 18:15-27; pp. 19:27-20:9; p. 35:7-11.

work with Coalspur, including by not enforcing minimum volume commitments and liquidated damages clauses, in light of Coalspur's reduced volume needs.[17]

21. As a result of this positive experience, in May of 2021, after it had become clear that the Ridley Agreement was not reflective of market rates, and after negotiations with Ridley regarding possible amendments or buyouts of the Ridley Agreement had broken down, Coalspur commenced detailed discussions with Westshore to provide the necessary terminal and export services to Coalspur.[18]

22. Coalspur and Westshore entered into the Amended Westshore Agreement on May 19, 2021, pursuant to which Westshore agreed to provide Coalspur with terminal services at the Westshore Terminal [redacted].[19]

23. By contrast with the Ridley Agreement:

(a) [redacted];[20] and

(b) [redacted]

17 Swartz Cross at p. 20:12-17.

18 Swartz Cross at p. 29:2-13; p. 31:1-14.

19 Confidential Swartz Affidavit at para 10.

20 Confidential Swartz Affidavit at para 20.

[redacted].[21]

24. Based on projected shipments of 4 million tonnes of coal in 2021 (May to December) and 6 million tonnes each year thereafter, no shortfall payments should ever become due and owing by Coalspur under the Amended Westshore Agreement. However, in both scenarios, significant amounts would be due and owing to Ridley for failure to meet minimum volume requirements under the Ridley Agreement.

25. In addition to the foregoing, the distance by rail from the Vista Project to the Westshore Terminal is approximately 24% shorter than the distance from the Vista Project to the Ridley Terminal.[22] If the Ridley Agreement is disclaimed and coal is shipped from the Vista Project only to Westshore, cumulative transportation-related savings alone are projected to be between [redacted] over the life of the Amended Westshore Agreement.[23]

B. Coalspur's Good Faith Efforts to Negotiate with Ridley

26. Given the serious impact of the Ridley Agreement on Coalspur's operations and cash flows, Coalspur engaged in significant good faith discussions with Ridley to amend the Ridley Agreement to ameliorate its more onerous terms and allow a viable structure to be negotiated. Such negotiations began in September 2020 as part of a broader process undertaken by Coalspur during the latter part of 2020 and the early months of 2021 to work with key stakeholders to address the

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[21] Confidential Swartz Affidavit at para 20.

[22] Confidential Swartz Affidavit at para 23.

[23] Confidential Swartz Affidavit at para 29; Confidential Supplemental Report to the Third Report of FTI Consulting Canada Inc., in its Capacity as Monitor of Coalspur Mines (Operations) Ltd., dated June 28, 2021 (the "**Confidential Monitor's Supplement**") at para 17.

cash flow issues that Coalspur was projecting for 2021, and to facilitate Coalspur's short- and long-term viability.[24] Such discussions included: (a) a conference call between Coalspur, Ridley, and Canadian National Railway ("**CN**") on September 15, 2020 to discuss performance issues at Ridley, deteriorating market prices for coal, and other market dynamics; and (b) further conference calls between Coalspur and Ridley on October 29, 2020, October 30, 2020, and December 6, 2020, during which Coalspur raised concerns regarding the economic feasibility of the Ridley Agreement.[25]

27. In anticipation of the conversation with Ridley on October 30, 2020, Coalspur circulated to Ridley a forecast detailing Coalspur's anticipated 2020 and 2021 cash flows. Coalspur projected that it would generate significant negative cash flows in 2021, notwithstanding the implementation of significant cost-cutting and debt-service measures. The forecast was intended to convey to Ridley Coalspur's need to manage expenses in order to maintain profitable operations and to establish a cost structure compatible with the continued operation of the company.[26]

28. Notwithstanding Coalspur's attempts to negotiate with Ridley through the fall and early winter of 2020, Ridley was not receptive to providing cost relief to Coalspur.[27]

29. In April 2021, immediately prior to obtaining CCAA protection, Coalspur made one final effort to negotiate a commercial resolution of the Ridley Agreement with Ridley. Between April 15 and 23, 2021, Coalspur engaged in significant without prejudice discussions with representatives of Ridley's ownership group regarding both amendments to the Ridley

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[24] Affidavit of Donald S. Swartz II, sworn June 8, 2021 (the "**Public Swartz Affidavit**") at para 18.

[25] Public Swartz Affidavit at para 19.

[26] Public Swartz Affidavit at para 20.

[27] Public Swartz Affidavit at para 22.

Agreement and a termination of the Ridley Agreement in exchange for certain payments by Coalspur and a mutual release between the parties.[28] Ridley terminated such discussions on April 23, 2021.

30. Ridley falsely alleges that Coalspur concealed its intention to file for protection under the CCAA from Ridley. However, the evidence – including that of Ridley's own affiants on cross-examination – clearly demonstrates the falsity of this assertion. Ridley's own affiant, Mr. Robert Booker, confirmed on cross-examination that: (a) during negotiations in mid-April, Coalspur's representatives advised Ridley's representatives that they may need to file for CCAA protection, (b) Ridley was provided with draft CCAA materials by Coalspur in mid-April, (c) Coalspur served Ridley with its CCAA application materials on April 20, 2021 – 6 days before the CCAA initial application, and (d) Ridley's counsel attended Coalspur's application for an initial CCAA order on April 26, 2021.[29]

31. Mr. Booker also confirmed in cross-examination that pre-filing negotiations between Ridley and Coalspur reached an advanced stage: indeed, the parties came to an agreement to terminate the Ridley Agreement and provide a mutual release in exchange for a payment from Coalspur to Ridley of $18 million.[30] However, the parties could not agree on payment terms. Coalspur offered to pay Ridley $12 million immediately and then the remaining $6 million over time; Ridley refused these terms and demanded immediate payment of the full $18 million.[31]

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[28] Public Swartz Affidavit at para 25.

[29] Transcript of Oral Questioning of Robert Allan Booker (On affidavit sworn May 21st, 2021) Held via videoconferencing, June 3, 2021 (the "**Booker Cross**") at p. 13:18-23; p. 20:16-25; p. 20:10-15; p.21:1-8.

[30] Booker Cross at pp. 13:1-17:2.

[31] Booker Cross at pp. 14:20-17:16.

32. As a result of this disagreement over payment terms, Ridley unilaterally terminated the negotiations on April 23, 2021.[32] Ridley made no overtures to Coalspur after terminating the negotiations. Coalspur filed for CCAA protection three days later.

PART III - LAW AND ARGUMENT

33. The three issues to be resolved on this application are whether:

(a) Ridley's objection to Coalspur's disclaimer of the Ridley Agreement should be rejected pursuant to section 32 of the CCAA;

(b) Coalspur is compelled to perform the Ridley Agreement or remedy any existing defaults thereunder until the Ridley Agreement is disclaimed; and

(c) Any amounts owing by Coalspur to Ridley under the Ridley Agreement constitute pre-filing unsecured claims.

A. CCAA Test for Disclaimer of the Ridley Agreement is Satisfied

34. Section 32 of the CCAA grants debtors the ability to disclaim contracts in a CCAA proceeding.[33] Section 32(1) provides that a debtor may, with the consent of the monitor, disclaim or resiliate any agreement to which the debtor was a party on the date of the initial order. If a counterparty objects to the disclaimer, the counterparty may apply to the CCAA court pursuant to section 32(2) for a determination that the agreement is not to be disclaimed or resiliated.

35. Section 32(4) outlines the following factors a court must consider (among others) when evaluating a counterparty's objection to a disclaimer:

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

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[32] Booker Cross at p. 17:5-17; Public Swartz Affidavit at para 25.

[33] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 **("CCAA")** at s. 32 **[TAB 1]**.

> (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.

Importantly, no single factor is definitive, and section 32(4) is not exhaustive.[34] A court may consider other factors when determining whether an agreement should be disclaimed.

36. In the circumstances facing Coalspur, each of the section 32(4) factors militates in favour of upholding the disclaimer of the Ridley Agreement. Termination of the Ridley Agreement is appropriate, reasonable and arose after good faith negotiations failed to achieve a consensual resolution that would preserve the relationship between Coalspur and Ridley on commercially reasonable terms.[35] Moreover, disclaiming the Ridley Agreement fulfills the broad remedial and equitable purposes at the heart of the CCAA. The Monitor has concluded that disclaimer of the Ridley Agreement will enhance Coalspur's prospects of achieving a viable restructuring.[36]

37. CCAA courts will not lightly overrule the combined judgment of the Monitor and the debtor that the disclaimer of an uneconomic contract is appropriate and will assist the debtor in achieving a restructuring. Both the business judgment of the debtor and the opinion of the Monitor have been given, and should be given, significant weight in CCAA proceedings.[37]

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[34] *Re Aveos Fleet Performance Inc*, 2012 QCCS 6796 [*Aveos*] at para 39 **[TAB 3]**.

[35] *Re Allarco Entertainment Inc*, 2009 ABQB 503 [*Allarco*] at para 59 **[TAB 4]**.

[36] Monitor's Third Report at paras 27 and 35.

[37] See for example *Nortel Networks Corporation (Re)*, 2018 ONSC 6257 at para 27 **[TAB 5]**; *Aralez Pharmaceuticals Inc. (Re)*, 2018 ONSC 6980 at para 36 **[TAB 6]**; and *Aveos* at para 53 **[TAB 3]**.

(a) Disclaimer will enhance the prospects of a viable restructuring

38. Both pre- and post-2009 case law affirm that a disclaimer need only *enhance* the prospects of a viable restructuring in order to be permissible – the debtor is not required to prove that disclaimer is essential or that disclaimer is the only alternative.[38] CCAA courts will approve a disclaimer where it is advantageous and beneficial to a restructuring.[39]

39. Even where the debtor could continue to operate while maintaining a disclaimed contract, the disclaimer may still enhance the prospects of a viable restructuring. As Justice Morawetz noted, "Although the savings realized from the disclaimer do not, in isolation, represent a significant amount, in my view, that is not the end of the inquiry. In order to enhance the prospects of a viable plan of reorganization being put forward, it is necessary to assess the totality of what [the debtor] is attempting to achieve in this restructuring."[40]

40. Coal is a volatile commodity from a price perspective. Ridley's own evidence illustrates that between August 2020 and March 2021, the Newcastle average benchmark coal price varied between $49.75/tonne and $93.95/tonne – an 89% difference.[41] In this CCAA proceeding, Coalspur is seeking to restructure its business to ensure that its operations remain viable during periods of both high and low commodity prices. Coalspur must streamline costs and minimize

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[38] See for example *Re Timminco Ltd*, 2012 ONSC 4471 [*Timminco*] at para 54 **[Tab 7]**; *Homburg Invest Inc*, 2011 QCCS 6376 at para 103 **[Tab 8]**, leave to appeal refused, 2012 QCCA 665; *Aveos* at paras 48-49 **[Tab 3]**.

[39] *Re AbitibiBowater*, 2009 QCCS 2188 [*AbitibiBowater*] at para 23 **[Tab 9]**.

[40] *Laurentian University of Sudbury*, 2021 ONSC 3272 [*Laurentian*] at para 56 **[Tab 10]**, leave to appeal refused, 2021 ONCA 448.

[41] Affidavit of Cordell Dixon, sworn May 21, 2021 (the "**Dixon Affidavit**"), Exhibit 12: Excel Report of Current and Future Thermal Coal Prices Prepared by Mr. Adrian Lunt, a Commodities Research & Derivatives Trading Analyst of American Metals & Coal International, Inc., dated May 10, 2021, page 1; Public Swartz Affidavit at paras 10-13.

unnecessary expenses to ensure that the company can weather the changes in commodity prices and is not exposed to ongoing liquidity issues moving forward.[42]

41. Consistent with these goals, Coalspur estimates that disclaiming the Ridley Agreement will save Coalspur [redacted] in 2021 alone, thereby significantly facilitating its restructuring efforts and ongoing CCAA proceeding.[43] Further, by disclaiming the Ridley Agreement and shipping its coal production through the Westshore Terminal, Coalspur projects total savings over the life of the Amended Westshore Agreement of approximately [redacted], comprised of [redacted].[44]

42. Ridley has suggested that, [redacted], at some production rate, the Ridley Agreement becomes more economic than the Westshore Agreement.[45] This suggestion should be given no weight. Coalspur is only licensed to operate Phase 1 of the Vista Project.[46] Phase 1 has a capacity of 6.5 million tonnes per year.[47] While Coalspur has applied to obtain necessary permits to operate Phase II of the Vista Project and the Underground Test Mine, which together would approximately double mine output, such applications are currently tied up in the judicial review process before the Federal Court.[48] Coalspur estimates that production of 6 million

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42 Beyer Affidavit at para 137; Confidential Swartz Affidavit at para 15.

43 Confidential Swartz Affidavit at para 36.

44 Confidential Swartz Affidavit at para 36.

45 Swartz Cross at p. 53:5-23.

46 Beyer Affidavit at para 29.

47 Beyer Affidavit at para 30.

48 Beyer Affidavit at paras 34-36; Swartz Cross at p. 17:1-2.

tonnes per year will be achieved in the coming years.[49] At 6 million tonnes per year, the Amended Westshore Agreement is significantly more economically advantageous than the Ridley Agreement.

43. Moreover, the Ridley Agreement's Minimum Throughput Commitment (6.075 million tonnes of coal shipped per year) is higher than the current projected output at the Vista Project both for 2021 and in all future years, triggering a requirement by Coalspur to make an annual shortfall payment to Ridley.[50] At a minimum throughput of [redacted] tonnes per year, no such payment is expected to become due and owing under the Amended Westshore Agreement, thereby resulting in both short- and long-term cost savings for Coalspur.

44. Recognizing that it is able to achieve substantially identical service under the Amended Westshore Agreement under more favourable terms and with lower risk of shortfall payments than under the Ridley Agreement, Coalspur exercised its business judgment to disclaim the Ridley Agreement with the consent of the Monitor.[51] It is the view of both the Monitor and Coalspur that disclaiming the Ridley Agreement will enhance the prospects of a successful restructuring and enable Coalspur to emerge from CCAA protection as a more resilient entity.[52] Given the significant cost savings that Coalspur will realise as a result of the disclaimer, this conclusion by the Monitor and Coalspur is well-founded.

45. In challenging this decision, Ridley relies on erroneous extrapolations of Coalspur's 13-week cash flows and makes numerous unfounded assumptions to argue, in an

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[49] Confidential Swartz Affidavit at para 19.

[50] Public Swartz Affidavit at para 17.

[51] Confidential Swartz Affidavit at para 15.

[52] Monitor's Third Report at para 51.

artificially simplistic way, that Coalspur could survive as a company while maintaining the Ridley Agreement.[53] Ridley goes so far as to propose that another stakeholder should simply waive its right to payment for management services as a cost-saving measure to enable Coalspur to continue performing under the Ridley Agreement.[54] There is no basis on which this Court can engage in this hypothetical and speculative exercise. Even Ridley's representative admitted on cross-examination that his calculations are inaccurate and riddled with unstated assumptions.[55]

46. On the revenue side, Mr. Dixon's model depends for its accuracy on future price forecasts made by a Mr. Adrian Lunt.[56] Not only does this Court have essentially no information about who Mr. Lunt is and why he ought to be qualified to provide opinion evidence on the future price of coal, but the little we do know about Mr. Lunt is that he works for an organization that is a partial owner of the Ridley Terminal (or at least works for a company that has a relationship with AMCI Group – which is an owner of RTI).[57] Moreover, as Mr. Swartz point out in his cross-examination, Coalspur has no way "to hedge or lock in the pricing that we're currently experiencing."[58]

47. Even if Ridley's calculations were accurate (and they are not), the test that Ridley purports to apply is not the test for opposing a disclaimer under section 32 of the CCAA. The test

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53 Mr. Dixon acknowledged on cross-examination that these calculations omitted several significant costs associated with operating a business and that he made several unwarranted assumptions in preparing his calculations: Transcript of Oral Questioning of Cordell Dixon (On affidavit sworn May 21st, 2021) Held via videoconferencing, June 3, 2021 (the "**Dixon Cross**") at pp. 48:22-50:13; pp. 51:18-54:8; p. 57:17-22; pp. 57:24-59:23; pp. 61:2-63:15; pp. 64:6-66:5.

54 Dixon Affidavit at paras 35, 36, and 38; Bland Affidavit at paras 11-13.

55 Bland Affidavit at paras 7-10.

56 Dixon Affidavit at para 30.

57 Dixon Cross at pp. 42:17-44:14.

58 Swartz Cross at p. 50:10-15.

is not whether a debtor company could continue to maintain a commercially unreasonable agreement at the expense of other stakeholders and in the face of future jeopardy to its economic viability. Nor is the test whether there are measures available, however unreasonable or commercially onerous, that could allow the debtor to preserve a contract for the benefit of one stakeholder. The relevant factor refers to whether the disclaimer will enhance the debtor's ability to restructure for the benefit of all stakeholders. Coalspur submits that such factor is clearly and unequivocally established on the evidence in this case.

(b) No significant financial hardship

48. A court must consider whether a counterparty will experience significant financial hardship when determining whether to authorize a disclaimer. Apart from bald unsupported assertions of financial jeopardy, Ridley has led no financial evidence whatsoever to establish that it will suffer significant financial hardship.

49. Whether disclaimer of an agreement will cause "significant financial hardship" to the counterparty is a subjective test, requiring a close examination of the individual circumstances and character of the counterparty.[59] It is not an objective test measured merely by the dollar value of the contract – mere loss of a revenue stream alone is not sufficient.[60] As Justice Morawetz concluded, "an objective test for 'significant financial hardship' would make it difficult to [*sic*] debtor companies to disclaim large contracts regardless of the financial ability of the counter

59 *Timminco* at para 60 **[TAB 7]**.

60 *Aveos* at para 40 **[TAB 3]**.

parties to absorb the resultant losses."[61] Such a result would be contrary to the purposes of the CCAA.[62]

50. To resist disclaimer under section 32, a creditor must establish that it is uniquely affected by the proposed disclaimer, over and above the negative effects experienced by all other creditors or counterparties to disclaimed contracts. In words endorsed by Justice Morawetz,

> On its own terms ***the CCAA effectively imposes a high threshold, beyond economic or financial loss, for the consideration under section 32(4): there must be evidence of financial hardship, it must be significant financial hardship, and it must be likely to be caused by the disclaimer***. Financial loss or damage, without more, is not sufficient...It appears that Section 32 itself recognizes the distinction, providing expressly in ss. 32(7) that where a party suffers "a loss" in relation to the disclaimer the consequence is that such party "is considered to have a provable claim."[63]

51. Courts will not permit a counterparty to allege significant financial hardship merely to improve its own position at the expense of other unsecured creditors. The equities generally favour permitting disclaimer that ensures like creditors receive equitable treatment:

> [T]he 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.[64]

(i) No evidence of significant financial hardship

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61 *Timminco* at para 60 **[TAB 7]**.

62 *Timminco* at para 60 **[TAB 7]**.

63 *Re Target Canada Co*, 2015 ONSC 1028 at para 26 **[TAB 11]**.

64 *Timminco* at para 62 **[TAB 7]**.

52. Since the test for significant financial hardship is subjective, the onus is on Ridley to establish that it will experience significant financial hardship, over and above the mere loss of a significant revenue stream, as a result of Coalspur's disclaimer of the Ridley Agreement. Ridley has adduced no such evidence. In fact, it has adduced no financial evidence at all. It has not provided copies of its financial statements, nor has it included any projections showing the anticipated impact of the disclaimer on its future revenue stream. In the absence of such evidence, there is no basis on which this Court can conclude that this factor is satisfied.

53. Ridley baldly states in its Application that the disclaimer will result in its own insolvency. In its supporting Affidavits, however, it adduces no such evidence. Ridley merely reiterates in its evidence (significantly less definitively) that "Ridley anticipates that it would be <u>pushed to the brink of insolvency</u> by the end of the year."[65] Notably absent from its evidence is even a bald statement that the disclaimer will <u>cause</u> Ridley to become insolvent.

54. Where CCAA counterparties have sought to resist disclaimer on the grounds that their own solvency is at risk, the counterparties have (unlike Ridley) provided detailed financial information to support this claim. However, even where such evidence is provided, this factor is not determinative.

55. For example, in *Laurentian*, Justice Morawetz confirmed the disclaimer of a contract over the opposition of a counterparty (Thorneloe), which provided firm evidence that it would become insolvent if the contract was disclaimed. In *Laurentian*, the debtor established that disclaimer of three contracts, including Thorneloe's, would save it between $7.1-7.3 million

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[65] Booker Affidavit at para 60.

annually.[66] Thorneloe argued that notwithstanding such savings, disclaimer of the contract would not result in a material improvement to the debtor's financial situation. To support this claim, Thorneloe filed a report by a qualified insolvency and restructuring expert discussing the financial impact that the disclaimer would have on Thorneloe based on its historical audited financial statements of Thorneloe.[67] The report concluded that disclaimer would result in significant financial hardship to Thorneloe, causing it to seek insolvency protection, while not enhancing the debtor's liquidity or restructuring prospects.[68]

56. Notwithstanding this expert evidence, the CCAA court authorized the disclaimer. Justice Morawetz noted, "Thorneloe was offered alternatives…More importantly, it is also necessary to take into account that if Laurentian's restructuring does not succeed and it ceases operations, Thorneloe, as conceded by its counsel, will also be unable to continue operations."[69] In *Laurentian*, the Court found that even compelling evidence establishing a likelihood of counterparty insolvency was insufficient to justify imperiling a debtor company's restructuring.

57. Similarly, in *AbitibiBowater*, a contracting counterparty (SFK) opposed a disclaimer and provided evidence that "its survival [was] at stake because… it [would] be unable to respect the solvency ratios under its financial covenants" if the contract was disclaimed.[70] To support this argument, SFK provided its internal forecasts for that year and its consolidated

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66 *Laurentian* at para 37 **[TAB 10]**.

67 Supplementary Motion Record of Thorneloe University dated April 19, 2021, Tab 2: Affidavit of Allan Nackan, sworn April 19, 2021, Exhibit A, Appendix 3 at 403, online (pdf): <https://documentcentre.ey.com/api/Document/download?docId=33441&language=EN>; *Laurentian* at para 38 **[TAB 10]**.

68 *Laurentian* at paras 41-42 **[TAB 10]**.

69 *Laurentian* at para 68 **[TAB 10]**.

70 *AbitibiBowater* at para 54 **[TAB 9]**.

financial statements for three preceding years.[71] The court rejected SFK's arguments and authorized the disclaimer because the financial position of the debtor was worse than that of the creditor, even if the creditor's solvency was threatened. Furthermore, the court noted that SFK had not established that it could not obtain alternate supplies elsewhere if the contract was disclaimed.[72]

58. Both Mr. Booker and Mr. Dixon acknowledged in cross-examination that Ridley has prepared detailed financial statements and forecasts, in addition to detailed breakdowns of its own customer base.[73] Ridley has chosen not to produce these materials.[74]

59. Ridley's sole explanation for declining to provide such available evidence is that the materials are "confidential".[75] However, this is no response to the issue. Sealing orders are readily available to protect genuinely confidential information in CCAA proceedings. Indeed, Coalspur has adduced significant confidential material on this application to demonstrate the extent to which the Ridley Agreement disclaimer will enhance its prospects to restructure. To facilitate such disclosure, Coalspur negotiated limited consents to disclosure with Westshore and CN, made confidentiality arrangements with Ridley and its counsel, and obtained a Restricted Court Access Order.

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[71] *AbitibiBowater* at paras 52-53 **[TAB 9]**.

[72] *AbitibiBowater* at para 58 **[TAB 9]**.

[73] Booker Cross at pp. 29:21-31:10; Dixon Cross at p. 8:10-15; Dixon Cross, pp. 14:11-15:23.

[74] Booker Cross at pp. 29:12-30:10; see also Dixon Cross at pp. 40:12-41:25 for additional documents Ridley has not fully produced.

[75] Booker Cross at pp. 36:25-37:15.

60. Further, as the Court noted in *Re Quest University Canada,* "any financial consequences to Southern Star will largely depend on what mitigating measures are undertaken."[76] Such statement applies equally to Ridley. The financial consequences of the disclaimer to Ridley will depend on the extent to which Ridley is unable to mitigate its damages. Ridley has provided no evidence on this issue. Indeed, Ridley's evidence suggests that Ridley was prepared to terminate the Ridley Agreement with Coalspur for payment of $18 million USD because such payment permitted Ridley to partially mitigate its damages.[77] With no financial evidence at all, and no clear evidence of whether or how Ridley might mitigate its damages, this Court is unable to ascertain whether Ridley's financial hardship is "significant".[78]

61. A party seeking relief in a CCAA proceeding must be prepared to prove its case. It is not reasonable to ask the Court and all parties to accept bald assertions of significant financial hardship on faith. In the absence of any actual financial evidence from Ridley, it can only be inferred that the financial evidence that Ridley chose not to produce was not supportive of its case.

62. In any event, the evidence that has been adduced both by Ridley and Coalspur in respect of Ridley's Application undermines its assertions of financial hardship. First, in his affidavit, Mr. Booker misleadingly alleges that Coalspur's coal shipments represented approximately 40% of shipment volumes at Ridley Terminal – suggesting by implication that the loss of Coalspur's contract volume would be devastating.[79] However, Mr. Booker acknowledged

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[76] *Re Quest University Canada*, 2020 BCSC 1883 [*Quest*] at para 109 **[TAB 12]**, leave to appeal refused, 2020 BCCA 364.

[77] Booker Affidavit at para 30: during the pre-filing period, Ridley was prepared to accept a buyout of the Ridley Agreement because "a substantial upfront cash payment would very materially enhance Ridley's financial ability to make the necessary investments that would be required to be able to handle wood pellets, which bulk product has a more promising future than thermal coal."

[78] *Quest* at para 109 **[TAB 12]**.

[79] Booker Affidavit at para 65.

on cross-examination that these numbers are wrong.[80] In fact, Coalspur shipments only represented 30.8% of total shipments at Ridley Terminal, and then only in 2020.[81]

63. The Vista Project has only been operational since 2019.[82] Coalspur's first shipment of coal to Ridley only occurred in May 2019.[83] In 2019, Coalspur's shipments amounted to 6% of the Ridley Terminal's shipment of coal and related products and only 5.4% of total volumes shipped from Ridley Terminal.[84] For the years 2018 and earlier, Coalspur did not ship any coal through Ridley Terminals, or at all.[85] Ridley's evidence of the allegedly devasting impact of the loss of Coalspur's shipments is therefore fundamentally misleading and demonstrably incorrect.

64. Second, even excluding the volume of coal shipped by Coalspur through the Ridley Terminal in 2020, Ridley shipped greater commodity volumes through the Ridley Terminal in 2020 than it did in 2018 (the year prior to receipt of any volumes from Coalspur) or any other reported year between 2014 and 2018.[86] Total volumes shipped from Ridley Terminal in 2018 (i.e., the year prior to Coalspur starting to ship coal from Ridley Terminal) was 9,124,068 tonnes.[87] In

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80 Booker Cross at pp. 32:11-34:3.

81 Public Swartz Affidavit at para 29(i); see also Public Swartz Affidavit, Exhibit B. Coalspur understands that the transcript of Mr. Swartz's cross-examination erroneously refers to Coalspur shipments representing 38% of total shipments at Ridley Terminal. This is either a transcription error or Mr. Swartz misspoke. As Exhibit B to the Public Swartz Affidavit demonstrates, Coalspur shipments represented only 30.8% of total shipments at the Ridley Terminal. In his cross-examination, Mr. Booker confirmed that the numbers contained in Exhibit B were substantially correct: Booker Cross at p. 26:9-15.

82 Beyer Affidavit at para 28.

83 Booker Cross at p. 31:12-23.

84 Monitor's Third Report at paras 42-43; Public Swartz Affidavit at para 29(i).

85 Public Swartz Affidavit at para 28; Dixon Cross at p. 12:16-25.

86 Public Swartz Affidavit at para 29(b).

87 Public Swartz Affidavit at para 29(b).

2020, excluding Coalspur's volumes, Ridley Terminal shipped 9,382,191 tonnes.[88] It is clear from such data that Ridley's growth and operational viability is in no way tied to Coalspur as it now suggests.

65. Third, even without Coalspur's shipments, coal shipment volumes at Ridley Terminal continued to increase. In August of 2019, Ridley signed an agreement with Teck Resources for a term of January 2021 through January 2027 (the "**Teck Agreement**") increasing the amount of coal delivered by Teck Resources from 3 million tonnes per year to 6 million tonnes per year.[89] Under the Teck Agreement, Teck also has the option to increase their coal deliveries to the Ridley Terminal to up to 9 million tonnes per year.[90]

66. Lastly, from a pure financial perspective, the last available financial statements for the Ridley Terminal (which Coalspur obtained from publicly available sources on the internet as no such information has been produced by Ridley in this matter) show that, in 2018, Ridley had total revenues of $117,792,000 and total comprehensive income of $47,170.000 – all before shipping a single piece of coal from the Vista Project.[91]

67. In the words of the Monitor, "Ridley Terminal has a long history of operating without revenue or coal delivered from Coalspur. Ridley has been receiving coal from Coalspur for ~2 years of its over 35-year history…Given the relatively short business relationship between Coalspur and Ridley and that the loss of coal deliveries from Coalspur would put Ridley back in line with historical export volumes they operated at from 2017 to 2019 (excluding Coalspur's 6%

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88 Public Swartz Affidavit at para 29(b).

89 Dixon Cross at p. 31:3-19.

90 Dixon Cross at p. 31:20-23.

91 Dixon Cross at p. 11:7-19 and Exhibit 1 at p. 27.

share of production in 2019), it is the Monitor's view that the Ridley Disclaimer will not cause significant financial hardship to Ridley."[92]

(ii) Balance of prejudices

68. Coalspur does not dispute that disclaimer of the Ridley Agreement, made in the exercise of Coalspur's business judgment and with the Monitor's approval, will leave Ridley with a potential damages claim for resulting losses against Coalspur that it may not be able to recover in full, or perhaps at all, within these CCAA proceedings. However, this loss is simply a consequence of Coalspur's insolvency, which impacts all stakeholders. This loss does not rise to the level of significant financial hardship. As the British Columbia Court of Appeal observed (regarding disclaimer of contracts in a CCAA plan):

> …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. […] ***many individuals and corporations, as well as the Province, incurred major losses under the Plan. Each of them might also ask "Why me?" However… that is a frequent and unfortunate fact of life in CCAA cases, where the only "upside" is the possibility that bankruptcy and even greater losses will be averted.***[93]

69. Furthermore, and in any event, even if Ridley will experience significant financial hardship – which cannot be assumed in the absence of any evidence – this factor is only one among

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92 Monitor's Third Report at paras 49-50.

93 *Re Skeena Cellulose Inc*, 2003 BCCA 344 at para 60 **[TAB 13]**.

many that determine whether the disclaimer should be authorized. If Coalspur is unable to achieve a viable restructuring, very significant hardship will be experienced by all stakeholders. This prejudice must be balanced against the prejudice experienced by Ridley upon disclaimer of the Ridley Agreement, even if such prejudice to Ridley rises to the level of "significant financial hardship" (which is denied).

70. In support of its Application, Ridley invokes certain alleged prejudice in the form of employee layoffs and, more generally, harm to the Prince Rupert community resulting from the economic impact of Coalspur's disclaimer of the Ridley Agreement. Coalspur is unaware of any CCAA case law in which "harm to a community" has been held to preclude the disclaimer of an executory contract to which a CCAA debtor is a party (particularly in the absence of any evidence that the counterparty itself will suffer significant financial hardship). In any event, once again, Ridley overstates this concern.

71. Ridley contends that the disclaimer of the Ridley Agreement will result in the termination of 40 employees, which Ridley characterizes as "mass layoffs".[94] Assuming these numbers are correct, there is no doubt that such terminations will cause hardship to those laid off. However, by its own representation, Ridley will still employ over 100 people.

72. More importantly, such prejudice must be balanced against the very severe prejudice to Coalspur and the community of Hinton if Coalspur cannot successfully restructure. The Vista Project is one of the single largest employers in the Hinton and Edson areas of Alberta,

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[94] Booker Affidavit at paras 66-67. At the end of 2020, Ridley had 141 employees: Booker Cross at p. 35:6-10. Ridley contends that it has already terminated 6 people (leaving 135 employees) and will have to terminate 14 people later this month (for a total of 20 terminations), and "further anticipates that additional rounds of layoffs of 15% of Ridley's current staff will be required in the fall": Booker Affidavit at para 66. 15% of 135 is 20.25. Since it is not possible to terminate one-quarter of one employee, Coalspur assumed 20 additional terminations in the fall, for a total of 40 terminations.

a region that has been severely impacted by the suspension of Coalspur's operations and the movement to care and maintenance of three adjacent mines between 2014 and 2019.[95] Before its forced shutdown in February 2021, the Vista Project employed more than 300 individuals, many of whom are from local Indigenous groups.[96] If Coalspur can successfully restructure, and if necessary regulatory approvals are eventually obtained for approval of Phase II of the Vista Project and the Underground Test Mine, an additional 370 full-time jobs could be created in this region.[97]

73. The potential prejudice to the community if Coalspur cannot successfully restructure clearly outweighs any alleged prejudice to the Prince Rupert community from the disclaimer of the Ridley Agreement.

(c) No Bad Faith

74. Ridley suggests that Coalspur has failed to negotiate in good faith to preserve the Ridley Agreement. Such a suggestion is patently false, as discussed above at paragraphs 26 to 32. Further, and in any event, the Ontario Superior Court has recently affirmed that any failure of the debtor to negotiate with a counterparty to a contract that is to be disclaimed does not constitute bad faith.[98]

75. Ridley has further asserted that Coalspur's decision to cease performing the Ridley Agreement is "willful and commercially immoral conduct" that is "simply contemptuous of the

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[95] Beyer Affidavit at para 37.

[96] Beyer Affidavit at para 38.

[97] Beyer Affidavit at para 38.

[98] *Laurentian* at paras 71-72 **[TAB 10]**.

CCAA process."[99] However, as this Court has noted, "It is not unusual for a CCAA debtor to fail to perform uneconomic ongoing monthly contracts, both before and after filing, whether formally disclaimed or not, and such failure to perform is not per se bad faith."[100]

76. For all of the above reasons, Ridley's objection to the disclaimer of the Ridley Agreement cannot be sustained.

B. "Specific Performance" By Any Other Name

77. As an adjunct to its opposition to the disclaimer, Ridley seeks an order that Coalspur is "bound" by the terms of the Ridley Agreement. Coalspur does not dispute that the Ridley Agreement is (or was) a binding agreement; however, it disclaimed such agreement and decided to immediately cease performing (i.e. to breach) its onerous obligations thereunder, as it is entitled to do. These steps were taken in good faith, with a view to furthering its restructuring for the benefit of all stakeholders.

78. Ridley's request therefore appears to be a disguised attempt to obtain a decree of specific performance. Coalspur submits that there is no explicit or implicit obligation of specific performance under the CCAA during the interim period between delivery of a notice of disclaimer and the determination of an objection, or otherwise. In fact, this Court has recently confirmed in *Bellatrix* that no such obligation exists.

79. Coalspur was entitled to determine in its business judgment that it was in the best interest of its stakeholders to cease performance of the uneconomic Ridley Agreement, even before

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99 Booker Affidavit, Exhibit 9: letter dated May 10, 2021 from David E. Gruber on behalf of Ridley to Randal Van de Mosselaer on behalf of Coalspur, page 2.

100 *Bellatrix* at para 102 **[TAB 2]**.

its disclaimer took effect, and to benefit from the terms provided by the Amended Westshore Agreement. As CCAA courts have held on numerous occasions, a CCAA debtor, like any contracting counterparty, can breach a contract, leaving the counterparty with a claim for damages (if any).[101] This principle applies whether or not the debtor has chosen to invoke the process provided in section 32 of the CCAA to formally disclaim the agreement, thereby benefitting from the certainty created by that process, particularly the statutory effective date.

80. This principle was recently confirmed by this Court in *Bellatrix.* In that case, the CCAA debtor and a creditor (BP) were parties to an eligible financial contract (EFC) which, under the CCAA, could not be disclaimed. BP argued that the disclaimer provisions of the CCAA should be read as imposing a default order of specific performance on all executory contracts to which the debtor was a party: "BP submits that the 'clear implication' of the statutory disclaimer provisions of the CCAA is that a company is required to perform its obligations under executory contracts as of the filing date, unless and until those contracts can be validly disclaimed under section 32."[102]

81. Ridley has made a similar argument in this proceeding. In its letter of May 7, 2021, Ridley's counsel wrote: "Coalspur sought and obtained from the Court the benefit of a stay of proceedings of its agreements, including with Ridley. <u>It has a corresponding obligation to honour those agreements unless and until they are disclaimed</u> in accordance with the CCAA."[103]

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[101] See for example *Re Blue Range Resource Corp*, 1999 ABQB 1038 [*Blue Range*] at para 36 **[TAB 14].**

[102] *Bellatrix* at para 42 **[TAB 2]**.

[103] Booker Affidavit, Exhibit 6: letter dated May 7, 2021 from David E. Gruber on behalf of Ridley to Randal Van de Mosselaer on behalf of Coalspur, page 1.

82. There is no support in the CCAA for this position and it was rejected by this Court in *Bellatrix*. A CCAA initial order does not impose an order of specific performance on all contracts and invoking the section 32 disclaimer process does not imply a mandate of specific performance in the interim, even where a counterparty objects. Unless a counterparty seeks and obtains an order of specific performance – and satisfies the very high test for such a decree, which Ridley has not done – a CCAA debtor retains the ability to unilaterally stop performing its contractual obligations, leaving the counterparty with a claim for its losses. As this Court noted in *Bellatrix*, "the CCAA does not prohibit a debtor from failing to perform a contract, be it an EFC or otherwise. Nor is it correct that in failing to perform the GasEDI Agreement, Bellatrix is in breach of a court order. There is nothing in either the EFC Decision or the order that emanates from it that compels performance of the agreement"[104] (emphasis added).

83. The implications of Ridley's assertion that Coalspur has an "obligation to honour [the Ridley Agreement] unless and until [the Ridley Agreement is] disclaimed in accordance with the CCAA"[105] (or of interpreting the CCAA as implicitly imposing an obligation of specific performance) run contrary both to the reasons in *Bellatrix* and the policies underlying the CCAA. Specifically, if accepted, Ridley's position would effectively disrupt the *pari passu* regime with respect to unsecured creditors and would put a CCAA debtor at a disadvantage vis-à-vis its creditors – a disadvantage not shared by other companies outside CCAA protection.

84. CCAA courts have often emphasized that specific performance works an inequity on other stakeholders. As a CCAA court noted in respect of a counterparty's efforts to prohibit a

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104 *Bellatrix* at para 84 **[TAB 2]**.

105 Booker Affidavit, Exhibit 6: letter dated May 7, 2021 from David E. Gruber on behalf of Ridley to Randal Van de Mosselaer on behalf of Coalspur, page 1.

debtor from terminating a contract: "In effect what the applicants are seeking here is an order for specific performance. Specific performance can be particularly inappropriate in an insolvency, because its effect generally will be to create a preference over other unsecured creditors."[106]

85. CCAA courts have further held that the fact that a counterparty may find its claim compromised in a CCAA proceeding is no justification for an order of specific performance. As this Court articulated in *Blue Range Resources*, in rejecting certain creditors' application to prohibit the termination of a contract:

> 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 sympathise 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.[107]

86. Compelling Coalspur to continue performing the Ridley Agreement is particularly unfair to both Coalspur and its stakeholders, given the structure of the agreement. As discussed at length above, the terms of the Ridley Agreement are off-market and include significant minimum volume requirements. The costs of Coalspur performing the Ridley Agreement will divert resources otherwise available to fund its restructuring efforts for the benefits of all stakeholders to one stakeholder – Ridley. In essence, Ridley would "be able to elevate [its] claim for damages above the claims of all other unsecured creditors through this route."[108]

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[106] *Re Skeena Cellulose Inc*, 2002 BCSC 1280 at para 46 **[TAB 13]**; see also *Blue Range* at para 37 **[TAB 14]**.

[107] *Blue Range* at para 38 **[TAB 14]**.

[108] *Blue Range* at para 38 **[TAB 14]**.

87. By contrast, Ridley's damages for the loss of the benefits of the Ridley Agreement, if any, will be measured in accordance with ordinary contract damages principles, subject to mitigation and to compromise on the same basis as the claims of all other unsecured creditors.

C. Damages from the Ridley Agreement constitute pre-filing claims

88. Apart from partially loading one vessel, Ridley has not provided any services to Coalspur in the post-filing period.[109] Any damages arising from Coalspur's disclaimer or breach of the Ridley Agreement constitute unsecured pre-filing claims. It is firmly established in the caselaw that all liabilities arising from pre-filing contracts (i.e. contracts to which the debtor was a party as of the filing date) are pre-filing obligations – even liabilities that crystallize or come due after the filing date.[110] For example, in *Bellatrix*, BP submitted that it was "a post-filing creditor" as the contractual breach by Bellatrix occurred during the post-filing period. Rejecting this submission, this Court noted: "This is incorrect: its damages claim arises from a pre-filing contract, whether it is an EFC or not."[111]

89. The Ridley Agreement is a pre-filing agreement. Accordingly, any damages flowing from Coalspur's breach of the Ridley Agreement during the post-filing period are pre-filing claims that must be treated on the same footing as all other unsecured claims.[112]

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[109] Ridley shipped one vessel on behalf of Coalspur of coal that was in its possession and physically located at the Ridley Terminal as at the date of Coalspur's CCAA filing. Coalspur has paid Ridley in full the costs of this shipment.

[110] *Repsol Canada Energy Partnership v Delphi Energy Corp*, 2020 ABCA 364 at para 20 **[TAB 15]**; see also *Arrangement relatif à Metaux Kitco*, 2017 QCCA 268 at paras 77-78 **[TAB 16]**; CCAA, s. 19 **[TAB 1]**.

[111] *Bellatrix* at para 70 **[TAB 2]**.

[112] *Bellatrix* at paras 98 and 117-118 **[TAB 2]**.

90. Coalspur therefore submits that there is no basis in fact or in law for Ridley's opposition to the disclaimer of the Ridley Agreement, or for the requested order that Coalspur is "bound" by its terms. Ridley's application should therefore be denied, and Coalspur's application should be granted.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 2nd day of July, 2021

Emily Paplawski

Randal Van de Mosselaer / Emily Paplawski
Osler, Hoskin & Harcourt LLP
Counsel for the Applicants

TABLE OF AUTHORITIES

TAB	AUTHORITY
1.	*Companies' Creditors Arrangement Act,* RSC 1986, c C-36
2.	*Bellatrix Exploration Ltd (Re)*, 2020 ABQB 809, leave to appeal dismissed, 2021 ABCA 85
3.	*Re Aveos Fleet Performance Inc*, 2012 QCCS 6796
4.	*Re Allarco Entertainment Inc*, 2009 ABQB 503
5.	*Nortel Networks Corporation (Re)*, 2018 ONSC 6257
6.	*Aralez Pharmaceuticals Inc (Re)*, 2018 ONSC 6980
7.	*Re Timminco Ltd*, 2012 ONSC 4471
8.	*Homburg Invest Inc*, 2011 QCCS 6376, leave to appeal refused, 2012 QCCA 665
9.	*Re AbitibiBowater*, 2009 QCCS 2188
10.	*Laurentian University of Sudbury,* 2021 ONSC 3272, leave to appeal refused, 2021 ONCA 448
11.	*Re Target Canada Co*, 2015 ONSC 1028
12.	*Re Quest University Canada*, 2020 BCSC 1883, leave to appeal refused, 2020 BCCA 364
13.	*Re Skeena Cellulose Inc*, 2002 BCSC 1280; *Re Skeena Cellulose Inc*, 2003 BCCA 344
14.	*Re Blue Range Resource Corp*, 1999 ABQB 1038, reversed in part, 2000 ABCA 200
15.	*Repsol Canada Energy Partnership v Delphi Energy Corp*, 2020 ABCA 364
16.	*Arrangement relatif à Metaux Kitco*, 2017 QCCA 268

TAB 1

CANADA

CONSOLIDATION

Companies' Creditors Arrangement Act

R.S.C., 1985, c. C-36

Current to June 16, 2021

Last amended on November 1, 2019

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18.2 [Repealed, 2005, c. 47, s. 131]

18.3 [Repealed, 2005, c. 47, s. 131]

18.4 [Repealed, 2005, c. 47, s. 131]

18.5 [Repealed, 2005, c. 47, s. 131]

PART III

General

Duty of Good Faith

Good faith

18.6 (1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.

Good faith — powers of court

(2) If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the court may make any order that it considers appropriate in the circumstances.

1997, c. 12, s. 125; 2005, c. 47, s. 131; 2019, c. 29, s. 140.

Claims

Claims that may be dealt with by a compromise or arrangement

19 (1) Subject to subsection (2), the only claims that may be dealt with by a compromise or arrangement in respect of a debtor company are

(a) claims that relate to debts or liabilities, present or future, to which the company is subject on the earlier of

(i) the day on which proceedings commenced under this Act, and

(ii) if the company filed a notice of intention under section 50.4 of the *Bankruptcy and Insolvency Act* or commenced proceedings under this Act with the consent of inspectors referred to in section 116 of the *Bankruptcy and Insolvency Act*, the date of the initial bankruptcy event within the meaning of section 2 of that Act; and

(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

18.2 [Abrogé, 2005, ch. 47, art. 131]

18.3 [Abrogé, 2005, ch. 47, art. 131]

18.4 [Abrogé, 2005, ch. 47, art. 131]

18.5 [Abrogé, 2005, ch. 47, art. 131]

PARTIE III

Dispositions générales

Obligation d'agir de bonne foi

Bonne foi

18.6 (1) Tout intéressé est tenu d'agir de bonne foi dans le cadre d'une procédure intentée au titre de la présente loi.

Bonne foi — pouvoirs du tribunal

(2) S'il est convaincu que l'intéressé n'agit pas de bonne foi, le tribunal peut, à la demande de tout intéressé, rendre toute ordonnance qu'il estime indiquée.

1997, ch. 12, art. 125; 2005, ch. 47, art. 131; 2019, ch. 29, art. 140.

Réclamations

Réclamations considérées dans le cadre des transactions ou arrangements

19 (1) Les seules réclamations qui peuvent être considérées dans le cadre d'une transaction ou d'un arrangement visant une compagnie débitrice sont :

a) celles se rapportant aux dettes et obligations, présentes ou futures, auxquelles la compagnie est assujettie à celle des dates ci-après qui est antérieure à l'autre :

(i) la date à laquelle une procédure a été intentée sous le régime de la présente loi à l'égard de la compagnie,

(ii) la date d'ouverture de la faillite, au sens de l'article 2 de la *Loi sur la faillite et l'insolvabilité*, si elle a déposé un avis d'intention sous le régime de l'article 50.4 de cette loi ou qu'elle a intenté une procédure sous le régime de la présente loi avec le consentement des inspecteurs visés à l'article 116 de la *Loi sur la faillite et l'insolvabilité*;

b) celles se rapportant aux dettes et obligations, présentes ou futures, auxquelles elle peut devenir before the earlier of the days referred to in subparagraphs (a)(i) and (ii).

Exception

(2) A compromise or arrangement in respect of a debtor company may not deal with any claim that relates to any of the following debts or liabilities unless the compromise or arrangement explicitly provides for the claim's compromise and the creditor in relation to that debt has voted for the acceptance of the compromise or arrangement:

(a) any fine, penalty, restitution order or other order similar in nature to a fine, penalty or restitution order, imposed by a court in respect of an offence;

(b) any award of damages by a court in civil proceedings in respect of

(i) bodily harm intentionally inflicted, or sexual assault, or

(ii) wrongful death resulting from an act referred to in subparagraph (i);

(c) any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity or, in Quebec, as a trustee or an administrator of the property of others;

(d) any debt or liability resulting from obtaining property or services by false pretences or fraudulent misrepresentation, other than a debt or liability of the company that arises from an equity claim; or

(e) any debt for interest owed in relation to an amount referred to in any of paragraphs (a) to (d).

R.S., 1985, c. C-36, s. 19; 1996, c. 6, s. 167; 2005, c. 47, s. 131; 2007, c. 36, s. 69.

Determination of amount of claims

20 (1) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor is to be determined as follows:

(a) the amount of an unsecured claim is the amount

(i) in the case of a company in the course of being wound up under the *Winding-up and Restructuring Act*, proof of which has been made in accordance with that Act,

assujettie avant l'acceptation de la transaction ou de l'arrangement, en raison d'une obligation contractée antérieurement à celle des dates mentionnées aux sous-alinéas a)(i) et (ii) qui est antérieure à l'autre.

Exception

(2) La réclamation se rapportant à l'une ou l'autre des dettes ou obligations ci-après ne peut toutefois être ainsi considérée, à moins que la transaction ou l'arrangement ne prévoie expressément la possibilité de transiger sur cette réclamation et que le créancier intéressé n'ait voté en faveur de la transaction ou de l'arrangement proposé :

a) toute ordonnance d'un tribunal imposant une amende, une pénalité, la restitution ou une autre peine semblable;

b) toute indemnité accordée en justice dans une affaire civile :

(i) pour des lésions corporelles causées intentionnellement ou pour agression sexuelle,

(ii) pour décès découlant d'un acte visé au sous-alinéa (i);

c) toute dette ou obligation résultant de la fraude, du détournement, de la concussion ou de l'abus de confiance alors que la compagnie agissait, au Québec, à titre de fiduciaire ou d'administrateur du bien d'autrui ou, dans les autres provinces, à titre de fiduciaire;

d) toute dette ou obligation résultant de l'obtention de biens ou de services par des faux-semblants ou la présentation erronée et frauduleuse des faits, autre qu'une dette ou obligation de la compagnie qui découle d'une réclamation relative à des capitaux propres;

e) toute dette relative aux intérêts dus à l'égard d'une somme visée à l'un des alinéas a) à d).

L.R. (1985), ch. C-36, art. 19; 1996, ch. 6, art. 167; 2005, ch. 47, art. 131; 2007, ch. 36, art. 69.

Détermination du montant de la réclamation

20 (1) Pour l'application de la présente loi, le montant de la réclamation d'un créancier garanti ou chirographaire est déterminé de la façon suivante :

a) le montant d'une réclamation non garantie est celui :

(i) dans le cas d'une compagnie en voie de liquidation sous le régime de la *Loi sur les liquidations et les restructurations*, dont la preuve a été établie en conformité avec cette loi,

Decision

(8) The decision of the Superintendent of Bankruptcy after the hearing, together with the reasons for the decision, must be given in writing to the monitor not later than three months after the conclusion of the hearing, and is public.

Review by Federal Court

(9) A decision of the Superintendent of Bankruptcy given under subsection (8) is deemed to be a decision of a federal board, commission or other tribunal that may be reviewed and set aside under the *Federal Courts Act*.

2005, c. 47, s. 131; 2007, c. 36, s. 75.

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

Décision

(8) La décision du surintendant des faillites est rendue par écrit, motivée et remise au contrôleur dans les trois mois suivant la clôture de l'audition, et elle est publique.

Examen de la Cour fédérale

(9) La décision du surintendant, rendue et remise conformément au paragraphe (8), est assimilée à celle d'un office fédéral et est soumise au pouvoir d'examen et d'annulation prévu par la *Loi sur les Cours fédérales*.

2005, ch. 47, art. 131; 2007, ch. 36, art. 75.

Pouvoir de délégation

31 (1) Le surintendant des faillites peut, par écrit, selon les modalités qu'il précise, déléguer les attributions que lui confèrent les articles 29 et 30.

Notification

(2) En cas de délégation, le surintendant des faillites ou le délégué en avise, de la manière réglementaire, tout contrôleur qui pourrait être touché par cette mesure.

2005, ch. 47, art. 131.

Contrats et conventions collectives

Résiliation de contrats

32 (1) Sous réserve des paragraphes (2) et (3), la compagnie débitrice peut — sur préavis donné en la forme et de la manière réglementaires aux autres parties au contrat et au contrôleur et après avoir obtenu l'acquiescement de celui-ci relativement au projet de résiliation — résilier tout contrat auquel elle est partie à la date à laquelle une procédure a été intentée sous le régime de la présente loi.

Contestation

(2) Dans les quinze jours suivant la date à laquelle la compagnie donne le préavis mentionné au paragraphe (1), toute partie au contrat peut, sur préavis aux autres parties au contrat et au contrôleur, demander au tribunal d'ordonner que le contrat ne soit pas résilié.

Absence d'acquiescement du contrôleur

(3) Si le contrôleur n'acquiesce pas au projet de résiliation, la compagnie peut, sur préavis aux autres parties au 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.

contrat et au contrôleur, demander au tribunal d'ordonner la résiliation du contrat.

Facteurs à prendre en considération

(4) Pour décider s'il rend l'ordonnance, le tribunal prend en considération, entre autres, les facteurs suivants :

a) l'acquiescement du contrôleur au projet de résiliation, le cas échéant;

b) la question de savoir si la résiliation favorisera la conclusion d'une transaction ou d'un arrangement viable à l'égard de la compagnie;

c) le risque que la résiliation puisse vraisemblablement causer de sérieuses difficultés financières à une partie au contrat.

Résiliation

(5) Le contrat est résilié :

a) trente jours après la date à laquelle la compagnie donne le préavis mentionné au paragraphe (1), si aucune demande n'est présentée en vertu du paragraphe (2);

b) trente jours après la date à laquelle la compagnie donne le préavis mentionné au paragraphe (1) ou à la date postérieure fixée par le tribunal, si ce dernier rejette la demande présentée en vertu du paragraphe (2);

c) trente jours après la date à laquelle la compagnie donne le préavis mentionné au paragraphe (3) ou à la date postérieure fixée par le tribunal, si ce dernier ordonne la résiliation du contrat en vertu de ce paragraphe.

Propriété intellectuelle

(6) Si la compagnie a autorisé par contrat une personne à utiliser un droit de propriété intellectuelle, la résiliation n'empêche pas la personne de l'utiliser ni d'en faire respecter l'utilisation exclusive, à condition qu'elle respecte ses obligations contractuelles à l'égard de l'utilisation de ce droit, et ce pour la période prévue au contrat et pour toute période additionnelle dont elle peut et décide de se prévaloir de son propre gré.

Pertes découlant de la résiliation

(7) En cas de résiliation du contrat, toute partie à celui-ci qui subit des pertes découlant de la résiliation est réputée avoir une réclamation prouvable.

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.

Collective agreements

33 (1) If proceedings under this Act have been commenced in respect of a debtor company, any collective agreement that the company has entered into as the employer remains in force, and may not be altered except as provided in this section or under the laws of the jurisdiction governing collective bargaining between the company and the bargaining agent.

Application for authorization to serve notice to bargain

(2) A debtor company that is a party to a collective agreement and that is unable to reach a voluntary agreement with the bargaining agent to revise any of the provisions of the collective agreement may, on giving five days notice to the bargaining agent, apply to the court for an order authorizing the company to serve a notice to bargain under the laws of the jurisdiction governing collective bargaining between the company and the bargaining agent.

Conditions for issuance of order

(3) The court may issue the order only if it is satisfied that

(a) a viable compromise or arrangement could not be made in respect of the company, taking into account the terms of the collective agreement;

(b) the company has made good faith efforts to renegotiate the provisions of the collective agreement; and

Motifs de la résiliation

(8) Dans les cinq jours qui suivent la date à laquelle une partie au contrat le lui demande, la compagnie lui expose par écrit les motifs de son projet de résiliation.

Exceptions

(9) Le présent article ne s'applique pas aux contrats suivants :

a) les contrats financiers admissibles;

b) les conventions collectives;

c) les accords de financement au titre desquels la compagnie est l'emprunteur;

d) les baux d'immeubles ou de biens réels au titre desquels la compagnie est le locateur.

2005, ch. 47, art. 131; 2007, ch. 29, art. 108, ch. 36, art. 76 et 112.

Conventions collectives

33 (1) Si une procédure a été intentée sous le régime de la présente loi à l'égard d'une compagnie débitrice, toute convention collective que celle-ci a conclue à titre d'employeur demeure en vigueur et ne peut être modifiée qu'en conformité avec le présent article ou les règles de droit applicables aux négociations entre les parties.

Demande pour que le tribunal autorise le début de négociations en vue de la révision

(2) Si elle est partie à une convention collective à titre d'employeur et qu'elle ne peut s'entendre librement avec l'agent négociateur sur la révision de celle-ci, la compagnie débitrice peut, après avoir donné un préavis de cinq jours à l'agent négociateur, demander au tribunal de l'autoriser, par ordonnance, à donner à l'agent négociateur un avis de négociations collectives pour que celui-ci entame les négociations collectives en vue de la révision de la convention collective conformément aux règles de droit applicables aux négociations entre les parties.

Cas où l'autorisation est accordée

(3) Le tribunal ne rend l'ordonnance que s'il est convaincu, à la fois :

a) qu'une transaction ou un arrangement viable à l'égard de la compagnie ne pourrait être fait compte tenu des dispositions de la convention collective;

b) que la compagnie a tenté de bonne foi d'en négocier de nouveau les dispositions;

TAB 2

2020 ABQB 809
Alberta Court of Queen's Bench

Bellatrix Exploration Ltd (Re)

2020 CarswellAlta 2545, 2020 ABQB 809, [2020] A.J. No. 1453, [2021] A.W.L.D. 478, [2021] A.W.L.D. 481, [2021] A.W.L.D. 483, [2021] A.W.L.D. 568, 327 A.C.W.S. (3d) 166, 86 C.B.R. (6th) 191

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

In the Matter of the Compromise or Arrangement of Bellatrix Exploration Ltd.

B.E. Romaine J.

Judgment: December 22, 2020
Docket: Calgary 1901-13767

Counsel: Kelly Bourassa (agent), James Reid (agent), for National Bank of Canada
Robert J Chadwick, Caroline Descours, for Bellatrix Exploration Ltd.
Howard A Gorman, Q.C., Gunnar Benidiktsson, for BP Canada Energy Group LLC
Joseph G.A. Kruger, Q.C., Robyn Gorofsky, for Monitor, Pricewaterhousecoopers Inc.

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

I Introduction

1 The ultimate issue in this application is whether BP Canada Energy Group ULC or the First Lien Lenders to Bellatrix Exploration Ltd. have priority to certain funds held by the Monitor and by Bellatrix pending resolution of disputed claims. These claims include BP's breach of contract claim arising from Bellatrix's purported disclaimer of, and ongoing failure to perform under, a GasEDI agreement between Bellatrix and BP.

2 Bellatrix has obtained protection from its creditors under the *Companies Creditors' Arrangement Act*, RSC 1985, c. C-36, as amended. It holds approximately US$14.2 million of the funds in issue and approximately US$1.6 million is held by PricewaterhouseCoopers Inc. in its capacity as Court-appointed Monitor of Bellatrix.

II Relevant Facts

3 Bellatrix and BP were parties to a GasEDI Base contract for the short-term sale and purchase of natural gas and a Special Provisions for GasEDI Base Contract, both dated as of March 1, 2010 (collectively, with transaction confirmations, the "GasEDI Agreement").

4 Bellatrix and BP entered into two transaction confirmations pursuant to the terms of the GasEDI Agreement, dated as of December 12, 2017.

5 Pursuant to the GasEDI Agreement, Bellatrix was required to deliver natural gas to an agreed delivery point in Alberta. BP would then purchase and take title to that natural gas. Pursuant to the transaction confirmations, BP agreed to pay for the natural gas in accordance with a pricing formula based on posted index prices at specific or designated downstream pricing hubs in the US and Ontario, on a month to month basis. The GasEDI Agreement does not provide BP with a security interest in respect of Bellatrix's obligations under the contract.

6 Bellatrix was granted protection under the CCAA by an initial order dated October 2, 2019.

7 On November 25, 2019, with the Monitor's approval, Bellatrix sent BP a Disclaimer Notice with respect to the GasEDI Agreement, pursuant to section 32(1) of the CCAA. The Disclaimer Notice provided that the disclaimer of the GasEDI Agreement, unless successfully objected to by BP, would not take effect until December 25, 2019, 30 days later.

8 On November 25, 2019, BP responded to the Disclaimer Notice, advising Bellatrix of its view that the GasEDI Agreement constituted an eligible financial contract ("EFC") under the CCAA, and that therefore it could not be disclaimed.

9 On November 26, 2019, Bellatrix stopped delivering gas to BP.

10 On November 27, 2019, Bellatrix offered to resume delivery of natural gas under the GasEDI Agreement during the disclaimer period if BP would agree not to withhold revenues owed to Bellatrix. Bellatrix proposed that BP pay Bellatrix revenue without any set-off, reduction or deduction. On the same day BP responded, refusing to accept the terms of this proposal.

11 On November 28 and November 29, 2019, BP sent letters reiterating its position that the GasEDI Agreement was an EFC and could not be disclaimed, and demanding that Bellatrix immediately resume performance under the contract. In its letters, BP stated that, even if the GasEDI Agreement was not an EFC, Bellatrix continued to be bound by the terms of the agreement until the expiry of the disclaimer notice period, and that Bellatrix's unilateral breach thereof constituted a post-filing breach.

12 Bellatrix had delivered natural gas to BP in accordance with the GasEDI Agreement from November 1 to November 25, 2019. The amount payable to Bellatrix by BP for that natural gas was US$1,583,859.38, subject to any valid rights of set-off. That amount would ordinarily have been paid on December 24, 2019.

13 On December 6, 2019, Bellatrix, BP and the Monitor entered into an agreement pursuant to which BP paid the December payment to the Monitor in trust pending further resolution of matters relating to Bellatrix's disclaimer of the GasEDI Agreement. The agreement reserved all rights of BP in respect of the December payment, including the right, if applicable, to set-off or net the December payment against any obligations of Bellatrix to BP under the GasEDI Agreement.

14 BP filed an application seeking a declaration that the GasEDI Agreement is an EFC within the meaning of the CCAA. BP sought additional relief in its application, including an order enjoining Bellatrix from unilaterally suspending deliveries of gas under the agreement, but due to time constraints, the parties agreed to limit submissions to the single issue of whether the GasEDI Agreement is an EFC. If BP had proceeded with the other relief it sought and been successful, Bellatrix would have been required to deliver gas to BP, but not entitled to receive the proceeds of sale.

15 On February 4, 2020, Jones, J. held that the agreement was an EFC: *Bellatrix Exploration Ltd., Re*, [2020] A.J. No. 329 (Alta. Q.B.) (the "EFC Decision"). This decision is under appeal, leave granted 2020 ABCA 178 (Alta. C.A.). The decision makes no reference to any obligation of Bellatrix with respect to continued performance of the agreement.

16 On February 6, 2020, BP counsel wrote to Bellatrix counsel advising, among other things, that, as a result of the EFC Decision, BP expected Bellatrix to resume performance of the GasEDI Agreement.

17 On February 11, 2020, counsel to Bellatrix responded noting that the EFC Decision did not address any of the other relief sought in BP's application, including a requirement that Bellatrix perform its obligations under the GasEDI Agreement. The response reiterated Bellatrix's position that BP has an unsecured claim in Bellatrix's CCAA proceedings. The response also advised that Bellatrix did not expect any potential purchaser or credit bid party to assume the terms of the GasEDI Agreement.

18 Counsel to BP filed an order with respect to the EFC Decision on March 5, 2020. The order, among other things, grants BP leave to apply to the Court for such further advice and direction as may be required with respect to the remainder of relief sought in the GasEDI Agreement application.

19 BP brought no application to address the remainder of the relief sought in the EFC determination application until BP filed its cross-application on August 7, 2020 to the application filed by the Agent to the First Lien Lender, five months later.

20 On March 20, 2020, Bellatrix applied for, among other things, an order extending the stay of proceedings under the CCAA to May 7, 2020. As a result of Court closures due to the COVID-19 pandemic, the application was made via desk application, subject to any interested party objecting to the application.

21 There were no objections to the application, and on March 31, 2020, the Court granted an order extending the stay of proceedings to May 7, 2020. The order provided for a further automatic stay extension to June 8, 2020, subject to, among other things, any objections from interested parties.

22 In a May 1, 2020 decision allowing leave to appeal the EFC Decision, Strekaf, J.A. directed that the determination of how the interests of BP and other parties to the CCAA proceedings could best be protected pending the hearing of the appeal of the EFC Decision should be determined by this Court. No party has sought a stay of the EFC Decision.

23 There were no objections to the automatic stay extension on June 8, 2020 from any interested parties, and the stay has continued. Applications for the stay extension orders submit that Bellatrix has been acting in good faith and with due diligence in carrying out the terms of all orders of the Court and in respect of all matters relating to the CCAA proceedings.

24 On May 8, 2020, Hollins, J. granted an Approval and Vesting Order approving the sale of substantially all of Bellatrix's assets to Spartan Delta Corp. Bellatrix closed the sale on June 1, 2020. The GasEDI Agreement was not assumed by the purchaser.

25 Pursuant to the Spartan transaction, the purchaser acquired substantially all of Bellatrix's assets and assumed all of Bellatrix's liabilities in respect of its wells, environmental obligations, pre-filing cure costs in respect of assumed contracts and certain other assumed labilities. The Spartan transaction also permitted the purchaser to make offers of employment to Bellatrix's employees.

26 The First Lien Lenders are secured creditors of Bellatrix pursuant to a credit agreement dated June 4, 2019 and certain security granted in relation to that agreement. In contrast to the GasEDI Agreement, the credit agreement and the security granted in relation thereto secure any indebtedness that may become owing by Bellatrix under any swap contracts or other derivative agreements with the First Lien Lenders. The Agent of the First Lien Lenders, on behalf of the lenders, has a registered, valid and enforceable first priority security interest in all of Bellatrix's present and after-acquired personal property and a first priority floating charge on all of Bellatrix's present and after-acquired real property.

27 On May 22, 2020, the Court granted a Stay Extension and Distribution Order authorizing Bellatrix to distribute $47.5 million, a portion of the net proceeds from the Spartan sale, to the Agent of the First Lien Lenders in partial satisfaction of their secured claim. Bellatrix held back certain funds from distribution, including funds for disputed claims such as the BP claim.

28 Bellatrix remains indebted to the First Lien Lenders in excess of $44.5 million. Bellatrix may not be able to pay the secured claim of the First Lien lenders in full given the results of the sale process. In the circumstances, a claims process has not been initiated in these CCAA proceedings.

29 The First Lien Lenders seek a declaration that they have a first priority interest in all the property of Bellatrix, including funds held back in relation to the BP claim, a declaration that amounts owing to BP, if any, are an unsecured claim, and an order directing the Monitor to make a further distribution to the Agent in the amount of approximately $28.9 million. Bellatrix supports this position and submits that the Agent for the First Lien Holders is entitled to distribution of the sale proceeds and the December payment of approximately $1.6 million held in trust by the Monitor in priority to BP.

30 In a cross application, BP seeks judgement for damages in an amount equivalent to US$14.2 million, an order lifting the stay in the CCAA proceedings to permit BP to enforce the judgement, and an order directing the Monitor to pay BP the approximately US$1.6 million December payment from the held-back funds, an order directing Bellatrix to pay the remainder

of the claimed damages out of the sale of proceeds of its assets, or, in the alternate, granting BP a charge over the property of Bellatrix in the amount of the claimed damages with priority over the secured creditors and *pari passu* with the Interim Lenders Charge, or in the further alternative, an order declaring that any funds held by the Monitor and Bellatrix up to the amount of the claimed damages are held in trust for BP.

III Issues

31 The main issue is whether the CCAA grants BP, as the non-insolvent counterpart to an EFC that has not chosen to terminate the agreement, any security or priority for its damages as a result of Bellatrix's ongoing failure to perform under the agreement. In other words, does the exception to the debtor's right to disclaim an EFC set out in section 34(7)(a) of the CCAA create an obligation for the debtor to continue to perform the EFC throughout insolvency proceedings?

32 Other issues include the following:

(a) Is BP entitled to the funds held by the Monitor in respect of the December payment pursuant to a right of set-off?

(b) Is BP entitled to lift the stay to permit it to obtain and enforce a judgment against the sale proceeds?

(c) Is BP entitled to equitable relief?

(d) Has BP proved the amount of its claim for damages?

IV Analysis

A. Does the exception to the debtor's right to disclaim an EFC set out in section 34(7)(a) of the CCAA create an obligation for the debtor to continue to perform the EFC throughout insolvency proceedings?

33 The stay provision of the CCAA, which prevents termination of an agreement because of a contractual counterparty's insolvency, does not apply to an EFC: section 34(7).

34 Section 34(8)(a) of the CCAA allows solvent counterparties to EFCs certain "permitted actions" during the stay period if they are allowed to take such actions under the specific EFC agreement, including netting or setting off or compensation of obligations between the company and the other parties to the EFC. However, section 34(10) does not permit enforcement actions to recover net termination values once they are determined. Rather, if net termination values are owed by the company to another party to the EFC, section 34(10) deems the non-insolvent counterparty "to be a creditor of the company with a claim against the company in respect of those net termination values".

35 As noted by the First Lien Lenders, the purpose of protection for EFCs under the CCAA is to provide stability to financial markets by allowing a non-defaulting counterparty the right to terminate and crystallize claims arising under an EFC.

36 Like other creditors of the company, the net claims of a non-insolvent counterparty after termination are subject to the stay of proceedings. The Canadian Bankers Association in its submissions in favour of EFC amendments to the *Bankruptcy and Insolvency Act* in 1991 commented that:

> ... it cannot be overemphasized that our proposal is not to benefit either party to an eligible financial contract. ... Any net amount, if owed to the other party, would be fully subject to the proposed stay provisions. What would be achieved is that the rights of both parties would have been reduced to a fixed and certain amount, just like an amount owed under a regular contract at the time of the stay. (emphasis added): as cited in *Re Androscoggin Energy LLC*, [2005] OJ No. 395 at para 3.

37 The Insolvency Institute of Canada Report of the Task Force on Derivatives dated September 26, 2013 notes at pages 2 and 3 that:

> EFC protection is a significant exception to the stay of proceedings under the CCAA and BIA. There are two main purposes of the EFC safe harbours: (i) to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent

counterparty under the EFC and (ii) to reduce systemic risk in Canadian and global financial markets. Non-defaulting counterparties may be at risk because, in certain instances, the amounts under the EFCs are very substantial and the value of the underlying products subject to EFCs are volatile in nature and can change dramatically during an insolvency proceeding. If the solvent counterparty to an EFC is subject to a stay of proceedings and therefore unable to terminate its EFCs with the insolvent counterparty, there is a risk that the value of such EFCs could deteriorate sufficiently (from the insolvent counterparty's perspective) to put the solvent counterparty at risk. Systemic risk may arise where the solvent counterparty is a systemically important institution or where the solvent counterparty has entered into EFCs with one or more other counterparties. In extreme cases, the failure of one counterparty could have a domino effect, where the failure of one counterparty, particularly a derivatives dealer, triggers the failure of a second counterparty who is also a derivatives dealer and the failure of the second counterparty could trigger the failure of others. Multiple insolvencies may cause a lack of liquidity in the financial sector and unavailability of credit to solvent enterprises and, ultimately, systemic risk. The systemic risk could spread to global markets and lead to world-wide financial instability and, in extreme cases, recession.

38 The protection offered to non-insolvent counterparties to an EFC is the ability to terminate the EFC and crystallize its loss despite the stay provision of the CCAA, a protection not afforded to other creditors. The other protection is allowing set-off if the EFC agreement itself permits it. The exceptions were included in the *Act* for the protection of the derivative market generally from volatile and systemic risk. They do not compel a CCAA debtor to continue to perform an EFC that has not been terminated, nor does the CCAA provide the non-insolvent counterparty with any priority for its claim, apart from the protection of the exemption.

39 Unless the non-insolvent counterparty to the EFC has a security interest, it is an unsecured creditor, and participates in the CCAA proceedings on the same footing as other creditors: *Blue Range Resource Corp., Re*, 2000 ABCA 239 (Alta. C.A.) at para 9.

40 Therefore, assuming that the GasEDI Agreement is an EFC, BP is allowed to terminate it and crystallize its loss. However, as BP has not done so, its remedy for Bellatrix's breach of the GasEDI Agreement is a claim in the CCAA proceedings as an unsecured creditor unless there are other remedies available to it in the specific circumstances.

41 BP submits that, unless it is granted the relief it seeks, the practical effect of Bellatrix's conduct would be to render the disclaimer rules of the CCAA meaningless. It notes that a valid disclaimer under section 32(7) of the CCAA results in a "provable claim", unsecured unless otherwise provided for in the disclaimed contract. However, if CCAA debtors are allowed to breach executory contracts at will, the result is identical: the solvent party has a provable claim, unsecured unless otherwise provided for under the contract. BP submits that, if that is true, section 32(7) of the CCAA is without a purpose, as there is no practical difference between contracts that can and cannot be lawfully disclaimed. Either way, if the debtor chooses to breach the contract, the solvent counterparty is left with the same remedy — which in many cases, is no remedy at all.

42 Therefore, BP submits that the "clear implication" of the statutory disclaimer provisions of the CCAA is that a company is required to perform its obligations under executory contracts as of the filing date, unless and until those contracts can be validly disclaimed under section 32.

43 As noted previously, the exception from EFCs included in the disclaimer provisions of the *Act* do not expressly provide that an EFC must be performed. Such a mandatory requirement would thwart the objectives of the CCAA, since compelling a CCAA debtor to performs an EFC that it cannot afford to perform would in many cases affect its ability to attempt to restructure.

44 The disclaimer provisions, while initiated by the debtor, provide the solvent party to a disclaimable contract an opportunity to object to the disclaimer and a process for doing so. Section 32(4) of the *Act* sets out factors that the court must consider in deciding the issue.

45 While the solvent party to a contract that the debtor merely stops performing may not have available to it the same statutory process, it may apply to the court for an order compelling performance as BP initially purported to do. The court supervising the CCAA proceedings in its consideration of such an application would likely take into account factors similar to those set

out in section 32(4), including whether compelling performance would interfere with the prospect of a viable arrangement, and whether refusing such an order would cause significant financial hardship to a party to the contract.

46 While the considerations may be similar, a disclaimer proceeding is initiated by the debtor, provides for a statutory process and mandates a termination date for the disclaimer. As noted by Morawetz, J. in *Target Canada Co., Re*, 2015 CarswellOnt 3274 (Ont. S.C.J.), the disclaimer is beneficial to creditors generally because it enables the debtor to move forward with a liquidation plan without further delay. In contrast, the unilateral non-performance of a contract gives rise to uncertainty for both the debtor and the counterparty as to the status of the contract, including whether or not the solvent counterparty at its election will accept the termination of the contract as repudiated, and the date of its termination.

47 The disclaimer provisions are thus not rendered meaningless by the existence of a less formal option, but provide an opportunity for orderly termination and certainty to the parties to the disclaimed contract. Implying an obligation to perform an uneconomic contract that may affect the ability of the CCAA debtor to attempt to restructure would require more direct statutory language.

48 It must be noted that Bellatrix attempted to resolve the issue through the disclaimer option before the GasEDI Agreement was found to be an EFC.

B. Is BP entitled to the funds held by the Monitor in respect of the December payment pursuant to the right of set-off?

49 Assuming that the GasEDI Agreement is an EFC, section 34(8)(a) of the CCAA permits the netting or setting off of obligations between the debtor company and the other party to the EFC if the EFC is terminated on or after the commencement of the CCAA proceedings and if such action is "in accordance with the provisions of the contract".

50 However, BP has not terminated the GasEDI Agreement and is not seeking to terminate and set-off its position to reduce exposure to risk. Therefore, the set-off provisions of section 34(8)(a) are not available to it.

51 BP seeks to maintain Bellatrix's obligation to perform the agreement but set-off amounts it owes to Bellatrix for previously delivered product. Whether or not the GasEDI Agreement is an EFC, the agreement does not on its terms allow the set-off of the December payment.

52 Section 10.2 of the base contract in the GasEDI Agreement permits the non-defaulting party to withhold any amounts owed to the defaulting party when there is an event of default or a potential event of default and to set-off such amounts against "any amounts owed to the Defaulting Party under the [GasEDI Agreement] whether or not yet due" and set-off against such withheld amounts "any amounts *owed the non-Defaulting Party hereunder* (whether or not yet due)". BP submits that it is entitled to set-off its damages claim against the December payment, relying on the language "whether or not due" in section 10.2.

53 However, BP is the payor, not the payee under the agreement and Bellatrix was not obligated to pay BP anything "hereunder", either when the agreement to hold the funds in trust was entered into or when the funds would normally be paid later in December. Although an event of default includes a party's failure to deliver gas "for the greater of 4 cumulative days or 5% of the number of days in a Delivery Period .... in any one transaction", and BP may have a claim for damages in an amount has not yet been determined, there were no amounts "owed to" BP at the time of the December payment in respect of which it could exercise any contractual right of set-off.

54 Section 10.5 of the agreement states that a "Performing Party" has the right to withhold any or all payments due the non-performing party for the period of the applicable non-performance and net or set-off amounts due the Performing Party against such withheld amounts. Bellatrix stopped delivering gas on November 26, 2019. The December payment was for the delivery of gas between November 1 and November 25, 2019. Therefore, for the same reasons, section 10.5 of the agreement does not give BP a right of set-off.

55 BP thus has no contractual right of set-off with respect to the December payment but submits that it has a right of equitable set-off, citing *Blue Range Resource Corp., Re*, 2000 ABCA 200 (Alta. C.A.). In *Blue Range*, the appellants were allowed to

set-off anticipated damages they would incur under certain natural gas marketing contracts against payments owed under those contracts for the delivery of natural gas.

56 In that case, as in this, the cost to the appellants to replace the gas was higher than the cost they were paying under the contracts. The Court of Appeal in *Blue Range* set out the principles from the Supreme Court of Canada decision in *Telford v. Holt* (1987), 41 D.L.R. (4th) 385 (S.C.C.), at 398 that apply when dealing with equitable set-off:

> 1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands;
>
> 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed;
>
> 3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross claim;
>
> 4. The plaintiff's claim and the cross-claim need not arise out of the same contract; and
>
> 5. Unliquidated claims are on the same footing as liquidated claims.

57 The Court noted at para 19:

> The important point for invoking equitable set-off is the close connection of the transactions. Would it be manifestly unjust to require the appellants to pay the costs of the February and March deliveries in view of the fact that they will suffer significant losses due to the early termination of the same contract that called for the delivery of gas in February and March? In our view, such a requirement is unjust.

58 In *Blue Range*, the CCAA debtor terminated the contracts. Here, BP's position is that the GasEDI Agreement has not been terminated, remains in full force and effect and that Bellatrix is required to perform the agreement.

59 The First Lien Lenders and Bellatrix submit that BP does not meet the test for equitable set-off because it would not be "manifestly unjust" to allow Bellatrix to claim the December payment without taking into consideration the cross-claim.

60 They point out that, in a letter dated February 11, 2020, Bellatrix's counsel advised BP on its position on the ability of a CCAA debtor to elect non-performance of an agreement. Bellatrix responded that the EFC Decision did not deal with the issue of performance or set-off. Bellatrix has been consistent in its position throughout the CCAA proceedings. Despite this, BP did not apply to lift the stay or to claim a right of set-off until this application was filed.

61 While I have found later in this decision that BP's delay in taking action would not disentitle it from a equitable remedy, BP has not established an equitable ground for being protected, and therefore fails the *Telford* test for that reason. BP is not entitled to set-off the December payment, whether or not the GasEDI Agreement is an EFC.

62 Bellatrix submits that, since BP does not fit within the permitted set-off provisions of section 34(8), but for the agreement among Bellatrix, BP and the Monitor to have the Monitor hold the December payment in trust, BP would have been in violation of the stay under the initial CCAA order had it purported to withhold the December payment. If it had unilaterally withheld the payment, BP would have deprived Bellatrix of substantial liquidity at a time when Bellatrix was seeking to pursue its strategic process to identify a going concern transaction for the benefit of its many stakeholders, relying on funds drawn under its Interim Financing Facility, and Bellatrix would have been unable to make various payments to secured and other unsecured creditors.

63 However, as I have found that BP has neither a legal nor an equitable right of set-off, it is not necessary that I decide this issue.

C. Is BP entitled to lift the stay to permit it to obtain and enforce a judgement against the sale proceeds?

64 As a corollary to the relief of lifting the stay, BP asks the Court to direct immediate payment of the alleged damages to BP out of the sale proceeds, less the December payment.

65 The test for lifting a stay focuses on the totality of circumstances and the relative prejudice to the parties involved: *Alberta Energy Regulator v. Lexin Resources Ltd*, 2019 ABQB 23 (Alta. Q.B.) in the context of a receivership, citing *Alignvest Private Debt Ltd. v. Surefire Industries Ltd.*, 2015 ABQB 148 (Alta. Q.B.) at para 40 and 43 (appeal on other grounds dismissed, [2015] A.J. No. 1234 (Alta. C.A.)).

66 Guidance can be drawn from the provisisons of section 69.4 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 as amended, in determining whether a stay in CCAA proceedings should be lifted. The Court should be satisfied that the party applying to lift the stay is likely to be materially prejudiced by the stay or that it would be equitable to lift the stay on other grounds. The burden is on the applicant: *Ma, Re*, [2001] O.J. No. 1189 (Ont. C.A.).

67 Lifting the stay is not routine: there must be sound reasons to relieve against the stay: *Ma, Re*, at para 3.

68 In order for a party applying to lift the stay to show material prejudice, it must show that it would be treated differently or some way unfairly or would suffer worse harm than other creditors if the stay is not lifted: *Golden Griddle Corp. v. Fort Erie Truck & Travel Plaza Inc.* (2005), 29 C.B.R. (5th) 62 (Ont. S.C.J.) at para 18-19. Examples may include hardship caused by the stay or necessity of payment or a situation where it is in the interests of justice to allow the stay to be lifted: *Canwest Global Communications Corp., Re* (2009), 61 C.B.R. (5th) 200 (Ont. S.C.J. [Commercial List]). The prejudice to the applicant should be different qualitatively from that suffered by other creditors, who also lose, in whole or part, the benefit of their contracts by reason of the debtor's insolvency.

69 BP submits that it suffers unique harm from the breach of the GasEDI Agreement, and argues that such prejudice favours the lifting of the stay to allow it to enforce its damages claim against Bellatrix. However, BP does not provide any valid reason why its damages claim is unique.

70 First, BP submits that it is a post-filing creditor. This is incorrect: its damages claim arises from a pre-filing contract, whether it is an EFC or not.

71 Second, BP notes, relying on *Bank of Montreal v. Probe Exploration Inc.*, [2000] A.J. No. 1752 (Alta. Q.B.), that courts are reluctant to interfere with the rights of contractual parties in a liquidation scenario where the result would be to prefer the interests of the debtor and its primary secured creditor. However, I agree with the First Lien Lenders that the *Probe* case is distinguishable from the situation of Bellatrix's failure to perform under the GasEDI Agreement.

72 In *Probe*, the unique facts included the existence of an intercreditor agreement that contemplated the mutual intent between the secured creditor and the party opposing the termination of the agreement at issue that any purchaser of Probe would be bound by Probe's obligations under the contract.

73 BP submits in proposing the lifting of the stay that Bellatrix has abused and violated the CCAA process. As noted later in this decision, there is no basis for this allegation.

74 BP also submits that the stay should be lifted because the GasEDI Agreement as an EFC is entitled to certain benefits. These benefits do not imply a right to lift the stay in the context of a damages claim. Section 34(10) of the *Act* makes it clear that such a claim merely makes the holder a creditor, in this case an unsecured creditor. The unique risks inherent in the status of an EFC contract are recognized in the limited relief offered in section 34. The CCAA does not provide any special security or priority for a damages claim arising from an EFC.

75 Finally, as noted by the Agent, this is the end of the CCAA process, and in the nature of a priorities dispute. There exists no valid reason to lift the stay or to order the immediate payment to BP of damages out of the sale proceeds or to grant BP a priority charge on the sale proceeds ranking *pari passu* with the Interim Lenders Charge unless consideration of good faith or equity compel that result.

D. Is BP entitled to equitable relief?

76 BP seeks a declaration of constructive trust as a remedy for Bellatrix's breach of the GasEDI Agreement, arguing that Bellatrix's stakeholders have been unjustly enriched. BP also submits that Bellatrix has engaged in a pattern of abusive conduct and has unjustly appropriated approximately $14.5 million by breaching a contract that it is prohibited from disclaiming.

77 The onus of proving a constructive trust rests with the claimant. It is a discretionary remedy that will not be imposed without taking into account the interest of others who may be affected by granting the remedy: *Hoard, Re*, 2014 ABQB 426 (Alta. Q.B.) at para 26.

78 As noted at para 23 of *Hoard*, given that the BIA provides a code by which legislators have balanced the interest of those adversely affected by the bankruptcy, the legal rights of creditors should not be defeated unless it would be unconscionable not to recognize a constructive trust. The same reasoning applies to the CCAA.

1. Unjust enrichment

79 A constructive trust can be used to remedy unjust enrichment where monetary damages are inadequate and there is a link or causal connection between the claimant's contribution and the property in which the constructive trust is claimed: *Moore v. Sweet*, 2018 SCC 52 (S.C.C.) at para 91. Therefore, even if the elements of unjust enrichment are satisfied in this case, there is no link between the funds that are the proceeds of sale of Bellatrix's assets and BP. The most that could be recovered through this remedy would be the December payment.

80 The doctrine of unjust enrichment requires an enrichment, a corresponding deprivation, and the absence of a juristic reason for the enrichment: *Hoard*, at para 26.

81 With respect to the requirement of enrichment, the Alberta Court of Appeal noted in *Luscar Ltd. v. Pembina Resources Ltd.*, 1994 ABCA 356 (Alta. C.A.) at para 129 that:

> where there exists a contract under which parties are governed, and one party gains by the breach of the same, that party is not truly enriched, because the breaching party takes that gain subject to its liability for breach of contract.

82 With respect to deprivation, BP was not required to provide any goods or services to Bellatrix or take on any financial risk or exposure. As noted in this decision, BP has failed to establish the amount of any financial hardship it may have suffered as a result of Bellatrix's disclaimer or breach of the GasEDI Agreement.

83 BP concedes that the provisions of the CCAA can provide a juristic reason for an enrichment, but submits that BP is in a unique position as compared to other CCAA creditors in that Bellatrix has breached a contract that it was prohibited from breaching, both by the CCAA and by the Court.

84 As noted previously, the CCAA does not prohibit a debtor from failing to perform a contract, be it an EFC or otherwise. Nor is it correct that in failing to perform the GasEDI Agreement, Bellatrix is in breach of a court order. There is nothing in either the EFC Decision or the order that emanates from it that compels performance of the agreement.

85 The statutory priority of the First Lien Lenders under the CCAA constitutes a juristic reason to deny recovery to BP through the doctrine of unjust enrichment.

86 BP submits that Bellatrix conceded in its submissions before the Court in the application to determine whether the agreement is an EFC that, if it was, Bellatrix would be obligated to perform it. However, Bellatrix actually stated that if the agreement was an EFC, it would be required either to perform it "or otherwise to pay damages to BP".

87 Therefore, BP is not entitled to a constructive trust as a remedy for unjust enrichment.

2. Wrongful Conduct

88 In *Soulos v. Korkontzilas* (1997), 46 C.B.R. (3d) 1 (S.C.C.), the Supreme Court held that a constructive trust can also be used to right wrongful conduct. The following conditions must be met: the insolvent company must be under an equitable obligation in relation to the activities giving rise to the assets in its hands; the property in the hands of the insolvent company must be shown to have resulted from deemed or actual agency activities in breach of its equitable obligation to the claimant; the claimant must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the insolvent company remain faithful to their duties; and there must be no factors that would render the imposition of a constructive trust unjust in all the circumstances.

89 Subsequent decisions emphasize that the property sought to be impressed with the trust must be the property obtained through the wrongful act, *Hoard* at para 35.

90 BP submits that the timing of Bellatrix's purported disclaimer and breach of contract was not a coincidence, in that Bellatrix knew payments for gas delivery under the GasEDI Agreement would be subject to BP's contractual right to set them off against BP's damages for Bellatrix's breach of contract. It argues that Bellatrix timed its delivery of the disclaimer notice and its breach of contract for the day immediately after BP made its payment for October gas deliveries on November 25, 2019, thus depriving BP of the ability to set that payment off against damages.

91 However, although it issued a disclaimer notice on November 25, 2019, Bellatrix continued to deliver gas under the agreement until November 24, 2019 and thus was not in breach of the contract until after that date. It did not mislead BP about the timing of its decision. While the decision on the timing of the disclaimer notice may have been strategic, it was not wrongful conduct.

92 BP also alleges that the timing of the disclaimer notice put it in the position of being an involuntary interim lender, as Bellatrix was able to use funds that BP may have been able to set-off if it had known about the disclaimer earlier.

93 BP's position is different from the position of an interim lender that advances funds to an insolvent debtor to finance an uncertain restructuring process. BP did not advance the roughly $14.5 million that Bellatrix estimated it would be able to achieve in additional revenue by selling its gas elsewhere, and BP it is not out of pocket for that amount.

94 BP also submits that failure to perform the agreement allowed Bellatrix to sell the gas it would have been required to sell BP to other parties and use the proceeds to fund operations and pay other creditors, including the actual interim lender, and that this was wrongful conduct.

95 As noted previously, Bellatrix's decision to cease performing an uneconomic contract during the CCAA process is not wrongful conduct: it allowed the company to generate increased revenue it would not be able to generate under the BP agreement to fund the company's operations while it attempted to restructure. BP was not required to pay for gas that was not delivered or provide any services to Bellatrix. While the outcome of the process was a liquidation, it was a going concern liquidation that was the best opportunity for the preservation of jobs and likely the maximization of value.

96 As noted previously, there is no merit to the allegation that Bellatrix misled the Court. As was the case with unjust enrichment, there is no link or causal connection between the alleged wrongful acts and the proceeds of sale of Bellatrix's assets.

97 In short, BP has no basis to claim a constructive trust based on wrongful conduct.

98 In *Hollinger Inc., Re*, 2013 ONSC 5431 (Ont. S.C.J. [Commercial List]) at para 39, leave to appeal denied in 2014 ONCA 282 (Ont. C.A.), the Ontario Court of Justice found that there is no legitimate reason for the proprietary remedy where the claimant relies on the remedy to try and gain a super-priority over other creditors in the CCAA. BP has an unsecured monetary damages claim and it should not be entitled to a constructive trust that would subvert the priorities of other creditors unless it has established that it would be unconscionable not to recognize such a trust. BP has not done so.

3. Bad Faith

99 BP also relies on section 18.6 of the CCAA, a new provison that provides that any interested person in any proceedings under the *Act* shall act in good faith with respect to the proceedings, and that if it is satisfied that an interested person fails to act in good faith, the Court may make the appropriate order. The duty of acting in good faith is not a new duty for a CCAA debtor: sections 11.02(3), 33(3), 50(12), 50.4(11) and 65.12(2)

100 As I have noted previously, BP has not established any wrongful conduct by Bellatrix, which has merely used the tools available to it under the CCAA. Bellatrix was faced with an uneconomic agreement that it could not afford to perform while attempting to restructure. Bellatrix advised BP at an early stage of the proceedings that, in the circumstances, the agreement would never be accepted by a purchaser of Bellatrix's assets, which BP as a sophisticated party would likely have recognized. BP had the option of terminating the agreement as an EFC and exercising its right to set-off after termination, but chose the option of maintaining that Bellatrix was required to continue to perform the agreement.

101 While Bellatrix breached the GasEDI Agreement by non-performance, it has been transparent and candid throughout with respect to its position and conduct. Although it did not abide by the statutory 30 days notice under its notice of disclaimer, that was after BP refused to accept the disclaimer and advised Bellatrix of its view that the agreement was an EFC.

102 It is not unusual for a CCAA debtor to fail to perform uneconomic ongoing monthly contracts, both before and after filing, whether formally disclaimed or not, and such failure to perform is not per se bad faith.

103 The December payment has been held in trust pending a resolution of the issues of set-off and priority, so Bellatrix has not failed to act in good faith with respect to the payment. The timing of the disclaimer notice, while strategic, was not bad faith conduct, and Bellatrix has not, as alleged by BP, misled the Court or failed to comply with a Court order.

104 The Monitor has stated that it is satisfied that Bellatrix has acted in good faith throughout the proceedings.

105 As noted by Dr. Janis Sarra in "La bonne foi est une considération de base — Requiring Nothing Less than Good Faith in Insolvency Law Proceedings", Annual Review of Insolvency Law, eds Janis Sarra & Barbara Romaine, Toronto: Thomson Reuters Canada, 2014:

> The court will find bad faith conduct where a debtor, creditor or their professionals fail to meet the requirements to act candidly, honestly, forthrightly and reasonably in their dealings with one another and the court; where parties act capriciously and arbitrarily; or where they lie or otherwise knowingly mislead each other about matters relating to the insolvency proceedings.

106 Bellatrix has not exhibited conduct that would fall within these categories and has not acted in bad faith.

107 The First Lien Lenders and Bellatrix point out that BP failed to allege that Bellatrix was not acting in good faith through four stay applications, and only raised the allegation at the end of August, 2020. However, BP responds that, as Bellatrix as a concession to BP agreed to hold back an amount from the sale proceeds to cover BP's damages claim, it had no need to object to the stay extension. While I have not found bad faith by Bellatrix, I accept that BP's failure to object to the stay does not preclude its claim of bad faith in the circumstance.

4. Delay

108 The First Lien Lenders and Bellatrix submit that it would be inequitable to grant BP the super-priority it seeks for damages in priority to the stakeholders of Bellatrix.

109 They note that BP initially applied for various forms of relief, including orders directing Bellatrix to resume performance of the GasEDI Agreement and to remedy any existing default, but ultimately only pursued the issue of characterization of the GasEDI Agreement as an EFC. While BP may have been constrained by time limits in its initial application heard on January 23, 2020, it knew by February 25, 2020, that Jones, J's decision dealt only with the characterization of the GasEDI Agreement

as an EFC, and that it was free to proceed with the remainder of the relief it sought before any other commercial duty judge. The order emanating from the decision grants BP leave to apply for further advice and direction with respect to the remaining relief.

110 While the pandemic interfered with regular commercial duty chambers in March and April, during Bellatrix's May 22, 2020 application before Hollins, J. to make interim distributions to certain priority and secured lenders. BP advised the Court that it may have a priority claim against Bellatrix and asked the Court to set aside US$14.5 million to be held in trust pending resolution of the disclaimer dispute with Bellatrix. The Court refused and suggested that BP bring its own application if it was concerned that it was facing disadvantage. It was not until August 7, 2020, in response to First Lien Lenders priority application, that BP brought a cross-application seeking relief similar to that it had originally sought in December, 2019.

111 The First Lien Lenders submit that it would be inequitable and prejudicial to the First Lien Lenders if BP were now allowed a priority claim in relation to Bellatrix's breach of the GasEDI Agreement. Bellatrix remains indebted to the First Lien Lenders in excess of $44 million and it is clear that Bellatrix would not be able to pay the First Lien Lenders' secured claims in full if BP's unsecured damages claim is paid in priority to its claim.

112 Bellatrix points out that BP did not proceed to seek the remainder of its relief at a time when Bellatrix may have been able to perform the contract if ordered to do so. Now, nine months later, it has no assets that would allow performance.

113 BP responds that it has protested its treatment from the start, and that the First Lien Lenders have suffered no prejudice from the delay, as they and Bellatrix were aware of BP's claim from December, 2019, even though BP did not act on it until after the sale of assets had been concluded. As noted in *Blue Range Resource Corp., Re*, 2000 ABCA 285 (Alta. C.A.), albeit in a different context, the fact that creditors will receive less money if late claims are allowed is not prejudice. "Re-organization under the CCAA involves compromise. Allowing all legitimate creditors to share in the available proceeds is an integral part of the process. A reduction in that share can not be characterized as prejudice: *Cohen, Re* (1956), 36 C.B.R. 21 (Alta. C.A.) at 30-31": *Blue Range* at para 40.

114 Bellatrix and the First Lien Lenders were fully aware of BP's claim, and there is no evidence that earlier determination of the claim would have caused Bellatrix to do anything differently with respect to the sale of assets. This is not a case of a creditor "lying in the weeds", or even a case where BP implied that it had changed its position even though it did not take earlier action. In the specific circumstances of this case, including the disruption of court proceedings caused by the COVID pandemic, I would find that BP is not disentitled to relief on the basis of delay if I am incorrect on its entitlement to equitable relief.

E. Has BP proved the amount of its claim for damages?

115 The amount of damages claimed by BP, in this application, $14.5 million, is equal to the amount that Bellatrix estimated, as part of the EFC determination application, that it could generate as additional revenue from the date of the disclaimer until the end of October, 2020, based on certain assumptions.

116 BP concedes that its damages claim is based on this estimate. However, that estimate must be reduced by the fact that Bellatrix did not realize any revenues for its natural gas after the sale of its assets closed on June 1, 2020.

117 I agree with Bellatrix and the First Lien Lenders that benefits to Bellatrix of the disclaimer do not necessarily equate to BP's entitlement to damages. BP has not provided any evidence of its actual damages relating to the disclaimer of or non-performance under the GasEDI Agreement, taking into account any mitigation BP would have been able to obtain by entering into other arrangements for the purchase of natural gas or otherwise.

118 Therefore, the claim remains an unliquidated unsecured claim.

V Conclusion

119 The First Lien Lenders are entitled to a declaration that they have a first priority interest in all the property of Bellatrix, including the December payment held in trust and funds held back from the sale of assets. Any amounts owing to BP are an

unsecured claim. The Monitor is authorized to make a further distribution to the Agent in the amount of approximately $28.9 million, the exact amount subject to its final calculations.

120 BP's cross-application is dismissed.

Lenders' application granted; corporation's application dismissed.

TAB 3

2012 QCCS 6796
Cour supérieure du Québec

Aveos Fleet Performance Inc., Re

2012 CarswellQue 14439, 2012 QCCS 6796, 233 A.C.W.S. (3d) 287, 2 C.B.R. (6th) 222, J.E. 2013-232, EYB 2012-216879

In The Matter of The Companies' Creditors Arrangment Act, R.S.C. 1985, c. C-36

Aveos Fleet Performance Inc. / Aveos Fleet Performance Aéronautique Inc. (Insolvent Debtors-petitioners) et Aero Technical US, Inc. (Insolvent Debtor) c. FTI Consulting Canada Inc., Monitor, et Northgatearinso Canada Inc. (Petitioner) et Credit Suisse AG Cayman Islands Branch (Secured Creditor)

Schrager, J.S.C.

Audience: 28 septembre 2012 - 30 octobre 2012
Jugement: 20 novembre 2012
Dossier: C.S. Montréal 500-11-042345-120

Avocat: Me Martin Poulin for Insolvent Debtor/Petitioner
Me Geneviève Cloutier for Northegatearinso Canada Inc.
Me Bernard Bouchard Me Caroline Dion, for Canadian Counsel for Credit Suisse AG, Cayman Islands Branch
Me Sylvain Rigaud for FTI Consulting Canada Inc.

***Schrager, J.S.C.*:**

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.I. 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.

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.

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 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 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

Motion dismissed.

Notes de bas de page

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

2 *Timminco Ltd., Re*, 2012 ONSC 4471 (Ont. S.C.J. [Commercial List]) at par. 52 to 57; *Boutique Jacob inc., Re*, 2011 QCCS 276 (C.S. Que.) at par. 38 to 41 and 46; *Homburg Invest Inc., Re*, 2011 QCCS 6376 (Que. Bktcy.) at par. 103-106; *9145-7978 Québec inc., Re*, 2007 QCCA 768 (C.A. Que.) at par. 26 to 29.

3 *Timminco Ltd., Re*, op.cit, at par. 52-27

4 *Nortel Networks Corp., Re*, 2009 ONCA 833 (Ont. C.A.); *First Leaside Wealth Management Inc., Re*, 2012 ONSC 1299 (Ont. S.C.J. [Commercial List]); *PCAS Patient Care Automation Services Inc., Re*, 2012 ONSC 3367 (Ont. S.C.J. [Commercial List]); *Brainhunter Inc., Re* (2009), 62 C.B.R. (5th) 41 (Ont. S.C.J. [Commercial List]); *Anvil Range Mining Corp., Re* (2002), 34 C.B.R. (4th) 157 (Ont. C.A.)

5 *Ted Leroy Trucking Ltd., Re*, [2010] 3 S.C.R. 379 (S.C.C.)

6 *Hart Stores Inc. / Magasins Hart inc., Re*, 2012 QCCS 1094 (C.S. Que.)

7 R.S.C. *c*. B.-3

8 *Pine Valley Mining Corp., Re*, 2008 BCSC 368 (B.C. S.C. [In Chambers]) para. 37-42; *Canwest Global Communications Corp., Re*, 2010 ONSC 1746 (Ont. S.C.J. [Commercial List]), para. 29-31, 33-35

9 *Canwest Global Communications Corp., Re*, op.cit.

10 *Timminco Ltd., Re*, op.cit., para. 44

11 Section 8 C.C.A.A.

TAB 4

2009 ABQB 503
Alberta Court of Queen's Bench

Allarco Entertainment Inc., Re

2009 CarswellAlta 1458, 2009 ABQB 503, [2009] A.W.L.D. 4034, [2010] 4 W.W.R. 299, 12 Alta. L.R. (5th) 341, 180 A.C.W.S. (3d) 569, 483 A.R. 53, 58 C.B.R. (5th) 140

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

And in the Matter of Allarco Entertainment Inc. and Allarco Entertainment 2008 Inc. and Alliance Films Inc.

J.B. Veit J.

Heard: September 2-3, 8-9, 2009
Judgment: September 14, 2009
Docket: Edmonton 0903-09146

Counsel: Frank R. Dearlove for Applicant, Alliance Films Inc.
Charles P. Russell, Q.C. for Allarco Entertainment Inc., Allarco Entertainment 2008 Inc.
Richard T.G. Reeson, Q.C. for Alberta Treasury Branches
Michael J. McCabe, Q.C. for Pricewaterhouse Coopers Inc.
David Ullmann for MGM Television of Canada, a division of Metro-Goldwyn-Mayer Studios, Inc.
Marc-Andre Morin for Twentieth Century Fox/Incendo Television Distribution Inc., Incendo Media Inc.
Harry Fogul for Twentieth Century Fox/Incendo Television Distribution Inc.
Eric Vallieres for TVA Films, a division of TVA Group Inc.
Patrick Roche for Maple Pictures Corp.
Roger P. Simard for National Bank of Canada
Danny M. Nunes for NBC Universal
Bertrand Langlois for Christal Films Distribution Inc.
Alan H. Brown for Starz Media LLC

***J.B. Veit J.*:**

Summary

1 On June 16, 2009, the Allarco Entertainment companies, which operate Super Channel - a pay-per-view television channel - obtained protection from their creditors pursuant to the provisions of the *Companies' Creditors Arrangement Act*. As part of the initial, *ex parte*, order under the statute, Allarco Entertainment obtained a "pay-per-play" regime in relation to its obligations to Alliance Films Inc., a program supplier. Alliance Films now applies for a variation of the initial order: it argues that the court had no jurisdiction to grant what amounts to a major, unilateral, variation of its contracts with Allarco Entertainment. For an overall fee which was to be paid in instalments, the Alliance contracts allowed Allarco Entertainment to exhibit films and television series, including the right to exhibit through subscription video on demand, for a limited number of times over a specific time period. Alliance asserts that the contract fees are paid for the ongoing right to exhibit the films or series episodes, that there is no "pay-per-play" provision in the contracts, and that the courts should not have imposed such a variation on Alliance.

2 Alternatively, Alliance argues that if the court does have jurisdiction to approve such contract variations, the court should not have exercised its discretion in favour of this variation because a "pay-per-play" regime constitutes a negative incentive on the debtor, Allarco Entertainment, to use the service provided by Alliance.

3 Alliance Films Inc. brought this motion in July, 2009. The court adjourned the motion on the condition that Allarco Entertainment negotiate in good faith with Alliance. The resulting negotiations were unsuccessful. On August 17, 2009, Allarco Entertainment terminated its contracts with Alliance Films. In its amended motion, in addition to asking for a variation in relation to the "pay-per-play" term in the initial order, Alliance also now asks the court to invalidate Allarco Entertainment's terminations.

4 *In its initial order, even if the court did have jurisdiction to vary the Allarco Entertainment/Alliance Film contracts by establishing a different payment structure than the one set out in the contracts, it should not have done so: a post-protection service provider usually has the right to maintain its contract prices.*

5 The CCAA states that where, under licence agreements, a contractor provides new services to a debtor who has obtained creditor protection, that service provider is entitled to "immediate payment"; this is compared to the provider who provided services prior to the granting of creditor protection, whose right to enforce payment is stayed. The CCAA does not state the basis on which compensation is to be paid for post-protection services. Allarco Entertainment argues that the basis for compensation should be "what is just and reasonable"; here, the debtor claims that a "pay-per-play" payment scheme is fair because it will get rid of instalment payments to Alliance, the payment of which will hinder Allarco Entertainment's ability to re-organize. Alliance Films argues that, at this stage of the CCAA proceedings, the court does not have the right to make unilateral contract changes. At this stage of the proceedings, the broad wording of the CCAA, which is remedial legislation, does allow the courts to make some contracts between debtors and creditors: for example, with respect to utilities such as electricity, the court can allow the service provider to be paid not only the usual utility rate but also a security deposit: *Fonderie Poitras ltée, Re*. Another example is the court's decision that some contract provisions relate to past services, and cannot therefore be enforced, and that other contract provisions relate to post-protection services for which the debtor incurs an obligation of immediate payment: *Nortel*. These are examples of the limited way in which the courts have jurisdiction to vary contracts in an initial order under CCAA proceedings. It is not necessary to articulate the principle which applies to the jurisdiction of the court in relation to contracts, s. 11.3(a) of the CCAA, and initial orders, but if that were required, it may be that, in the initial order courts have only a limited jurisdiction to affect contractual rights and that contractual payment terms negotiated between debtors and creditors generally represent the payments which debtors are required to make if they use the services set out in those contracts post-protection as that scale of payment best represents both a fair and reasonable price for the services and business in the ordinary course. This principle arises from the common law's respect for contractual obligations. Generally, contracts cannot be varied by courts: contracts represent, in effect, a law which private parties have agreed applies to them. Court can interpret or rectify, but not vary, contracts. Even courts of equity generally limited themselves to deciding which contracts, or portions of contracts, would not be enforced by the justice system. Legislation could, of course, give to the courts the jurisdiction to vary or create contracts; however, given the clear state of the common law on this issue, explicit statutory provisions would be required to give courts a general jurisdiction to vary contracts. Such explicit authority is not given to courts in the CCAA at this stage of proceedings. The court's only authority in the situation here was to distinguish between those portions of the Alliance contracts which represent services that have already been performed, the enforcement of which is stayed, and those portions which deal with the provision of ongoing services, the payment for which Allarco Entertainment was required to make according to the contract if it wished to continue using Alliance's services.

6 *Allarco Entertainment is, however, entitled to terminate its contracts with Alliance Films.*

7 After the issuance of the initial order, Allarco Entertainment negotiated with Alliance in good faith. The granting of protection from creditors is designed to promote such negotiations. Alliance is not required to continue to provide services to Allarco Entertainment post-protection; on the other hand, Allarco Entertainment is entitled to terminate contracts. The court does have a general oversight jurisdiction to determine if the termination of a contract by a debtor is just and reasonable. On this motion, Allarco Entertainment has satisfied that test: among other important aspects of the statutory test, the evidence establishes that, during the negotiations, Alliance Films was attempting to obtain a security status for its contracts which did not exist in its original contracts. Granting new security to Alliance post-protection would have given Alliance an advantage over other Allarco Entertainment creditors. Allarco Entertainment was in fact prevented from acceding to these attempts by Alliance Films.

Cases and authority cited

8 **By Alliance Film:** *Thomson Knitting Co., Re*, 1925 CarswellOnt 5 (Ont. C.A.) citing *William Hamilton Manufacturing Co. v. Hamilton Steel & Iron Co.* (1910), 23 O.L.R. 270 (Ont. C.A.); *Doman Industries Ltd., Re*, 2003 CarswellBC 538 (B.C. S.C. [In Chambers]); *Skeena Cellulose Inc., Re*, 2003 CarswellBC 1399 (B.C. C.A.); *Doman Industries Ltd., Re*, 2004 CarswellBC 1545 (B.C. C.A. [In Chambers]); *T. Eaton Co., Re*, 1999 CarswellOnt 3542 (Ont. S.C.J. [Commercial List]) citing *Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.); *Doman Industries Ltd., Re*, 2004 CarswellBC 1262 (B.C. S.C.); *Companies Creditors' Arrangement Act*, R.S.C. 1985, c. C-36, as amended, s. 11.3; *Stelco Inc., Re*, 2005 CarswellOnt 1537 (Ont. C.A.); *In Re Enron Corp.*, 279 B.R. 695 (U.S. Bankr. S.D. N.Y. 2002) (Gonzalez); *In re Kmart Corp.*, 293 B.R. 905 (U.S. Bankr. N.D. Ill. 2003); *In re Thatcher Glass Corp.*, 59 B.R. 797 (U.S. Bankr. D. Conn. 1986) at 6.

9 **By the Allarco Entertainment corporations:** *Lehndorff General Partner Ltd., Re* (1993), 9 B.L.R. (2d) 275 (Ont. Gen. Div. [Commercial List]); *T. Eaton Co., Re* (1997), 46 C.B.R. (3d) 293 (Ont. Gen. Div.)); *Nortel Networks Corp., Re* [2009 CarswellOnt 3583 (Ont. S.C.J. [Commercial List])], 2009 WL 1763447; *In re Kmart Corp.*, 293 B.R. 905 (U.S. Bankr. N.D. Ill. 2003) (Sonderby); *In Re Enron Corp.*, 279 B.R. 695 (U.S. Bankr. S.D. N.Y. 2002) (Gonzalez); *Skeena Cellulose Inc., Re* (2003), 43 C.B.R. (4th) 187 (B.C. C.A.); *Blue Range Resource Corp., Re* (2000), 192 D.L.R. (4th) 281 (Alta. C.A.); *T. Eaton Co., Re* (1999), 14 C.B.R. (4th) 288 (Ont. S.C.J. [Commercial List]); *Doman Industries Ltd., Re* (2004), 29 B.C.L.R. (4th) 178 (B.C. S.C.); *Blue Range Resource Corp., Re* (1999), 245 A.R. 154 (Alta. Q.B.); *New Skeena Forest Products Inc., Re*, 2005 BCCA 192 (B.C. C.A.); *Woodward's Ltd., Re* (1993), 100 D.L.R. (4th) 133 (B.C. S.C.); *Campeau v. Olympia & York Developments Ltd.* (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.); *Air Canada, Re*, 66 O.R. (3d) 257, [2003] O.J. No. 2976 (Ont. C.A.); *SageCrest Dixon Inc., Re*, [2009] O.J. No. 1127 (Ont. S.C.J. [Commercial List]); *Air Canada, Re*, [2003] O.J. No. 6239 (Ont. S.C.J. [Commercial List]).

10 **By the court:** *Smith Brothers Contracting Ltd., Re*, [1998] B.C.J. No. 728 (B.C. S.C.); *West Bay SonShip Yachts Ltd., Re*, 2009 BCCA 31, [2009] B.C.J. No. 120 (B.C. C.A.); *Smoky River Coal Ltd., Re*, 2001 ABCA 209, [2001] A.J. No. 1006 (Alta. C.A.); *Fonderie Poitras ltée, Re*, 2009 QCCA 1416, [2009] J.Q. No. 7438 (C.A. Que.); *Boutiques San Francisco Inc., Re*, [2004] Q.J. No. 2886 (C.S. Que.).

11 Appendix A: The payment scheme in the initial order

1. Background

12 The following information is uncontested, or if contested, the court is able to come to a conclusion on the existence of a fact without ordering a trial of that issue.

a) Factual

13 The Allarco Entertainment companies operate Super Channel, an English language general interest pay television channel, one of only 3 pay-per-view television channels in Canada. The business of the companies is licensed and regulated by the Canadian Radio-Television and Telecommunications Commission, CRTC. One of the licensing requirements is the delivery of a certain proportion of Canadian content programming, which requirement ensures greater value for programming packages which satisfy that requirement.

14 The Allarco Entertainment companies rely on broadcasting distribution undertakings, BDUs, such as Rogers, Shaw and Bell TV, to sell Super Channel as a programming option. By law, the BDUs are obligated to treat all program networks equally, and not to unfairly encourage their customers to purchase the services of one program network in preference to others. Allarco Entertainment has an ongoing complaint about one of the BDUs, alleging that that distributor has not dealt fairly with Super Channel; this complaint is now the subject of a lawsuit, which is being case managed in Ontario. In a parallel mode, Allarco Entertainment has also laid its complaints against that BDU with the CRTC; there has not yet been a resolution of those complaints by the Commission.

15 When they applied for an initial order under the CCAA, the Allarco Entertainment companies had approximately 425 outstanding program license agreements, PLAs, with various entertainment program suppliers. Although the Allarco Entertainment companies had their own form of PLA which it used whenever possible, some of the more well known program licensors required the Allarco Entertainment companies to enter into the licensors' standard form of PLA. Approximately $64,000,000.00 of programming has been delivered to the Allarco Entertainment companies, for which payment had not been made when those companies applied for protection from their creditors.

16 Allarco Entertainment's PLAs with Twentieth Century Fox are the most significant component of the Super Channel programming cost.

17 Alberta Treasury Branch is the first secured creditor of the Allarco Entertainment companies; it holds general security agreements containing a charge over Allarco Entertainment's present and after acquired personal property. The ATB facility is currently fully drawn. ATB has agreed, on certain conditions, to reestablish the MasterCard facility for Allarco Entertainment. ATB has also indicated to Allarco Entertainment that it is prepared, on certain conditions, to forbear in pursuing recovery under the guarantee of the ATB facility.

18 Alliance has 5 PLAs with Allarco Entertainment. The PLAs typically give to Allarco Entertainment the right to play the programs offered in a package on an exclusive basis. Moreover, the first time an individual program is broadcast, Allarco Entertainment can advertise the play as a premiere, which has added value over and above the rights of exclusive broadcast.

19 When Alliance first brought this motion, it was concerned mainly with two of its program licence agreements with Allarco Entertainment, the January 15, 2008 PLA - Super Channel Q1 08 package - and the February 25th 2008 PLA - Super Channel Q2 08 package. Those agreements are similarly structured. However, there are at least two important terms which are found in the latter agreement which are not found in the former.

20 The first of these terms is:

> **Security Interest**
>
> Licensee shall grant Licensor a security interest in respect of Licensee's payment obligations and Licensee shall execute and deliver documentation necessary to effect the foregoing.

Although Q2 2008 was agreed to and accepted by the parties on March 31st, 2008, by June 16, 2009, no security documents had been prepared by either Allarco Entertainment or Alliance Films. Alliance characterizes this contractual term as an equitable charge which has all the validity of a legal charge.

21 The second of the terms is:

> **Termination Rights**
>
> In the event of default by Licensee (including failure to pay amounts when due and/or if assignment for the benefit of creditors, seeks relief under any bankruptcy law or similar law for the protection of debtors, or allows a petition of bankruptcy to be filed against it, or a receiver or trustee to be appointed for substantially all of its assets that is not removed with 30 days), Licensor shall be entitled to terminate or suspend Licensee's rights with respect to programming (i) licensed hereunder; and/or (ii) licensed to Licensee by Licensor pursuant to any other agreement. In the event Licensor decides to terminate Licensee's rights to programming, all rights will automatically revert to Licensor, free and clear of any and all encumbrances and Licensor shall be entitled to immediate possession of all related materials.

In its PLAs which contained termination rights, Alliance did not terminate its contracts with Allarco Entertainment once it knew that Allarco Entertainment had obtained an initial order under the CCAA.

22 Alliance has 3 other PLAs with Allarco Entertainment. Alliance did not focus on these 3 PLAs because no payments are due at this time in relation to those agreements. Of those additional agreements: PLA 2007/2008 Allarco Package does not contain any security or termination clauses; PLA Super Channel Q4- 08 package does not contain a security clause but does contain a termination clause; and, PLA Super Channel Q3-08 Package contains both a security clause and a termination clause.

23 In their applications before the Court, Allarco Entertainment has provided the court with this broad stroke explanation of what its Plan of Arrangement might entail:

• sale to a third party investor of a portion or all of the equity in the business, having in mind the value of the existing CRTC license;

• ongoing active involvement in the business by entities related to Charles R. Allard, the sole director of Allarco Entertainment Inc.;

• significant reduction in both the cost of programming and general overhead expense would allow a viable business at a much lower level of subscriber involvement;

• success in the claim against the BDU would increase the number of subscribers;

• injection of funding into the business either by way of equity or further loans.

24 The Allarco Entertainment companies proposed, and in the initial order the court approved, PricewaterhouseCoopers Inc. as the Monitor under these proceedings. The Monitor has not, of course, taken a position on this application; however, the Monitor reports that, to date, it has not uncovered any abusive conduct by the Allarco Entertainment companies.

25 Paragraph 16 of the initial order provided that payment under the PLAs between Allarco Entertainment and various program licensors was to be made in accordance with the terms set out in para. 43 of the affidavit of the President and Chief Operating Officer of the Allarco Entertainment companies. Those terms are set out in appendix A hereto.

26 Since the granting of the initial order, Allarco Entertainment has continued to advertise access to Alliance programming, including subscription on demand, SVOD, rights.

27 The initial order has been extended by court order to September 30, 2009.

28 There is a dispute between the parties about the proportion of the contract payments which Alliance Films has received, and would receive, since the protection order. That issue will be discussed further in relation to the termination by Allarco Entertainment of the Alliance contracts.

29 There is a dispute between the parties concerning the content of the negotiations which preceded the termination by Allarco Entertainment of the Alliance contracts. This dispute will be referred to in the discussion of the termination issue hereunder.

30 As of August 17, 2009, Allarco Entertainment repudiated its contracts with Alliance and noted, "Any damages suffered by Alliance as a result of such repudiation will be dealt with in the claims process in the CCAA proceedings".

31 Although the PLA providers set out in the Appearances section hereunder have been given notice of this application, only MGM has provided evidence and submissions on the motion, although many of the other parties attended the hearing by telephone. MGM is owed in excess of $1,400,000.00 in outstanding claims for licensing fees not paid to it prior to the date of the initial order in these proceedings. MGM would have expected payments in excess of $2,000,000.00 between the date of the initial order and February 2010 in the ordinary course. MGM will continue to provide Allarco with new films, at a discounted price, while MGM defers certain other payments for films which have already been delivered to Allarco. MGM is of the view that the continuation of the CCAA process is in the best interest of MGM and likely in the best interest of many other programming suppliers in these proceedings.

b) Legislative

32 Section 11 of the CCAA reads:

> 11.(1) Notwithstanding anything in the Bankruptcy and Insolvency Act or the Winding-up Act, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.
>
> (2) An application made for the first time under this section in respect of a company, in this section referred to as an "initial application", shall be accompanied by a statement indicating the projected cash flow of the company and copies of all financial statements, audited or unaudited, prepared during the year prior to the application, or where no such statements were prepared in the prior year, a copy of the most recent such statement.
>
> (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,
>
> > (a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
> >
> > (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
> >
> > (c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.
>
> (4) A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,
>
> > (a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
> >
> > (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
> >
> > (c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.
>
> . . . . .
>
> (6) The court shall not make an order under subsection (3) or (4) unless
>
> > (a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
> >
> > (b) in the case of an order under subsection (4), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

33 In 1997, the following amendment was made to s. 11 of the BCCA:

> > 11.3 No order made under section 11 shall have the effect of
> >
> > > (a) prohibiting a person from requiring immediate payment for goods, services, <u>use of</u> leased or <u>licensed</u> property or other valuable consideration provided after the order is made; or
> > >
> > > (b) requiring the further advance of money or credit.

(Emphasis added)

2. At This Stage of the CCAA Proceedings, Does the Court Have the Jurisdiction to Approve Unilateral Contract Changes Proposed by Allarco Entertainment to Alliance Film Contracts?

34 The short answer to this question is, No.

35 As a prelude to the discussion of the specific issue which is before the court, the court observes that the conclusion reached by Bauman J. in *Smith Brothers*, a leading decision on the interpretation of s. 11.3 of the CCAA, to the effect that it is the *use* (emphasis in the original at para. 19) of "leased property, not the making of the lease itself, after the stay order, which is within the purview of s. 11.3(a)" also apply here. The implications of that finding are twofold: the Alliance contracts are "true" licenses within the meaning of *Smith Brothers* - which means on the one hand that they are not security documents - and, Alliance cannot be forced to provide the portions of those contracts which relate to the provision of services post-protection without an immediate claim for those services.

36 The nature of the Alliance contracts is that they provide a service - the right to advertise and broadcast the availability of a package of programming - rather than the right to make a single broadcast. The advertising by Allarco Entertainment of the availability of the Alliance Films packages, including SVOB rights, constitutes "use" of the Alliance Films licensed property.

37 Allarco argues that s. 11.3 (a) of the CCAA which entitles a service provider to require immediate payment for services provided after the initial order does not indicate the payment basis on which those services will be provided. Allarco Entertainment suggests that this gap in the legislation is one which the court has the jurisdiction to fill and that the test for determining payment should be what is a just and equitable basis for compensation. Alliance argues that there is no gap, or that if there is a gap, the terms of the contract relating to payment should be accepted as being the proper basis for the provision of post-protection services.

38 To provide guidance in filling the gap, Allarco Entertainment proposes American jurisprudence pursuant to s. 503(b) of the *Bankruptcy Code* which allows a court to give priority treatment to "administrative expenses". However, in order to do so, the court must conclude not only that the debt arises out of a transaction with the debtor in possession, but also that the payment of the debt is beneficial to the operation of the debtor's business. Allarco notes that the concept of "beneficial" is narrowly interpreted, as is to be expected in a regime where those administrative expenses receive priority. For example, in *Kmart Corporation*, the bankruptcy court asserted that "post-petition performance alone does not automatically translate into a benefit to the estate, even if there was inducement on the part of the debtor"; the same principle was also applied in *Enron*.

39 I agree with Allarco Entertainment that there is a gap in the CCAA relating to the payment for post-protection services.

40 However, with respect, I disagree with Allarco Entertainment's proposed use of American jurisprudence. As the B.C. Court of Appeal emphasizes in *West Bay SonShip*, although similar policy objectives inform Canadian and American insolvency legislation, and while certain American decisions might even be persuasive in certain Canadian insolvency situations, in each specific potential use of American jurisprudence care must be exercised to ensure that, in the particular case, both the American legislative scheme is similar to that in Canada and, in the absence of expert evidence on the state of American law, that the American reasoning in a particular case is not conflated with the state of American jurisprudence on the issue.

41 For example, here the Alliance Films PLAs are, in Canadian or Albertan parlance, executory contracts. However, American authorities are not helpful on the treatment of "executory contracts" in the CCAA partly because the specialized interpretation of that term in American bankruptcy law is different from the interpretation of that term in Alberta and perhaps in Canada:

> 31 In "A Joint Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals - Joint Task Force on Business Insolvency Law Reform - March 15, 2002", the authors cited the following meanings for "executory contract":

> What is an executory contract? Neither the CCAA nor the BIA use the expression, but the United States Bankruptcy Code does in s. 365 ("Code, s. 365"). In general contract law, "executory contract" means a contract under which one or both parties still have obligations to perform. However, in U.S. bankruptcy law the expression is normally given a narrower meaning. According to the most widely accepted definition in the United States, an executory contract for the purposes of Code s. 365 is:
>
>> a contract under which both the obligations of the bankrupt ["A"] under the contract and the other party to the contract ["B"] are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.
>>
>> (Countryman, "Executory Contracts in Bankruptcy" (1974) 57 Minnesota Law Review 439 (Part 1), at 460).

42 More pertinently in this particular case, while there is in the American *Bankruptcy Code* a priority for administrative expenses which include "the actual, necessary costs and expenses of preserving the estate", there is no such limitation in s. 11.3 of the CCAA. Here, all post-protection service providers are entitled to claim immediate payment for their services. Therefore, the American jurisprudence is not, in this particular case, helpful.

43 In any event, however, no decision has been brought to my attention in which an American court has, other than in a utility situation which will be discussed later in the context of Canadian case law, itself calculated a price other than the contract price for the provision of post-protection services. Indeed, the weight of American jurisprudence on the issue appears to be that the contract price is assumed to be a reasonable price unless the debtor can show that the contract price is clearly unreasonable.

44 In the circumstances here, rather than to rely on American jurisprudence for guidance, it is more appropriate to rely on Canadian law and on first principles. As has been noted in much of the jurisprudence which interprets the CCAA, there is jurisdiction in the statute for a court to work out arrangements that will maximize benefits to all affected parties. As our Court of Appeal put it in *Smoky River Coal Ltd., Re*:

> 16 CCAA orders become the roadmap for the proceedings and the litigation which may follow. Orders must therefore be drafted with clarity and precision. The purpose of the CCAA must be kept at the forefront in both drafting and interpreting a CCAA order. The CCAA is remedial legislation. As was stated in Re Lehndorff General Partner Ltd. (1992), 17 C.B.R. (3d) 24 (Ont. Gen. Div):
>
>> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on <u>business in the ordinary course</u> or otherwise deal with their assets so as to enable a plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court.
>>
>> (Emphasis added)

45 The court's jurisdiction is not, however, unlimited. One limiting feature is the timing of the court's intervention. There is no doubt that, at the stage of the approval or failure of a plan, a court can impose terms on an unwilling creditor. We are not, however, at that stage.

46 At this stage, that is the stage of the initial order, whatever services are provided post-protection are offered by service providers who are entitled to be paid for those services. Generally, two payment regimes will be adopted. One is that ongoing service providers will accept, at least until the presentation of a plan, some new, negotiated, plan. Obviously if the parties to a contract agree to a variation of the terms of that contract, that variation governs. However, a service provider is not required to provide post-protection services without the right to claim immediate payment. If a service provider will not agree to modify its contractual payment terms in order to provide post-protection services, then the debtor must either terminate the contract or pay the contractual amount. In reaching this conclusion, I rely on the fact that, at the stage of the initial order, it would be

inappropriate for a court to attempt to draw up a contract for the parties. What the parties have negotiated in a contract should generally be presumed to be a fair and reasonable price for the services provided. Not only are courts not business experts, but the cost of attempting to bring the court up to speed on the reasons that a creditor and a debtor each have for advancing a payment proposal would exhaust the financial capacity of an already insolvent debtor. At the stage of the presentation of a plan, the situation is, of course, different: at that stage the court has much more information on which to rely, including the business acumen of all other creditors.

47 Two exceptions to the general rule that contract terms govern have been identified in the jurisprudence. First, there are utility contracts: see *Hydro-Québec*. Even though the original contract for service did not contain any form of security payment, a court approved a security deposit as a term of post-protection provision of services. The provision of utilities is, however, a unique form of contract. On the one hand, utility contracts are contracts of adhesion whose payment terms are typically regulated by government or government-established commissions, and, on the other, the debtor does not typically have any choice in service providers. In those circumstances, it is appropriate for a court to set the terms of payment for post-protection services since a utility provider should not be required to provide post-protection services which require the advance of further credit: see s. 11.3(b). It appears that American jurisprudence takes a similar view with respect to utilities: see *Thatcher Glass*. The crucial nature of utility services requires the intervention of the court where the parties cannot agree on a fee for post-protection services; in other circumstances, a service provider can protect itself by refusing to provide services. These principles are usefully addressed by the Court of Appeal in *Fonderie Poitras ltée, Re*:

> 80 L'alinéa a) de l'article 11.3 de la LACC établit un principe clair : pendant la période de suspension, le fournisseur a droit d'être payé pour les services qu'il rend au fur et à mesure de leur utilisation.
>
> 81 Voici d'ailleurs les commentaires du professeur Richard H. McLaren au sujet de cet article:
>
>> Section 11.3 acts as an exemption to the stay provisions of s. 11 of the CCAA. It appears the section is meant to balance the rights of creditors with debtors. The section addresses the concern that judges had too much discretion in issuing stays. Under s. 11.3(a), if a person supplies goods or services or if the debtor continues to occupy or use leased or licensed property, the court will not issue a stay order with respect to the payment for such goods or services or leased or licensed property. In essence, s. 11.3(a) will not permit the court to prohibit these individuals from demanding payment from the debtor for goods, services or use of leased property, after a court order is made.16
>
> 82 Ce principe connaît cependant des limites pratiques. Il arrive parfois que la réalité s'oppose à ce que le fournisseur soit payé immédiatement pour les services qu'il fournit à une compagnie débitrice. La fourniture d'électricité en est un exemple patent : il s'agit d'un service continu qu'il est impossible de facturer au fur et à mesure de la consommation.
>
> 83 En pareilles circonstances, il est juste et équitable pour le fournisseur de services de demander des garanties de paiement. Commentant la décision Re Smoky River CoalLtd17, les auteurs Houlden, Morawetz et Sarra déclarent:
>
>> Under its inherent powers, the court can create a security for creditors who supply goods and services to the debtor after the filing of a CCAA petition and can provide for the priority and ranking of such a security interest with respect to other security holders. If the plan under the CCAA fails, the court can determine who are entitled to share in the proceeds of the security interest.18
>
> . . . . .
>
> 87 Au sujet du droit applicable, le juge Rolland s'exprime en ces termes:
>
>> [13] Il découle de ce qui précède qu'un fournisseur ne peut exiger d'être payé d'avance pour un service à fournir.
>>
>> [14] Ainsi, un créancier peut exiger d'être payé immédiatement lors de la livraison, mais pas de recevoir un paiement d'avance pour des services à fournir.
>>
>> [15] La situation est relativement simple lorsqu'il s'agit d'un bien individualisé, vendu et livré.

[16] Cela peut être plus compliqué dans les cas d'un approvisionnement continu d'un service comme l'électricité, le téléphone ou le gaz.

[17] Exiger de la débitrice qu'elle paie un mois d'avance comme le demande Gaz Métro, alors qu'elle entend fermer plus de 30 locaux au cours des prochains jours ou semaines, a pour effet de créer un fardeau trop onéreux pour la débitrice.

[18] La LACC ne fait pas exception quant aux créanciers qu'il s'agisse de fournisseur d'un service continu par opposition à un fournisseur de biens.

[19] Le tribunal a discrétion pour établir une procédure permettant au fournisseur de ne pas être préféré ou pénalisé par rapport aux autres créanciers.

(je souligne)

48 In that particular case, the court concluded that a $42,000.00 guarantee was reasonable in the circumstances.

49 The second exception from the obligation to pay the contract price for post-protection service, an exception which constitutes a lesser intrusion on the freedom of contract than the outright establishment of new payment terms, is the selection by a court from amongst the provisions of one contract of certain services for which the debtor must pay the contract price while other provisions are identified as ones for which the debtor is not immediately required to pay: *Nortel*. In that case, the contract - a collective agreement - included both payments to persons who were no longer providing service to the debtor and payments to persons who were providing post-protection service to the debtor. The union advanced two arguments in support of its claim that all contract payments should be made post-protection. The first was that the services that had been provided in the past were part of the consideration for services that were being provided post-protection. The second was that, because of a statutory requirement, the union did not have the freedom which most service providers have, to refuse to provide ongoing service to a debtor which has received protection from its creditors. (On this latter point, there is a certain analogy between the union - which could not, for legislative reasons, withdraw its services despite the wording of s. 11.3(a) - and Alliance, which cannot withdraw the services which it provided in three contracts because those contracts grant licences to Allarco Entertainment without termination rights arising on insolvency.) The *Nortel* court rejected both arguments. Although the court decided which portions of the contract had to be paid, it did not purport to vary the contractual basis for payment; it merely decided which portions of the contract were eligible for payment post-protection.

50 It appears that a similar approach was taken in *Boutiques San Francisco Inc.*: the debtor could either decide to terminate the contract for display shelves, or pay the contract price for those units.

51 There may be other exceptions to the general rule but I have not been provided with any Canadian case law which has identified any such exceptions.

52 The two exceptions to the rule that post-protection services are to be paid according to the contract price reenforce the generality of the rule. Generally, contracts cannot be varied by courts: they can be interpreted or rectified but not varied. Even courts of equity limited themselves to remedies which recognized the basic authority of contracts: a court of equity might, for example, require a contracting party to render proper accounts even though that was not a term of the contract if the rendering of accounts was necessary to enforce the contract. Similarly, a court of equity might grant relief from the consequences of certain contracts - such as contracts that were unconscionable. In other cases, a court might decide that, for public policy reasons, certain contracts, such as gambling contracts, would not be enforced by the justice system.

53 Legislation could, of course, give to the courts a broad jurisdiction to create or vary contracts or to over-ride them. An example of the latter is the *Divorce Act* which provides that a court should taken into account any contract between the parties in relation, for example, to spousal support, but that the court is not limited in making a spousal support order by the terms of the contract between the parties.

54 Given the respect for contracts in the common law, explicit statutory provisions are required to give courts the jurisdiction to impose unilateral variations in contracts. Such explicit authority is not given to courts in the CCAA at the initial order stage.

55 Moreover, as was noted at the outset, it is important to correctly identify the nature of the Alliance PLAs: these are not pay-per-play contracts, but rather contracts which allow Allarco Entertainment to advertise the availability of Alliance product without in fact broadcasting Alliance product. The effect of imposing a pay-per-play payment term on Alliance at this stage would be to impose upon Alliance the obligation to provide a continuing service - allowing Allarco Entertainment to continue to advertise the availability of Alliance programming -without providing payment for that service. Indeed, as Alliance has emphasized, Allarco Entertainment's web-site continued, post-protection, to advertise Alliance programming. It is not necessary on this application to determine whether forcing Alliance to continue to provide its services to Allarco Entertainment can also be characterized as requiring Alliance to make a further advance of credit to Allarco.

56 For the reasons set out above, having now heard argument from the party affected, this court varies para. 16 of its initial, *ex parte*, order by removing the reference to para. 43(b) of the Knox affidavit and replacing it with a reference to the contractual payments due to Alliance.

3. Should the court invalidate Allarco Entertainment's termination of the Alliance Films contracts?

57 The short answer to this question is, No.

58 Alliance correctly states that the statutory right of a debtor which has obtained protection from its creditors to terminate contracts is subject to judicial oversight. Alliance argues that it is not reasonable for Allarco Entertainment to terminate its contracts because:

- Allarco was able to obtain a "pay-per-play" clause and they should therefore be required to honour the contracts;
- the exchanges between Allarco and itself establish that Allarco was intent on obtaining a "pay-per-play" provision to give itself additional, inappropriate, power in its negotiations with Alliance;
- it is not appropriate for Allarco Entertainment to defend its actions by starting from the proposition that it has only so much cash available; rather, Allarco should be required to raise additional funds;
- Allarco Entertainment did not negotiate in good faith.

59 For the purpose of this application, the court sets the following test which Allarco Entertainment must meet for termination of its contracts with Alliance Films: the termination must be fair, appropriate, reasonable, and must have been issued after good faith negotiations. I have concluded that Allarco Entertainment meets that test.

60 In coming to that conclusion, the most important of the reasons considered by the court is the evidence that Alliance attempted, during the negotiations, to become a secured creditor, an effort that would have given Alliance an unfair advantage over other Allarco Entertainment creditors. The fact that Alliance was negotiating for such security benefits is acknowledged by Alliance; it takes the position, however, that this was not a "new" feature since some of its contracts contained provision for granting security. With respect, this is not defensible. Each contract must be enforced on its own; three of the Alliance contracts did not contain a security clause. With respect to those agreements, the addition of a security clause would be "new". Moreover, even with respect to those two contracts which did contain a security clause, no security documents had been executed.

61 In addition to the grave concern about Alliance attempting to improve its position relative to other debtors, there are other factors which the court weighs in Allarco Entertainment's favour in concluding that it should not invalidate Allarco's termination of Alliance contracts:

- while it is true that, during the negotiations, Allarco Entertainment was the beneficiary of a "pay-per-play" regime and had thus obtained what it wanted relative to Alliance as a creditor, Allarco Entertainment was also aware that Alliance had attacked the legitimacy of that provision. While on this motion Allarco valiantly argued in favour of the "pay-per-play" regime relative to Alliance, it is not unreasonable to assume that Allarco also came to an informed decision that it was at least vulnerable on that issue;

• there was a reasonable business basis for Allarco Entertainment's original application for a "pay-for-play" regime relative to Alliance. It appears to me that the main business argument in Allarco's failure is that substantial ongoing payments to Alliance throughout the year as opposed to what the evidence describes as the overwhelming position in other contracts which provide for payments at the beginning and at the end of the licence period, or at the beginning, after 12 months and at the end of the licence period seriously hamper Allarco's attempts to establish a plan which would allow them to go forward rather than to fall into bankruptcy;

• there is a dispute between Allarco Entertainment and Alliance about the cost to Alliance of the "pay-per-play" provision: Allarco states that it had paid more than 5 cents on the dollar of contractual obligations. Alliance states that termination of its contracts will place it in a worse position that the PLA providers with whom Allarco has been able to reach an accommodation. While it may be true that termination will be less advantageous to Alliance than going forward on some accommodation basis, part of the point of the CCAA is to allow for the termination of some contracts so long as the test for termination is met;

• similarly, it is a reasonable business concern of Allarco's to have fresh programming to offer potential subscribers and that such programming not consist solely of leftovers from other potential licensees;

• it would not make sense to impose upon an insolvent company the obligation to borrow more money in order to meet all its debts before it terminated certain of its contracts. Such an inflexible rule would make an effective reorganization impossible. On the evidence on this motion, at this stage of the CCAA proceedings, Allarco Entertainment has made reasonable arrangements with its banker and guarantor;

• there is no evidence that Allarco negotiated in bad faith. Rather, the evidence suggests that Allarco was attempting to make reasonable accommodations with Alliance. For example, it is not reasonable that Allarco should be required to take only that programming which has been refused by all other potential licensees. Nor is it the case that Alliance is irrevocably linked to Allarco: Alliance has other markets to which it can offer its programming;

• finally, the opinion of MGM - a creditor which is roughly in the same position relative to Allarco Entertainment as is Alliance - that there have been significant changes in the business of all affected companies which legitimizes the writing down of entertainment packages for the purposes of the development of a CCAA plan supports the general approach which Allarco Entertainment has taken in the negotiations.

62 Although Alliance Film's notice of motion requests an order invalidating Allarco Entertainment's termination of the Alliance Films contract, at the hearing Alliance suggested that what it really wanted was a determination of the variation agreement first. If that issue were resolved in its favour, Alliance then hoped that further negotiations with Allarco Entertainment would be possible. Alliance suggested that even if Allarco Entertainment were to maintain its termination of the contracts, then Alliance may require some additional evidence to support its position that the termination should not be approved. With respect, I cannot adopt that approach. The determination about whether a termination at this stage meets the required test should be made as close as possible to the date of termination in order to ensure that the court has the same overall perspective as did the parties as of the date of termination.

4. Costs

63 If the parties are not agreed on costs, I may be spoken to within 30 days of the release of this decision.

Motion granted in part.

APPENDIX A

The following are the portions of para. 43 of Mr. Knox's first affidavit which are incorporated by reference in para. 16 of the initial court order:

> (a) For those existing Program License Agreements in which the fee for delivery of a single broadcast, such as a prize fight, must be paid upon delivery of that Program, the cash flow contemplates such payment as each Program is delivered;
>
> (b) <u>In the case of those existing Program License Agreements with fixed terms and with a limited number of Exhibition Days, and where the license window is already open, the Cash Flow Projections have been prepared based upon a formula where the overall cost of the Contract is divided by the total number of Exhibition Days permitted, with that Exhibition Day rate being applied for the number of Exhibition Days the Business actually runs that program during the Cash Flow Projection period</u>;
>
> (c) For existing Program Licensing Agreements which provide for monthly payments, those payments falling due during the CCAA proceedings will be paid;
>
> (d) As a license window opens during the CCAA Proceedings on a Licensing Agreement now in existence, license fees shall be paid in accordance with that Licensing Agreement; and
>
> (e) For Programming which is obtained by the Business during the CCAA Proceedings under Licensing Agreements not now in existence, the licensing fees shall be paid in accordance with the terms of each such Program License Agreement.

(Emphasis added)

The only program licence agreements which come within the terms set out in para. (b) above are the Alliance Films Inc. PLAs.

TAB 5

2018 ONSC 6257
Ontario Superior Court of Justice [Commercial List]

Nortel Networks Corporation (Re)

2018 CarswellOnt 18952, 2018 ONSC 6257, 298 A.C.W.S. (3d) 238, 64 C.B.R. (6th) 278

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION, NORTEL COMMUNICATIONS INC., ARCHITEL SYSTEMS CORPORATION AND NORTHERN TELECOM CANADA LIMITED (Applicants)

G.B. Morawetz R.S.J.

Heard: October 17, 2018
Judgment: October 23, 2018
Docket: CV-09-7950-00CL

Counsel: Christopher Armstrong, for Monitor, Ernst & Young Inc.
Scott Bomhof, for US Debtors, Nortel Networks Inc. et al.
Jeffrey Spiegelman, for Apex Logistics
Paul McCullough, for Ministry of the Environment, Conservation and Parks

***G.B. Morawetz R.S.J.*:**

1 At the conclusion of the hearing on October 17, 2018, I granted the motion with reasons to follow. These are the reasons.

2 Ernst & Young Inc., in its capacity as monitor (the "Monitor") of the Canadian Debtors brought a motion for:

a. an order (the "MECP Belleville Settlement Order") approving the Belleville Property Settlement Agreement (MECP) dated October 10, 2018 among Her Majesty the Queen in Right of Ontario as Represented by the Minister of the Environment, Conservation and Parks ("MECP"), Nortel Networks Limited ("NNL") and the Monitor (the "MECP Belleville Settlement"); and

b. an order (the "Brockville Settlement Order") approving the Brockville Property Settlement Agreement dated April 2, 2018, among SCI Brockville Corporation ("SCI"), Sanmina Corporation, NNL and the Monitor, as amended by the Amendment to Brockville Property Settlement Agreement dated October 11, 2018 (the "Brockville Settlement").

3 In addition to the MECP Belleville Settlement and the Brockville Settlement, NNL and the Monitor have also entered into settlements regarding all other claims asserted against the Canadian Debtors relating to the Belleville Property and the Brockville Property (each as defined below).

4 The Monitor reports that the MECP Belleville Settlement, the Brockville Settlement and the other settlements are the result of extensive good faith, arms-length negotiations among the Canadian Debtors, the Monitor, MECP, SCI and various other environmental stakeholders that have been carried out over the past several years in an attempt to reach a consensual resolution regarding environmental matters pertaining to the Belleville Property and the Brockville Property and the Director's Orders in respect thereof.

5 The Monitor reports that the settlements provide significant benefits to the Canadian Debtors and their stakeholders by crystalizing the liabilities of NNL, which in turn allows for a reduction of related reserves and facilitates a further distribution to creditors.

6 Although the Director's Orders vary on a case by case basis, each required NNL to prepare, seek MECP approval of, and implement a remediation work plan for the particular Property or portions thereof.

7 In addition to the Director's Orders, various proofs of claim totaling in excess of Cdn. $230 million were filed against the Canadian Debtors asserting claims with respect of the environment impacts that the various properties and, in some cases, lands adjacent thereto by various third parties. In addition, the MECP also filed an Omnibus Proof of Claim against NNL in respect of costs of remediating environmental impacts related to the properties for Cdn. $100 million (the "MECP Claims").

8 Excluding the MECP Claims, the filed claims relating to the Belleville Property and the Brockville Property total approximately $142 million and $35 million, respectively.

9 Nortel's Plan of Compromise and Arrangement (the "Plan") received court approval in 2017. In light of the implementation of the Plan in May 2017, the Canadian Debtors and Monitor communicated to the MECP and other environmental stakeholders that, in order to facilitate the wind-down of the Canadian Estates and distributions to creditors, final resolutions of the Belleville Property and Brockville Property environmental claims was required in the near term.

10 On October 1, 2018, counsel to the Monitor advised that all claims relating to the Belleville Property and the Brockville Property had been resolved and that the parties were in the process of finalizing documentation.

11 The proposed MECP Belleville Settlement provides for the full and final settlement of all matters at issue among NNL, the Monitor and the MECP with respect to the Belleville Property, including the Director's Order related to the Belleville Property and the MECP Claim.

12 The principle terms of the MECP Settlement provide that on the effective date, the parties agree that MECP shall have a Proven, Affected, Unsecured Claim against the Canadian Estates under the Plan in the amount of Cdn. $3,500,000. On the effective date, MECP releases the Canadian Debtors, the Monitor and related parties from all claims the MECP in any way have arising out of or connected to the Belleville Property and all manner or regulatory actions and any liability arising therefrom. Further, from and after the date of the MECP Belleville Settlement, none of the released parties shall be required to perform or satisfy any environmental obligations in connection with the subject property.

13 The parties brought to the Court's attention that the MECP Belleville Settlement is subject to the satisfaction or waiver of certain conditions precedent, including: (i) court approval; and (ii) the Director's Orders shall have been revoked against NNL and a withdrawal of the NNL appeal of the Director's Orders shall be accepted and the NNL appeal dismissed by order of the Environmental Review Tribunal (the "ERT").

14 A hearing to have the Director's Orders revoked as against NNL by order of the ERT is scheduled for October 23, 2018.

15 In addition to the MECP Belleville Settlement, NNL and the Monitor also entered into settlement agreement with each of the three other claimants who asserted claims relating to the Belleville Property. The three settlements are for proven, unsecured claims aggregating approximately Cdn. $3 million, include comprehensive releases in favour of the Canadian Debtors and are conditional upon the revocation of the Belleville Property Director's Order against NNL and the withdrawal of the NNL appeal by the Director's Order by final order of the ERT.

16 The Monitor advises that the individual claimants have received claims based upon alleged damages specific to them and unlike the MECP, do not have a claim in relation to the remediation of the Belleville Property. As a result, the Monitor is satisfied that the various claims accepted relating to the Belleville Property comply with the rule against double proofs.

17 With respect to the Brockville Property, a former wholly-owned subsidiary of NNL was the owner of the Brockville Property until 1999 when the issued and outstanding shares of the subsidiary were sold to a predecessor to SCI. At the time of the sale, the Brockville Property was subject to certain environmental impacts. In connection with the sale, NNL agreed to indemnify SCI against certain environmental liabilities. Following the CCAA filing, NNL ceased to perform any remedial work at the Brockville Property effective April 23, 2012. SCI filed a Proof of Claim against NNC asserting a claim of approximately $21.2 million, plus Cdn, $254,206.97 (the "SCI Claim"). Apex Logistics Inc. ("Apex"), the current owner of the Brockville Property, also filed a Proof of Claim in the amount of Cdn. $16,500,000.

18 The proposed Brockville Settlement provides for a full and final settlement of all matters among NNL, the Monitor, SCI and Sanmina Corporation, including the Director's Order relating to the Brockville Property and the Proof of Claim filed by SCI. The principle terms of the settlement provide that the parties agree that SCI shall have a Proven, Effected, Unsecured Claim against the Canadian Estates in the amount of Cdn. $10,735,000 (the "SCI Proven Claim"). Further, SCI agrees that it will perform any and all investigatory and remediation work in respect of the Brockville Property as may be required by the MECP and, on the effective date, this Sanmina parties will release the Canadian Debtors, the Monitor and their related parties from all claims the Sanmina parties may have in respect of the Brockville Property.

19 Settlement is subject to certain conditions precedent including: (i) court approval; (ii) the Director's Orders shall have been irrevocably withdrawn against NNL by order of the ERT; (iii) the MECP consents to the Brockville Settlement, irrevocably withdraws the MECP Claim and delivers an executed release to the Canadian Debtors; and (iv) Apex consents to the settlement, irrevocably withdraws its Proof of Claim and delivers and executed release to the Canadian Debtors. The MECP has executed a consent to the Brockville Settlement and release pursuant to which, in exchange for payment of Cdn. $10, the MECP consents to the Brockville Settlement, agrees to take steps necessary to ensure that the Director's Order as against NNL is revoked, and on the effective date irrevocably withdraws the MECP Claim and delivers a release to the Canadian Debtors and the Monitor.

20 The Monitor also advises that NNL and the Monitor have reached a settlement agreement with Apex to settle Apex's Proof of Claim in exchange for acceptance of a general unsecured claim against NNL in the amount of Cdn. $250,000.

21 Finally, a hearing date of the Director's Order revoked as against NNL is scheduled for October 22, 2018.

22 Further, the NNL and the Monitor have also entered into agreement with the MECP and Apex relating the Brockville Property. The settlement has been structured such that SCI has received a claim that relates to the historic and future anticipated costs to perform investigatory remediation work at the Brockville Property, whereas Apex received a claim based upon alleged loss specific to it, but not in relation to the remediation. As a result, the monitor is satisfied that the various claims accepted relating to the Brockville Property comply with the rules against double proofs.

23 The Monitor has recommended approval of the MECP Belleville Settlement and the Brockville Settlement.

24 When approving a settlement under the CCAA, the court must be satisfied that:

(i) The transaction is fair and reasonable;

(ii) The transaction would be beneficial to the debtor and its stakeholders generally; and

(iii) The settlement is consistent with the purpose and spirit of the CCAA (see: *Labourers' Pension Fund of Central and Eastern Canada v. Sino-Forest Corp.*, 2013 ONSC 1078 (Ont. S.C.J. [Commercial List]) at para. 49, leave to appeal to CA refused, 2013 ONCA 456 (Ont. C.A.), leave to appeal to SCC refused [2013] S.C.C.A. No. 395 (S.C.C.)).

25 The Monitor submits that both settlements will provide significant benefit to the Canadian Debtors and their stakeholders and assist in advancing these proceedings. In particular, the settlements will provide certainty in respect of the Canadian Debtors environmental liabilities by crystalizing the liabilities of NNL, which in turn will allow for the reduction of related reserves and facilitate a further distribution to creditors.

26 Counsel to the Monitor points out that, over the past several years, the Canadian Debtors and the Monitor have worked with the MECP and other environmental stakeholders an interested parties in good faith in an attempt to reach a consensual and final resolution in respect of the Director's Orders, the ERT proceedings and the various claims asserted against NNL in the CCAA proceedings. I am satisfied that both settlements have been arrived at following the exchange of significant information in respect of the claim and following an extensive negotiation process among the parties.

27 I am also satisfied that the Monitor has a thorough understanding of the issues involved and in such circumstances I am prepared to place significant weight on the recommendation of the Monitor in support of the settlement.

28 The proposed form of orders provide a court ordered release of the "released parties" from any liability to any person in respect of the Belleville Property and the Brockville Property, respectively, save for:

(i) the claims that have been accepted by the Monitor under the MECP Belleville Settlement, the Brockville Settlement and the other settlements; and

(ii) any claim that is not permitted to be released pursuant to s. 5.1(2) of the CCAA or with respect to fraud on the part of any released party.

29 The "released parties" include the Canadian Debtors, the Monitor (both in its capacity as Monitor and in its personal capacity) and each of their respective counsel and former affiliates, directors, officers, employees, agents, trustees, beneficiaries, lawyers, personal representatives and authorized representatives.

30 I note that courts have previously approved and granted releases, in favour of third parties, in connection with court approved settlement agreements and specifically, the court has granted a release similar to the requested releases in connection with the approval of the settlement pertaining to the London Property (see *Nortel Networks Corp., Re*, 2010 ONSC 1708 (Ont. S.C.J. [Commercial List]); *Grace Canada Inc., Re* (2008), 50 C.B.R. (5th) 25 (Ont. S.C.J. [Commercial List]);, and London Settlement Agreement Order dated November 28, 2017 (Court File No.: 09-CL-7950).

31 In *Nortel Networks, (Re)*, the court determined that a settlement agreement containing a third-party release would be found to be fair and reasonable where the release (1) is necessary and connected to a resolution of claims against the debtor, (2) will benefit creditors generally, and (3) is not overly broad or offensive to public policy (see *Nortel*, *supra* at para. 79 and *Grace*, *supra* at para. 40).

32 I am satisfied in these circumstances that the releases contemplated by the proposed orders are fair and reasonable and satisfy the guidelines set by the court in *Nortel* and *Grace*.

33 In arriving at this conclusion, I am satisfied that the releases are necessary and connected to a resolution of claims against the Canadian Debtors and once implemented, represent a final resolution of all issues pertaining to the Belleville Property and the Brockville Property with respect to the CCAA proceedings.

34 It is noted that the settlements follow on years of negotiations among the relevant parties. The Nortel proceedings have been ongoing for nearly a decade and I am satisfied that potential claimants have been given every opportunity to assert claims against the Canadian Debtors and their former directors and officers, including in respect of alleged environmental liabilities. In these circumstances, the granting of the relief sought is both fair and reasonable and will ensure finality with respect to these claims against the Canadian Estates.

35 I also note that in addition to owners or former owners of property, environmental legislation permits the MECP to issue orders against a person who has or had "management or control" of a property, for example, former directors and officers. If pursued by the MECP, such persons could, in turn, assert claims for indemnity against the Canadian Debtors. As the settlements are intended to represent a final settlement of the liability of the Canadian Estates in relation to the Belleville Property and the Brockville Property, I am satisfied that the requested third party relief is inextricably linked to the resolution of environmental claims against the Canadian Estates and will ensure closure in respect of the Belleville Property and the Brockville Property.

36 This closure will allow the Monitor to reduce the significant administrative and unsecured claims and reserves that were established in respect of the Canadian Debtors, potential environmental liabilities, which in turn facilitates the further distribution to creditors. As such, the proposed relief will also benefit creditors generally.

37 I am also satisfied that the proposed releases are neither over broad nor offensive to public policy. As in *Nortel*, *supra*, the claims being released specifically relate to the subject matter of the agreement and the party granting the release received consideration in respect thereof. The releases sought are specifically tied to potential liabilities to the Canadian Debtors and their related parties and the claimants are receiving significant consideration in the form of unsecured claims totally approximately Cdn. $17.5 million. In my view, the relief sought is narrowly tailored to the specific subject matter and is not overly broad or offensive to public policy. Moreover, in my view, the releases do not purport to release any liability that cannot be released under s. 5.1(2) of the CCAA or any liability for fraud, and as such, are appropriately tailored.

38 In the result, the requested relief is granted and the MECP Belleville Settlement Order and the Brockville Settlement Order have been signed in the form submitted.

Motion granted.

TAB 6

2018 ONSC 6980
Ontario Superior Court of Justice [Commercial List]

Aralez Pharmaceuticals Inc. (Re)

2018 CarswellOnt 19784, 2018 ONSC 6980, 299 A.C.W.S. (3d) 462, 65 C.B.R. (6th) 149

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 ARALEZ PHARMACEUTICALS INC. AND ARALEZ PHARMACEUTICALS CANADA INC. (Applicants)

S.F. Dunphy J.

Heard: November 16, 2018
Judgment: November 21, 2018
Docket: Toronto CV-18-603054-00CL

Counsel: Maria Konyukhova, Kathryn Esaw, for Applicants
Jeffrey Levine, for Official Committee of Unsecured Creditors
David Bish, for Monitor, Richter Advisory Group
Danish Afroz, for Deerfield Management Company, L.P.

***S.F. Dunphy J.*:**

1 This case raises for determination the always-troubling question of Key Employee Retention Plans (or "KERPs") and Key Employee Incentive Plans (or "KEIPs"). At the conclusion of the hearing. I indicated that I would be approving the proposed KERP involving three employees with reasons to follow and would take under reserve the matter of the proposed KEIP.

2 For the reasons that follow, I have determined to approve the KEIP as well. My reasons that follow apply to both programs.

Background facts

3 The applicants Aralez Pharmaceuticals Inc. and Aralez Pharmaceuticals Canada Inc. brought this application under the *Companies' Creditors Arrangement Act*, R.S.C. 1990, c. C.-36 and an initial order was granted by me on August 10, 2018 with Richter Advisory Group Inc. appointed as Monitor. A number of affiliated entities in the same corporate group sought relief pursuant to Chapter 11 of the United States Bankruptcy Code on the same day. The Chapter 11 case is being managed by Justice Glenn in the United States Bankruptcy Court for the Southern District of New York. Both courts have adopted a cross-border protocol.

4 As their names suggest, the Aralez group of companies are in the pharmaceutical industry. The debtor companies have operated in an integrated manner and have 41 employees at the Canadian entities and 23 in the Chapter 11 entities.

5 In addition to being operationally integrated, Aralez has an integrated capital structure as well. The secured credit facility is secured by substantially all of the assets of the debtor companies on both sides of the border. The secured creditors — Deerfield Partners L.P. and Deerfield Private Design Fund III, L.P. — possess security on substantially all of the assets of the debtor companies on both sides of the border. The security in Canada has been subjected to independent review by the Monitor and its counsel and no issues have arisen nor have any creditors objected to their claims.

6 These cases have been targeting a managed liquidation from the start. On September 18, 2018, the Canadian and US entities entered into three stalking horse agreements and, pursuant to a court-ordered sales process order, are in the process of completing a bid process in the coming days. The three stalking horse bids place a "floor" under sale proceeds of approximately $240 million subject to possible adjustments. This compares to the secured claim of Deerfield that is approximately $275 million.

7 I understand that a motion may be brought in the United States to challenge some aspects of Deerfield's security in that jurisdiction (no such motion has been suggested in Canada to date). However, as things currently stand, the bid process underway would have to yield a fairly significant improvement from the existing stalking horse offers in order to result in surplus being available for junior creditor groups. The point of this analysis is merely to establish that Deerfield's input into the process of design of the KEIP and KERP programs before me is a material factor. Any funds diverted to KEIP or KERP programs have a substantial likelihood of coming out of Deerfield's pocket in the final analysis and any improvements or de-risking to either cash flow or sales proceeds will enure very substantially to Deerfield's benefit.

8 Stated differently — Deerfield has significant "skin in the game" when it comes to a KERP or KEIP.

9 Deerfield's interest acquires somewhat greater weight when one considers that one of the stalking horse bids (in the United States) is a credit bid whereas the Canadian stalking horse bid involves a sale of the assets of Aralez Pharmaceuticals Inc., resulting in the unsecured creditors of subsidiary Aralez Pharmaceuticals Canada Inc. being granted effective priority over Deerfield despite Deerfield's secured claims. Deerfield is thus very likely to be one of the only Canadian creditors substantially impacted by the KEIP or KERP.

10 This does not imply that the Court is a rubber stamp as to whatever Deerfield may have approved nor does it imply that other voices have no weight. It does imply that some comfort can be taken that this process has been subject to arm's length market discipline. Deerfield has an interest in getting as much as possible in the way of value-added effort out of the employee group and they have an interest in getting that effort at as low a cost as they can bargain for.

11 The KERP program involved only three employees, was reported upon extensively by the Monitor and was not opposed by any stakeholder. I approved it at the hearing with reasons to follow (these are those reasons). The KEIP program affects nine senior management employees whose services are provided to both the Canadian and United States debtors and was accordingly presented to both courts for approval. I am advised that Justice Glenn approved the KEIP program for purposes of the United States debtors on November 19, 2018.

12 While the KERP and KEIP programs were presented to me separately, they have many features in common. Were this not a transnational proceeding, it is quite likely that I should have had but a single combined KERP-KEIP program before me since these are not commonly differentiated in this jurisdiction. Different considerations obtain in the United States where KERP programs for some categories of employees are not allowed and KEIP programs are subject to specific rules one of which is that the predominant purpose of a KEIP must be *incentive* and not *retention*. Both are appropriate criteria in our process. In approving the KEIP program for the United States debtors, Justice Glenn indicated that he was satisfied that the KEIP program was designed primarily to incent the beneficiaries of the program.

13 The Canadian KERP impacts three employee of Aralez Pharmaceuticals Canada Inc. The KERP would provide these three with a retention bonuses of between 25% and 50% of salary. The total amount payable under the proposed program would be $256,710 and payment is to be made on the earlier of termination without cause, death or permanent disability and the closing of a sale of the Canadian assets.

14 The KEIP impacts nine senior management employees of the Canadian debtors who provide services (in all but one case) that benefit both estates. None of the KEIP participants are expected to have on-going roles once the bankruptcy sales process is completed. The program is designed to incent participants to assist in achieving the highest possible cash flow during the bankruptcy process (thereby reducing the need to rely upon DIP financing) and to achieve the highest level of sales proceeds. Cash flow is measured relative to the DIP budget and nothing is payable until sales are completed.

15 The affected individuals are members of the senior management team that can be expected to be in a position to achieve a positive impact upon both criteria (cash flow and sales proceeds), but their roles are such that the level and value of the contributions of each towards those targets are difficult to measure with precision. Total payouts under the "super-stretch" targets could rise to as much as $4,058,360. This figure may be compared to the stalking horse bids that establish a floor price of $240 million.

16 Since all but one of the participants in the KEIP program are providing services for the benefit of both United States and Canadian debtors, the KEIP program has been designed such that costs will be shared by the two estates regardless of residence.

17 The design of the two programs was supervised by Alvarez & Marsal Inc, the financial advisor to the United States and Canadian debtors. The Compensation Committee of the parent company's Board was involved as was the debtor's counsel. The Monitor was consulted at every step in the process and provided significant input that was taken into account. The Board of Directors of each affected entity has approved the plans.

18 The programs were disclosed to the proposed beneficiaries at or near the outset of the bankruptcy process. At the request of the DIP Lender, court approval of these programs was not sought at that time as is relatively common. The stalking horse bids were several weeks away from being finalized and significant effort from the affected employees would be needed to but those transactions to bed. The sales process that followed also needed to be put on the rails and the all hands were needed to ensure that the business passed through the initial stages of the bankruptcy filing without undue adversity. In short, the affected employees were asked to acquiesce in the deferral of approval of these programs with the understanding that the employer would pursue their approval in good faith.

19 With only a few weeks remaining until the expected end of the sales process, it is fair to observe the employees have more than delivered on their end of the bargain. Cash flow has held up very well and the stalking horse bids have been firmed up at a favourable level.

20 The motion for approval of the KEIP (not the KERP) was opposed by the Official Committee of the Unsecured Creditors appointed pursuant to the United States Chapter 11 process. I shall not review here the nature of their standing claim — and the dispute of that claim. Their intervention has been focused, their arguments precise and the prospect of harm in the form of unnecessary delay or expense is minimal. Without prejudice to the position of everyone on the status of this committee in other contexts, I agreed to hear them and receive their written arguments. The cross-border protocol that both courts have approved affords me discretion to allow the Official Committee standing on a case-specific or *ad hoc* basis.

21 In the view of the Official Committee, the KEIP program bonuses are too high and too easily earned. I shall address both of these arguments below.

Issues to be determined

22 Ought this court to exercise its discretion to approve the KERP or KEIP programs as proposed by the applicants?

Analysis and discussion

23 KERP/KEIP programs throw up a number of thorny issues that must be grappled with because there are a number of potentially conflicting policy considerations to balance.

24 The early stages of an insolvency filing are chaotic enough without having added pressures of trying stem the hemorrhage of key employees. "Key" is of course an elastic concept. Everyone is key to someone. Employees are not hired to amuse management but to perform necessary functions. Sorting out "key" in the context of the organized chaos that is the early days of an insolvency filing requires a weathered eye to be cast in multiple directions at once:

- restructuring businesses often have inefficiencies that need identifying and resolving that may impact some otherwise "key" employees;

• with the levers of traditional shareholder oversight blunted in insolvency, the risks of management resolving conflicts in favour of self-interest are acute;

• it is easy to overstate the risk of loss of key employees if a "bunker mentality" causes management to take counsel of their fears rather than objective evidence, such evidence to be informed by a recognition that *some* degree of instability is inevitable; and

• "business as usual" is a goal, but never a perfectly achievable one and small amounts of stability acquired at high cost may be a bad investment.

25 While the risks of abuse or wasted effort are easily conjured, the legitimate use of an appropriately-calibrated incentive plan are equally obvious:

• Employees in newly-insecure positions are easy prey to competitors able to offer the prospect of more stable employment, sometimes even at lower salary levels, to people whose natural first priority is looking after their families;

• There is a risk that the most employable and valuable employees will be cherry-picked while the debtor company may find itself substantially handicapped in trying to compete for replacement employees;

• Whether by reason of internal restructuring or a court-supervised sales process, employees may often find themselves being asked to bring all of their skills and devotion to the task of putting themselves out of work; and

• Since many employers use a mix of base salary and profit-based incentives, employees of an insolvent business in restructuring may find themselves being asked to do more — sometimes covering for colleagues who have being laid off or who have left for greener pastures - while earning a fraction of their former income.

26 What is wanting to sort out these competing interests is one thing that the court — on its own at least — is singularly ill-equipped to provide. It is here that the essential role of the Monitor as the proverbial "eyes and ears of the court" comes to the fore. The court cannot shed its robe and wade into the debate in a substantive way. The Monitor on the other hand can shape the manner in which the debate is conducted and in which the decisions presented to the court for approval are made.

27 What the court is unable to supply on its own can be summed up in the phrase "business judgment". Outside of bankruptcy, the debtor company is entitled to exercise its own business judgment in designing such programs subject to the oversight of shareholders and the directors they appoint. Inside bankruptcy, the oversight of the court is required to assess the reasonableness of the exercise of the debtor company's business judgment. In my view, the court's role in assessing a request to approve a KERP or KEIP program is to assess the totality of circumstances to determine whether the process has provided a reasonable means for *objective* business judgment to be brought to bear and whether the end result is objectively reasonable.

28 Perfect objectivity, like the Holy Grail, is unattainable. However, where business judgment is applied in a process that has taken appropriate account of as many of the opposing interests as can reasonably be brought into the equation, the result will adhere most closely to that unattainable ideal.

29 My review of the limited case law on the subject of KERP (or KEIP) approvals suggests that there are no hard and fast rules that can be applied in undertaking this task. However the principles to be applied do emerge. Morawetz J. suggested a number of considerations in *Cinram International Inc., Re*, 2012 ONSC 3767 (Ont. S.C.J. [Commercial List]) (CanLII), relying on the earlier decision of Newbould J. in *Grant Forest Products Inc., Re* [2009 CarswellOnt 4699 (Ont. S.C.J. [Commercial List])], 2009 CanLII 42046 [1] . I reproduce here the synthesis of Morawetz J. (*Cinram*, para. 91):

a. whether the Monitor supports the KERP agreement and charge (to which great weight was attributed);

b. whether the employees to which the KERP applies would consider other employment options if the KERP agreement were not secured by the KERP charge;

c. whether the continued employment of the employees to which the KERP applies is important for the stability of the business and to enhance the effectiveness of the marketing process;

d. the employees' history with and knowledge of the debtor;

e. the difficulty in finding a replacement to fulfill the responsibilities of the employees to which the KERP applies;

f. whether the KERP agreement and charge were approved by the board of directors, including the independent directors, as the business judgment of the board should not be ignored;

g. whether the KERP agreement and charge are supported or consented to by secured creditors of the debtor; and

h. whether the payments under the KERP are payable upon the completion of the restructuring process.

30 I have conducted my examination of the facts of this case having regard to the following three criteria which I think sweep in all of the considerations underlying *Grant* and *Cinram* and which provide a framework to consider the degree to which appropriately objective business judgment underlies the proposal:

(a) *Arm's length safeguards*: The court can justifiably repose significant confidence in the objectivity of the business judgment of parties with a legitimate interest in the matter who are independent of or at arm's length from the beneficiaries of the program. The greater the arm's length input to the design, scope and implementation, the better. Given the obvious conflicts management find themselves in, it is important that the Monitor be actively involved in all phases of the process — from assessing the need and scope to designing the targets and metrics and the rewards. Creditors who may fairly be considered to be the ones indirectly benefitting from the proposed program and indirectly paying for it also provide valuable arm's length vetting input.

(b) *Necessity*: Incentive programs, be they in the form of KERP or KEIP or some variant are by no means an automatic or matter of course evolution in an insolvency file. They need to be justified on a case-by-case basis on the basis of necessity. Necessity itself must be examined critically. Employees working to help protect their own long-term job security are already well-aligned with creditor interests and might generally be considered as being near one end of the necessity spectrum while those upon whom great responsibility lies but with little realistic chance of having an on-going role in the business are the least aligned with stakeholder interests and thus may generally be viewed as being near the other end of the necessity spectrum when it comes to incentive programs. Employees in a sector that is in demand pose a greater retention risk while employees with relatively easily replaced skills in a well-supplied market pose a lesser degree of risk and thus necessity. Overbroad programs are prone to the criticism of overreaching.

(c) *Reasonableness of Design*: Incentive programs are meant to align the interests of the beneficiaries with those of the stakeholders and not to reward counter-productive behavior nor provide an incentive to insiders to disrupt the process at the least opportune moment. The targets and incentives created must be reasonably related to the goals pursued and those goals must be of demonstrable benefit to the objects of the restructuring process. Payments made before the desired results are achieved are generally less defensible.

(a) Arm's length safeguards

31 In my view, there is substantial evidence that the process of negotiating and designing both programs has benefitted from significant arm's length and objective oversight in the negotiation, design and implementation phases of these two programs.

32 The process leading to both programs began prior to the insolvency filings on August 10, 2018. Aralez had engaged A&M as its financial advisor for the restructuring process and asked A&M to help formulate both the key employee incentive and retention programs. A&M worked on program design in consultation with the debtor's legal counsel and with input from the compensation committee of the Aralez Pharmaceuticals Inc. Board of Directors, none of whom are beneficiaries of either program.

33 The Monitor has been consulted extensively. The Monitor has inquired into the design and objects of the proposed plans and has verified the levels of the proposed incentives relative to the objectives of the programs and other historical data. The Monitor's input has resulted in a number of alterations to the proposals as these have evolved. As the programs have emerged from the process, the Monitor's conclusion is that the KERP is comparable to other KERP plans this court has approved and is reasonable in the circumstances. The Monitor has concluded that the KEIP addresses the concerns raised by the Monitor, protects the interest of Canadian stakeholders and these would not be materially prejudiced by approval of the KEIP. Both recommendations are entitled to very significant weight from this court.

34 The U.S. Trustee raised a number of concerns with the proposed KEIP which have also resulted in revisions.

35 Finally, Deerfield has been consulted and has indicated that they take no objection to either program as they have emerged from this process. For the reasons discussed above, Deerfield's *imprimatur* carries a particularly significant degree of weight in these circumstances in terms of establishing the arm's length and market-tested nature of the two programs before me.

36 The business judgment of Deerfield and the Board of Directors of API are entitled to significant weight. The independent and very significant input of the Monitor, A&M and the U.S. Trustee afford significant comfort that objective viewpoints have played a significant role in designing and vetting the proposals. Finally, the recommendation of the Monitor is entitled to significant weight given the unique role the Monitor plays in the Canadian restructuring process.

37 In summary, the process followed provides a high degree of comfort that a reasonable level of objective business judgment has been brought to bear. Circumstances will not allow every case the luxury of such a thorough process. However, this process was professionally designed thoroughly run. It has appropriately generated a high level of confidence in the integrity of the outcome

(b) Necessity

38 The design of the two programs demonstrates an appropriate regard for the criterion of necessity. They are not over-broad.

39 Any analysis of whether a program is over-broad must take into account the nature of the business. In some respects, Aralez may be likened to a virtual pharmaceutical company in that it out-sources many functions of a traditional pharmaceutical company such as manufacturing. It thus has relatively few employees compared to its size.

40 In designing the programs and assessing which employees to be included, an assessment was undertaken of each prospective beneficiary in terms of the ease with which they might be replaced, the degree to which they are critical to daily operations of the debtor companies or completion of the sales process and — for the KERP program at least — the perceived level of retention risk. The Monitor's input was sought at each level of the design and finalization of the programs.

41 The KERP program involves three employees in Canada and I am advised that their inclusion in the KERP is a condition of the purchaser under the stalking-horse bid. The loss of these three employees — critical to the Canadian business being sold — would endanger the stalking horse bid process at worst and disrupt the business being sold by requiring the debtor companies to deal with recruiting, transition and similar matters at a juncture where they are least able to deal with them at best. Their departure at this juncture would entail significant additional expenditures in terms of professional time at least if that event did not endanger the stalking horse bid.

42 The KEIP program involves nine members of senior management. They are employees the nature of whose function defies precise description or measurement. They are employees who act in concert with each other as part of a team for whom neither the clock nor the calendar play more than a subsidiary role in dictating their hours of labour. These employees are essential to ensuring the business remains stable and performs well during the restructuring process. They play a key role in helping ensure the sales process achieves the highest level of return. They are also employees most of whom are laboring under the near certainty that the more efficient and successful they are in their efforts, the sooner they will be out of a job.

43 At such a high level, personal reputation and professional pride remain as significant motivators to be sure. While a job well done may be its own reward, appropriate financial incentives are not without their place. This is a classic case for a well-designed incentive program.

44 I am satisfied that the design of these programs satisfies the criterion of necessity.

(c) Reasonableness of design

45 The KERP program provides for retention bonuses ranging from 25% to 50% of annual salary. The aggregate compensation available is $256,710, a figure that may be contrasted to the stalking horse bid for the Canadian assets of $62.5 million. Payment is made on the earlier of termination without cause by the company, death or permanent disability and the completion of the sales transaction.

46 The timing of payments and the amount of the payments provided for, relative both to the salary of the individuals and to the value of the company, are both well in-line with precedent.

47 The KEIP program provides for incentive payments to participants based on the debtors' performance relative to target established for cash flow targets during the bankruptcy proceedings and relative to the achieved asset sale proceeds. Failure to reach targets results in no bonus, while four levels of bonus are possible (Threshold[2] , Target, Stretch and Super Stretch).

48 The real controversy on the motion was in respect of the KEIP.

49 It is true that the cash flow performance of the debtors to date plus the projections of cash flow over the coming weeks put the KEIP participants well on track to achieving the highest "super-stretch" level of incentive. It is also true that if *no* bids are received in the sales process now underway and only the stalking horse bids are completed, the participants will be comfortably within the "target" level of incentive for asset sales. Combined, this means that that total incentives of approximately 81.25% of salary appears to be all but assured to KEIP participants. In the circumstances, the Official Committee objects that these incentives are simply too easily earned.

50 They also object to the level of incentives relative to salary as being unacceptably high.

51 The answer to both of these objections lies in the peculiar facts of this case.

52 The KERP and KEIP programs were both conceived of and designed primarily in the period leading up to the initial filings made in August 2018, although alterations have been made following the input of, among others, the United States trustee. The employees selected for inclusion in both programs have been operating in the expectation that the employer would proceed in good faith to seek court approval as soon as practicable. At the request of the DIP Lender, the process of seeking court approval was deferred to put priority on the process of securing and finalizing the stalking horse bids and getting the sales process underway. At the time these plans were first offered to employees, forecasting cash flow in bankruptcy and sales proceeds was looking through a glass darkly. It is only hindsight — and the past efforts of the employees — that has made the targets appear to be such an easy goal.

53 Of course, the employer could not promise and the employee could not expect that court approval of these plans would be a rubber stamp. That does not mean that this court should not take into account the circumstances prevailing when the plans were first offered to employees and the good faith of the employees in continuing to apply their shoulders to the wheel without causing disruption to the process when it could least afford it. It would be fundamentally unfair to penalize the affected employees for their good faith and constructive behavior in this case. It would also be counter-productive as such a precedent would not fail to alter behavior in future cases.

54 I am satisfied that the targets were realistic and appropriate at the time they were set and served to align the interests of employees with stakeholders in an appropriate manner.

55 The level of incentive is also less than meets the eye when the facts are examined more closely. While the combined cash flow plus asset sale incentives could result in incentives of up to 125% of salary, that figure is premised on base salary. In the case of the employees within the proposed KEIP program, base salary has been but one portion of their total compensation. When historical compensation is taken into account, the incentive payments recede to levels significantly below the 80% level calculated by the Official Committee to something closer to 50%.

56 I am satisfied that the incentive amounts are reasonable in all of the circumstances.

Disposition

57 In the result, I confirmed the KERP program at the hearing of the motion on December 16, 2018 and am granting the motion in respect of the KEIP program at this time. My approval extends to the requested priority charges securing the KEIP payments.

58 Order accordingly.

Motion granted.

Footnotes

1 See also Pepall J. (as she then was) in *Canwest Global Communications Corp., Re* [2009 CarswellOnt 6184 (Ont. S.C.J. [Commercial List])], 2009 CanLII 55114 at para. 49-52.

2 The threshold incentive based on cash flow was removed after discussions with the United States Trustee.

TAB 7

2012 ONSC 4471
Ontario Superior Court of Justice [Commercial List]

Timminco Ltd., Re

2012 CarswellOnt 10568, 2012 ONSC 4471, [2012] O.J. No. 4008, 222 A.C.W.S. (3d) 932, 93 C.B.R. (5th) 326

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)

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 Committee
Charles Sinclair for United Steelworkers
James Harnum for Mercer Canada

***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.

TAB 8

2011 QCCS 6376
Quebec Superior Court

Homburg Invest Inc., Re

2011 CarswellQue 13411, 2011 QCCS 6376, J.E. 2012-365, EYB 2011-199183

In the matter of the plan of compromise or arrangement of: . . . Homburg Invest Inc., Debtor-Petitioner, and The Entities Listed In Annex 1, Debtors-mises-en-cause, v. The Cadillac Fairview Corporation Limited, Statoil Canada Ltd., Bos Solutions Ltd., Canadian Tubular Services Inc., Keywest Projects Ltd., Mhi Fund Management Inc., Spt Group Canada Ltd., Premier Petroleum Corp., Tucker Wireline Services Canada Inc., Surge Energy Inc., Moe Hannah McNeill LLP, Logan Completion Systems Inc. and CE Franklin Ltd., Mises en cause, and Samson Bélair/Deloitte & Touche inc., Monitor

Gouin J.C.S.

Heard: November 7 - November 18, 2011
Judgment: December 5, 2011
Docket: C.S. Qué. Montréal 500-11-041305-117

Counsel: *Me Martin Desrosiers, Me Alexandre Fallon, Me Éric Préfontaine*, for Debtor Homburg Invest Inc.
Me Jocelyn Perreault, for Monitor
Me Gerry Apostolatos, Me Stefan Chripounoff, for Statoil Canada Ltd.
Me Mark E. Meland, for Cadillac Fairview Corporation Limited
Me Louis Dumont, Me Martin Poulin, for Tucker Wireline Services Canada Inc.
Me Mathieu Lévesque, for BOS Solutions Ltd., Canadian Tubular Services Inc., Premier Petroleum Corp, Moe Hannah McNeil LLP
Me Alexandre Panneton, for Surge Energy Inc.
Me Philippe G. Giraldeau, for Taberna Europe CDO I PLC, Taberna Europe CDO II PLC, Taberna Preferred Funding VIII, Ltd. and Taberna Preferred Funding VI, Ltd.
Me Joseph Reynaud, for Trustees

***Gouin J.S.C.*:**

1. INTRODUCTION

1. INTRODUCTION

1 The Court is seized with an « *Amended Motion for an Order Confirming the Re-Assignment and Assignment of certain Agreements and the Release of HII's Obligations under these Agreements* » (the « *Motion* ») pursuant to Sections 11, 11.3 and 32 of the *Companies' Creditors Arrangement Act* [1] (the « *CCAA* »), and presented by the Debtor Homburg Invest Inc. (»*HII* »).

2 The Motion is made further to various disclaimer notices relating to lease, assignment and sublease agreements with respect to premises (117,568 square feet) in a « B » rated building located at 635, 8th Avenue South West, in Calgary, Alberta (the « *Premises* »), and other related agreements, amongst HII and the mises-en-cause.

3 Essentially, HII is requesting an order to be released from its obligations under these agreements in order to achieve a viable compromise or arrangement in its CCAA proceedings.

4 The granting of such an order would have the effect of enforcing immediately the obligations and undertakings of the mise-en-cause Statoil Canada Ltd. (»*Statoil* ») under these agreements vis-à-vis the landlord and subtenants of the Premises.

5 Capitalized terms not otherwise defined herein have the same meaning as in the Motion.

2. MOTION WILL BE GRANTED

6 The Court will release HII from its obligations under the Assignment, the Head Lease and the Subleases, and will enforce the re-assignment of the Head Lease and the assignment of the Subleases to Statoil, in accordance with the contractual default remedial procedure already provided for under the Assignment and the NDAs.

3. RELEVANT FACTS

7 The Head Lease [2] between The Cadillac Fairview Corporation Limited (»*Cadillac* »), as landlord, and Statoil, as tenant, dated October 11, 2005, provides for the renting of the Premises, for a term of up to June 30, 2018, in consideration of a total monthly rental of approximately $567,000, namely a yearly basic rent of approximately $34 per square foot, plus operating costs, taxes and other sums agreed to be paid thereunder.

8 At the end of 2009, Statoil needed larger premises and became aware that HII was looking to sublet space it had taken over in an « AA » rated building located in Calgary, called « Jamieson Place », for nearly the same basic rent per square foot as for the Premises.

9 Thus, the market rental was favourable for such a move by Statoil, although the yearly basic rent per square foot for the Premises was then down to approximately $15 to $16 [3] .

10 However, HII had to agree to take over the Premises and the related Head Lease, and Statoil was to remain liable for all of the tenant's obligations [4] thereunder.

11 Statoil clearly knew that HII, a real estate investment and development company, did not intend to use the Premises, but rather to sublease it to third parties.

12 Therefore, in order to protect itself against lower rental to be expected from subtenants of the Premises, Statoil proposed to Cadillac that, in the event of a default by HII under the Head Lease, Cadillac would allow the subtenants to remain in the Premises on the same terms and conditions as in the subleases (the « *Proposed Assignment* ») [5] .

13 Cadillac refused the Proposed Assignment.

14 The Assignment [6] of the Head Lease, as proposed by Cadillac, was signed on April 5, 2010 between Cadillac, Statoil and HII, providing, *inter alia* :

> [. . .] Notwithstanding the within assignment (or any disaffirmance or disclaimer of the within assignment), the Assignor shall remain liable during the balance of the Term of the Lease for the observance and performance of all the terms, covenants and conditions contained in the Lease. » [7]

15 Moreover, Statoil undertook to pay to Cadillac an assignment fee of $2.5 million (the « *Assignment Fee* »), to be unaffected by any disclaimer or termination of the Head Lease [8] .

16 As expected [9] , HII sublet the Premises to eleven Subtenants [10] , at a yearly basic rent of approximately $14 per square foot.

17 Cadillac consented to each and every Sublease, subject to the following :

[. . .] The Sub-Tenant shall be jointly and severally liable with the Tenant to observe and perform the Tenant's obligations in the Lease with respect to the Subleased Premises; » [11]

Only the Subtenant, Surge Energy Inc. was successful in limiting its liability to $14 per square foot.

18 In order to protect their exposure under this joint and several liability with HII, each of the Subtenants requested that, concurrently with the Subleases, NDAs (Non Disturbance Agreements) be signed with Statoil [12], providing, *inter alia*, for the latter's obligation to cure [13] a default of HII [14] :

2. <u>OBLIGATION OF STATOIL TO CURE</u>

If at any time prior to the expiration of the Sublease Agreement :

(a) The Landlord intends to terminate the Head Lease due to the default of Homburg;

(b) The Landlord delivers a notice of default (the « **Notice of Default** ») to Homburg;

(c) The Landlord provides Statoil with a copy of the Notice of Default; and

(d) Homburg fails to rectify the default (the « **Default** ») specified in the Notice of Default within the required time;

then Statoil shall, without further notice or demand, exercise its rights contained in the Assignor's Right to Cure. In particular and without limiting the generality of the foregoing Statoil shall:

(i) rectify the Default within the required time;

(ii) accept the reassignment of and assume all of the rights and privileges of and fulfill and perform all of the covenants, duties and obligations of the Tenant under the Head Lease; and

(iii) honour the rights of the Subtenant pursuant to the New Sublease Agreement (as defined below).

19 This obligation of Statoil to cure a default of HII under the Head Lease and provided in the Assignment [15], is as follows :

11. ASSIGNOR'S RIGHT TO CURE - If the Landlord intends to terminate the Lease, the Landlord agrees to deliver to the Assignor a copy of the notice of default which the Landlord delivers to the Assignee. The Assignor shall have the same period of time to remedy the default as the Assignee plus an additional five (5) business days and upon the rectification of such default by the Assignor all rights of the Assignor under the Lease and all of the rights of the tenant under the Lease shall be reassigned to the Assignor without the requirement of any further documentation and the Assignee shall surrender up possession of the Premises to the Assignor forthwith. Upon such reassignment the Assignor shall be entitled to all rights, title, estate, interest and benefits arising under the Lease, including without limitation the right to all rents and benefits arising under any subleases of the Premises. All the forgoing shall be without prejudice to all rights and remedies which the Assignor may have against the Assignee in respect of any breach of the Lease by the Assignee or which the Landlord may have against the Assignee or Assignor pursuant to the Lease of this Agreement.

20 On September 13, 2011, further to HII's default to pay the September 2011 rental ($561,279.56) under the Head Lease, Cadillac sent a Notice of Default [16] to HII and Statoil, requesting the payment thereof on or before September 19, 2011, failing which it would exercise all available rights and remedies, including, at its option, the right to terminate the Head Lease.

21 Cadillac did not request from this Court the lifting of the HII Stay before sending the Notice of Default.

22 On September 16, 2011, upon receipt of the Notice of Default, François Parent of Statoil wrote the following email [17] to Wendy L. Cardell of Cadillac :

> [. . .] I have in fact received the letter and we are currently consulting with our counsel on the issue prior to making any sudden moves.
>
> Statoil will assume its responsibilities in the matter, no worries.

23 On September 27, 2011, Statoil remedied HII's default by paying $561,279.56, and François Parent wrote the following email [18] to Wendy L. Cardell :

> [. . .] We are aware of the contract agreements, and, as stated before, we will take-on our responsibilities, but, also will be waiting for Deloitte's report to agree that all contractual agreements can take effects (sic). [. . .]

24 On September 30, 2011, and with the Monitor's approval, HII served upon Cadillac and Statoil the Head Lease Disclaimer [19] and the Assignment Disclaimer [20], both dated September 29, 2011, and to be effective on October 31, 2011.

25 On September 30, 2011, and also with the Monitor's approval, HII served upon each Subtenant the Subtenant Notices [21], including the Notices of Consequential Termination of Sublease, dated September 29, 2011, and to be effective on October 31, 2011.

26 On October 5, 2011, HII paid to Cadillac the rent for the period of September 9 (the date of the Initial Order) to October 31, 2011; therefore, Cadillac received double the rental payment for the period from September 9 to September 30, 2011.

27 Cadillac confirmed to the Court that it is keeping in trust this over payment, subject to the parties' respective rights. On the other hand, the second instalment of the Assignment Fee was not paid by Statoil on October 31, 2011, as provided in the Assignment [22], nor was the November 2011 rental.

28 On October 5, 2011, Statoil sent a letter [23] to Cadillac to advise that the $561,279.56 for the September 2011 rent was paid in error: (i) HII had already paid the rent for the period of September 9 to October 31, 2011, and (ii) the Notice of Default was a nullity, having been issued in violation of the HII Stay. It therefore demanded the return of the funds.

29 On October 11, 2011 and further to requests received from certain Subtenants pursuant to Section 32(8) of the CCAA, HII provided the HII Reasons [24], explaining that it was not economic for HII to retain the Head Lease, the rent payable thereunder being significantly higher than the rents received under the Subleases.

30 As a matter of fact, the expected aggregate net loss for HII, up to the end of the Head Lease's term, would be approximately $22,573,260.17 [25], including the tenant improvement costs, namely a monthly net loss of approximately $245,000, without the tenant improvements.

31 Cadillac and the Subtenants had initially applied to this Court to contest the Head Lease Disclaimer, the Assignment Disclaimer and the Subtenants Notices (the « *Applications* »), but they are prepared to desist from the Applications in the event the Motion is granted.

32 Essentially, the Motion aims at enforcing the various steps to be followed further to HII defaulting under the Head Lease, the whole as provided under section 11 of the Assignment [26], and under section 3 of the NDAs [27] :

> **3. <u>TERMINATION OF SUBLEASE AGREEMENT AND ATTORNMENT</u>**
>
> Concurrent with Statoil again becoming Tenant under the Head Lease as provided in paragraph 2 above; the Sublease Agreement and all rights of the Subtenant and Homburg as Sublandlord thereunder shall simultaneously terminate. Statoil and the Subtenant agree that the Subtenant shall then immediately be deemed to have attorned to Statoil as subtenant under a new sublease and to have entered into a new sublease agreement (the « **New Sublease Agreement** ») for the remainder

of the term of the Sublease Agreement (the « **Remainder Term** »). The New Sublease Agreement and such attornment shall be upon all of the same terms and conditions as the Sublease Agreement as applicable only to the Subleased Premises, except that :

(I) the Sublandlord shall be Statoil;

(II) the term of the New Sublease Agreement shall be the Remainder Term;

(III) notices to be provided to the Sublandlord shall be redirected to Statoil at the address indicated in paragraph 5 of this Agreement; and

(IV) no credit shall be given for any security deposit or prepaid rent paid by the Subtenant under the Sublease Agreement which has not, as such, been been (sic) transferred to Statoil.

And provided that :

[. . .]

The New Sublease Agreement shall be effective on the date the Head Lease is reassigned to or deemed to have been reassigned to Statoil pursuant to the exercise of the Assignor's Right to Cure. [. . .]

33 Therefore, in addition to requesting a release of its obligations under the Head Lease, the Assignment and the Subleases, HII asks that the contractual default remedial procedure provided under the Assignment and the NDAs be implemented and that Statoil step into the shoes of HII.

4. POSITION OF PARTIES

4.1 Position of HII

34 At the time of the issuance of the Initial Order on September 9, 2011, HII was already in default under the Head Lease, having not paid the September 2011 rental.

35 When Cadillac issued the Notice of Default[28] on September 13, 2011, the HII Stay was in effect, but it did not affect Statoil's on-going obligations towards Cadillac and the Subtenants under the Head Lease, the Assignment and the NDAs.

36 Upon the expiry of the delay stipulated in the Notice of Default to cure the default, Statoil was obliged, pursuant to Section 2 of the NDAs[29] and Section 11 of the Assignment[30], to cure the default.

37 As a matter of fact, Statoil complied with this first step and, on September 27, 2011, it remedied HII's default. Its payment was not made in error, but rather to satisfy Statoil's obligations under the Assignment and the NDAs.

38 This contractual default remedial procedure provides also for concurrent steps, namely the re-assignment of the Head Lease to Statoil, and the execution of new subleases with the Subtenants and Statoil, as sublandlord, upon the same terms and conditions as the Subleases, with the few exceptions listed under section 3 of the NDAs.

39 Therefore, no matter (i) the HII Stay, (ii) HII's eventual plan of compromise or arrangement, (iii) the requested release of HII's obligations under the Head Lease, the Assignment and the Subleases, and (iv) whether or not HII proceeds with any of the Head Lease Disclaimer, the Assignment Disclaimer and the Subtenant Notices, Statoil will not be released, in any way, from any of its contractual obligations to Cadillac or the Subtenants under the Head Lease, the Assignment and the NDAs; neither was any such effect ever intended.

40 On the contrary, section 11 of the Assignment and sections 2 and 3 of the NDAs were specifically written to protect Cadillac and the Subtenants in the event of HII's default under the Head Lease

41 Accordingly, in order to avoid any undue delay prejudicial to Cadillac's, and the Subtenants', clear rights, the Court should order the immediate enforcement of all the steps of the contractual default remedial procedure provided under the Assignment and the NDAs.

42 The foregoing is under reserve of the filing by Statoil, and any other interested person, of restructuring claims pursuant to HII's eventual claims process and plan of compromise or arrangement under the CCAA.

4.2 Position of Statoil

4.2.1 No urgency to proceed with the Motion

43 Statoil pleads that there is no urgency in proceeding with the Motion as ordered by the Court [31]. It contends that it did not have a reasonable period of time to prepare for the Motion's hearing.

4.2.2 The Court has no jurisdiction and HII has no legal standing

44 Statoil argues that the Court does not have the jurisdiction to hear the Motion and HII does not have the legal standing and interest to advance the Motion, for the following reasons :

a. the Court cannot decide on contractual rights and obligations which :

(i) are governed by the law of Alberta;

(ii) relate to Premises located in Alberta;

(iii) have a « real and substantial connection » to Alberta; and

(iv) for which the parties are resident in Alberta;

therefore, the Motion should be adjudicated upon by the Alberta civil courts [32];

b. the relief sought under the Motion is not inextricably connected to HII's restructuring as it affects contractual rights and obligations amongst third parties; furthermore, pursuant to Section 11.3(1) of the CCAA, the Court cannot authorize the assignment of agreements to a non-agreeing party.

4.2.3 Subsidiarily, the Assignment Disclaimer should be annulled

45 *Subsidiarily*, Statoil maintains that the Assignment Disclaimer should be annulled for the following reasons :

a. on a preliminary basis :

(i) Statoil did not contest the Assignment Disclaimer because it is a named party in Cadillac's contestation and therefore benefits from Cadillac's contestation which enables it to appear and argue at the hearing thereof;

(ii) now that Cadillac is prepared to desist from its contestation, Statoil should be authorized to file its own contestation and the time period to do so should be extended accordingly;

b. the Court's broad discretionary powers do not allow circumventing Section 32(9)(d) of the CCAA which prevents expressly a lessor [sublessor] from disclaiming a lease [sublease];

c. HII has not established the prospects for a viable compromise or arrangement pursuant to Section 32(4) of the CCAA;

d. Statoil will suffer significant hardship; and

e. the Assignment Disclaimer was issued without first being discussed with Statoil, as provided under the Initial Order.

4.2.4 Subsidiarily, the relief sought cannot be granted as Statoil has not exercised its option to cure HII's default which, in any event, is subject to conditions precedent, not yet satisfied

46 *Subsidiarily*, Statoil maintains that the contractual default remedial procedure is subject, *firstly*, to conditions precedent being satisfied and, *secondly*, to Statoil exercising its option to cure HII's default, which it is not obliged to do as per the Assignment.

47 Indeed, in the event the conditions precedent are satisfied, Statoil maintains that:

a. under the Assignment, Statoil has the <u>option</u> to cure HII's default, to have the Head Lease re-assigned to it and to be obligated towards Cadillac thereunder; and

b. under the NDAs, Statoil has the <u>obligation</u> to cure HII's default vis-à-vis Cadillac, to have the Head Lease re-assigned to it and to honour the rights of the Subtenants under the Subleases.

48 At paragraph 68 of its contestation of the Motion, Statoil adds: « *While there may be some ambiguity as to what legal consequence is effected as a result of the satisfaction of the condition precedents* (sic)*, the condition precedents* (sic) *themselves are completely unambiguous* ».

49 Those conditions precedent [33] are the following:

a. Cadillac manifests its clear intent to terminate the Head Lease by way of notice or otherwise to Statoil;

b. Cadillac delivers a notice of default to HII, with a copy to Statoil; and

c. HII fails to rectify the default specified in the notice within the required time.

50 In accordance with Alberta law, the conditions precedent should be given their literal and « unambiguous » meaning.

51 Applying such an interpretation, Statoil maintains that : (i) it has not been notified *yet* by Cadillac of its *clear* intent to terminate the Head Lease, (ii) no notice of default has been *properly* sent to HII *yet*, the HII Stay having never been lifted, and (iii) the September 27, 2011 default payment by Statoil of $561,279.56 to Cadillac was issued *in error* [34] .

52 Therefore, Statoil concludes that the conditions precedent having not been satisfied, its option and obligation under the Assignment and the NDAs have not been triggered, and the relief sought in the Motion cannot be granted.

4.3 Position of Cadillac and Subtenants

53 Cadillac and the Subtenants support the Motion and, if it is granted, they will desist from their contestation of the Head Lease Disclaimer, the Assignment Disclaimer and the Subtenant Notices.

5. ISSUES TO BE CONSIDERED

54 The Court will consider each of the following issues :

a. Was there urgency in proceeding with the Motion as ordered by the Court?

b. Does the Court have jurisdiction to hear, and adjudicate upon, the Motion <u>and</u> does HII have the legal standing and interest for the relief sought under the Motion?

c. What are Statoil's obligations under the Assignment and the NDAs, and were the conditions precedent satisfied?

d. Is there any reason not to release HII from its obligations under the Head Lease, the Assignment and the Subleases, and therefore not to enforce the contractual default remedial procedure provided under the Assignment and the NDAs?

6. ANALYSIS

6.1 Was there urgency in proceeding with the Motion as ordered by the Court?

6.1.1 Case Management Order #5 dated November 7, 2011

55 On November 7, 2011, Statoil requested that the hearing be postponed to prepare its defence and preliminary objections.

56 While the Court was mindful of giving Statoil reasonable time, it was also concerned about the « uncertainty » resulting from the ongoing litigation and its impact on the Subtenants and HII's restructuring.

57 Therefore, the Court refused the postponement and ordered the parties to commence the hearing, with the understanding that the continuation and completion thereof would be on November 18, 2011, thereby giving the parties additional time to finalize their preparation.

58 In these circumstances, the Court ordered the parties to agree on a timetable as provided under Case Management Order #5, dated November 7, 2011.

6.1.2 CCAA procedural process

59 The CCAA, as business driven legislation, aims at protecting insolvent debtors while restructuring their enterprises.

60 The economic and human uncertainty in such situations are of first importance, and the legislator has given the courts the necessary powers and broad discretion under the CCAA [35] to proceed efficiently and expeditiously [36].

61 The parties are required to move fast in raising issues and arguments to be considered by the courts [37].

62 During the hearing, the Court asked Statoil to explain clearly the arguments supporting its position and, except for legal technicalities, it has failed to raise one solid substantive argument. It just wants time to turn over each possible stone and explore all means of defence.

63 Such a position is unacceptable in a restructuring process, particularly in a context where eleven Subtenants are kept wondering whether or not they would be entitled to move into the Premises, or be entitled to stay in the Premises upon paying the rent provided in the Subleases.

64 The present clear circumstances, as related above, demand rapid and innovative solutions to avoid unnecessary prejudice and damages to multiple stakeholders.

65 Fortunately, the legislator has provided the Court with the necessary power to face such a situation; the Court will exercise it.

6.2 Does the Court have jurisdiction to hear, and adjudicate upon, the Motion and does HII have the legal standing and interest for the relief sought under the Motion?

66 The Court is of the opinion that it has jurisdiction to hear, and adjudicate upon, the Motion pursuant to Section 11 of the CCAA and its inherent jurisdiction, and that HII has the legal standing and interest to seek the relief thereunder.

6.2.1 Applicable laws

67 It is not because the Head Lease, the Assignment, the NDAs and the Subleases are governed by the laws of Alberta, that the courts of Alberta have exclusive jurisdiction over this matter [38]. In any event, it is consistent with Alberta law for this Court to adjudicate the rights of the parties thereunder [39].

68 If it were otherwise, the supervising court in CCAA proceedings would become a « dispatching » court every time there arose a litigious matter governed by the laws of a different province. This is certainly not what the legislator intended in creating an efficient restructuring process under the CCAA.

69 On being properly advised by the parties' experts on the applicable principles and rules, the supervising judge is in a position to adjudicate upon matters submitted for his or her consideration.

70 There is « one command centre » in a restructuring process, and it is with the supervising court which issued the initial order pursuant to Section 11.02(1) of the CCAA.

6.2.2 Third parties rights

71 Statoil argues also that the Court has no jurisdiction as it is requested to adjudicate upon contractual rights and obligations amongst third parties. Statoil also submits that HII does not have standing to present such request, which should be dealt with by the civil courts.

72 But, the Court is being asked to release HII of its obligations under agreements which provide for a specific solution in the event HII defaults thereunder. It is, what the Court calls, the « *contractual default remedial procedure* ».

73 It implies the re-assignment of the Head Lease to Statoil, and a kind of assignment of the Subleases to Statoil, and the parties are requesting the Court to enforce the related steps provided thereunder.

74 Statoil is not being forced to accept assignments; it is simply being asked to respect its undertakings; it is not in contravention of Section 11.3 of the CCAA.

75 The Court is of the opinion that it has the power to enforce the contractual default remedial procedure, thereby minimizing the prejudice and potential claims in HII's restructuring [40].

76 The advantages of doing so outweigh the disadvantages [41], and it is supported by the Monitor [42]; therefore, the Court will permit its implementation.

6.3 What are Statoil's obligations under the Assignment and the NDAs, and were the conditions precedent satisfied?

6.3.1 Statoil's obligations

77 The Court is of the opinion that there is no ambiguity in interpreting the Assignment and the NDAs.

78 The parties knew exactly what they were negotiating, and the contractual default remedial procedure has been put in place to deal with a depressed rental market and an eventual HII's default.

79 That depressed market, on the one hand, served Statoil's purposes in permitting its moving from a « B » rated building to an « AA » rated building but, on the other hand, prompted Cadillac and the Subtenants to protect themselves in requesting Statoil to undertake to fill in the financial gap, if need be.

80 Statoil has adopted quite an awkward position in arguing that section 11 of the Assignment [43] gives it an « option », but not an obligation, to cure HII's default, while recognizing that it has no such option vis-à-vis the Subtenants pursuant to section 2 of the NDAs [44], but an obligation to cure HII's default.

81 When asked by the Court what was the alternative to its « alleged option », Statoil replies « to simply refuse meeting » its obligations, thereby forcing a tripartite damages litigation, before the civil courts of Alberta, between itself, Cadillac and the Subtenants.

82 The real debate would then only be with respect to mitigation of damages.

83 This is just unacceptable.

84 But, as further argued by Statoil, in any event, as the conditions precedent have not been satisfied, its obligations under the Assignment and the NDAs have not been triggered yet.

6.3.2 Conditions precedent

85 As mentioned above, those conditions precedent are the following:

a. Cadillac manifests its clear intent to terminate the Head Lease by way of notice or otherwise to Statoil;

b. Cadillac delivers a notice of default to HII, with a copy to Statoil; and

c. HII fails to rectify the default specified in the notice within the required time.

6.3.2.1 Notice to terminate the Head Lease

86 Statoil argues that Cadillac has not as yet sent to it a notice of intent to terminate the Head Lease, or otherwise indicated that it intended to terminate the Head Lease.

87 Section 11 of the Assignment [45] does not provide for such a notice, nor section 2 of the NDAs [46].

88 Furthermore, the Notice of Default [47] clearly states that failing payment of the sums claimed therein, Cadillac :

> [. . .] will, without further notice to you, exercise all rights and remedies as are available to it at law, including at its option, terminating the lease.

89 In any event, the Court is of the opinion that Statoil has been clearly notified that Cadillac was considering terminating the Head Lease.

6.3.2.2 Notice of Default sent to HII, with a copy to Statoil

90 Statoil maintains that no notice of default has been properly sent to HII, the HII Stay having never been lifted.

91 Statoil is correct that, before sending the Notice of Default to HII, Cadillac should have obtained a lifting of the HII Stay, but this was not necessary to put Statoil on notice.

92 In any event, if need be, the HII Stay could be lifted on a *nunc pro tunc* basis to permit the sending of the Notice of Default [48].

6.3.2.3 Erroneous payment issued by Statoil to Cadillac

93 Statoil maintains that the September 27, 2011 default payment by Statoil of $561,279.56 to Cadillac was issued in error [49].

94 At the time the payment was made, the September rent had not been paid by HII and therefore, pursuant to subsection 7(a) of the Assignment [50], Statoil had an obligation towards Cadillac to pay it.

95 The Court retains from the proof that Statoil did not make the September 27, 2011 payment in error, including, *inter alia*:

a. the September 16, 2011 email from François Parent of Statoil to Wendy L. Cardell of Cadillac [51] ;

b. the September 27, 2011 email from François Parent of Statoil to Wendy L. Cardell of Cadillac [52] ;

c. the Payment advice from Statoil to Cadillac, dated September 27, 2011, with the reference « DEFAULT - HOMBURG 09/13/2011 » [53] .

96 It appears to the Court that Statoil changed its strategy after the payment. This is not a payment made in error.

6.3.3 Conclusion

97 Statoil does not raise any substantive argument to support its position. Its reliance on very technical issues indicates simply a desire to avoid its clear obligations under the Assignment and the NDAs.

6.4 Is there any reason not to release HII from its obligations under the Head Lease, the Assignment and the Subleases, and therefore not to enforce the contractual default remedial procedure provided under the Assignment and the NDAs?

6.4.1 Restriction under Section 32(9)(d) of the CCAA

98 Statoil argues that, by its Motion, HII is in fact disclaiming the Subleases, in contravention of Section 32(9)(d) of the CCAA.

99 However, what is being asked of the Court is not a disclaimer of the Subleases, but that new sublease agreements, incorporating the same terms and conditions as the Subleases, with a few exceptions, be entered into between Statoil and the Subtenants, the whole in accordance with section 3 of the NDAs [54] .

100 The Subleases will terminate as a consequence of the enforcement of the contractual default remedial procedure but, simultaneously, there will be execution of new subleases with Statoil, as sublandlord, and the Subtenants, as the new subtenants.

101 Thus, the Court is of the opinion that what is being proposed is not in contravention of Section 32(9)(d) of the CCAA.

6.4.2 Prospects for a viable compromise or arrangement

102 Statoil argues that the Assignment Disclaimer is not supported by the prospects for a viable compromise or arrangement pursuant to Section 32(4)(b) of the CCAA.

103 Firstly, it is not necessary that a proposed disclaimer be essential for the restructuring; it has to be advantageous and beneficial [55] .

104 Secondly, the proof is uncontradicted: HII does not occupy, but only manages, the Premises, and it will keep incurring a recurrent net monthly loss of $245,000 up to June 30, 2018, excluding tenant improvements [56] .

105 The Monitor confirms that the Assignment Disclaimer will enhance the prospects for a viable compromise or arrangement, while minimizing, or even, eliminating entirely, any losses of Cadillac and the Subtenants resulting therefrom [57] , thereby reducing potential claims to be filed in HII's plan of compromise or arrangement.

106 The benefit is self-evident : HII must eliminate this ongoing liability if any plan of compromise or arrangement is to be filed.

6.4.3 Hardship suffered by Statoil

107 Statoil, the Canadian subsidiary of a global multi-billion dollar oil and gas exploration and production company, with approximately 37,000 employees worldwide [58], certainly assessed its risks when it signed the Assignment and the NDAs.

108 At that time, the Premises were to be vacated and the annual market rent per square foot was between $14 and $16, while it was $34 under the Head Lease.

109 Statoil is a sophisticated entity and could foresee the financial impact of its undertakings under the Assignment and the NDAs. It cannot, today, argue under Section 32(4)(c) of the CCAA that the Assignment Disclaimer is causing it significant financial hardship.

6.4.4 No prior discussion pursuant to paragraph 28(e) of the Initial Order

110 Paragraph 28(e) of the Initial Order provides for a disclaimer « to be on such terms as may be agreed between HII and the relevant party ».

111 What ever might be agreed between HII and Statoil with respect to the ensuing restructuring claim by Statoil in HII's plan of compromise or arrangement, will have no effect at all on Statoil's obligations vis-à-vis Cadillac and the Subtenants.

6.4.5 Conclusion

112 Therefore, the Court is of the opinion that there is no need to extend the delay to permit a contestation by Statoil of the Assignment Disclaimer as, at the end of the day, the Head Lease will still stand, but with Statoil as tenant, and the Subleases will, indirectly, still stand, but with Statoil as sublandlord, the whole in accordance with the contractual default remedial procedure agreed to by the parties under the Assignment and the NDAs [59], and which survive any disclaimer [60].

113 In refusing to respect its clear obligations and undertakings under the Assignment and the NDAs, Statoil is causing prejudice and financial hardship to Cadillac and the Subtenants, and to HII's restructuring process.

114 The Court is of the opinion that granting the order sought is a fair, equitable, practical and efficient solution to HII's default under the Head Lease.

114 *FOR ALL THE ABOVE REASONS, THE COURT:*

115 *DISMISSES* Statoil's contestation of the Motion;

116 *DISMISSES* Statoil's request for an extension of the delay to permit a contestation by it of the Assignment Disclaimer;

117 *DECLARES* that, for all legal purposes, the conditions precedent provided for under section 11 of the Assignment and section 2 of the NDAs have been satisfied, and *ORDERS* that all the steps of the contractual default remedial procedure provided therein and in section 3 of the NDAs be implemented immediately;

118 *PRAYS ACTE* of the undertaking of Cadillac not to terminate the Head Lease and to consent to the re-assignment of the Head Lease to Statoil;

119 *DECLARES* that, as of the date of this Order (the « *Assignment Date* »), all rights and obligations of Statoil under the Head Lease assigned to HII pursuant to the Assignment are re-assigned to Statoil, and *ORDERS* HII to surrender possession of the Premises (as defined in the Assignment) to Statoil, as at the Assignment Date;

120 *DECLARES* that, in conformity with the terms of the Head Lease and the Assignment, Statoil remains liable to remedy all monetary defaults under the Head Lease and the Assignment;

121 *DECLARES* that, as at the Assignment Date, the rights of the Subtenants and of HII under the Subleases are terminated, and that the Subtenants are deemed to have attorned to Statoil as sublandlord under new sublease agreements for the remainder

of the term of the Subleases and upon all of the same terms and conditions as contained in the Subleases, as contemplated under the NDAs and, for greater clarity, save for the exceptions provided at section 3 of the NDAs (the « *New Sublease Agreements* »);

122 *PRAYS ACTE* of Statoil's undertaking in the NDAs to honour the rights of the Subtenants pursuant to the New Sublease Agreements, and *DECLARES* that Statoil has the obligation to honour the rights of the Subtenants pursuant to the New Sublease Agreements;

123 *PRAYS ACTE* of HII's undertaking to withdraw the Head Lease Disclaimer (Exhibit R-26), and *DECLARES* that the Head Lease is not disclaimed;

124 *PRAYS ACTE* of the obligation of Statoil under Subsection 7 (a) of the Assignment to remain liable during the balance of the term of the Head Lease for the observance and performance of all of the terms, covenants and conditions contained in the Head Lease, notwithstanding any disclaimer of the Assignment;

125 *DECLARES* that the Assignment Disclaimer (Exhibit R-27) has no effect on the obligations of Statoil towards Cadillac under the Head Lease and the Assignment, and *DECLARES* that Statoil remains liable to perform all of its obligations to Cadillac under the Head Lease and Assignment;

126 *DECLARES* that the Subtenant Notices (Exhibit R-28) have no effect on the obligations of Statoil towards the Subtenants under the NDAs;

127 *DECLARES* HII to be released from all of its obligations pursuant to the Head Lease, the Assignment and the Subleases, subject to the right of Cadillac, Statoil and the Subtenants, or any other interested person, to file, if required, a proof of claim for any loss suffered in relation to the Head Lease Disclaimer (as if it has not been withdrawn by HII and had come into effect on October 30, 2011), to the Assignment Disclaimer and to the Subtenant Notices, and to the present Order, which provable claims, as the case may be, shall be treated in an eventual claims process in the CCAA process and subject to an arrangement or compromise under the CCAA;

128 *ORDERS* the provisional execution of the present Order notwithstanding appeal;

129 *THE WHOLE* with costs against Statoil, but limited only to HII's costs.

Footnotes

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

2 Exhibit R-1.

3 Cross-examination of François Parent by counsel to HII, p. 38.

4 Exhibit R-1, section 8.03(b).

5 Exhibit FP-2, section 9.

6 Exhibit R-2.

7 Exhibit R-2, section 7(a).

8 Exhibit R-2, section 10.

9 Exhibit R-2, section 8(a).

10 Exhibits R-3, R-5, R-7, R-9, R-11, R-13, R-15, R-17, R-19, R-21 and R-23.

11 Exhibit D-4, section 4(a).

12 Cross-examination of François Parent by counsel to HII, p. 48.

13 Exhibits R-4, R-6, R-8, R-10, R-12, R-14, R-16, R-18, R-20, R-22 and R-24, p. 4, paragr. Q and R, and section 2.

14 Cross-examination of François Parent by counsel to HII, p. 91; Cross-examination of François Parent by counsel to Cadillac, p. 25.

15 Exhibit R-2, section 11.

16 Exhibit R-25.

17 Undertaking #6 to the cross-examination of François Parent by counsel to HII.

18 Exhibit #6 to François Parent's detailed affidavit in support of Statoil's contestation of Motion; Cross-examination of François Parent by counsel to Cadillac, p. 33.

19 Exhibit R-26.

20 Exhibit R-27.

21 Exhibit R-28.

22 Exhibit R-2, section 10.

23 Exhibit D-1.

24 Exhibit R-29.

25 Exhibit R-30.

26 *Supra*, note 15.

27 Exhibits R-4, R-6, R-8, R-10, R-12, R-14, R-16, R-18, R-20, R-22 and R-24, section 3.

28 Exhibit R-25.

29 Exhibits R-4, R-6, R-8, R-10, R-12, R-14, R-16, R-18, R-20, R-22 and R-24.

30 Exhibit R-2.

31 Case Management Order #5, dated October 7, 2011.

32 Rule 11.25 of the *Alberta Rules of Court*, Alta. Reg. 124/2010.

33 Section 11 of Exhibit R-2, *supra*, note 15, and section 2 of Exhibits R-4, R-6, R-8, R-10, R-12, R-14, R-16, R-18, R-20, R-22 and R-24, *supra* note 13.

34 Affidavit of François Parent, paragr. 23-34.

35 Section 11 CCAA; *SemCanada Crude Company (Re: Celtic Exploration Ltd.)* (2010) 495 A.R. 367, at paragr. 133 (Alta Q.B.).

36 *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, paragr. 19, 58, 61, 68, 70, 71; *Grant Forest Products Inc. (Re)*, 2009 CarswellOnt. 6099, 58 C.B.R. (5th) 127 (Ont. S.C.J.).

37 *9145-7978 Québec Inc.* (Arrangement relatif à) [2007] R.D.I. 483, paragr. 8, 10, 11 (Q.C.A.).

38 *Phillips v. Phillips*, [2006] CarswellAlta 46, paragr. 62, 78, 82-83, 85 (Alta C.A.).

39 *Smoky River Coal Ltd. et al. (Re)* (1999), 237 A.R. 326, at paragr. 11, 53, 60, 69-70, 72 (Alta C.A.); *Sulphur Corp. of Canada Ltd. (Re)* (2002), 319, at paragr. 35 (Alta Q.B.).

40 *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, 2008 ONCA 587, paragr. 80-82; *Gauntlet Energy Corp. (Re)*, 2003 ABQB 718, paragr. 58, 66-67; *Playdium Entertainment Corp. (Re)* (2001) 31 CBR (4 th) 302, paragr. 14, 16-17, 26, 32-33, 42; *T. Eaton Co. (Re)*, (1997) 46 CBR (3d) 293, paragr. 1-4, 6 (Ont. Ct. J., Gen. Div.).

41 *Hayes Forest Services Limited (Re*) 2009 BCSC 1169 (CanLII, paragr. 51; Nexient Learning Inc. (Re), 2009 CanLII 72037, paragr. 59 (Ont. S.C.).

42 Monitor's Third report, dated November 4, 2011, paragr. 28.

43 *Supra*, note 15.

44 *Supra*, note 13.

45 *Supra* note 15.

46 *Supra* note 13.

47 Exhibit R-25.

48 *Brookside Capital Partners Inc. v. Kodiak Energy Services Ltd.*, [2006] CarswellAlta 1036, paragr. 40-44 (Alta Q.B.).

49 Affidavit of François Parent, paragr. 23-34.

50 Exhibit R-2.

51 *Supra*, note 17.

52 *Supra*, note 18.

53 Undertaking #3 to the cross-examination of François Parent by counsel to HII.

54 *Supra*, note 27.

55 AbitibiBowater Inc. (Arrangement relatif à), 2009 QCCS 2188.

56 *Supra*, note 42, paragr. 18.

57 *Supra*, note 42, paragr. 28.

58 Cross-examination of François Parent by counsel to HII, pages 11-12; Cross-examination of François Parent by counsel to Cadillac, pages 30-31.

59 *Crystalline Investments Ltd. v. Domgroup Ltd*., [2004] 1 SCR 60, paragr. 26-29, 42.

60 Exhibit R-2, section 7(a).

TAB 9

2009 QCCS 2188
Cour supérieure du Québec

Abitibibowater, Re

2009 CarswellQue 12167, 2009 CarswellQue 4937, 2009 QCCS 2188, [2009] R.J.Q. 1738, 183 A.C.W.S. (3d) 26, 58 C.B.R. (5th) 1, J.E. 2009-1107, EYB 2009-159133

Dans l'affaire du plan d'arrangement de:Abitibibowater inc., Abitibi-Consolidated inc. et Bowater Canadian Holdings Inc., Intimées, c. Ernst & Young inc., Contrôleur, et SFK Pâte, s.e.n.c., Requérante

Mayrand J.C.S.

Heard: 11 mai 2009 - 14 mai 2009
Judgment: 21 mai 2009
Docket: C.S. Qué. Montréal 500-11-036133-094

Counsel: *Me Guillaume-Pierre Michaud*, pour ACI Term Lenders
Me Karim Renno, Me Martin Desrosiers, Me Karine Chênevert, pour la requérante
Me Guy P. Martel, Me Mélanie Béland, pour les intimées
Me Gilles Paquin, pour le contrôleur
Me Frederick L. Myers, pour ad hoc Committee of Bondholders
Me Vanessa Jodoin, pour ad hoc Committee of the Senior Secured Noteholders

***Mayrand J.C.S.*:**

1 The applicant, SFK Pulp General Partnership ("*SFK*"), seeks cancellation of the notice of repudiation (the "*Notice"*) sent to it by Abitibi-Consolidated Company of Canada ("*ACI*"), relating to two wood chip and bark supply agreements (the "*Contracts*").

2 Under the protection of the *Companies' Creditors Arrangement Act* [1] ("*CCAA*"), AbitibiBowater Inc. and its subsidiaries (the "*ABI group*") have availed themselves of s. 46(f) of the Initial Order granted by this Court on April 17, 2009, authorizing them to terminate their Contracts.

3 Since the preliminary discussions between ACI and SFK were unsuccessful, ACI sent the Notice on April 24, 2009, taking effect immediately. The party that considers itself injured may, under the [TRANSLATION] "snap-back provision" in the Initial Order, request a review of the decision to terminate the Contracts. Hence the present application.

4 Initially, SFK's application included applications for provisional orders and protection orders. In order to avoid additional costs and delay, the parties have agreed to have the issue decided forthwith on its merits.

4 *THE PARTIES*

- **SFK**

5 SFK is a general partnership that owns and operates a northern bleached softwood kraft ("*NBSK"*) pulp mill (the "*Mill*") located in Saint-Félicien, in the Lac-Saint-Jean region. It acquired the Mill from ACI in 2002 and paid $628 million for it, notably through public issues. Shares, which sold for $10 at that time, are now trading at 35¢.

6 The Mill is the only one in Quebec that produces commercial NBSK pulp, recognized for its superior quality. SFK sells it to the paper industry and exports it elsewhere in Canada, to the United States and Europe. The Mill has 306 employees and generates a large number of indirect jobs. It goes without saying that it is one of the engines of the local and regional economy.

- **ABI Group and ACI**

7 The background, corporate status, and indebtedness of the ABI group are amply described in the Initial Order granted by this Court on April 17, 2009. The ABI group's indebtedness is close to $10 billion and its losses during the past nine months amount to approximately $1.9 billion. The indebtedness of ACI and its subsidiaries was $6 billion and its operating losses $1.06 billion in 2008.

8 The ABI group operates 23 pulp and paper mills and 30 lumber mills in the United States, Canada, the United Kingdom, and South Korea. Mill operations are down, running at 32% of capacity, in rotation and by work shift in order to limit job losses. Some mills have completely shut down.

9 The ABI group owns six sawmills and has a substantial interest in at least three others within a 100-km radius of the Mill in Saint-Félicien. It is central to the regional economy, and in much greater proportions than SFK.

9 *THE ISSUE*

9 *THE QUESTIONS TO BE DECIDED CAN BE SUMMARIZED AS:*

1. **What are the criteria applicable to the repudiation of contracts under the CCAA?**
2. **In light of these criteria, does the Court need to intervene to restore the Contracts?**

THE POSITION OF THE PARTIES

- **SFK**

10 According to SFK, the Court should refuse to endorse the repudiation of the Contracts because the balance of inconvenience and the prejudice involved weigh in favour of SFK, already seriously affected by the economic crisis. It invokes s. 32 of *Bill C-47*,[2] assented to in December 2007 but not enacted.

11 It claims, *inter alia*, that the contract for wood chips is to ACI's advantage, and that repudiation constitutes a disguised unilateral amendment.

- **ABI Group and ACI**

12 The ABI group is required to compromise its debt and reorganize its operations. ACI, with the Monitor's approval, decided to repudiate the Contracts on the grounds that they were too onerous in several respects and would be harmful to its reorganization.

13 Contrary to what underlies SFK's claims, the ABI group and ACI argue that the prejudice needs to be evaluated on a collective, not an individual, basis.

14 Apart from the Monitor, which supports what they are doing, the ABI group and ACI have received support from their long-term lenders and the holders of secured and unsecured debt, which insist that SFK be treated the same way they are.

PURPOSE OF THE CCAA AND THE JUDGE'S ROLE

15 The main purpose of the CCAA is to enable an insolvent company to continue in business and return to solvency, to the benefit of all those who are affected and who will be involved in the reorganization.

16 Other Canadian courts designate these parties as the "broader constituency of investors, creditors and employees and reflects diverse societal interests". [3]

17 For the ABI group and ACI, these are their creditors (secured and unsecured), their investors (the holders of secured and unsecured debt), and their shareholders, employees, suppliers, and bridge lenders. For the purposes of this judgment, the Court shall refer to them as stakeholders.

18 Vested with broad judicial discretion, [TRANSLATION] " . . . the role of the judge, assisted by the Monitor, is like that of a captain in the midst of a storm who has to decide whether to throw the problem cargo overboard in order to save the ship. There is no room for prevarication". [4]

19 These considerable powers are exercised in a fair and reasonable manner, in light of the facts in the present case, while keeping as a guideline the main purpose of the CCAA: to facilitate the reorganization of a company for the benefit of the company and its stakeholders. [5]

20 From the perspective of the CCAA, there are no winners, but a single hope, that the debtor company will emerge successfully from its restructuring, for its benefit and that of the stakeholders.

ANALYSIS

1. The criteria applicable to the termination of a contract under the CCAA

21 It is not disputed that the CCAA permits the debtor company to terminate its contracts. Furthermore, the Initial Order explicitly provides for this. Where the parties disagree is concerning the standard and its application.

22 First, one comment must be made. SFK claims that the amendments projected by *Bill C-47* must be considered. These amendments are not in force and cannot be taken into consideration to decide the present question. [6]

23 This being so, the standard retained by the courts permits the debtor company to terminate a contract insofar as such termination is advantageous and beneficial for its reorganization, although it does not have to establish that it is essential thereto.

24 Since the judgment in *PCI*, [7] which endorsed this standard and the decision of the Court of Appeal in *Mine Jeffrey* [8] confirming its principles, the state of law has remained the same, subject, however, to the comments below.

25 The power to repudiate contracts derives from the statutory discretion conferred by the CCAA and not the inherent jurisdiction [9] to which courts had recourse when called to decide questions whose innovativeness was limited only by the lawyers' imagination.

26 The exercise of this statutory discretion, including the discretion which allowed repudiation of contracts, is subject to an analysis of the criteria of fairness and reasonableness essential to each decision made by a judge pursuant to the CCAA.

27 This analysis is done in a collective manner, by taking all the stakeholders into account, not each one individually. In *Skeena Cellulose Inc.*, [10] the British Columbia Court of Appeal wrote the following in this regard:

> [60] 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. . . . As the Chief Justice noted, many individuals and corporations, as well as the Province, incurred major losses under the Plan. **Each of them might also ask**

"Why me?" However, as he also noted, that is a frequent and unfortunate fact of life in CCAA cases, where the only "upside" is the possibility that bankruptcy and even greater losses will be averted.

27 (Emphasis added.)

28 More recently, the Quebec Court of Appeal considered the standard applicable to the termination of a lease: [11]

[TRANSLATION]

[27] . . . But, in any case, does there need to be a peril? Is it enough that termination is essential for a turnaround? Is it enough for it to be expedient or desirable?

29 In response, the Court of Appeal cited the comments of Mtre Sylvain Vauclair, [12] which it sets forth as the general rule in this area, namely: [13]

[TRANSLATION]

[28] Concerning the standard that is to guide a judge, the appellant cites Mtre Sylvain Vauclair who, after an overview of the situation in the United States, the common-law provinces of Canada, and Quebec, finds that:

First, no decision contradicts the proposition that a debtor company may terminate the contracts to which it is a party and which are harmful to its restructuring under the terms of the CCAA.

Second, the courts exercise their inherent jurisdiction with prudence, certainly, but not only in cases necessary to the survival of the debtor company or otherwise of importance.

[29] In an apt analysis of Dylex, the author writes:

The owner of certain shopping centres is opposed to the debtor company terminating the leases for these centres on the ground that these terminations "would materially affect each shopping centre".

These terminations are part of a program of 200 store closures.

These three terminations, taken singly, do not seem crucial to the plan or to the survival of the debtor company and the judge describes the situation in the following manner at page 109, para. 5:

The subject stores have been a financial drain on Dylex, at a time when it is in a tight financial squeeze. Their closure is projected to bring about variable cost saving [*sic*] and a [*sic*] amelioration of some fixed costs . . .

Once again, a court points out:

It is clear that s. 11 of the C.C.A.A. gives the power to the Court to sanction a plan which includes termination of leases as part of the debtor's plan of the arrangement . . .

It should be noted that the court specifically rejects the argument to the effect that the desired terminations must be essential to the success of the plan of arrangement.

(Emphasis added.)

30 In short, the CCAA aims to allow the debtor company to overcome its financial difficulties while at the same time limiting the prejudice suffered by those whose interests are affected, taking into consideration the interests of all the stakeholders. That is why the decisions leading to it must be fair and reasonable. [14]

31 The law having been stated, it may now be applied. As Farley J. pointed out: "Equitable treatment does not mean equal treatment. Equal treatment may be contrary to equitable treatment." [15]

2. Does the Court need to intervene and restore the Contracts?

32 First of all, two matters raised by SFK must be dealt with. SFK is wrong to accuse ACI of bad faith for initiating discussions before sending the Notice. Even if the termination of the Contracts could have the effect of [TRANSLATION] "forcing" negotiations, this in itself is not illegal.

33 The Court also cannot retain SFK's story that ACI is making money with the wood chips or that it is a [TRANSLATION] "good business". This cannot be supported. The wood chips are by-products of the activities of the sawmills operated by the ABI group, the cost of production for which is very high when done outside lumber manufacturing operations.

• **The forest industry against the backdrop of the world economic crisis**

34 That said, the analysis of this question must take into account the global decline in the forest industry and paper mills.

35 In 2007 and 2008, the unprecedented slump in the U.S. housing market was evidenced by the decline in housing starts (less than 500,000 units under construction), unheard of since World War II. As a result, the profitability of forestry operations and of the paper mills dependent on these operations has been wavering.

36 Since November 2008, the ABI group's operations have been reduced to 32% of their capacity. All sawmills are running a deficit on an annual basis, and there is no sign that points to a rebound in the lumber industry in the short- or medium term. [16]

37 The termination of the Contracts is part of the restructuring of the ABI group's wood products segment, namely logging, transportation of wood to sawmills and manufacture of lumber.

38 In addition, there are by-products from wood processing, including wood chips and bark.

39 SFK, which does not have wood or stumpage rights, needs wood chips to fuel the Mill and bark to meet its energy consumption. During the acquisition of the Mill in 2002, ACI and SFK therefore agreed on Contracts.

40 The wood chip supply contract, with a term of twenty (20) years, guarantees a wood chip supply of 612,000 dry metric tons ("*DMT*") per year; 70% must come from black spruce, and the remainder from gray pine or other softwood.

41 The price per DMT is calculated by correlating the price of NBSK pulp and the market value (the "*market price*") of wood chips. The price per DMT cannot however be $20 more than or less than the market price of a DMT of wood chips in a given year. SFK assumes freight at a cost of $16.23 per tonne. At least 70% of the base quantity comes from the ABI group sawmills, which are located less than 100 km from the Mill.

42 As a result of market fluctuations, the price of NBSK pulp plummeted, while for wood chips, it rose to a historic high ($145 DMT). The price of wood chips is also higher in Quebec than anywhere else in North America.

43 According to the price ratio stipulated in the contract, ACI sells its wood chips to SFK at $125 DMT. Since 2002, SFK has accordingly benefited from a discount of $20 per DMT, compared to the market price. ACI established that since 2002, this discount has translated into a cost of $90 million, or $12.24 million per year ($20 multiplied by the number of tonnes sold to SFK).

44 There is, however, more.

45 Economic conditions considerably reduced lumber processing activities, and ACI could no longer produce a sufficient quantity of wood chips to meet the needs for maintaining the paper mills in the ABI group and also to discharge its obligation to deliver 612,000 DMT of wood chips to SFK annually.

46 ACI is therefore required to buy wood chips from third parties and produce a limited quantity of wood chips by processing entire logs. According to the Monitor's report, ACI must add an annual loss of $1.5 million for the past four years because of this inefficient production.[17]

47 In 2007 and 2008, ACI had to buy respectively 1,050,000 DMT and 786,000 DMT of wood chips from third parties at the market price, and in some cases, even at a higher price, given the major repercussions of falling demand for wood products. These losses are in addition to those resulting from the low level of sawmill operations.

48 The EBITDA[18] of the ABI group sawmills, including that of the sawmills located in the Lac Saint-Jean region, is as follows:

	Fiscal 2007	Fiscal 2008	1st Quarter 2009	April 2009
ABI group	-$91 million	-$45 million	-$16 million	-$4.4 million
Lac-Saint-Jean region	-$23 million	-$9 million	-$5.4 million	-$2.3 million

49 The ABI group must therefore compromise its debt repayment and reorganize its operations. Under the circumstances, ACI decided to repudiate the Contracts, which were too costly and harmful to its reorganization.[19] The resulting savings from the repudiation of the wood chip contract worked out to 25% of the results for April 2009.

- **The position of SFK**

50 When a major industry player like the ABI group wavers, it will inevitably affect its suppliers, employees and service providers.

51 The position of SFK is not exactly robust, but it is nonetheless stronger than that of ACI. Hard hit by the crisis in the forest industry and the decline in the price of NSBK pulp, SFK had suspended operations in the Mill twice since December 2008, for a total period of 62 days, even before receiving the Notice.

52 While the financial position of the ABI group and ACI has been worsening for a number of years, the financial deterioration of SFK's operations is more recent. The financial statements of SFK and its affiliates have reported a negative EBITDA since the first quarter of 2009. Beforehand, EBITDA was as follows: 1) 2006 = $39.8 million; 2) 2007 = $39.2 million; and 2008 = $39.5 million.

53 SFK's consolidated forecasts for fiscal 2009 show a negative EBITDA of $17.5 million if it pays for wood chips at the market price, *i.e.*, $1 million more a month.

54 SFK argues that its survival is at stake because with the higher costs of chips at market price, it will be unable to respect the solvency ratios under its financial covenants,[20] which makes it vulnerable vis-à-vis its lenders.

55 This is likely. However, according to its consolidated financial statements, the assets of the holders of partnership shares are quite significant: $522 million in 2008, $509 million in 2009, and $449 million according to forecasts for fiscal 2009.

56 SFK will need to discuss with its lenders and ACI, which offers to continue to supply it, but to a lesser degree (500,000 DMT) and at market price.

57 In passing, the Court points out that the restructuring concerned is not that of SFK, but rather of the ABI group and ACI.

58 Furthermore, SFK has not shown that without the wood chip contract, it could not have obtained supplies elsewhere.

59 SFK currently has approximately 56,000 DMT of wood chips and is already obtaining supplies from a third party. In March 2009, it entered into a supply contract with Chantiers Chibougamau for the delivery of 100,000 DMT at a price of $138, excluding freight. It obtained supplies there in March instead of from ACI, invoking the CFI standard.

60 During this time, ACI, bound by the wood chip contract, was unable to sell wood chips in addition to being unable to sell them to third parties at market price. Lastly, wood chip inventories will become available for SFK because ACI will no longer need to get supplies from third parties, which will free a corresponding number of tonnes of wood chips.

61 One cannot quite simply consider, as SFK proposes, that the $12 million profitability gap is "a drop in the bucket" for ACI.

62 The ABI group sawmills are running at a monthly deficit of $4.4 million, with those at Lac-Saint-Jean at $2.3 million. The wood chip contract contributes up to 25%, which is not insignificant over a seven-year period, as it amounts to $90 million.

63 Short-term lenders, of which ACI is in dire need, will only materialize if ACI has a chance of honouring its obligations.

64 In reality, SFK's position is tantamount to requesting to balance the inconvenience resulting from the termination of the Contracts in light of the criteria for obtaining a protection order under the *Code of Civil Procedure*. The criteria guiding the judge under the CCAA are different.[21]

65 It bears repeating that what is at stake here is not limited to SFK, the ABI group, and ACI, but extends to the stakeholders dependent on its survival, including 10,000 employees in Canada, 1,700 forestry workers, 2,300 self-employed workers, 950 local and regional suppliers, 500 forestry operations specialists, and the list goes on.[22]

66 According to ACI and the Monitor, the repudiation of the contract is advantageous, beneficial and necessary for the reorganization of the company. The evidence supports this observation. In this context, bearing in mind the interests of all the stakeholders, the Court considers that there is no need to become involved.

67 It is small consolation, but SFK can file a proof of claim as an unsecured creditor for the damages suffered as a result of the termination of the Contracts.

68 As case law shows,[23] the one whose contract has been repudiated must be treated in the same way as all the other creditors of the debtor:

> 43 The applicants state that « <u>SCI is a large, multi-million dollar business enterprise</u>. » While that is true, SCI has also been struggling for many years to become profitable. There are many people in addition to the applicants who depend on SCI's viability. <u>While the applicants will no doubt be adversely affected by the terminations, they are in no different position in this regard than many other unsecured creditors of SCI who must prove their claims under the Plan and who stand to recoup only a small fraction of their claims</u>. It is to be noted that while the sale price of SCI was $8 million, the applicants have filed proofs of claim in excess of $5 million.
>
> 44 <u>It is the unfortunate and generally unavoidable result of an insolvency restructuring that some individuals or entities will suffer hardship</u>. In this case as part of its restructuring, SCI had to terminate numerous employees. They no doubt suffered hardship.

[Emphasis added.]

69 Although the challenge facing ABI and its stakeholders is enormous, it dates back to April 17, 2009. ACI has established that the wood chip contract is a drag on the restructuring of its operations and that it is bad for the reorganization of ABI group as a whole. That is enough in the circumstances.

• **Bark contract**

70 Bark is also a by-product of sawmill operations. The bark contract provides for delivery of 102,551 DMT of fresh bark to SFK every year at market price. Since 2007, ACI has not complied with the tonnages that should be delivered, for the same reasons as those stated previously regarding the production of wood chips.

	2007	**2008**
Fresh bark	83,000 DMT	57,000 DMT
On-site bark	16,000 DMT	21,000 DMT
Total	99,000 DMT	78,000 DMT

71 Even though SFK did not flag this default, the termination of the contract here is also justified because ACI will not be able to comply with the terms and conditions without slipping into the hole even further.

72 The impact of this termination on SFK is not so prejudicial because it can obtain supplies from the on-site bark, in the Lac-Saint-Jean region, which offers sufficient quantities for the next twenty to thirty years.

73 Although on-site bark costs a bit more than fresh bark, given its humidity level, and even though additional costs must be taken into consideration to access it, the cost will be substantially lower than that of fuel oil.

74 Under the circumstances, there is no question of the Court intervening here.

THE MONITOR'S RECOMMENDATION

75 In closing, even if the Monitor gave its approval only after the repudiation of the Contracts, it had been consulted beforehand and had identified the difficulties encountered in maintaining the Contracts. It recommended their termination. The Monitor's fourth report has a complete analysis of the impact of the Contracts and convinced the Court that this recommendation should prevail.

FOR THESE REASONS, THE COURT:

DISMISSES the *Motion to institute proceedings for provisional, protection, and final orders, declaring the repudiation of certain Contracts null and void*;

WITH COSTS.

Footnotes

1 R.S.C. 1985 c. C-36.

2 *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47 (amended S.C. 2007, c. 36, ss. 61 to 82) (*Bill C-47*).

3 *Skeena Cellulose Inc.* (B.C.C.A.) 2003 Carswell BC 1399 at para. 35.

4 *9145-7978 Québec inc.* (Arrangement relatif à) 2007 QCCA 768 at para. 11.

5 *Supra* note 3 at para. 39.

6 *Supra* note 4 at para. 5.

7 *PCI Chemicals Canada Inc.* (Re) J.E. 2002-718 (Sup. Ct.), leave to appeal refused, 2002 (J.Q.) No. 9988 (Que. C.A.).

8 *Syndicat national de l'amiante Asbestos inc. v. Mine Jeffrey Inc.*, J.E. 2003-346 (C.A.) at para. 32.

9 *Supra* note 3, para. 35; *Metcalfe & Mansfield Alternative Investments Corp.* (Re) 2008 ONCA 587 at paras. 50-52.

10 *Supra* note 3 at para. 60.

11 *Supra* note 4 at para. 27.

12 S. Vauclair, S. "Termination of a contract under the terms of an order, pursuant to the CCAA," second advanced lecture on bankruptcy and insolvency, *Derniers développements législatifs et pratiques* (2002).

13 *Supra* note 4 at para. 28.

14 *9145-7978 Québec inc. (Arrangement relatif à)*, 2007 QCCA 618 (Gendreau J.A.) judgment granting leave to appeal at para. 17.

15 *Samni Atlas Inc.*, *Re*,1998 3 C.B.R. (4th) 171 at para. 4.

16 Testimony of ABI's Yves Laflamme, Senior Vice President, Wood Products, whom the Court qualifies as being very credible.

17 Monitor's fourth report, para. 30.

18 Earnings before interest, income taxes, depreciation and amortization.

19 Supra note 3, para. 57: " . . . In the terminology used by Mr. Forstrom, there was a « causal link » between the terminations and the chances of success of the Reorganization Plan. For this reason, I do not agree with his submission that Dylex is different in principle from the case at bar: <u>the appellant's contracts in particular were said to be too costly for Skeena to continue operating under them, in the same way the terminated leases were said to be too costly for Dylex to continue leasing under them</u>. And, weighing Dylex's precarious financial position against that of the landlord (which was described as « less than robust »), the Court 'gave the nod' to the insolvent corporation, rejecting the proposition that Dylex should have to prove that without the three proposed closures (of leases), its proposal would not be viable. . . .

(Emphasis added)

20 (R-9) Credit agreement dated October 30, 2006.

21 It is appropriate to distinguish *Doman*, on which SFK relies, where the debtor wanted to take advantage of the repudiation of a contract without having established that it benefited therefrom for its reorganization: *Doman Industries Ltd.*, *Re*, 2004 BCCA 382.

22 See para. 318 of the *Application for the issue of an initial order* that was made in this record.

23 *Skeena Cellulose Inc.* (Re), 2002 Carswell BC 2032 at paras. 43-44, *per* Brenner J. (B.C. Sup. Ct.).

TAB 10

2021 ONSC 3272
Ontario Superior Court of Justice

Laurentian University of Sudbury

2021 CarswellOnt 7104, 2021 ONSC 3272, 331 A.C.W.S. (3d) 222

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 LAURENTIAN UNIVERSITY OF SUDBURY

G.B. Morawetz C.J. Ont. S.C.J.

Heard: April 29, 2021
Judgment: May 7, 2021
Docket: CV-21-656040-00CL

Counsel: D.J. Miller, Mitch W. Grossell, Andrew Hanrahan, Derek Harland, for Applicant
Ashley Taylor, Elizabeth Pillon, Ben Muller, for Court-appointed Monitor, Ernst & Young Inc
Vern W. DaRe, for Firm Capital Corporation, DIP Lender
Susan Philpott, Charles Sinclair, David Sworn, for Laurentian University Faculty Association (LUFA)
Tracey Henry, Danielle Stampley, for Laurentian University Staff Union (LUSU)
Aryo Shalviri, Pamela Huff, for Royal Bank of Canada
Andrew Hatnay, Demetrios Yiokaris and Sydney Edmonds, Eugene Meehan, Q.C., for Thorneloe University
Dylan Chochla, Stuart Brotman, for Toronto Dominion Bank
André Claude, for University of Sudbury
Donia Hashem, for Canada Foundation for Innovation
Virginie Gauthier, for Lakehead University
George Benchetrit, for Bank of Montreal
Joseph Bellissimo, Natalie Levine, for Huntington University
Gale Rubenstein, Bradley Wiffen, for Financial Services Regulatory Authority
Sarah Godwin, for Canadian Association of University Teachers
David Salter, Peter J. Osborne, for Board of Governors
Rachel Moses, for Royal Trust
Mark G. Baker, Andre Luzhetskyy, for Laurentian University Students' General Association
Michelle Pottruff, for Ministry of Colleges and Universities
Charlotte Servant-L'Heureux, for Assemblée de la francophonie de l'Ontario
Linda Chen, for Information and Privacy Commissioner of Ontario

***G.B. Morawetz C.J. Ont. S.C.J.*:**

1 On Sunday, May 2, 2021, the following endorsement was released:

[1] Thorneloe University ("Thorneloe") brings this motion under section 32(2) of the *Companies' Creditors Arrangement Act* ("CCAA") for an order that the following two agreements in the Notice of Disclaimer of Laurentian University of Sudbury ("Laurentian") dated April 1, 2021 are not to be disclaimed or resiliated:

(a) the Federation Agreement between Laurentian and Thorneloe, dated 1962 (the "Federation Agreement"); and,

> (b) the Financial Distribution Notice between Laurentian and Thorneloe dated May 1, 2019, amending the Proposed Grant Distribution and Services agreement between Laurentian, the University of Sudbury, Thorneloe University, and Huntington University dated November 10, 1993 (the "Financial Distribution Notice") (collectively, the "Agreements");

> and, for an order amending the Loan Amendment Agreement dated April 20, 2021 (the "DIP Amendment Agreement"), to delete the following condition:

> > 4. The Disclaimers of the Borrower's Federation Agreements and Financial Distribution Notices with each of Huntington University, Thorneloe University and the University of Sudbury (collectively, the "Federated Universities") issued on April 1, 2021 shall become effective, binding and final on May 1, 2021 (the "New Disclaimer Term").

> [2] This motion was heard via Zoom on April 29, 2021.

> [3] The University of Sudbury also brought a motion pursuant to section 32(2) of the CCAA with respect to a Federation Agreement between Laurentian and the University of Sudbury. This motion was heard via Zoom on April 30, 2021 by Gilmore J.

> [4] This endorsement is being released concurrently with the endorsement of Gilmore J.

> [5] For reasons to follow, Thorneloe's motion is dismissed.

2 These are my reasons.

BACKGROUND

3 In 1960, Thorneloe, Huntington University ("Huntington"), and the University of Sudbury ("U Sudbury") (collectively, the "Federated Universities"), were established by the Anglican, United and Roman Catholic churches, respectively. As religiously affiliated institutions, they were not eligible for government funding. The Province of Ontario passed an Act to Incorporate Laurentian University of Sudbury, S.O. 1960, c. 151, and Laurentian was established. On September 10, 1960, U Sudbury and Huntington entered into Federation Agreements with Laurentian and in 1962, Thorneloe entered into a Federation Agreement with Laurentian (collectively, the "Federation Agreements").

4 The Federated Universities agreed to suspend degree-granting authority (other than Theology, in the case of Thorneloe and Huntington) and effectively operate as a single university. The Federated Universities would teach courses to students for credit at Laurentian. Funding from the provincial government was provided to the Federated Universities, through Laurentian.

5 The arrangement among the Federated Universities to distribute government grants is set out in the Proposed Grant Distribution and Services Fees Agreement dated November 10, 1993.

6 The funding arrangement was changed commencing in the 2019 — 2020 academic year, per the Financial Distribution Notice.

7 Laurentian wants to disclaim the Federation Agreements and the Financial Distribution Notice with respect to Thorneloe and U Sudbury.

8 As referenced in the Third Report of the Monitor, the Federated Universities do not admit or register their own students, nor do they grant their own degrees (with the exception of Theology at Huntington and Thorneloe). All Federated University programs and courses are offered through Laurentian, and all students apply for admission to Laurentian. Students who enroll in a program at Laurentian may take elective courses at any or all of the Federated Universities as well as Laurentian. Students enrolled in programs, courses, majors and minors that are administered by the Federated Universities are students

of Laurentian, and these courses are credited towards a degree from Laurentian. Laurentian provides certain services to the Federated Universities, however, each of the Federated Universities is separately governed and manages its finances separately from Laurentian and each other.

9 The Monitor also reported that as all students are students of Laurentian regardless of whether they are enrolled in programs or take courses at one of the Federated Universities, the Federated Universities do not directly bill or collect tuition. Laurentian manages admission. Students are billed tuition by Laurentian. Students then choose courses from a Laurentian course catalogue which includes courses offered through the Federated Universities.

10 While Laurentian does not receive grant revenue or tuition revenue that is directly intended for the benefit of the Federated Universities, Laurentian and the Federated Universities have certain financial agreements in place pursuant to which Laurentian receives, allocates and distributes a portion of Laurentian's revenue to the Federated Universities in accordance with the funding formula (the "Federated Funding Formula"). Through this Federated Funding Formula, Laurentian compensates the Federated Universities for delivering programs and services to Laurentian students. The key terms of the Federated Funding Formula include the following:

(a) A portion of provincial grants received by Laurentian are distributed to the Federated Universities based on the proportion of students enrolled in the Federated Universities' programs;

(b) A portion of tuition fees received by Laurentian are distributed to the Federated Universities based upon student enrolment and courses offered through the Federated Universities; and

(c) An offsetting charge for service fees charged by Laurentian to the Federated Universities in exchange for Laurentian providing certain support services to the Federated Universities (calculated as 15% of grant and tuition revenues distributed to the Federated Universities).

11 As of the fall 2020 academic term, there were 417 students enrolled in full-time and part-time programs through the three Federated Universities (271 full-time equivalents). This includes 91 full-time and part-time students of Thorneloe (62.8 full-time equivalents), 108 full-time and part-time students at U Sudbury (69.6 full-time equivalents), and 163 full-time and part-time students at Huntington (103.2 full-time equivalents). The remaining students are enrolled in programs jointly offered by the Federated Universities.

12 Students who enrolled at Laurentian have had the ability to take elective courses at any or all of the Federated Universities, as well as at Laurentian. The main activity of both U Sudbury and Thorneloe is to offer elective courses through the Faculty of Arts for students enrolled in the Applicant's programs.

13 Each of the Federation Agreements contains an aspirational statement which addresses the Federated relationship:

> [B]oth Laurentian University and [the Federated University] declare and express the firm hope and conviction that the relationship between the Universities established by this agreement will be a permanent one . . . [a]nd to build a great institution of learning which shall forever be bilingual and nondenominational in its character.

14 Laurentian has Indenture Agreements with each of the Federated Universities, pursuant to which the Federated Universities lease land owned by Laurentian and on which they have constructed their own buildings. Each indenture provides for lease terms of 99 years, with the possibility of further renewal.

15 The indentures contain termination provisions which allow for the termination of the indenture if the relevant Federated University withdraws from the Federation with the Applicant. No notice of disclaimer was issued by Laurentian in respect of any of the indentures and the indentures are not the subject matter of this motion.

16 Laurentian takes the position that the main activity of the Federated Universities is offering elective courses that are administered for Laurentian's students. Each time a Laurentian student takes an elective course through the Federated Universities, rather than an elective through Laurentian, that represents lost tuition revenue to Laurentian.

17 Laurentian takes the position that in fiscal year 2020, as a result of Laurentian students' enrolment in programs and courses through the Federated Universities, Laurentian transferred to the Federated Universities approximately $3.5 million in total grants, $5.3 million in net tuition and $0.3 million in material fees, for a total of $9.1 million. That amount was offset by the administrative services fee of approximately $1.4 million, for a net transfer from Laurentian to the Federated Universities of approximately $7.7 million in fiscal year 2020.

18 Laurentian has approximately 9,300 undergraduate and graduate students. Laurentian asserts that its Faculty of Arts has the ability and capacity to offer a range of alternative electives to its students, such that there is no need for Laurentian to lose revenue because its students take elective courses offered through the Federated Universities. Since students enrolled in programming offered by the Federated Universities can otherwise be accommodated and enrolled in programs offered by Laurentian, Laurentian asserts that a substantial portion of the grant revenue represents lost revenue for Laurentian. Laurentian and the Monitor concede that Laurentian will not be able to accommodate 100% of the displaced students but anticipate that it will be able to accommodate most of them.

19 Laurentian also asserts that approximately 70% of its revenues in 2019-2020 is comprised of tuition and grant funding, and, due to the freeze of tuition fees, Laurentian cannot increase revenue through tuition fees. Thus, the only opportunity for Laurentian to fully utilize the revenue it receives in respect of its students is for them to be enrolled in programs and courses at Laurentian.

20 Thorneloe presents the facts from its viewpoint. It considers that the funds flow through Laurentian to Thorneloe pursuant to the Financial Distribution Notice. The funds do not belong to Laurentian and the funds do not represent a subsidy. As set out in the Financial Distribution Notice, Laurentian charges Thorneloe an additional 15% of Thorneloe's earned government grants and tuitions.

21 Thorneloe also points out that it is a small component of the Laurentian Federation, employing a total workforce of 28, including seven full-time faculty members, 12 sessional faculty members, six staff and three casual staff.

22 Notwithstanding its small size, Thorneloe contends that it has a big impact. In 2019-2020, Thorneloe taught 2861 Laurentian students, representing 297 full-time equivalents ("FTEs"). In 2020-2021, Thorneloe taught slightly fewer (2477) Laurentian students, after it made the decision to close underperforming programs.

23 Thorneloe also contends that the financial problems of Laurentian are not attributable to Thorneloe or the Federation model.

CCAA PROCEEDINGS

24 Laurentian obtained an initial stay of proceedings under the CCAA on February 1, 2021. The objective of the CCAA filing was the subject of comment in the affidavit of Dr. Robert Haché, sworn January 30, 2021, filed in support of the initial application. Section VIII covers the "Proposed Restructuring of Laurentian", the "Evaluation of the Federated Universities Model" and the "Restructuring of Program Offerings".

25 Paragraph 295 of the affidavit reads as follows:

> The Laurentian 2.0 framework seeks to accomplish the foregoing through:
>
> > (a) *Restructuring the Academic Model* by streamlining academic programming and delivery through the reduction of number of programs, restructuring academic supports and terminating the agreements and relationship with the Federated Universities; and
> >
> > (b) *Restructuring the Business Model* by updating business operations, restructuring existing obligations through a compromise in the CCAA and ultimately balancing the budget.

26 Paragraph 298 reads, in part, as follows:

> [298] More particularly, during this CCAA proceeding, LU ("Laurentian") intends to:
>
> . . .
>
> > (b) re-evaluate the Federated Universities model in such a way that the historic significance of the Federated Universities can be preserved while ensuring that the relationships reflect the current realities of each organization;

27 Paragraphs 299 — 301 read as follows:

> [299] In 2019, LU provided notice of a change in the funding agreement between LU and each of the Federated Universities. While this amendment was necessary to make the funding arrangements consistent with metrics in respect of tuition and grants from the Province, further work is required. LU estimates that the Federated Universities model costs LU approximately $5 million each year.
>
> [300] Currently, the Federated Universities have duplicate organizational infrastructure, functions and services. Although LU respects the autonomy of the Federated Universities, the Federated Universities also have financial challenges. One successful outcome of this CCAA proceeding may be the remolding of the Federated Universities model in such a way that creates economies of efficiency for LU and the Federated Universities while maintaining the historical significance and identities of the Federated Universities.
>
> [301] This Court-supervised proceeding will assist LU in focusing its discussions and negotiations with leadership of the Federated Universities to arrive at a compromise and solution that is acceptable and, more importantly, ensures the long-term sustainability of LU. If necessary, LU may utilize the proposed mediation to address and resolve the Federated Universities model.

28 The Honourable Justice Sean Dunphy conducted a judicial mediation to address a number of issues facing Laurentian. Although the contents of any discussions have not been made public, it is apparent that the issues as between Laurentian and the Federated Universities were discussed but were not resolved.

29 On April 1, 2021, Laurentian gave Notice to Disclaim or Resiliate an Agreement with Thorneloe and with U Sudbury. The notice covered both the Federation Agreements and the Financial Distribution Notice.

30 The Monitor approved the Notices of Disclaimer.

31 On April 15, 2021, Thorneloe delivered a Motion Record opposing the Notice of Disclaimer issued to Thorneloe.

32 U Sudbury also delivered a Motion Record opposing the Notice of Disclaimer. The motion was the subject of a bilingual hearing before Gilmore J.

ISSUE

33 Thorneloe submits there is one issue to be determined on this motion: should the court prohibit the disclaimer?

ANALYSIS

34 Section 32 of the CCAA addresses the disclaimer or resiliation of agreements.

35 The debtor company may, on notice to the other parties to an agreement and the monitor, disclaim or resiliate an agreement to which the company is a party at the commencement of the CCAA proceedings: s. 32(1). The monitor must approve the proposed disclaimer or resiliation. Otherwise, the debtor is required to make an application to the court for an order that the agreement be disclaimed or resiliated: ss. 32(1) and (3). The counterparty has 15 days to make an application to the court

opposing the disclaimer or resiliation: s. 32(2). In deciding whether to make the order, the court is to consider, among other things, the factors set out in s. 32(4), which read as follows:

> **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.

36 Thorneloe makes the following arguments in opposition to the disclaimer:

> (a) Thorneloe did not cause Laurentian's financial problem;
>
> (b) The disclaimer will result in significant financial hardship for Thorneloe and result in Thorneloe having to make an insolvency filing pursuant to the CCAA or the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B–3;
>
> (c) Thorneloe is immaterial to Laurentian's financial situation and therefore, the disclaimer would not result in a material improvement to Laurentian's restructuring;
>
> (d) The relationship between Laurentian and Thorneloe is not a commercial relationship to which the disclaimer provisions of the CCAA were intended to apply; and
>
> (e) Laurentian is acting in bad faith contrary to s. 18.6 of the CCAA.

37 The Monitor approved the disclaimer for reasons set out in the Third Report as follows:

> 169. . . . [I]t is the Monitor's view that the Notices of Disclaimer will enhance the prospects of a viable compromise or arrangement being made in respect of the Applicant. In fact, it is the Monitor's view that without the Notices of Disclaimer, the Applicant is unlikely to be able to complete a viable plan of compromise or arrangement.
>
> . . .
>
> 172. While the net estimated savings achieved to date is significant and addresses the Applicant's operational deficit, it is unlikely to be sufficient to cover among other items: (a) the repayment of the DIP Facility (even if refinanced over time) and (b) payment of distributions to creditors pursuant to a plan of compromise or arrangement in connection with the compromise of their claims.
>
> 173. As a not-for-profit, LU is unable to issue equity to creditors. It has no or limited ability to service additional debt beyond the refinancing of the DIP. As set out above, LU has limited opportunity to drive increased revenue. Therefore, LU must, through its restructuring, generate sufficient savings to provide for the ability to make payments over time to its creditors in partial satisfaction of their claims. The savings generated to date through the LUFA Term Sheet, LUSU Term Sheet and non-union employee savings represent a significant component of the required savings, but not the entirety.
>
> 174. The Federated Universities model represents a significant cost to LU. In Fiscal 2020, LU transferred approximately $7.7 million to the Federated Universities as a result of LU students taking programs and courses offered through the Federated Universities. This included the transfer of approximately $3.5 million of grants received by LU, $5.3 million in net tuition collected from LU students and $0.3 million in material fees in respect of Federated Universities courses all offset by a 15% service fee of approximately $1.4 million. . . .

175. The Monitor understands that the majority of the funds transferred to the Federated Universities relates to the delivery by the Federated Universities of elective courses taken by students enrolled in LU programs as opposed to students enrolled in programs offered through the Federated Universities.

176. In conducting its review of its academic offerings and operational restructuring model, LU determined that it has the ability and capacity to offer a comprehensive list of programs and courses to LU students from the suite of programs and courses delivered by LU faculty in the absence of continuing the Federated Universities relationship. As a result, LU determined that it could retain the vast majority of the funds transferred to the Federated Universities and continue to support students without incurring those incremental costs.

177. As a result, LU is of the view that savings estimated in the range of $7.1 to $7.3 million annually can be generated through the disclaimer of the Federated Universities as part of this restructuring.

178. The Monitor recognizes the potential financial hardship that the Notices of Disclaimer may have for the Federated Universities. However, given the additional savings required for LU to have a reasonable opportunity to put forward a viable plan of compromise or arrangement and effect a successful restructuring, the Monitor is of the view that the disclaimer of the Federated Universities agreements is necessary.

38 To counter the submissions of Laurentian and the views and recommendations expressed by the Monitor, Thorneloe filed a Report on Financial Impact of Termination of Federated Agreement and Financial Distribution Agreement on Thorneloe University. The Report was prepared by Mr. Allan Nackan, a partner with A. Farber & Partners Inc. Mr. Nackan has been identified as an expert for the purposes of providing his opinion. I am satisfied that Mr. Nackan is an expert in the area of insolvency and restructuring. However, Mr. Nackan acknowledged in cross-examination that he is not an expert in terms of government funding of universities and that he has no prior experience in determining university funding. His lack of industry-specific experience has to be taken into account when considering his report and conclusions.

39 It is also necessary to acknowledge the expertise of Ernst & Young Inc., the court-appointed Monitor. The Monitor is an officer of the court, with a duty to be neutral and objective: *Bell Canada International Inc., Re*, 2003 CarswellOnt 4537 (Ont. S.C.J. [Commercial List]). The principals of Ernst & Young Inc., including Sharon Hamilton, who signed the Monitor's Third Report, are widely acknowledged as being experts in the field of insolvency and restructuring. Moreover, the Monitor has been involved since the proceedings began and has extensive knowledge of the Applicant's operations and restructuring efforts.

40 Farber was retained to provide an opinion on whether the termination of the Federated Agreement and the Financial Distribution Notice would result in significant financial hardships to Thorneloe, and whether or not the termination would enhance Laurentian's prospects of a viable compromise or arrangement.

41 Farber concludes the termination of the Federated Agreement will cause serious financial hardship to Thorneloe as a consequence of which Thorneloe will have to resort to a formal insolvency process.

42 Farber also concludes that the termination of the Federated Agreement will have an immaterial impact on overall costs reduction in Laurentian's restructuring process and is unlikely to enhance prospects of Laurentian making a viable plan.

43 In a supplementary report, Farber concludes that:

- Laurentian is not facing an immediate liquidity crisis on May 1, 2021;
- there is no compelling reason that would necessitate termination of the federated arrangement with Thorneloe on May 1, 2021;
- from a financial perspective, Laurentian and the DIP Lender have not provided information to support the need for a Disclaimer Deadline of May 1, 2021.

44 A consideration of the s. 32(4) factors requires a balancing of interests. The subsection is silent with respect to the relative importance of any one of the factors to be considered and is not restricted to the listed factors. The test does, however, require the court to balance the benefit of the proposed disclaimer for Laurentian against the detrimental impact on Thorneloe. The disclaimer of a contract must be fair, appropriate and reasonable in all the circumstances. Ultimately, it is a discretionary decision to determine whether the disclaimer should be upheld. This discretion is exercised by weighing the competing interests and prejudice to the parties and assessing whether the disclaimer or resiliation is fair and reasonable.

45 In my view, the considerations in the Third Report of the Monitor reflect a proper balancing of the competing interests of Laurentian and all stakeholders, including Thorneloe. The Third Report discusses the financial challenges facing Laurentian and proposes solutions that could enhance the prospects of a viable plan of compromise or arrangement, while acknowledging the potential financial hardship on the Federated Universities. The Farber Report and the Supplementary Farber Report focuses of the impact of the disclaimer on Thorneloe and the short term DIP Financing requirements. In narrowing its focus, the Farber Report does not take into account that in order to enhance the prospects of a viable plan of compromise or arrangement, it is often necessary to take into account the potential compromises that will have to be made by all stakeholder groups. For this reason, I have concluded that the Third Report of the Monitor has to be given greater weight than the Farber Report and the Supplementary Farber Report.

46 Laurentian submits that the Courts have identified guiding principles for the analysis:

(a) the recommendation of the Monitor is afforded significant weight in CCAA proceedings (see Nortel Network Corp. Re 2018 ONSC 6257 at para. 27; Aralez Pharmaceuticals Inc., Re 2018 ONSC 6980 at para. 36; and Aveos Fleet Performance Inc. 2012 QCCS 4074 at para. 50(f);

(b) the disclaimer does not need to be essential to the restructuring, it only need be advantageous and beneficial (see Timminco Ltd., Re 2012 ONSC 4471 at para. 54 (“Timminco”); see also Homberg Invest Inc. 2011 QCCS 6376 at para. 103);

(c) the threshold to establish "significant financial hardship" in opposing a disclaimer is high. There must be specific evidence of financial hardship. Mere loss or damage is not sufficient, and it must be likely that the hardship is caused by the disclaimer (see Target Canada Co. Re 2015 ONSC 1028 at para. 26);

(d) the test to establish "significant financial hardship" is subjective and depends on an examination of the individual characteristics and circumstances of the counterparty (see *Timminco* at para. 60); and

(e) the Court should take into consideration the effect that the disclaimer will have on the outcome for all other unsecured creditors and be an equitable result that is dictated by the guiding principles of the CCAA (see *Timminco* at para. 62).

47 There is no doubt that Laurentian has significant financial challenges. There is also no doubt that, if a successful restructuring is to be achieved, it must be done on an expedited basis. If Laurentian is to successfully restructure its affairs, it is essential that it maintain continuity of operations. The spring term commences May 3, 2021 and extends until the latter part of July 2021. The fall term commences at the beginning of September 2021. If the restructuring is to succeed, Laurentian must be in a position to provide assurances to both its students and faculty that it has a viable plan that will ensure continued operations for both the spring term, the fall term and beyond.

48 Laurentian, with the assistance of the Monitor, identified a number of areas in which a financial restructuring was required. These include a downsizing of the number of programs being offered by Laurentian and also the necessity to arrive at new, sustainable collective agreements with LUFA and LUSU. These requirements and accommodations are set out in the motion to extend the stay of proceedings.

49 Laurentian also identified, at the outset of the CCAA proceedings, that it would be necessary to have a fundamental readjustment or realignment with the Federated Universities.

50 Although Thorneloe is of the view that its relationship with Laurentian has only a minor impact on the financial position of Laurentian, it seems to me that this view is far too narrow in scope. Laurentian has identified that if the disclaimers involving Thorneloe and U Sudbury are upheld, together with the revised agreement with Huntington, this will result in $7.7 million of additional funds remaining with Laurentian on an annual basis. This calculation has been identified by the Monitor and, in my view, represents a real source of annual financial relief for Laurentian.

51 Thorneloe counters by indicating that it is only one of three Federated Universities; the $7.7 million figure cannot be attributed, in total, to Thorneloe. At first glance, this is an attractive and persuasive argument. It does not, however, take into account that Huntington, in negotiating its settlement with Laurentian, has included what is known colloquially as a "most favoured nation" clause. Quite simply, if Thorneloe is able to negotiate a better alternative than the agreement negotiated by Huntington, Huntington is in a position to reopen negotiations with Laurentian to obtain similar treatment. Therefore, it seems to me that although there are three Federated Universities involved, their positions are interlinked and interrelated to such a degree that the $7.7 million calculation is relevant to take into account on this motion.

52 The Notices of Disclaimer are, in my view, central to the Applicant's restructuring. The Disclaimer will result in millions of dollars of additional tuition and grant revenue remaining within Laurentian. As noted in both the affidavit of Dr. Haché and the Monitor's Report, each time a Laurentian student takes an elective course offered through Thorneloe, revenue associated with that course is transferred from Laurentian to Thorneloe. Because the Applicant has the capacity to independently offer students the vast majority of all necessary programs and electives within its existing cost structure, each course taken by a Laurentian student through Thorneloe represents lost revenue for Laurentian.

53 The Applicant contends that it simply cannot afford to continue its relationship with the Federated Universities. In order to right-size the University, Laurentian cannot continue paying for programs and courses supplied by the Federated Universities that it does not require and are revenue negative for Laurentian.

54 The Applicant submits that it cannot simply "balance its budget" in order to achieve financial sustainability. It submits that it must generate positive cash flow from operations on an annual basis, prior to the funding of expenses, to achieve financial sustainability. In my view, this submission is consistent with the objective and necessity of achieving long-term sustainability.

55 Laurentian has also submitted that the savings to be realized from the disclaimer are necessary for the purposes of submitting a viable plan. The Monitor is in agreement with this submission.

56 Although the savings realized from the disclaimer do not, in isolation, represent a significant amount, in my view, that is not the end of the inquiry. In order to enhance the prospects of a viable plan of reorganization being put forward, it is necessary to assess the totality of what Laurentian is attempting to achieve in this restructuring.

57 Laurentian suggests that savings have to be realized from a number of sources, including the Federated Universities. Without the total amount of savings being realized, Laurentian submits that it will been unable to put forward the basis of a plan that will be acceptable to its various constituents.

58 It is necessary to take into account another factor, namely that there is evidence that Laurentian has achieved other milestones in its attempt to put forward a viable plan of reorganization. These include the revised relationships with LUFA and LUSU, the reduction in the number of courses, and the reduction in the number of staff. None of these milestones were realized without significant compromise and hardship being experienced by faculty, students and the greater Sudbury community. Without such compromises, Laurentian will not be able to survive.

59 It is also necessary to take into account the position of the DIP Lender. The DIP Lender has put forth a condition for its continued support and for increased financing. That condition is that the Disclaimer with respect to Thorneloe and U Sudbury had to be finalized by May 1, 2021, subject to any reserved decision of the court.

60 Thorneloe challenges the position of the DIP Lender for two reasons. First, the condition relating to the Disclaimer was not a condition of the original DIP and was inserted only after the Notice of Disclaimer was issued. Second, the analysis performed by Farber indicates that the increased DIP Loan is not required until the latter part of June at the earliest.

61 There is, in my view, no basis to question the legitimacy of the DIP Lender nor question the conditions that the DIP Lender has put forth with respect to any request to extend the DIP Loan and to increase the amount of the DIP Financing. The DIP Lender is entitled to take into account commercial reality in assessing its options.

62 The DIP Lender is not a pre-existing lender to Laurentian, nor is there any evidence that the DIP Lender is engaged in a "loan to own strategy". These facts distinguish this DIP Lender from a number of DIP lenders that have been involved in the cases referenced by counsel to Thorneloe, as referenced in Rostom and Fell, "Recent Trends in DIP Financing" (2016) 5-4 IIC Journal; *Essar Steel Algoma (Re)*, Endorsement of Newbould J. dated November 16, 2015; and Great Basin Gold Ltd. (Re) 2012 BCSC 1459.

63 It is also relevant to remember that this is not a situation where the Court is being asked to approve DIP financing with this DIP Lender. These approvals were granted in February 2021 with no party objecting and with no appeals being filed. It was a competitive process and the DIP Lender was one of eight potential DIP lenders identified at the outset of the proceedings.

64 Thorneloe also takes issue with respect to the reluctance of a representative of the DIP Lender to be cross-examined or to answer any questions with respect to the DIP Financing.

65 In response, Laurentian takes the position that the terms for the continued DIP were negotiated as part of a process of achieving a viable long-term plan. Second, although the increased DIP may not be necessary until mid-June, it is a requirement for any extension of the stay to provide a cash flow statement that takes into account the entirety of the Stay Period, and it is necessary to provide the necessary assurances to faculty and students that Laurentian will be able to operate for the next academic term, which commences May 3, 2021 and extends towards the middle to the latter part of July 2021. It is simply not feasible, from its standpoint, to operate without the continued DIP Facility and the certainty that the DIP Facility will be available throughout the entirety of the academic term and the Stay Period.

66 With respect to the cross-examination of the DIP Lender, I note that no affidavit has been filed in these proceedings by a representative of the DIP Lender. In addition, the DIP Lender is not a pre-existing lender. The DIP Lender is not involved in any of the pre-CCAA DIP contractual relationships. It is up to the debtor, with the assistance of the Monitor, to negotiate the terms of the DIP Financing. There is no evidence that the DIP Lender has any ulterior motive in negotiating the condition to extend additional financing and to extend the term.

67 Thorneloe also raises the concern that the Disclaimer will result in significant financial hardship for Thorneloe and result in Thorneloe having to make insolvency filings pursuant to the CCAA or the Bankruptcy and Insolvency Act.

68 There is no doubt that this is a legitimate point being raised by Thorneloe. The impact of the disclaimer on Thorneloe is significant. The consequence of the disclaimer is such that Thorneloe will be unable to operate in its current form. However, Thorneloe was offered alternatives. The form of the Huntington Transition Agreement was offered to Thorneloe but was not accepted. More importantly, it is also necessary to take into account that if Laurentian's restructuring does not succeed and it ceases operations, Thorneloe, as conceded by its counsel, will also be unable to continue operations.

69 Thorneloe also contests the disclaimers on the basis that the relationship between Laurentian and Thorneloe is not a commercial relationship to which the disclaimer provisions of the CCAA were intended to apply. In my view there is no merit to this submission. The CCAA proceedings were commenced on February 1, 2021. The Initial Order declares that Laurentian is insolvent and is a company to which the CCAA applies. The disclaimer provisions in s. 32 are available to a debtor company. The exceptions set out in s. 32(9) have no application in the circumstances. Laurentian is entitled to utilize the disclaimer provisions in accordance with s. 32.

70 Thorneloe also takes the position that Laurentian is acting in bad faith contrary to s. 18.6 of the CCAA which provides:

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

71 In support of this argument, Thorneloe points to Laurentian's attempt to terminate its relationship with Thorneloe, knowing that the disclaimer will result in Thorneloe's insolvency, and to Laurentian's persistence in the face of evidence that termination will not materially assist its restructuring. Thorneloe also submits that Laurentian has consistently and continually wanted to terminate its relationship with Thorneloe and thereby failed to engage in good faith negotiations.

72 I do not accept that Laurentian has acted in bad faith. Restructurings are not easy and often result in treatment that a party can consider to be extremely harsh. However, that does not necessarily mean that the other party has not been acting in good faith. In its Third Report, the Monitor makes specific reference to the bad faith argument being raised by Thorneloe. It is significant that the Monitor makes no statement that would suggest in any way that Laurentian has been acting in bad faith. The Monitor ultimately recommends at paragraph 206 of its Third Report that the court grant the relief sought by the Applicant, which includes the disclaimer and also an extension of the stay of proceedings.

73 Section 11.02(3) of the CCAA addresses the burden of proof on an application for an extension of the stay of proceedings other than the initial application. This includes a requirement that the applicant satisfy the court that it has acted, and is acting, in good faith and with due diligence. By supporting the application for the extension and upholding the disclaimer, it can be inferred that the Monitor does not support the argument of Thorneloe to the effect that Laurentian has been acting in bad faith.

74 My summary of the factors set out in s. 32(4) of the CCAA is as follows:

> (a) the Monitor approved the proposed disclaimer;
>
> (b) the Disclaimer will enhance the prospects of a viable compromise or arrangement being made in respect of Laurentian;
>
> (c) the Notice of Disclaimer will have financial consequences to Thorneloe, but this is not a sufficient reason to disallow the Notice of Disclaimer. Thorneloe was offered an alternative, similar to Huntington, which was not accepted.

75 In addition, it seems to me that, in the circumstances of this case, it is necessary to consider the broader implication of disallowing the Notice of Disclaimer — namely the potential demise of Laurentian.

76 The dilemma facing the court is clear. If Thorneloe's motion succeeds, with the result that the Disclaimer is not effective, it could lead to an unraveling of Laurentian's restructuring plan and the collapse of Laurentian. This in turn would have significant impact on all faculty, students and the greater Sudbury community. It would also result in the financial collapse of Thorneloe. Obviously, this is not a desirable outcome.

77 If the Notices of Disclaimer are upheld, I acknowledge that this could lead to the cessation of operations of Thorneloe. I do not lightly discount the impact on faculty, employees and students at Thorneloe, but the impact is significantly less than if Laurentian and Thorneloe are both forced to suspend or cease operations.

78 Given these two undesirable options, the better choice or to put it another way, the least undesirable choice, is to uphold the Notices of Disclaimer.

DISPOSITION

79 In the result, the motion brought by Thorneloe to invalidate the Notice of Disclaimer is dismissed.

Motion dismissed.

TAB 11

2015 ONSC 1028
Ontario Superior Court of Justice

Target Canada Co., Re

2015 CarswellOnt 3274, 2015 ONSC 1028, 23 C.B.R. (6th) 303, 252 A.C.W.S. (3d) 11

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 Target Canada Co., Target Canada Health Co., Target Canada Mobile GP Co., Target Canada Pharmacy (BC) Corp., Target Canada Pharmacy (Ontario) Corp., Target Canada Pharmacy Corp., Target Canada Pharmacy (SK) Corp., and Target Canada Property LLC

Geoffrey Morawetz R.S.J.

Heard: February 11, 2015
Judgment: February 18, 2015
Docket: CV-15-10832-00CL

Counsel: Jeremy Dacks, John MacDonald, Shawn Irving for Applicants, Target Canada Co., Target Canada Health Co., Target Canada Mobile GP Co., Target Canada Pharmacy (BC) Corp., Target Canada Pharmacy (Ontario) Corp., Target Canada Pharmacy Corp., Target Canada Pharmacy (SK) Corp., and Target Canada Property LLC
Jay Swartz for Target Corporation
William Sasso, Sharon Strosberg, Jacqueline Horvat for Pharmacy Franchisee Association of Canada
Susan Philpott for employees of the Applicants
Alan Mark, Melaney Wagner, Graham Smith, Francy Kussner for Monitor, Alvarez & Marsal Inc.
J. Dietrich for Merchant Retail Solutions ULC, Gordon Brothers Canada ULC and G.A. Retail Canada ULC
Andrew Hodhod for Bell Canada
Harvey Chaiton for Directors and Officers

***Geoffrey Morawetz R.S.J.*:**

1 The Pharmacy Franchisee Association of Canada ("PFAC") brought this motion for the following relief:

a. appointing PFAC as the representative of the Pharmacists and Franchisees (collectively, the "Pharmacists") under the Pharmacy Franchise Agreements ("Franchise Agreements");

b. appointing Sutts, Strosberg LLP as the Pharmacists' Representative Counsel (the "Representative Counsel");

c. appointing BDO Canada ("BDO") as the Pharmacists' financial advisor;

d. directing that the Pharmacists' reasonable legal and other professional expenses be paid from the estate of the Target Canada Entities with appropriate administrative charges to secure payment;

e. directing that the "Disclaimer of Franchise Agreements" dated January 26, 2015 by the Franchisor, Target Pharmacy Franchising LP ("Target Pharmacy") be set aside;

f. declaring that the Franchise Agreements and/or related agreements may not be disclaimed without court order; and

g. directing that Target Pharmacy cannot deny the Pharmacists access to premises, discontinue supplies or otherwise interfere with a Pharmacist's operations without that Pharmacist's consent or a court order.

2 On January 26, 2015, Target Pharmacy delivered Disclaimers of Franchise Agreements and related agreements to each of the Pharmacists operating the pharmacies at 93 locations across Canada (outside Quebec), seeking to shut down these pharmacies in the Target Canada store locations within 30 days.

3 The Pharmacists ask the court to deny Target Pharmacy's Disclaimer of the Franchise Agreements because (i) the Disclaimers will not enhance the prospects of a viable arrangement being made; and (ii) the Pharmacists will suffer significant financial hardship as a consequence of the disclaimer, with insolvency and/or bankruptcy awaiting many of them.

4 Under the proposed wind-down, Target Pharmacy is not responsible for pharmacy shut-down costs. Instead, the Pharmacists are responsible for (i) the payment of salaries, severance pay and other obligations to their own employees, suppliers and contractors; (ii) the relocation costs of their pharmacies; and (iii) the continuation of services to their patients in accordance with professional standards.

5 The Pharmacists recognize that they face numerous challenges as a result of Target store closures. In relocating, or winding-down pharmacy operations, the Pharmacists are required to comply with applicable legislation, regulations and standards governing the conduct of pharmacists in Canada, including such matters as: notice of pharmacy closure; notice of intention to open a new pharmacy; the safe-guarding of personal health records; providing notice to patients respecting their personal health information; and safeguarding and disposing of narcotics and controlled substances.

6 The Pharmacists seem to accept that when a Target store closes, the pharmacy within that store will also close. They state that they require "breathing space" that may be afforded to them by an order that the Franchise Agreements are not to be disclaimed at this time. They ask the court to direct Target Pharmacy and its Affiliates not to deny them access to their licenced space or otherwise interfere with the Pharmacist's operations without the consent of or on terms directed by the court. Practically speaking, the Pharmacists want to postpone the effect of the disclaimer in the hope of obtaining a continuation of support payments from Target Canada for an unspecified time.

7 There is no doubt that the closure or pending closure of Target Canada is causing and will cause significant dislocation for a number of parties. For the most part, Target Employees will lose their jobs. Representative Counsel have been appointed to assist employees in a process that includes an Employee Trust.

8 The closure of Target Canada also impacts suppliers to Target, especially sole suppliers. The insolvency of Target Canada and its filing under the Companies' Creditors Arrangement Act (CCAA) has no doubt resulted in Target defaulting on a number of contractual relationships. These suppliers will have claims against Target Canada that will be filed in due course.

9 The closure of Target Canada also affects the Pharmacists. The insolvency of Target and its filing under the CCAA has resulted in Target defaulting on its contractual relationships with the Pharmacists. Target wishes to disclaim the Franchise Agreements. The Monitor approved the proposed disclaimer and, as noted, disclaimer notices were sent on January 26, 2015.

10 The Pharmacists are challenging the disclaimer and seek an order under s. 32(2) of the CCAA that the Franchise Agreements not be disclaimed. Section 32(4) of the CCAA references a section 32(2) order and provides:

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.

11 The reality that the Target stores will be closing provides, in my view, the starting point to analyze the issue being brought forward by the Pharmacists.

12 Following the closing of a particular Target Store, it is unrealistic for the Pharmacist to carry on the operation of the pharmacy. As noted by counsel to the Applicants, as soon as operations cease at a particular location, the store will "go dark" and there will no longer be employee or security support that would permit the Franchisees to continue to operate. Further, counsel to the Applicants submits it would not be either commercially reasonable or practical for the Franchisees to continue to operate in a closed store, nor would it be reasonable or in the interests of stakeholders to require these locations to remain open in order to serve the interests of the Franchisees.

13 It is in this context that the issue of the disclaimer has to be considered.

14 Counsel to the Pharmacists seem to appreciate the reality of the situation, as reflected in the following references in their factum.

> 49. It is cold comfort for the Pharmacists to be advised that their losses in relation to the disclaimer of the Franchise Agreement are provable claims in the CCAA proceedings. The Pharmacists must pay their employees now. It is problematic that a provable claim may result in the possible recovery of some part of those payments, at a future uncertain date, if the funds are available in the Target Pharmacy Estate.
>
> 50. Evidence that simply provides that a debtor company will be more profitable with the disclaimer contracts is insufficient. Setting aside the disclaimers in this case will provide the Pharmacists with flexibility and time to make informed decisions and carry out their own relocation and/or wind-down in a manner that causes the least amount of damages to themselves and those who depend on them. ...
>
> 53. Respectfully, such disclaimer should not be permitted until the court receives an independent report of the circumstances of each of the Pharmacists and directs the orderly wind-down and/or relocation of such operations on terms that are fair and reasonable. ...
>
> 55. In no respect is the 30-day termination of the Franchise Agreements fair, reasonable and equitable to the Pharmacists, their employees and the public they serve. For many Pharmacists, it minimizes their capacity to relocate, [and] will leave them without funds to pay their employees, or the capacity to meet their ongoing obligations to their patients.

15 It seems to me, having considered these submissions, that the Pharmacists recognize that it is inevitable that the pharmacies will be shut down.

16 With respect to the factors to be considered as set out in s. 32(4), the disclaimer notices were approved by the Monitor. The Pharmacists complain that no reasons were provided in the notice approved by the Monitor. However, there is no requirement in s. 32(1) for the Monitor to provide reasons for its approval. This is reflected in Form 4 — Notice by Debtor Company to Disclaim or Resiliate an Agreement.

17 However, the absence of reasons does not lead necessarily to the conclusion that the Monitor did not consider certain factors prior to providing its approval.

18 The Monitor has made reference to the issues affecting the pharmacies in its Reports.

19 The pharmacies were specifically the subject of comment in the Monitor's First Report at sections 8.2 - 8.5, and in the Second Report at section 6. Section 6.1 (h) of the Second Report specifically comments on the disclaimer notices. A summary of the reasons is provided at section 6.2.

20 The information contained in the Monitor's reports establishes that there was communication as between Target Canada, the Monitor and the Franchisees such that it was clear that the stores were being closed. Specific reference to the communication is set out in the Monitor's Report at section 6.1(f), which in turn references the second Wong affidavit, filed by the Applicants.

21 I am satisfied that the Monitor considered a number of relevant factors prior to approving the disclaimer notices.

22 With respect to the second factor to be considered, namely whether the disclaimer would enhance the prospects of a viable compromise or arrangement being made in respect of the company, the Applicants have indicated they may be filing a plan of arrangement. I note that a plan may be required to ensure an orderly distribution of assets to the creditors.

23 The Applicants seek to achieve an orderly wind-down and maximization of realizations to the benefit of all unsecured creditors. It seems to me that if the disclaimers are set aside it would delay this process because it would extend the time period for Target Canada to make payments to one group of creditors (the Pharmacists) to the detriment of the creditors generally. Further, in the absence of an effective disclaimer, the Target Entities will continue to incur significant ongoing administrative costs which would be detrimental to the estate and all stakeholders.

24 The interests of all creditors must be taken into account. In this case, store closures and liquidation are inevitable. The Applicants should focus on an asset realization and a maximization of return to creditors on a timely basis. Setting aside the disclaimer might provide limited assistance to the Pharmacists, but it would come at the expense of other creditors. This is not a desirable outcome. I expressed similar views in *Timminco Ltd., Re*, 2012 ONSC 4471 (Ont. S.C.J. [Commercial List]) at paragraph 62 as follows:

> [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.

25 I am satisfied that the disclaimer will be beneficial to the creditors generally because it will enable the Applicants to move forward with their liquidation plan without a further delay to accommodate the Pharmacists.

26 The third factor is whether the disclaimer would likely cause significant financial hardship to a party to the agreement. This factor is addressed by Counsel to the Monitor at paragraph 27 of its factum.

> 27. On its own terms the CCAA effectively imposes a high threshold, beyond economic or financial loss, for the consideration under section 32(4): there must be evidence of financial *hardship*, it must be *significant* financial hardship, and it must be *likely* to be caused by the disclaimer. Financial loss or damage, without more, is not sufficient, in the Monitor's submission. It appears that Section 32 itself recognizes the distinction, providing expressly in ss. 32(7) that where a party suffers "a loss" in relation to the disclaimer the consequence is that such party "is considered to have a provable claim."
>
> (emphasis in original)

27 In these circumstances, the pharmacies will inevitably close in the very near future whether or not the Franchise Agreements are disclaimed. I accept the submission of counsel to the Monitor to the effect that no Franchisee has adduced evidence that disallowing the Disclaimer and continuing to operate in otherwise dark, vacated premises would improve its financial circumstances.

28 The situation facing the Pharmacists is not pleasant. However, in my view, setting aside the disclaimer will not improve their situation. Extending the time before the disclaimers take effect has the consequence of requiring Target Canada to allocate additional assets to the Pharmacists in priority to other unsecured creditors. This is not a desirable outcome.

29 The Target Canada Entities, in consultation and with the support of the Monitor, have offered a degree of accommodation to the Pharmacists. The details are set out at paragraphs 64-66 of the affidavit of Mark Wong sworn February 16, 2015:

> 64. As outlined above, in consultation with and with the support of the Monitor, on February 9, 2015 the Target Canada Entities' legal advisors delivered an accommodation to PFAC's counsel intended to address the primary concern expressed by PFAC, namely that franchisees require additional time to transfer patient files and drug inventory and to relocate their respective pharmacy businesses. Under the terms of the accommodation, TCC will permit the pharmacists to continue to operate at their respective existing TCC locations until the earlier of March 30, 2015 and three days following written notice by TCC to the pharmacist of the anticipated store closure at such pharmacist's location. The accommodation provides that the Notices of Disclaimer will continue in effect and the franchise agreements will be disclaimed on February 25, 2015, but the pharmacists will be entitled to remain on the premises for an additional period of time.
>
> 64. Under the terms of the accommodation, pharmacists will be able to continue operating in TCC stores for longer than the 30-day period contemplated. Depending on the date the Agent decides to vacate certain TCC stores, many pharmacists may be able to continue operating for 60 days or more following delivery of the Notices of Disclaimer and approximately 75 days following the date of the Initial Order. As I described above, at any time after the third anniversary of the opening date of the pharmacy, TCC Pharmacy would have the right to terminate the franchise agreement for any reason on 60 days' notice.
>
> 66. The March 30, 2015 date indicated in the accommodation made by Target Canada Entities is intended to be a reasonable compromise whereby pharmacist franchisees will get additional time to transfer patient files and inventory and relocate their businesses, while at the same time permitting the Target Canada Entities to undertake the orderly wind down of TCC pharmacy operations and the TCC retail stores as a whole. As I described above, in order to accommodate the continued operations of the pharmacies during the wind down process, TCC Pharmacy and TCC have not yet delivered notices of disclaimer to a number of third-party providers such as McKesson, Kroll and others, which TCC Pharmacy has maintained at considerable cost. The March 30, 2015 outside date for the operation of all TCC pharmacies will allow TCC Pharmacy to time the delivery of disclaimer notices to these third-party providers so as to avoid incurring additional unnecessary costs. The certainty provided by the firm outside date is also to the benefit of the pharmacies themselves, each of whom will be required to win down their operations and make alternate arrangements in the very short term as a result of the imminent closures of TCC retail stores.

30 In the circumstances of this case, this accommodation represents, in my view, a constructive, practical and equitable approach to address a difficult issue.

31 Having considered the factors set out in section 32(4) of the CCAA, the motion of PFAC for a direction that the disclaimer of the Franchise Agreements be set aside is dismissed, together with ancilliary relief related to the disclaimers. It is not necessary to address the standing issue raised by the Monitor.

32 I turn now to the request of PFAC that it be appointed representative of the Franchisees and that Sutts, Strosberg LLP be appointed as the Pharmacists' Representative Counsel, and BDO as the Pharmacists' financial advisor.

33 In view of my decision relating to the disclaimers, the scope of legal and financial services required by the Pharmacists may be limited. However, there are many transitional issues that remain to be addressed. First and foremost is dealing with the patient records and ensuring uninterrupted delivery of prescription drugs to all such patients. There is also interaction required between Target Pharmacy, the Franchisees, and the regulators, concerning the relocation or shut down of pharmacies and the return of certain products to suppliers. This is not a simple case where the Franchisee receiving the disclaimer notice can simply walk away from the scene. From a professional and regulatory standpoint, they still have to participate in the process.

34 In addressing these transition issues and recognizing that similar circumstances exist for the Franchisees, there would appear to be some benefit in having a limited form of representation for the Franchisees. This would assist in ensuring that a

consistent approach is followed not only in the wind-down or relocation aspect of the process, but also in the claims process. In my view, the estate could benefit if this process was coordinated.

35 The Monitor and the Applicants would have a single point of contact which would likely result in a reduction in administrative time and costs during the liquidation and the claims process. I am satisfied that PFAC has the support of the majority of franchisees. PFAC is appointed as the Representative of the Pharmacists. Sutts, Strosberg LLP is appointed Representative Counsel and BDO is appointed as the Pharmacists financial advisor.

36 The funding of this representational role is to be limited. The Applicants are to make available up to $100,000, inclusive of disbursements and HST, to PFAC to be used for legal and financial advisory services to be provided by Sutts, Strosberg, as Representative Counsel and BDO as financial advisor in these proceedings. PFAC can provide copies of invoices to the Monitor, who can arrange for payment of same. Any surplus funds at the conclusion of the representation are to be returned to the Applicants. The contribution to PFAC can be used only to cover legal and financial advisory services provided to date in these proceedings as well as to assist on the going forward matters, subject to the following parameters.

37 Such assistance is to be limited to:

a. corresponding with the regulators concerning the wind-down process and the relocation process;

b. return of inventory; and

c. participating in the claims process.

38 If the individual franchisees decide not to participate in PFAC, they should not expect any further accommodation in a financial sense.

39 In arriving at this accommodation, I have taken into account that this limited funding will provide benefits to the Applicants under CCAA protection insofar as the legal and financial advisory services provided by Representative Counsel and BDO should reduce the overall administrative cost to the estate and will avoid a multiplicity of legal retainers. The representation and funding will also benefit the franchisees so that they can effectively shut-down or relocate their business and prepare any resulting claim in the CCAA proceedings.

40 Given the limited nature of the Applicants' financial contribution, an administrative charge is not, in my view, required.

41 In the result, PFAC's motion for representation status is granted, with limitations set out above. The motion in respect of the disclaimers is dismissed.

Motion granted in part.

TAB 12

2020 BCSC 1883
British Columbia Supreme Court

Quest University Canada (Re)

2020 CarswellBC 3091, 2020 BCSC 1883, 326 A.C.W.S. (3d) 192, 85 C.B.R. (6th) 41

In the Matter of the COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, as amended

In the Matter of the SEA TO SKY UNIVERSITY ACT, S.B.C. 2002, c. 54

In the Matter of A PLAN OF COMPROMISE AND ARRANGEMENT OF QUEST UNIVERSITY CANADA (Petitioner)

Fitzpatrick J.

Heard: November 12-13, 16, 2020
Judgment: November 16, 2020
Written reasons: December 2, 2020
Docket: Vancouver S200586

Proceedings: leave to appeal refused *Southern Star Developments Ltd. v. Quest University Canada* (2020), 2020 CarswellBC 3252, 2020 BCCA 364, Harris J.A., In Chambers (B.C. C.A.)

Counsel: J.R. Sandrelli, V. Cross, for Petitioner
V.L. Tickle, for Monitor PricewaterhouseCoopers Inc.
P. Rubin, G. Umbach, for Primacorp Ventures Inc.
K. Jackson, G. Nesbitt, for RCM Capital Management Ltd. and SESA-BC Holdings Ltd.
P. Reardon, K. Strong, for Southern Star Developments Ltd.
C.D. Brousson, for Vanchorverve Foundation
D.V. Bateman, for Dana Hospitality LP
D. Lawrenson, for Halladay Education Group
K. Mak, for Capilano University
J. D. West, for Landrex Ventures Inc.
J. Sanders, S. Rogers, for Quest University Faculty Union
K. Davies, for Bank of Montreal
A. Welch, for Her Majesty The Queen In Right of Province of British Columbia and the Ministry of Advanced Education Skills and Training
K.E. Siddall, for 1114586 B.C. Ltd.
L. Hiebert, for Association for the Advancement of Scholarship

***Fitzpatrick J.*:**

INTRODUCTION

1 On November 3, 2020, the petitioner, Quest University Canada ("Quest"), applied for various orders in these *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36 ("*CCAA*") proceedings. Orders sought by Quest included approval of a sale transaction with Primacorp Ventures Inc. ("Primacorp") and orders necessary to facilitate that transaction, namely allowing Quest to implement a claims process and calling a meeting to consider its plan of arrangement.

2 On November 3, 2020, I granted the Claims Process Order and a Meeting Order to allow the creditors to consider Quest's plan of arrangement dated November 1, 2020 (the "Plan"). I also approved Quest's agreement to pay Primacorp a Break Up Fee and granted a charge to secure that amount: *Quest University Canada (Re)*, 2020 BCSC 1845 (B.C. S.C.).

3 I adjourned Quest's application for a Transaction Approval and Vesting Order (TAVO) to approve the Primacorp transaction to these hearing dates to allow opposing parties to consider the matter further and prepare necessary materials.

4 Southern Star Developments Ltd. ("Southern Star") has since formalized its opposition to the granting of the TAVO. Indeed, its opposition has since increased in force because Quest and Primacorp have now changed the relief sought to approve the Primacopr transaction within the context of a "reverse vesting order" ("RVO"), as explained below. Southern Star also now applies for an order prohibiting Quest from disclaiming certain subleases, as is required in order for the Primacorp transaction to proceed.

5 In the meantime, other parties have joined in opposing the approval of the Primacorp transaction for a variety of reasons, including those advanced by Southern Star in relation to the RVO.

6 At the conclusion of this hearing, I granted the RVO and dismissed Southern Star's application, with written reasons to follow. These are my reasons for those orders.

BACKGROUND FACTS

7 This *CCAA* proceeding has been underway for almost ten months, after the granting of the Initial Order on January 16, 2020.

8 Since that time, the Court has extended the stay of proceedings a number of times, to allow Quest to undertake efforts to find a restructuring solution to its financial difficulties that would allow it to continue its educational endeavours. Many stakeholders have been actively involved in these proceedings, including secured creditors who, collectively, will be owed approximately $30.7 million by the end of December 2020.

9 I have also approved interim financing to allow Quest to continue its operations while in this proceeding, with that debt now approaching $11 million.

10 Quest's assets include lands in Squamish, BC, being Lot 1, on which the campus is located (the "Campus Lands"), as well as the surrounding 38 acres (the "Development Lands".) Lot 1 is encumbered by various charges, liens, interests, mortgages and assignments of rent, including a mortgage held by Capilano University ("CapU"). In addition, CapU holds various rights of first refusal, including a right of first refusal to purchase, a right of first refusal to lease and rights of first refusal to acquire the charges of Quest's major secured creditor, Vanchorverve Foundation ("VF") (collectively, the "ROFR").

11 Quest is also the registered owner of five real property lots (Lots A-E), four of which are the sites of its university residences (on Lots A-D) (collectively, the "Residences").

12 One of the significant flashpoints in this proceeding has been, and continues to be, in relation to the Residences that Quest leases from Southern Star. After the Residences became vacant in March 2020 following the onset of the COVID-19 pandemic, Quest attempted to defer payment of the substantial lease payments owed to Southern Star. On June 19, 2020, I denied that relief: *Quest University Canada (Re)*, 2020 BCSC 921 (B.C. S.C.) (the "Rent Deferral Reasons").

13 Quest's principal focus in these proceedings has been toward identifying a partner/investor to purchase its land assets and/or identifying an academic partner/investor that would permit Quest to continue as a post-secondary institution.

14 Since January 2020, Quest's Board of Governors and its Restructuring Committee have been working with a private educational consultant, Halladay Education Group Inc. to find a prospective academic partner. In addition, since March 2020, Quest has been working with Colliers Macaulay Nicolls Inc. to find prospective purchasers for Quest's real property assets.

15 There is no dispute that the sale and partner search process (SISP) has been extensive, as confirmed by the Monitor. Quest submits, and I accept that its management, the Restructuring Committee, and the Board analyzed all proposals based on a number of factors, including:

a) Creditor recovery from the purchase price or other consideration under the proposal;

b) That the proposal would result in a completed transaction;

c) That the proposal offered allowed for Quest's long-term continuation as a post-secondary academic institution; and

d) That the proposal would lead to the continuation of a school on Quest's lands that aligned with Quest's current vision and academic quality.

16 The SISP resulted in a number of academic and real estate organizations approaching Quest to express interest in pursuing a transaction. Quest engaged with a number of potential purchasers or partners from Canada, the United States and other countries. Some parties executed Non-Disclosure Agreements (NDAs) and Quest received numerous Letters of Intent (LOIs) and other proposals.

17 On May 28, 2020, this Court granted an extension of the stay of proceedings. At that time, Quest stated that there was a realistic potential of a transaction with the party identified as the "Academic Partner". Unfortunately, that transaction did not proceed.

18 On August 7, 2020, this Court granted a further extension of the stay of proceedings to December 24, 2020 to allow Quest to continue seeking proposals towards a transaction by that deadline and to allow Quest to offer the fall term to its students. Quest was still in discussions with various interested parties at that time. By then, Quest had received LOIs, including one from Primacorp (identified as "Academic Partner #2) as of July 29, 2020.

19 Since August 7, 2020, Quest and Primacorp have worked extensively to negotiate the definitive documents toward completing a transaction. On September 16, 2020, Quest and Primacorp executed a Purchase and Sale Agreement (the "Primacorp PSA").

20 The Primacorp transaction, as originally presented, provided for:

a) Sufficient funds to pay Quest's secured creditors' claims, including claims secured by the *CCAA* charges;

b) Funding for a plan of arrangement to be voted on by Quest's unsecured creditors;

c) Funds for these insolvency proceedings; and

d) A working capital facility, and marketing and recruiting support to permit Quest to become self-sustaining as a post-secondary institution.

21 The main and subsidiary agreements executed between Quest and Primacorp in September/October 2020 are complex. They were complete by October 28, 2020 and included, as defined in the Monitor's Fourth Report, the Primacorp PSA, the Campus Lease, an Operating Loan Agreement and an Operating Agreement. Significant terms included:

a) Primacorp will purchase substantially all of Quest's lands and related assets, including the Campus Lands, the Development Lands, the residence Lands (Lots A-E; four of which involve Southern Star's subleases), chattels and vehicles;

b) Primacorp will lease specific Campus Lands back to Quest under a long-term lease arrangement;

c) Primacorp will provide marketing and recruiting expertise to support Quest as a university;

d) The Purchase Price will satisfy all of Quest's secured lenders and any commissions on sales;

e) Primacorp will fund sufficient monies to pay the lesser of the Unsecured Creditor Claims and $1.35 million under Quest's Plan; and

f) Primacorp will provide Quest with a $20 million secured working capital facility to support its operations.

22 The Primacorp transaction was subject to a number of significant conditions:

a) Quest's disclaimer of the four Southern Star subleases of the Residences or an agreement with Southern Star. On October 23, 2020, Quest disclaimed those subleases;

b) Court approval of the Primacorp transaction including approval of a Break Up Fee and Break Up Fee Charge to secure Primacorp's costs. On November 3, 2020, I approved the Break Up Fee and granted a charge to secure this amount;

c) Creditor approval of Quest's Plan under the *CCAA*. On November 3, 2020, I granted the Meeting Order to allow Quest to present the Plan, after having completed a claims process under the Claims Process Order, also granted on that date; and

d) Court approval of the Plan under the *CCAA*.

23 On November 3, 2020, when Quest sought the TAVO (which was adjourned), Quest asserted that the Primacorp transaction was beneficial in many respects. Quest argued that it maximized the value of Quest's assets, offered the greatest benefit to stakeholders, had a high likelihood of completing, provided a recovery for secured and unsecured creditors, and had the highest likelihood that Quest will continue to operate within its current academic model.

24 The Monitor concurred. In its Fourth Report dated November 2, 2020, the Monitor referred to the fact that there were only two viable proposals, with Primacorp's offer being the superior one. The Monitor's Supplemental and Confidential Report dated November 2, 2020 (the "Confidential Report") is also before the Court, although filed under seal. That Confidential Report referred to four other proposals received by Quest that were "not currently at a stage such that they are capable of being accepted by Quest".

25 Quest and Primacorp both see the closing of the Primacorp transaction as very time sensitive. Pursuant to agreements with the Interim Lender, Quest was required to enter into a transaction by October 30, 2020 with an anticipated closing of November 30, 2020. The Interim Lender has since agreed to amend that requirement to extend the necessary closing date to December 24, 2020 in accordance with the Primacorp transaction.

26 In addition to satisfying increasing pressure to repay its secured creditors, Quest seeks to exit these *CCAA* proceedings as soon as possible to allow it to recruit and plan for the upcoming 2021/22 academic year. Finally, there are other more financially driven and critical concerns. The Interim Lender has indicated that it will not fund its loan past December 2020. Without funding of some sort, Quest has no liquidity or financial ability after that time to continue operations.

ISSUES

27 The paramount issue for consideration is, of course, whether the Court should approve the Primacorp transaction under s. 36 of the *CCAA*. A number of subsidiary issues also emerged at this hearing, as a result of submissions from various stakeholders:

a) *Lot E*: Southern Star objects to the TAVO (now RVO), as vesting off any interest it may have under an unregistered lease of Lot E;

b) *ROFR*: CapU objects to the sale to Primacorp, asserting that Quest is ignoring its rights under the ROFR that allows CapU to purchase/lease Quest's lands;

c) *Other Offer*: Landrex Ventures Inc. ("Landrex"), together with CapU, assert that they should be given further time to finalize their offer for Quest's assets;

d) *Disclaimers*: Southern Star, supported by its secured creditor, Bank of Montreal (BMO), applies for an order that the subleases of the Residences not be disclaimed by Quest; and

e) *RVO*: Southern Star and another unsecured creditor, Dana Hospitality LP ("Dana"), object to the TAVO (now RVO), as being inappropriate and unfair in the circumstances and contrary to the spirit of the *CCAA*.

28 I will address the subsidiary issues in the first instance, before turning to an overall assessment of the Primacorp transaction and whether the Court should approve that transaction.

Lot E

29 As I described in the Rent Deferral Reasons (at para. 62), Quest, Southern Star and other parties are involved in a complex suite of agreements concerning the Residences that were built some time ago.

30 Quest is the limited partner in a limited partnership agreement with Southern Star, who is the General Partner (GP). They formed the Southern Star Developments Limited Partnership (the "LP") to build the Residences. Quest, as the owner of Lots A-D, leases those lands under Ground Leases to Southern Star (as the GP of the LP). The ground leases are at a nominal rate. In turn, Southern Star (the GP), as landlord, and Quest, as tenant, entered into Subleases for the Residences, once they were built.

31 The initial arrangements between Quest and Southern Star anticipated that a fifth student residence would be built on Lot E, the lot adjacent to Lot D.

32 In September 2017, as part of those arrangements, Quest and Southern Star executed certain Land Title documents (Form C Charges) attaching a Ground Lease and a Sublease with respect to Lot E. When the parties executed the Form C Charges, the Ground Lease was incomplete in many respects; it did not include any legal description because Lot E was created after the execution of the Form C Charges; and, it did not specify the applicable dates of the 99-year term. Finally, the Schedules to the Ground Lease included various documents between Quest, Southern Star and Southern Star's lender intended to be later executed once the Ground Lease, the Sublease and the mortgage were finalized and registered at the Land Title Office.

33 The parties delivered to Form C Charges to a law firm to be held in escrow pending the commencement of construction of the Lot E residence. Only recently, in response to this application, did a lawyer of the law firm complete the legal description for Lot E. Quest authorized this addition some time ago and I do not consider that matter as determinative of Southern Star's rights, if any, under the Lot E Ground Lease.

34 At present, Quest's title to Lot E remains clear of any registration relating to Southern Star's Ground Lease so there is no need for Quest to obtain a vesting order to remove it from the title. However, Quest and Primacorp seek an order that any claims that arise from the yet incomplete and unregistered Ground Lease on Lot E shall not attach to Quest's assets that are to be vested in Primacorp. They also seek an order permanently enjoining Southern Star from registering the Lot E Ground Lease against title to Lot E.

35 Southern Star objects to the RVO as vesting off any interest it may have in the unregistered Lot E Ground Lease, arguing:

a) This Court has no jurisdiction to do so under the *CCAA*. Southern Star argues that this is simply a disguised disclaimer of the Ground Lease that the *CCAA* expressly prohibits. Disclaimers are allowed pursuant to s. 32 of the *CCAA*, however, limits are imposed by s. 32(9)(d) which provides that disclaimers can not be made:

> . . . in respect of real property or of an immovable if the company is the lessor.

b) If such jurisdiction exists under the *CCAA*, the relief sought is not fair and equitable in the circumstances.

36 I will begin by discussing the nature of any interest held by Southern Star in relation to the Lot E Ground Lease.

37 In my view, no "lease" *per se* is yet in existence and valid and enforceable between Quest and Southern Star. Although the parties executed the Form C Charges relating to the Lot E Ground Lease, Southern Star's principal, Michael Hutchison, acknowledges that they were not to be registered until construction had commenced. I conclude that the parties did not intend that the Ground Lease would be valid and effective between them until that time, in conjunction with the registration of the Sublease and the execution and registration of Southern Star's mortgage that would allow construction to begin.

38 Southern Star does not argue that it has acquired any legal or beneficial interest in Lot E. At its highest, I conclude that Southern Star's rights to Lot E are purely contractual; Quest agreed that it would grant the Lot E Ground Lease in the future and it would become effective upon certain conditions being satisfied — in essence, an agreement to agree. Those conditions included that Quest would decide to build a residence building on Lot E and that Southern Star would arrange financing to construct the building. In these circumstances, I readily conclude that this condition has not been satisfied and will never be satisfied by Quest given Quest's insolvency.

39 Further, even assuming that this is a "disguised" disclaimer, I conclude that Quest is not a "lessor" as that term is used in s. 32(9)(d) of the *CCAA*. Quest agreed that, if certain conditions were satisfied, it would become a "lessor" under the Ground Lease; however, that has not come to pass.

40 I conclude that I have the jurisdiction under s. 11 of the *CCAA* to grant the order sought by Quest to ensure that Southern Star does not assert any rights under the Lot E Ground Lease at a future date. In addition, I rely on s. 36(6) of the *CCAA* that allows the Court to exercise its jurisdiction to vest off "other restrictions".

41 The exercise of the Court's jurisdiction under s. 11 and 36 of the *CCAA* requires that the relief sought be "appropriate". This is in the sense that it accords with the statutory objectives of the *CCAA*, not only in terms of what the order will achieve, but the means by which it employs to that end: *Ted Leroy Trucking Ltd., Re*, 2010 SCC 60 (S.C.C.) [hereinafter Century Services] at para. 70.

42 In this respect, the parties have advanced arguments as to equitable considerations in terms of whether such relief is appropriate in the circumstances, while taking into account the respective positions of the parties. While in the receivership context, Quest has referred to various authorities that discuss the balancing of interests in similar situations where leases (in these cases effective and enforceable) were vested off title: *Meridian Credit Union Ltd. v. 984 Bay Street Inc.*, [2006] O.J. No. 3169 (Ont. S.C.J.) at paras. 19-23, citing *New Skeena Forest Products Inc. v. Kitwanga Lumber Co.*, 2005 BCCA 154 (B.C. C.A.); *Romspen Investment Corp. v. Woods Property Development Inc.*, 2011 ONSC 3648 (Ont. S.C.J.) at para. 66; rev'd other grounds *Romspen Investment Corp. v. Woods Property Development Inc.*, 2011 ONCA 817 (Ont. C.A.) at para. 25.

43 Southern Star argues that the equities favour it, not Quest, in these circumstances.

44 Southern Star contends that neither Quest nor Primacorp have made any attempt to negotiate with it concerning its interest in Lot E. I would not accede to this argument. While the negotiations between Quest, Primacorp and Southern Star were not fruitful, it remains the case that Quest has made good faith efforts to address Southern Star's interests, although its ability in that respect were hampered by Primacorp's willingness to accommodate those interests.

45 Southern Star also argues that it will be prejudiced if its contractual right is vested off in that Quest and Primacorp are not offering compensation for the loss of that interest. Southern Star focusses on what it says is the "status *quo*", arguing that it has the "right" to build a residence on Lot E. However, any such "right" is illusory at best, since Quest has no present ability to occupy the Residences, let alone the financial capability to participate in the construction of a fifth one on Lot E. Nor is there any realistic prospect that Quest will be in a position to do so in the future.

46 Southern Star's argument in relation to Lot E is an attempt to gain leverage more than anything else. If Southern Star's argument succeeds and the relief sought is refused, Southern Star would be in the same position — facing a sale of Lot E and a

likely order vesting off any rights or interests it may have. It is a condition of the Primacorp transaction that Lot E be transferred to it without any further involvement with Southern Star. Without an order rejecting Southern Star's claim in respect of the escrowed Ground Lease on Lot E, the likely result would be the end of these proceedings and the commencement of realization proceedings by the Interim Lender and other secured creditors.

47 The Ground Lease is not effective and enforceable; the Ground Lease is not registered on title to Lot E. Given the circumstances, Quest has no ability to build a residence on Lot E and there is no reasonable prospect of that happening, given its insolvency and the need to dispose of its assets, including Lot E.

48 While I acknowledge the negative impact on Southern Star arising from this relief, that impact must be balanced in the context of Quest's restructuring efforts in this proceeding. Those efforts are intended to address not only Southern Star's interests, but also the myriad interests held by other stakeholders. The sale of Lot E to Primacorp will allow Quest to realize on its interest in Lot E to the benefit of the stakeholders as a whole.

49 I conclude that the relief sought by Quest in the RVO in relation to Lot E is appropriate and it is granted.

CapU ROFR

50 Lot 1 and Lots A-E are subject to various charges in favour of CapU.

51 In March 2019, Quest granted mortgage security in favour of CapU in connection with a loan made to Quest. As part of these agreements, in April 2019, Quest also granted the ROFR in favour of CapU. CapU registered the ROFR against these lands. Under the Primacorp transaction, Quest is required to obtain title to Lot 1 and Lots A-E without reference to the ROFR.

52 Pursuant to s. 9 of the *Property Law Act*, R.S.B.C. 1996, c. 377, a right of first refusal to land is an equitable interest in land.

53 CapU has referred to two non-*CCAA* cases that discuss ROFRs generally.

54 In *Adesa Auctions of Canada Corp. v. Southern Railway of British Columbia Ltd.*, 2001 BCSC 1421 (B.C. S.C.) at paras. 26-30, the Court found that the contractual terms were to be strictly enforced and that the rights under the ROFR could not be defeated or circumvented by an offer that included other lands not covered by the ROFR. To similar effect, *Alim Holdings Ltd. v. Tom Howe Holdings Ltd.*, 2016 BCCA 84 (B.C. C.A.) at para. 41 states, following *Adesa*, that a ROFR will be triggered by a package sale that includes the subject property, subject to contrary language in the ROFR.

55 It is common ground, however, that different considerations may also apply in the *CCAA* context. Having said that, there is little case authority on the ability of a court in *CCAA* proceedings to vest off a ROFR, whether triggered or not.

56 In "Rights of First Refusal and Options to Purchase in Insolvency Proceedings" (2019) 8 J.I.I.C. 103 (the "ROFR Article"), the authors Virginie Gauthier, David Sieradzki and Hugo Margoc extensively review the issue, including in relation to Options to Purchase (OTPs). At 106, the authors state:

> . . . Section 11 of the *CCAA* grants courts the right to "make any order that it considers appropriate in the circumstances" except as limited by the CCAA. As such, the *CCAA* court is well equipped to approve the sale of an OTP- or ROFR-encumbered asset to a party other than the rights-holder and without having first complied with the restrictive covenants if the transaction is in the best interests of the creditors at large, provided that the interest of the OTP or ROFR-holders is taken into account. The court will consider, *inter alia*, the monitor's views on these issues before making any such approvals.

57 At 118-119, the authors conclude that:

> While jurisprudence on this matter is not conclusive, it appears that a *CCAA* court would likely only vest out a valid and unexpired OTP that runs with the land in exceptional circumstances such as in the context of a going-concern restructuring where obtaining the highest possible price for the encumbered asset is paramount to support the restructuring efforts of

> the debtor company, and where the OTP rights-holders are also creditors in the proceeding and could seek compensation for any loss incurred due to the removal of the OTP right.
>
> . . .
>
> In summary, common law *CCAA* courts may vest out valid or unexpired ROFRs and OPTs in a case where the equities favour such an order or on consent.

58 Quest has referred to *Bear Hills Pork Producers Ltd., Re*, 2004 SKQB 213 (Sask. Q.B.), additional reasons 2004 SKQB 216 (Sask. Q.B.). In that *CCAA* proceeding, the debtors sought approval of a sale of bundled assets relating to a hog farm, in the face of a ROFR that applied to the land only. Justice Kyle referred to the overall security affecting the assets; the court also commented that a withdrawal of the lands from the sale would not allow the proposed sale to complete, leading possibly to a liquidation (at paras. 4-5).

59 However, in *Bear Hills*, Kyle J. relied on authorities that have since been questioned in *Alim Holdings* (see paras. 38-41). Justice Kyle's conclusion at para. 10 that the ROFR was not triggered runs contrary to the court's conclusion in *Alim Holdings* at para. 41.

60 I have no doubt that courts across Canada have vested off ROFRs in the context of assets sales approved in *CCAA* proceedings. For example, Quest refers to *Arctic Glacier Income Fund, Re*, [2012] M.J. No. 451 (Man. Q.B.) where a ROFR was vested off title, although the circumstances under which that *CCAA* relief was granted is not clear.

61 Similarly, in *Great Slave Helicopters Ltd. v. Gwichin Development Corp.* (November 23, 2018), Doc. CV-18-604434-00CL (Ont. S.C.J.), Justice Hainey's endorsement directed that a purchaser of aggregated assets in a *CCAA* proceeding provide certain information to the holder of the ROFR with respect to the purchase price allocation. The ROFR Article, which discusses the circumstances before the court in *Great Slave Helicopters* at 108-109, indicates that the issue of the exercise of the ROFR was ultimately resolved consensually.

62 Fortunately, in this case, there is no dispute concerning the Court's jurisdiction to address CapU's rights arising under the ROFR. Both Quest and CapU agree that the Court has jurisdiction under the *CCAA* to vest off the ROFR, subject to a consideration of the equities as between the parties.

63 For the following reasons, I conclude that a balancing of the equities favours vesting off CapU's ROFR to allow the Primacorp transaction to proceed:

a) Since January 2020, Quest has been pursuing a going concern restructuring that will permit it to remain as a university and employer in the Squamish area. CapU has been involved in this proceeding from the outset and was well aware of the opportunity to participate in that pursuit;

b) There is a significant issue as to whether the ROFR has even been triggered by delivery of the Primacorp PSA. The definition provided in the ROFR of "Bona Fide Offer to Purchase" means, in part, an offer that is:

> (iii) only for the entirety of the Property [the lands] and all chattels thereto and <u>no other property, rights or assets</u>
>
> [Emphasis added.]

The definition of "Purchased Assets" in the Primacorp PSA is broad and refers not only to lands and chattels, but a variety of other assets (for example, contracts, plans, permits, vehicles and intellectual property). This express language is what the court in *Alim Holdings*, at para. 41, described could indicate an intention that any such aggregated offer would *not* trigger the ROFR;

c) The term of the ROFR expires in March 2024. The ROFR appears to contemplate that, even if CapU does not exercise the ROFR, the purchaser of the lands must still agree to grant CapU a ROFR on the same terms. Similarly, "change of control" provisions are potentially effective that would allow CapU to later acquire control of Quest in place of anyone else. This would frustrate Primacorp's expectation under the Primacorp PSA that it would have the right to nominate the board of governors for Quest after closing;

Primacorp does not agree to assume these restrictions. In addition, every other offer for Quest's assets required that the ROFR be vested off title to the lands. It is difficult to see that any purchaser would agree to take title to purchased assets with such significant restrictions. If the ROFR is effective, this would give rise to a severe "chilling effect" on the market, with potentially disastrous results for Quest's restructuring efforts;

d) The 60-day period within which CapU is entitled to consider any "Bona Fide Offer to Purchase" is simply unworkable in these circumstances. This is not a matter of expediency, without regard to any rights held by CapU. Quest will have no funds to continue its operations past December 2020 and, if realizations by the secured creditors ensue, CapU's ROFR rights will be illusory at best;

e) CapU complains that it received the redacted Primacorp PSA only recently, on October 29, 2020. CapU then requested an unredacted copy, which Quest agreed to do upon CapU executing an NDA. CapU refused to sign the NDA, stating that it would hamper its ability to participate in its own offer. Again, CapU has had months to formulate its own offer;

f) Quest asserts that CapU has no intention to or ability to make its own offer for all of Quest's assets in competition to the Primacorp transaction. CapU has not put forward any evidence at this hearing to confirm such intention or ability. Similarly, there is no evidence that CapU truly wishes to or is able to exercise any rights under the ROFR to purchase Quest's lands and chattels;

g) I consider that the evidence conclusively supports that CapU advances its arguments under the ROFR simply as a tactic to oppose the Primacorp transaction and delay the matter so that it and Landrex can seek to advance their own joint competing offer;

h) As I will discuss below, the terms of the joint Landrex/CapU proposal is only semi-formed at this point and Quest has indicated that some major terms are not acceptable. As such, it is highly questionable that this joint offer is, as CapU asserts, a "better, higher offer";

i) I conclude that Quest has given proper regard to and has not ignored CapU's rights under the ROFR in the context of these proceedings. CapU has had sufficient information even from the redacted Primacorp PSA to discern the substance of the Primacorp transaction in terms of advancing any competing offer or exercising the ROFR;

j) Given the above circumstances, including CapU's involvement in Quest's lengthy efforts to restructure, I cannot conclude that CapU will suffer significant prejudice if the ROFR is vested off. Quest has indicated that CapU will have the opportunity to file a proof of claim in respect of any loss alleged to arise because of the vesting off of the ROFR. Of course, the value of any such claim would be questionable unless CapU can establish that its rights were triggered by the Primacorp transaction and that it had the ability to complete under the ROFR; and

k) The Monitor supports the Primacorp sale, as maximizing the value of Quest's assets for the stakeholders and allowing a successful restructuring of Quest's business.

64 If CapU has rights under the ROFR, allowing CapU to assert those rights would delay the Primacorp sale and potentially negate it, all with potentially devastating effect on the broader stakeholder group. The Primacorp sale is the only sale that is before the Court that would result in a restructuring of Quest for the benefit of the stakeholders. Clearly, within that context, the rights of all affected stakeholders must be balanced in respect of any rights held by CapU.

65 In *Bear Hills*, similar considerations were before the court. The Saskatchewan Court of Queen's Bench approved a bundled sale of assets, without first requiring compliance with a ROFR. In part, the prospective purchaser would only consider purchasing the complete bundle of properties for an aggregate purchase price and did not allocate value on a property-by-property basis.

66 As I have sought to do here, the court in *Bear Hills* (at para. 9) was attuned to the overarching and remedial statutory purpose and objective of the *CCAA* to avoid the "social and economic losses resulting from liquidation of an insolvent company": *Century Services* at para. 70 and *9354-9186 Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10 (S.C.C.) at paras. 40-41. This objective is not to be achieved simply in the most expedient manner and without due regard to interests of stakeholders that are affected in that process. As the Court further stated in *Century Services* at para. 70, any restructuring is best achieved when "all stakeholders are treated as advantageously and fairly as the circumstances permit".

67 I am satisfied that it is appropriate, in the context of the Primacorp transaction, to vest off the ROFR held by CapU. In that regard, I have also considered the factors set out in s. 36(3) of the *CCAA* in terms of assessing any rights of CapU under the ROFR in that context.

Landrex / CapU Offer

68 Landrex, supported by CapU, opposes approval of the Primacorp transaction. Landrex argues that they should be given further time to present an offer for Quest's assets in competition with the Primacorp transaction.

69 As with CapU, Landrex has been fully engaged in discussions with Quest for some time now, having been alerted to the possibility of a transaction as long ago as fall 2019. Landrex's interest in Quest has always been in conjunction with securing an academic partner, namely, CapU.

70 In June 2020, Landrex and Quest entered into an agreement for a sale; however, the conditions lapsed.

71 On October 8, 2020, Landrex and Quest executed a further purchase and sale agreement (the "Landrex PSA") providing for a purchase price of $51 million for most of Quest's assets (Lot 1 only and excluding Lots A-E: obviating any need for disclaimers of the Southern Star Subleases or vesting off any of Southern Star's rights under the Lot E Ground Lease). The closing date under the Landrex PSA is December 23, 2020.

72 By the start of this hearing, significant conditions precedent in respect of the Landrex PSA were still outstanding. Those included the financing condition in favour of Landrex and the mutual condition by which "another party" (CapU) was to have secured a sublease with Quest after Landrex had granted CapU a lease in the first instance.

73 Landrex suggests that Quest is contractually bound to honour the Landrex PSA by allowing it further time to remove the conditions precedent, citing the good faith organizing principle discussed in *Bhasin v. Hrynew*, 2014 SCC 71 (S.C.C.). Further, Landrex argues that Quest has a duty to take all reasonable steps to satisfy the conditions precedent: *Dynamic Transport Ltd. v. O.K. Detailing Ltd.*, [1978] 2 S.C.R. 1072 (S.C.C.).

74 Further discussions and negotiations continued between Landrex and Quest beyond October 8, 2020; however, matters under the Landrex PSA were not advanced.

75 By late October 2020, Quest was under significant pressure, if not a legal requirement from the Interim Lender, to conclude a transaction. At that time, only two potentially viable proposals were on the table, one being from Primacorp. As above, where the Monitor noted in its Confidential Report that other proposals were "not currently at a stage such that they are capable of being accepted by Quest", those "other proposals" included the Landrex PSA.

76 By the time the Landrex PSA was executed on October 8, 2020, Landrex was not aware that Quest had already signed the Primacorp PSA. However, I agree with Quest's counsel that Landrex had not secured any rights of exclusivity in terms of advancing its offer. The Landrex PSA provided:

> 20.2 Notwithstanding anything else contained herein, Landrex acknowledges and agrees that, following from date of the acceptance of this Offer by the Vendor until the date that the Vendor waives or declares satisfied the Vendor's Condition, the Vendor will be authorized to negotiate with or offer the Property for sale to any third party (including the entering into of any agreement by the Vendor with any third party) . . .

77 Under the Landrex PSA, Quest's Vendor's Condition was approval from its Board of Governors. Quest never obtained that approval because Quest's Board of Governors did not agree to certain deal terms under the Landrex PSA.

78 By October 29, 2020, Landrex would have been fully aware that its offer was not going to be advanced by Quest any further since, by then, Quest had chosen Primacorp.

79 On November 2, 2020, Landrex made a further offer for $53.5 million. The only other significant change to their offer was to describe the requirement for a lease/sublease arrangement between Landrex, "another party" (intended to be CapU) and Quest as Landrex's condition precedent, not a mutual condition precedent. Quest did not accept this offer.

80 In any event, by that time, Landrex's financing condition was far from being satisfied. On November 9, 2020, TD Asset Management ("TD"), Landrex's lender, provided a letter simply stating that it was continuing to work with Landrex and CapU to provide that financing.

81 I acknowledge that, since the initial hearing date of November 3, 2020, Landrex has moved to finalize its offer but it has only done so to some extent.

82 On November 13, 2020, Landrex secured a letter from TD that referred to a term sheet being in place after a final financing structure was negotiated (no documents were disclosed). However, TD's commitment is clearly conditional upon CapU's board approving the lease between Landrex and CapU at a meeting that is not scheduled to take place until November 24, 2020. There is no evidence as to what those lease terms are and whether there is a reasonable likelihood that CapU's board will approve it. Further, this whole arrangement continues to hinge on a negotiated sublease between CapU and Quest, which is not in place.

83 On November 16, 2020, Landrex's counsel advised of yet further developments: (i) removal of its financing condition; (ii) an LOI with Southern Star by which it would take over the Residences but not require disclaimer of the Subleases; and, (iii) agreement with CapU to remove the ROFR.

84 Despite these developments, Quest advised that it was still not agreeable to the terms of the Landrex transaction. In addition, the Monitor continues to support approval of the Primacorp transaction, noting the uncertainty and potential delay of CapU obtaining ministerial approval to allow its participation in the Landrex transaction.

85 The s. 36(3) factors continue to provide a useful structure for consideration of the Landrex transaction, and these late breaking developments.

86 I am satisfied that Landrex was given a reasonable opportunity to participate in the SISP and that it has been aware of this opportunity for many months, even before it officially began. The fact that the cash consideration under the Landrex transaction exceeds that of Primacorp is deserving of consideration. However, other considerations arise, including that the Primacorp transaction involves significant other benefits to Quest in terms of its future operations, including the working capital facility of $20 million.

87 Both Quest and the Monitor continue to be of the view that the Primacorp transaction is more beneficial to the creditors. I agree with this, particularly considering the continuing uncertainty and risk associated with the Landrex/CapU transaction that is yet to be resolved, leaving aside that Quest has unequivocally stated that it has no intention to pursue it. Even if the further negotiations required under the Landrex sale were advanced in an expeditious manner, it seems unlikely to be finalized by the end of the year. To the contrary, the Primacorp transaction has been finalized after weeks of complex negotiations and Quest and Primacorp are ready to close without further delay. I agree that time is of the essence at this stage of the proceedings, for the reasons already noted above.

88 In the overall circumstances here, I see no reason to delay, if not risk, the "bird in hand" transaction that arose through a reasonable sales process, in the hope that a more uncertain transaction may be finalized, such as with Landrex.

Southern Star Disclaimers

89 On October 23, 2020, and with the approval of the Monitor, Quest issued notices of disclaimer (the "Disclaimers") to Southern Star relating to the Subleases on Lots A-D by which Southern Star leases those lands and the Residences to Quest.

90 A condition precedent of the Primacorp transaction is that either Quest will disclaim the Subleases or Primacorp will have entered into an agreement with Southern Star to its satisfaction. The evidence discloses that negotiations did take place between the parties but they did not reach a mutually acceptable agreement.

91 Quest's rent payments to Southern Star under the Subleases for the Residences on Lots A-D total approximately $236,218 per month.

92 Very recently, on November 15, 2020, before the conclusion of this hearing, Quest voluntarily withdrew the Disclaimers with respect to Lots A-B. Accordingly, failing an agreement between Primacorp and Southern Star, it remains a condition of the Primacorp transaction that Quest's Disclaimers of the Subleases in relation to Lots C-D be upheld.

93 The Ground Leases are registered against Lots A-D. BMO's security is registered against Southern Star's interest under the Ground Leases; in addition, Fivestone Capital Corp. ("Fivestone"), a company controlled by Mr. Hutchison, has registered security against the Grounds Leases. Quest does not seek any relief in respect of the Ground Leases; unlike Lot E, those documents are fully effective and enforceable and have been the basis upon which the parties have developed those properties.

94 What remains to be addressed is Southern Star's application pursuant to s. 32(2) of the *CCAA*, supported by BMO, for an order disallowing any disclaimer by Quest of the Subleases of the Residences on Lots C-D. Section 32(4) of the *CCAA* lists various non-exhaustive factors that the court is to consider in relation to disputes over disclaimers:

> 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.

95 In *League Assets Corp., Re*, 2016 BCSC 2262 (B.C. S.C.), I discussed the significance of disclaimers in *CCAA* proceedings, both from the point of view of the counterparty and that of the entire stakeholder group:

> [49] These *CCAA* provisions are not inconsequential in the face of this type of proceedings. At this point, the matter is no longer between the debtor company and a counterparty. There are other stakeholders involved and the statutory provisions, and the provisions of court orders such as the Initial Order, are meant to protect the stakeholder group as a whole, while also allowing a certain amount of flexibility for the debtor company. A disclaimer of a contract has consequences not only to the debtor company, but the estate generally. Such an action can substantially increase the debt being faced by the estate or divest the debtor of a substantial benefit that might be realized for the benefit of the creditors. It is in that context that the *CCAA* requires that certain procedures be followed by the debtor company, with the necessary oversight by the Court's officer, the Monitor, as to whether any disclaimer will be approved or not.

96 The factor under s. 32(4)(b) of the *CCAA* as to enhancing the prospects of a viable restructuring applies equally in respect of disclaimers in the context of a sales process by which the business is to continue as a going concern: *Timminco Ltd., Re*, 2012 ONSC 4471 (Ont. S.C.J. [Commercial List]) at paras. 51-52 and *Aveos Fleet Performance Inc./Aveos Fleet performance aéronautique inc., Re*, 2012 QCCS 6796 (C.S. Que.) at paras. 48-50. In addition, the disclaimer need not be proven as "essential", only "advantageous and beneficial": *Timminco* at para. 54.

97 Quest asserts that the Disclaimers are necessary to pursue and complete the Primacorp transaction, which it considers the best possible outcome for Quest and its stakeholders, including students, faculty, staff, secured and unsecured creditors,

suppliers and vendors. In its letter dated October 28, 2020 to Southern Star, Quest also refers to its liquidity crisis and that amounts owing to its secured creditors became due some time ago.

98 In its Fourth Report dated November 2, 2020, the Monitor confirmed its approval of the Disclaimers, based on:

> 2.8.1 The residences are not currently being used by Quest (other than two units being used by staff members and some limited use by a film crew recently) given on-line learning format being employed as a result of COVID 19;
>
> 2.8.2 It is a term of the Primacorp Agreement that the subleases be disclaimed; and,
>
> 2.8.3 The Monitor noted that the two most promising alternative parties in discussions with Quest also required the Southern Star subleases to be disclaimed.

99 Southern Star advances a number of arguments in relation to the Disclaimers.

100 Firstly, it argues that the Disclaimers will not result in a viable compromise or arrangement. Southern Star argues that there is no indication that Quest and Primacorp do not wish to continue to have the Residences as part of the student experience for those attending Quest.

101 I agree that, in the Rent Deferral Reasons, many of my comments (at paras. 23-26, 90) were confirmatory of the importance of the Residences to Quest in respect of its future operations. However, that was then and this is now. The pandemic continues in full force and Quest is necessarily required to make decisions in the face of current circumstances. I agree that it is likely that Quest will seek to continue the student residence experience once the pandemic has receded, however, when that might happen is anyone's guess.

102 In the meantime, Quest, under the Primacorp transaction, must make decisions as to its financial capabilities going forward. Maintaining two empty Residences with accompanying rent payments is, on its face, not a reasonable business decision in the circumstances. It was Primacorp, an arms length purchaser, who has imposed this condition.

103 Further, the Monitor agrees with Quest that the Disclaimers are necessary to enhance the prospects of Quest making a viable compromise or arrangement in these proceedings. There is no reason to question the Monitor's view as it is apparent that the Monitor has considered all relevant matters.

104 I agree that the Disclaimers will enhance the prospects of Quest making a viable compromise or arrangement. The Monitor overwhelmingly agrees after a consideration of all the circumstances including those particularly faced by Southern Star as a result.

105 Secondly, Southern Star argues that Quest delivered the Disclaimers simply to secure a bargaining advantage for Quest and Primacorp toward a re-visitation of the rent deferral issue or to attempt to reduce the rent. I agree that there is some indication that Quest and Primacorp had that in mind; however, that is often the reality that arises after a debtor concludes that it is no longer viable to abide by those contractual commitments and that a disclaimer is appropriate. If it were possible to come to an amicable resolution with Southern Star in the context of the Primacorp transaction, I expect Quest would have done so.

106 Southern Star refers to the statements in *Allarco Entertainment Inc., Re*, 2009 ABQB 503 (Alta. Q.B.) at para. 59, where Justice Veit considered whether certain contracts should be terminated. She was attuned to whether the termination was fair, appropriate and reasonable and whether it arose after good faith negotiations. In this case, there is no evidence to suggest that the parties did not approach the negotiations in good faith. Clearly, it is not my role on this application to assess the reasonableness of the respective positions of Quest, Primacorp and Southern Star in those negotiations. It does appear, however, that Quest and Primacorp have moved toward a middle ground by the withdrawal of the Disclaimers in relation to Lots A-B.

107 Thirdly, Southern Star places great emphasis on what it says will be the significant hardship it will suffer if the Disclaimers are upheld. Southern Star says that it has spent approximately $41.7 million to construct the Residences.

108 The monthly mortgage payments to BMO and Fivestone are approximately $220,000. The outstanding balance of the BMO loan facility is $34.4 million. Mr. Hutchison indicates that, without payment of rent by Quest, Southern Star will not be able to make its mortgage payments to BMO. In that event, BMO will be in a position to foreclose on the Ground Leases. Mr. Hutchison has guaranteed the BMO debt, as has another of Mr. Hutchison's companies.

109 As noted by Quest, any financial consequences to Southern Star will largely depend on what mitigating measures are undertaken. Those could include a re-letting of the Residences or a sale of its interests under the Ground Leases. At present, with no clear indication as to how those matters might evolve, I am unable to conclude with certainty that any hardship suffered by Southern Star would be "significant".

110 Regardless of any hardship faced by Southern Star, the reality is that Quest has only one viable means by which to advance the restructuring at this time — the Primacorp transaction. Within the confines of that transaction, Primacorp sees no merit in maintaining the Subleases on these two Residences. Apparently, no other interested party expressed an interest in maintaining the Subleases besides Landrex. In light of Landrex's submissions at the conclusion of this hearing on November 16, 2020, I have considered that the Landrex/CapU transaction may have presented a more palatable resolution of the Subleases given the recent LOI between Landrex and Southern Star. However, I conclude that delaying the Primacorp sale, on the prospect that the Landrex/CapU transaction will come about, is not a viable option for the reasons discussed above.

111 I agree that this decision will visit hardship, even arguably significant hardship, upon Southern Star. However, it is difficult to see that preventing delivery of the Disclaimers would avoid that result in any event. If the Primacorp transaction does not proceed, there is no transaction and Quest has no financial means to continue past December 2020. The Interim Lender has indicated that it will not advance funds to Quest beyond that date, and specifically, that it has no interest in funding continued rent payments to Southern Star.

112 In that event, Southern Star will be in the same position post December 2020, with Quest unable to pay the rent for the Residences at that time: see *Target Canada Co., Re*, 2015 ONSC 1028 (Ont. S.C.J.) at paras. 27-28.

113 As the court noted in *Target Canada* at paras. 24-25, the court must give due consideration to the stakeholder group as a whole in assessing whether the Disclaimers are fair and reasonable: *Doman Industries Ltd., Re*, 2004 BCSC 733 (B.C. S.C.) at para. 33. The price of setting aside the Disclaimers is that the Primacorp transaction will not proceed and a receivership at the behest of the Interim Lender will likely follow. In my view, this is not in the best interests of that larger stakeholder group which, in my view, has primacy here even in the face of the hardship and prejudice caused to Southern Star.

114 I dismiss Southern Star's application for order that the Subleases of the Residences on Lots C-D not be disclaimed by Quest.

RVO

115 At the November 3, 2020 hearing, when Quest originally sought the TAVO, Quest was seeking to uphold the Disclaimers of the Subleases. At that time, Southern Star's evidence and submissions were to the effect that, if the Court upheld the Disclaimers, it would have a substantial unsecured claim against the estate. As indicated above, the amount of any claim that Southern Star might advance in the estate is far from clear, given possible mitigation, although there is potential for a significant claim.

116 This position did not come as a surprise to Quest; however, it appears that Quest did not appreciate the potential magnitude of Southern Star's claim. More importantly, Quest has not fully appreciated that a very unhappy claimant — Southern Star under the Disclaimers — was not likely to vote in favour of the Plan and that the value of its claim could swamp the class votes to prevent any approval by the creditors. Again, creditor approval of the Plan is a requirement of the Primacorp Transaction.

117 In early November 2020, known unsecured creditor's claims were estimated at approximately $2.3 million. "Restructuring Claims" (which will include any claim of Southern Star under the Disclaimers) were yet unknown.

118 Initially, Primacorp agreed to fund Quest's Plan in the amount of the lesser of 50% of the claims or $1.35 million. The Monitor now states that there is a "high probability" that Southern Star's claim will be large enough such that Southern Star will control the value of the votes at the creditors meeting. Other major unsecured creditor claims have also since emerged, being that of Dana (estimated $1 million) and the Association for the Advancement of Scholarship (estimated $5 million).

119 As the Monitor notes, any of these claims could effectively veto the Plan.

120 Quest and Primacorp were then facing a dilemma. They determined that, while they might succeed on the Disclaimer issue, they could not likely obtain approval of the Plan, a further requirement of the Primacorp PSA, if Southern Star carried through with its suggested negative vote. While Quest could raise arguments in relation to the value of any claim advanced by Southern Star, uncertain and lengthy litigation would likely result; even if Quest was successful, it would be too late to factor into this restructuring.

121 Quest, with Primacorp's approval, solved this dilemma by revising the TAVO to an RVO. In addition, the Primacorp PSA was amended to delete the conditions precedent requiring creditor and court approval of the Plan. Accordingly, the only condition precedent that remains before closing of the Primacorp transaction is the granting of the RVO.

122 The Monitor supports this change as necessary in the circumstances in order to allow Quest to complete the Primacorp transaction. The Monitor supports the granting of the RVO.

123 In its Fifth Report dated November 10, 2020, the Monitor describes the characteristics of the new structure and steps under the RVO, which involves Quest's subsidiary, Guardian Properties Ltd. ("Guardian"):

> RVO Structure & Impact
>
> 2.6 The RVO provides for the following to occur in sequential order on the closing of the Primacorp Transaction:
>
>> 2.6.1 A wholly owned subsidiary of Quest, Quest Guardian Properties Ltd. ("Guardian") shall be added as a Petitioner in these CCAA proceedings. Guardian was incorporated on January 25, 2018 and has never carried on any business and has never held any assets or liabilities;
>>
>> 2.6.2 All of Quest's right, title and interest in and to the Excluded Assets (as defined in the Primacorp PSA and the RVO) shall be transferred to and vested in Guardian;
>>
>> 2.6.3 All Contracts (other than Approved Contracts), Claims and Liabilities of Quest shall be transferred to Guardian and Quest shall be released from and in respect of all obligations in respect of such Contracts, Claims and Liabilities;
>>
>> 2.6.4 Primacorp will pay the Purchase Price to the Monitor to the extent of the Secured Charges and all the Secured Claims and the Secured Charges shall be extinguished and cancelled. The Purchase Price will stand in the place of the Purchased Assets;
>>
>> 2.6.5 All of Quests right, title and interest in the Purchased Assets shall vest in Primacorp free and clear of any security interests, Claims and Liabilities; and,
>>
>> 2.6.6 Quest will cease to be a Petitioner in these CCAA proceedings leaving Guardian as the sole Petitioner.
>
> 2.7 The RVO contains release provisions similar to those contained in the Plan. Quest, its employees, legal advisors and other representatives, Quest's Governors and Officers, and the Monitor and its legal counsel shall be released from any and all demands and claims relating to, arising out of, or in connection with these CCAA Proceedings. The releases do not apply in the case of wilful misconduct or fraud.
>
> 2.8 As a result of the amendments to the Primacorp Transaction and the RVO, if the RVO is granted:

2.8.1 There will be no uncertainty as to whether the Primacorp Transaction can close and the condition precedent for the approval of the Plan is no longer applicable. As a result, there will be certainty for the go-forward operations of Quest, thereby creating security for the Quest students, faculty and staff leading into the critical enrolment period for the winter term;

2.8.2 Guardian will become responsible for the obligations under the Southern Star subleases should they not be disclaimed. As Guardian will not have the financial resources to meet those obligations, it is expected that Guardian would default on the Southern Star subleases in January 2021; and

2.8.3 The Plan, which will now compromise the debts of Guardian, will be funded through the Primacorp Transaction and therefore this aspect of the Primacorp Transaction and the Plan has not changed.

124 As I will discuss below, the effect and substance of the RVO is to achieve what Quest has originally sought by way of a restructuring in these proceedings; namely, a sale of certain assets to Primacorp and, importantly, Quest continuing as a going concern as an academic institution, in partnership with Primacorp. The only aspect now missing is that, under the RVO, Quest will avoid having to obtain creditor or Court approval of the Plan.

125 The intention is that the amounts that Primacorp was to fund under the Plan will now be transferred to Guardian to be distributed under Guardian's plan in relation to the Quest's liabilities that are to be transferred to Guardian. Effectively, Guardian will be funded just as it was originally intended that Quest's Plan was to have been funded to resolve those claims.

126 Southern Star and Dana, as unsecured creditors of Quest, object to the granting of an RVO, contending that it effectively and unfairly negates their right to vote on Quest's Plan under s. 6 of the *CCAA*. They object to the transfer of their claims to Guardian. They say that, although they will have the ability to vote on Guardian's plan, it will effectively mean that they cannot vote to block Quest's restructuring to enable it to continue as a going concern within the context of the Primacorp transaction.

RVO Jurisdiction and Authorities

127 There is no dispute between the parties that this Court has authority to grant the RVO under its general statutory jurisdiction found in s. 11 of the *CCAA*.

128 Quest has referred me to a number of decisions across Canada where courts have exercised that jurisdiction to grant an RVO in the context of sale approvals considered under s. 36 of the *CCAA*. I will review those decisions in some detail below to highlight the relevant circumstances.

129 In *T. Eaton Co., Re*, 2000 CarswellOnt 4502, 26 C.C.P.B. 295 (Ont. S.C.J. [Commercial List]), the Ontario court granted such an order under its *CCAA* proceedings. There are no written reasons discussing the circumstances in that case. The only brief reference to that structure is found in Claims Officer Houlden's decision in *Eaton's* that addressed an unrelated issue. The agreed statement of facts before the Claims Officer provided:

5. The *CCAA* Plan contemplated that all of the assets of Eaton's which were not being retained by Eaton's under the Sears Agreement would be transferred to a new corporation, Distributionco Inc. ("Distributionco"). These assets would then be liquidated by Richter & Partners Inc. ("Richter") in its capacity as court-appointed liquidator of the estate and effects of Distributionco. Richter would then distribute the assets of Distributionco to unsecured creditors and others in accordance with priorities set out in the *CCAA* Plan.

6. Under the *CCAA* Plan, unsecured creditor claims against Eaton's are converted into a right to participate in distributions in the liquidation of Distributionco based on the amount of the creditor's claim against Eaton's. Accordingly, a critical initial step in the liquidation of Distributionco is the determination of the validity and amount of claims asserted against Eaton's. For this purpose the *CCAA* Plan establishes a Claims Procedure for the resolution of such claims, of which the parties to this matter are aware.

130 It is unclear as to the basis upon which the court approved this structure in *Eaton's* although, as Southern Star notes, it was a transaction approved within the context of a *CCAA* Plan.

131 More recently, this structure was approved in *Plasco Energy, Re* (July 17, 2015), Doc. Toronto CV-15-10869-00C (Ont. S.C.J. [Commercial List]). In those *CCAA* proceedings, an agreement was approved that "effectively" transferred current tax losses and intellectual property to a purchaser. Justice Wilton-Siegel's endorsement stated:

> The Global Settlement contemplates implementation of a corporate reorganization by which the shares of Plasco will be transferred to an acquisition corporation owned by NSPG and CWP and the remaining assets of the applicants will be held by a new corporation, referred to as "New Plasco", which will assume all of the liabilities and obligations of Plasco. I am satisfied that the Court has authority under section 11 of the *CCAA* to authorize such transactions notwithstanding that the applicants are not proceeding under s. 6(2) of the *CCAA* insofar as it is not contemplated that the applicants will propose a plan of arrangement or compromise. For this purpose, I consider that the Global Settlement is analogous to such a plan in the context of these particular proceedings. . . .

132 Justice Gouin granted an RVO in the *CCAA* proceedings of *Stornoway Diamond Corp., Re* (October 7, 2019), Doc. Montreal 500-11-057094-191 (C.S. Que.). There are no written reasons from the court; however, the motion materials disclose that, under the transaction, the purchasers acquired substantially all the debtor's assets by purchasing 100% of the shares of one debtor company (SDCI, which held the acquired assets). In consideration, the purchaser released certain liabilities owed by the debtors and agreed to assume others.

133 In *Stornoway Diamond*, to ensure the purchaser acquired the assets free and clear of all encumbrances, the debtors incorporated a new subsidiary (Newco), added Newco as an applicant in the *CCAA* proceedings, and transferred all liabilities, obligations, and unacquired assets of SDCI to Newco. The debtor's motion referred to this transaction as the only viable alternative to preserve the going concern value of the debtor. The debtor noted that the equity and "non-operational related unsecured claims" had no value. As in the RVO sought here, the court's order included familiar aspects found in sanction orders, including releases.

134 An RVO was also approved in the *CCAA* proceedings of *Wayland Group Corp., Re* (April 21, 2020), Doc. Toronto CV-19-00632079-00CL (Ont. Gen. Div. [Commercial List]). Approval was sought in the context of preserving valuable cannabis licenses. Justice Hainey's brief endorsement indicates that the relief was unopposed. The court approved a sale of substantially all of the debtor's assets to the successful bidder under a share purchase agreement after a sales and investment solicitation process.

135 Other information before me regarding the *Wayland Group* transaction is found in the applicant's factum. The factum refers to both *Plasco Energy* and *Stornoway Diamond*, while also referring to ss. 11 and 36(3) of the *CCAA* as the jurisdictional basis for the relief. The applicants argued that transferring certain assets and liabilities of the debtors into a "newco" would ensure that the purchaser acquired the underlying assets of the target company free and clear of all claims and encumbrances and allow the business to continue as a going-concern. They asserted that this was the "only way" to complete the sale to realize the value in the assets; it was also argued that this transaction was in the best interests of stakeholders and did not prejudice major creditors. In *Wayland Group*, the transaction value was only sufficient to repay the interim lender and perhaps some amount for the first secured creditor.

136 The Ontario court again approved a similar RVO transaction in the *CCAA* proceedings of *Comark Holdings Inc., Re* (July 13, 2020), Doc. Toronto CV-20-00642013-00CL (Ont. Gen. Div. [Commercial List]). Justice Hainey granted the RVO while again indicating in a brief endorsement that the relief was unopposed. The share sale preserved the tax attributes of the debtor, which the purchaser viewed as critical for the success of the future business. The purchaser was a related party who was making a credit bid for the assets.

137 In *Comark Holdings*, the purchaser acquired all the issued and outstanding shares of the primary *CCAA* debtor and agreed to pay out all the secured debt and priority claims. The excluded assets, agreements, liabilities and encumbrances were

transferred to another entity that became a debtor in the *CCAA* proceedings, with the result that the *CCAA* debtor held its assets free and clear of all claims and encumbrances and was then removed from the *CCAA* proceedings. The purchaser and the primary *CCAA* debtor then amalgamated. The new *CCAA* debtor (Newco) was authorized to make an assignment into bankruptcy. The monitor, along with the principal secured creditors, including the interim lender, supported the transactions. As in *Plasco Energy*, *Stornoway Diamond* and *Wayland Group*, the debtors in *Comark Holdings* argued that this was the "only option" to preserve the business, that the value in that business would be lost in a liquidation and that the transaction was in the best interests of the stakeholders generally.

138 Justice Conway granted an RVO in the *CCAA* proceedings of *Beleave Inc., Re* (Sep 18, 2020), Doc. Toronto CV-20-00642097-00CL (Ont. Gen. Div. [Commercial List]). As in *Wayland Group*, the preservation of valuable cannabis licenses were at stake. The motion was supported by the monitor and unopposed. Justice Conway stated in her brief endorsement:

> The Applicants seek approval of the transaction whereby . . . (the Purchaser) will acquire the operating business of the Applicants. The structure of the transaction is partly by share sale and partly by asset sale. The reason for the structure is to accommodate the licensing requirements of Health Canada. The order is structured as a reverse vesting order, in which excluded liabilities and assets will be transferred to "Residualco", which will then become one of the Applicants in the *CCAA* proceedings. Reverse vesting orders have been approved by the courts in other cases: see *Re Stornoway Diamond Corporation* . . . and *Re Wayland Group Corp* . . .
>
> The transaction is the culmination of a stalking horse sales process approved by the court. The motion is unopposed. The Monitor recommends and supports the transaction in its Fourth Report. In particular, the Monitor states that the proposed transaction is economically superior to the estimated liquidation value of the Beleave Group's assets and operations, will allow the Purchaser to maintain operations and use of the Cannabis licenses and will provide for continued employment for a majority of the existing employees. In my view, the transaction satisfies s. 36(3) of the *CCAA* and the *Soundair* test and should be approved.

139 In *Beleave Inc.*, the RVO included releases of claims similar to that granted in other RVO decisions. These provisions were also consistent generally with sanction orders and are similar to the relief sought by Quest here.

140 Even more recently, the Alberta court approved an RVO structure in the *CCAA* proceedings of *JMB Crushing Systems Inc., Re* (October 16, 2020), Doc. Calgary 2001-05482 (Alta. Q.B.). Justice Eidsvik approved the RVO structure as part of a sale approval. No written reasons of the court are available, however, the monitor's bench brief discloses the relevant facts.

141 As in the above cases, the transaction addressed in *JMB Crushing* arose from a sale and investment solicitation process that yielded only one offer, with the RVO described as a critical component. The underlying intention was to preserve the value of the paid up capital and regulatory permits in the *CCAA* debtor.

142 In *JMB Crushing*, the monitor relied on the orders granted in *Plasco Energy*, *Stornoway Diamond*, *Wayland Group* and *Beleave Inc.*, arguing that the RVO structure was justified in those circumstances:

> 24. In recent *CCAA* proceedings, where it was not practical to compromise amounts owed to creditors through a traditional plan of compromise and arrangement, but it was critical to the viability of a transaction to "cleanse" the debtor company, such that a prospective purchaser may: (i) utilize non-transferrable regulatory licenses (by way of amalgamation or the purchase of the shares of the debtor company); or, (ii) make use of tax attributes of the debtor company, such as [paid up capital], Courts have recently approved and utilized reverse vesting orders to achieve such objectives.
>
> 25. The purpose of a reverse vesting order is to transfer and vest all of the assets and liabilities of a debtor company, which are not subject to a sale, to another company within the same *CCAA* proceedings. The cleansed debtor company is then able to: (i) be utilized by a purchaser as a go-forward vehicle, without any concern regarding creditors and obligations that may otherwise be "laying in the weeds"; and, (ii) allow the purchaser to make use of the debtor company's tax attributes and non-transferrable regulatory licenses. This approach is necessary in situations where the parties would otherwise be

unable to preserve the value of significant assets that are subject to restraints on alienation and to provide a corresponding realizable benefit for creditors and stakeholders.

143 In *JMB Crushing*, the monitor further justified the RVO structure in asserting that the debtor's secured creditors would suffer a shortfall even with such measures. The monitor stated that the unsecured creditors had no economic interest in the transaction and there was no reasonable prospect of any recovery to them. The debtor did not intend to undertake a claims process or present a plan to its unsecured creditors.

144 By pure coincidence, another and perhaps more compelling authority came to the attention of the parties during this hearing.

145 On November 11, 2020, the Québec Court of Appeal dismissed an application for leave to appeal the granting of an RVO by Gouin J. of the Québec Superior Court on October 15, 2020: *Arrangement relatif à Nemaska Lithium inc.*, 2020 QCCS 3218 (Que. Bktcy.); leave to appeal denied *Arrangement relatif à Nemaska Lithium inc.*, 2020 QCCA 1488 (C.A. Que.). The Court of Appeal's decision is in English; Gouin J.'s decision is in French and no English translation was available. As such, all references to *Nemaska Lithium* will be to the QCCA.

146 All counsel agree that Gouin J.'s decision in *Nemaska Lithium* is the first time a Canadian court has granted an RVO in contested *CCAA* proceedings.

147 In *Nemaska Lithium* (at para. 5), the court stated that the RVO allowed the purchaser to carry on the operations of the Nemaska Lithium entitles (mining in James Bay) by maintaining existing permits, licenses and authorizations. This goal was accomplished via a credit bid for the shares in Nemaska Lithium in return for assumption of the secured debt. At para. 22, the court refers to the intention of the "residual companies" to later present a plan of arrangement to the "remaining creditors", but the details are not disclosed.

148 In denying leave to appeal in *Nemaska Lithium*, the court stated that an appeal would hinder the progress of the proceedings. More relevant to this application were the court's comments on the legitimacy of the position of the only objecting creditor, Cantore, and the court's rejection that it was appropriate to allow Cantore to exercise a veto in the restructuring:

> [38] As it turns out, the value of the Cantore provable claims (setting aside the later debate regarding his potential real rights) stands at $8,160 million out of a total value of provable claims of $200 million. Thus, Cantore's provable claims represent at this point in time 4% of the total value of unsecured creditors" claims as determined by the Monitor. Yet, Cantore is the only creditor having voiced an objection to the RVO approval. This begs the question: whose interest is being served by the proposed appeal? What would be the true impact of the Cantore vote on the RVO transaction if it were made subject to prior approval on the part of the creditors as he suggests?
>
> [39] In these circumstances, I am simply not convinced that the arguments that are advanced by Cantore are anything but a "bargaining tool", while he pursues multidirectional attacks on the RVO with the same arguments that were dismissed in the first instance.

149 Similar to Cantore's position in the *Nemaska Lithium* restructuring, Southern Star and Dana's objections to the RVO are grounded in the assertion it will negate their effective veto on the Plan (and hence the Primacorp transaction) by which they seek to leverage further concessions. For obvious reasons, those concessions can only come about at a cost to other stakeholders, whose interests remain to be addressed.

Discussion

150 Quest, with the support of the Monitor, submits that the Primacorp transaction satisfies s. 36 of the *CCAA* and that the Court should grant the RVO pursuant to ss. 11 and 36 of the *CCAA*.

151 As with the structures approved in the above *CCAA* proceedings, the RVO has certain aspects that Southern Star says are objectionable. Those include primarily: (i) the addition of Guardian as a petitioner in the *CCAA* proceeding; (ii) the vesting of

the Excluded Liabilities and Excluded Contracts in Guardian; (iii) Quest's exit from this *CCAA* proceeding; and (iv) the release of Quest in respect of the Excluded Liabilities and Excluded Contracts.

152 Essentially, unsecured claims against Quest and minor assets are transferred to Guardian and Quest continues as a going concern after having transferred the bulk of its assets to Primacorp free and clear of any encumbrances (save for certain Retained Liabilities). Quest no longer requires approval of the Plan by the creditors and the Court to complete the Primacorp transaction.

153 At para. 19, the QCCA in *Nemaska Lithium* referred to Gouin J.'s comment that s. 36 of the *CCAA* allows the court a broad discretion to consider and, if appropriate, grant relief that represents an innovative solution to any challenges in a proceeding. Justice Gouin considered that approving an RVO structure was such an innovative solution. Indeed, this is the history of *CCAA* jurisprudence under the court's broad statutory discretion and court approval of innovative solutions continues to this time.

154 That said, the ability of a *CCAA* court to be innovative and creative is not boundless; as always, the court must exercise its discretion with a view to the statutory objectives and purposes of the *CCAA*: *Century Services*.

155 I find further support for Quest's position in the recent comments of the Court in *Callidus*. The Court was there addressing a different issue — whether a *CCAA* judge has jurisdiction under s. 11 to bar a creditor from voting where the creditor is "acting for an improper purpose" — but the Court's comments on the exercise of jurisdiction under the *CCAA* ring true in relation to the RVO structure:

> [49] The discretionary authority conferred by the *CCAA*, while broad in nature, is not boundless. This authority must be exercised in furtherance of the remedial objectives of the *CCAA*, which we have explained above (see *Century Services*, at para. 59). Additionally, the court must keep in mind three "baseline considerations" (at para. 70), which the applicant bears the burden of demonstrating: (1) that the order sought is appropriate in the circumstances, and (2) that the applicant has been acting in good faith and (3) with due diligence (para. 69).
>
> [50] The first two considerations of appropriateness and good faith are widely understood in the *CCAA* context. Appropriateness "is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*" (para. 70). Further, the well-established requirement that parties must act in good faith in insolvency proceedings has recently been made express in s. 18.6 of the *CCAA*, which provides:
>
>> Good faith
>>
>> 18.6(1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.
>>
>> Good faith — powers of court
>>
>> (2) If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the court may make any order that it considers appropriate in the circumstances.
>>
>> (See also *BIA*, s. 4.2; *Budget Implementation Act*, *2019, No. 1*, S.C. 2019, c. 29, ss. 133 and 140.)
>
> . . .
>
> [65] There is no dispute that the *CCAA* is silent on when a creditor who is otherwise entitled to vote on a plan can be barred from voting. However, <u>*CCAA* supervising judges are often called upon "to sanction measures for which there is no explicit authority in the *CCAA*" (*Century Services*, at para. 61; see also para. 62). In *Century Services*, this Court endorsed a "hierarchical" approach to determining whether jurisdiction exists to sanction a proposed measure: "courts [must] rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding" (para. 65). In most circumstances, a purposive and liberal interpretation of the provisions of the *CCAA* will be sufficient "to ground measures necessary to achieve its objectives" (para. 65)</u>.

. . .

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

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

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

. . .

[70] . . . The exercise of this discretion must further the remedial objectives of the *CCAA* and be guided by the baseline considerations of appropriateness, good faith, and due diligence. This means that, where a creditor is seeking to exercise its voting rights in a manner that frustrates, undermines, or runs counter to those objectives — that is, acting for an "improper purpose" — the supervising judge has the discretion to bar that creditor from voting.

. . .

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

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

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

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

[Underline emphasis added; italic emphasis in original.]

156 Quest is not seeking to bar Southern Star or Dana from voting on the Plan. It is seeking approval of a structure that would result in Guardian submitting its own plan to the unsecured creditors, which would include Southern Star and Dana, at which time they are generally free to vote their "self-interest" subject to any relevant constraint (for example, if the court finds that they are voting for an improper purpose): *Callidus* at para. 24 and 56.

157 There is no provision in the *CCAA* that prohibits an RVO structure. As is usually the case in *CCAA* matters, the court must ensure that any relief is "appropriate" in the circumstances and that all stakeholders are treated as fairly and reasonably "as the circumstances permit": *Century Services* at para. 70.

158 As with the sales considered in most of the above RVO cases, including *Nemaska Lithium*, this is the *only* transaction that has emerged to resolve the financial affairs of Quest. No other options are before the stakeholders and the Court that would suggest another path forward. As was noted by Gouin J. in *Nemaska Lithium* (at para. 12), it is not up to the Court to dictate the terms and conditions that are included in an offer. Primacorp has presumably made the best offer that it is prepared to make in the circumstances — that is the offer the Court must consider.

159 I agree with the Monitor that, without the RVO structure, the Primacorp transaction is in jeopardy. The only other likely path forward for Quest is receivership, liquidation and bankruptcy, a future that looms in early 2021 if the transaction is not approved.

160 Many of the RVO cases cited above involve a sale of an ongoing business with a purchaser. The RVO structure was crafted to allow those businesses to continue through the debtor company, since it was that corporate vehicle who owned the valuable "assets" that could be not transferred.

161 Akin to the tax losses, permits and licences that could not be transferred in those RVO cases, is Quest's ability to confer degrees under its statutory authority under s. 4(2) of the *Sea to Sky Act*, S.B.C. 2002, c. 54 (the "*Sea to Sky Act*"). Quest cannot sell its ability to grant degrees under s. 4(2) of the *Sea to Sky Act*. Nor can any purchaser acquire the right to grant degrees indirectly through a purchase of the shares in Quest. Pursuant to s. 2 of the *Sea to Sky Act*, Quest is a corporation "composed of the members of the board" and no shareholders exist. Pursuant to s. 1 of the *Sea to Sky Act*, the "board" means the board of governors of the university.

162 It is a critical requirement under the Primacorp transaction that Quest remain a viable entity to continue its operations and, in particular, continue to grant degrees. That is a significant component of the Primacorp transaction and the value that Primacorp is prepared to pay under the transaction reflects that component. In other words, the stakeholders are receiving a benefit from this transaction by which Primacorp ensures that Quest continues after exiting these *CCAA* proceedings.

163 At para. 38, the court in *Nemaska Lithium* asked:

> . . . whose interest is being served by the proposed appeal? What would be the true impact of the Cantore vote on the RVO transaction if it were made subject to prior approval on the part of the creditors as he suggests?

164 I acknowledge the negative consequences that arise particularly for Southern Star if the Primacorp transaction is approved, although there is significant uncertainty about the extent of any loss that may be suffered. Dana's unsecured claim has little, if any value, outside of the benefits of the Primacorp transaction.

165 In that light, I would ask Southern Star and Dana a similar question to that of the QCCA — to what end is your veto if Quest's Plan is put presented for creditor approval?

166 Both creditors potentially hold the sword of Damocles over the head of the significant broad stakeholder group who stand to benefit from the Primacorp transaction. Recently, Southern Star has secured further benefits by the withdrawal of two of the Disclaimers. Both objecting creditors have nothing to lose at this point in this dangerous game of chicken with Primacorp, with only the oversight of this Court to oversee this strategy. By any stretch, no one is blinking at this point, while significant other interests hang in the balance.

167 The Monitor's comments in its Fifth Report as to the jeopardy to those other interests are apt:

> 2.15 The Monitor has considered the competing interests of Southern Star and the interests of Quest's other stakeholders. In the Monitor's view, the Primacorp Transaction should not be jeopardized by the lack of agreement between Southern

> Star and Primacorp. Southern Star can mitigate its financial hardship by entering into an agreement with Primacorp for use of some or all of the residences. By contrast, Quest's other stakeholders have no ability to mitigate their potential losses in the event that the Primacorp Transaction does not close. They are reliant on the completion of the Primacorp Transaction or face significant losses themselves should it not complete.

168 In my view, in the vein of the Court's discussion in *Callidus*, these are unique and exceptional circumstances where the Court may grant the relief by allowing Quest to employ the RVO structure within the context of this sale transaction.

169 Southern Star and Dana seek to effectively block the only reasonable outcome here by insisting that they must approve of Quest's Plan in conjunction with the sale. However, creditor approval of a sale is not required under s. 36 of the *CCAA*.

170 The granting of the RVO in these circumstances is in accordance with the remedial purposes of the *CCAA*. To use the words of Dr. Sarra, quoted above in *Callidus*, I conclude that Southern Star and Dana are working actively against the goals of the *CCAA* by their opposition to the RVO.

171 I do not consider that an RVO structure would be generally employed or approved in a *CCAA* restructuring to simply rid a debtor of a recalcitrant creditor who may seek to exert leverage through its vote on a plan while furthering its own interests. Clearly, every situation must be considered based on its own facts; different circumstances may dictate different results. A debtor should not seek an RVO structure simply to expedite their desired result without regard to the remedial objectives of the *CCAA*.

172 Here, in these complex and unique circumstances, I conclude that it is appropriate to exercise my discretion to allow the RVO structure. Quest seeks this relief in good faith and while acting with due diligence to promote the best outcome for all stakeholders. I have considered the balance between the competing interests at play. This transaction is unquestionably the fairest and most reasonable means by which the greatest benefit can be achieved for the overall stakeholder group, a group that includes Southern Star and Dana.

173 The structure also allows Quest to continue its operations in partnership with Primacorp, a result that will avoid the devastating social and economic consequences that will be visited upon the stakeholders if this transaction is not approved. Ironically, the continuation of Quest's operations will also benefit Southern Star in the future through the continued payment of rent for two of the Residences. Other potential benefits may also arise if Southern Star and Quest are later able to come to terms once the pandemic has receded and students return to campus.

THE PRIMACORP TRANSACTION

174 Quest applies for the granting of the RVO in favour of Primacorp pursuant to s. 36(1) of the *CCAA*.

175 Section 36(1) of the CCAA allows the court to authorize the sale of a debtor company's assets out of the ordinary course of business. Section 36(3) of the *CCAA* lists the relevant non-exhaustive factors to be considered:

> (a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
>
> (b) whether the monitor approved the process leading to the proposed sale or disposition;
>
> (c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;
>
> (d) the extent to which the creditors were consulted;
>
> (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
>
> (f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

176 The well-known considerations identified in *Royal Bank v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.) at 6 are consistent with and overlap many of the s. 36(3) factors: see *Veris Gold Corp., Re*, 2015 BCSC 1204 (B.C. S.C.) at para. 25,

referring to various authorities such as *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 ONSC 2870 (Ont. S.C.J. [Commercial List]) at para. *13*. Those considerations include: (i) whether the party conducting the sale made sufficient efforts to obtain the best price and did not act improvidently; (ii) the interests of all parties; (iii) the efficacy and integrity of the process by which offers were obtained; and, (iv) whether there has been any unfairness in the sales process.

177 More generally, in analyzing whether a transaction should be approved, taking into consideration the s. 36(3) and *Soundair* factors, a court is to consider the transaction as a whole and decide whether or not the sale is appropriate, fair and reasonable: *Veris Gold* at para. 23.

178 I conclude that the s. 36(3) and *Soundair* factors all favour approving the Primacorp transaction and granting the RVO. Specifically:

a) The process leading to the Primacorp transaction has been lengthy and exhaustive. The Monitor has overseen that entire process;

b) Quest 's Restructuring committee and its Board of Governors have sought and obtained professional advice throughout the *CCAA* process toward finding a suitable academic partner and/or a purchaser/developer for Quest's lands;

c) No stakeholder objects to the proposition that the sales process was conducted in an appropriate, fair and reasonable manner;

d) The Primacorp transaction will see the repayment of Quest's secured creditors, now totalling approximately $42.2 million in what has been an increasingly pressurized environment to do so after long standing defaults;

e) Since August 7, 2020, the Interim Lender and VF, Quest's major secured creditors, have been kept apprised of developments. They both support the Primacorp transaction. In addition, other secured creditors have been involved throughout these proceedings and support the transaction;

f) There has been significant community and stakeholder involvement throughout the sales process;

g) The Primacorp transaction will ensure that Quest continues as a going concern, by continuing operations as a post-secondary institution in Squamish. This will result in continuing benefits to the broad stakeholder group. This includes faculty, staff, students, secured and unsecured creditors, suppliers, landlords and the community generally;

h) The broader stakeholder interests must be balanced against those who will be negatively affected by the transaction, such as Southern Star under the Disclaimers, although no viable offer has emerged that does not include the Disclaimers;

i) Quest's Board of Governors have exercised their business judgment and determined that the Primacorp transaction is the best option to fulfil the goals of Quest's restructuring;

j) The Primacorp transaction will fund a Plan for unsecured creditors;

k) The Primacorp transaction provides Quest with significant benefits in terms of its future operations. These include the $20 million working capital facility and Primacorp support for Quest's marketing, recruiting and operations to allow it to continue as a post-secondary institution into the future;

l) No other or better offer or proposal has emerged that can be considered superior to the Primacorp transaction;

m) The Monitor is satisfied that the consideration to be received from Primacorp is reasonable and fair, taking into account the market value of the assets and the other unique factors of these proceedings;

n) The Monitor is of the view that this transaction will yield a greater benefit to the stakeholders than might be achieved in a liquidation or bankruptcy;

o) Any delay of approval is likely to lead to ruinous consequences after December 2020, when Quest will be out of funds and the Interim Lender will be in a position to commence a receivership and liquidation of Quest's assets; and

p) Simply, Quest has run out of time to find a restructuring solution and the Primacorp transaction presently stands as the *only* viable option to avoid the devastating social and economic consequences to its stakeholders if a liquidation results.

CONCLUSIONS

179 I grant the RVO as sought by Quest, and as supported by the Monitor.

180 The Primacorp transaction is the best option available that maximizes recovery for Quest's creditors and preserves Quest's university operations. Allowing Quest to continue as a university will benefit all stakeholders, including Quest's current and former employees, current and future students of Quest and the community generally. The RVO structure is an appropriate means to accomplish this result in these unique and exceptional circumstances.

Application dismissed.

TAB 13

2003 BCCA 344
British Columbia Court of Appeal

Skeena Cellulose Inc., Re

2003 CarswellBC 1399, 2003 BCCA 344, [2003] B.C.W.L.D. 467, [2003] B.C.J. No. 1335, 123 A.C.W.S. (3d) 73, 13 B.C.L.R. (4th) 236, 184 B.C.A.C. 54, 302 W.A.C. 54, 43 C.B.R. (4th) 187

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

Skeena Cellulose Inc., Orenda Forest Products Ltd., Orenda Logging Ltd. and 9753 Acquisition Corp. (Respondents / Petitioners) and Clear Creek Contracting Ltd. and Jasak Logging Ltd. (Appellants / Applicants) and The Truck Loggers' Association (Intervenor)

Newbury, Hall, Levine JJ.A.

Heard: April 28-29, 2003
Judgment: June 9, 2003
Docket: Vancouver CA030149

Proceedings: affirming (2002), 5 B.C.L.R. (4th) 193 (B.C.S.C.)

Counsel: *J.S. Forstrom*, for Appellants
M.I. Buttery, S.A. Dubo, for Respondents
M. Maclean, J.I. McLean, for Intervenor, Truck Loggers' Association

***Newbury J.A.*:**

1 This appeal turns on the interaction of two statutory regimes — the scheme of "replaceable" or "evergreen" logging contracts established by the Province under the *Forest Act*, R.S.B.C. 1996, c. 157, and the scheme of judicial stays and creditors' compromises available under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended (the "CCAA"), to insolvent corporations whose indebtedness exceeds $5,000,000.

2 Both schemes are said to involve considerations of fairness and equity. In the case of the *Forest Act*, a detailed series of "contractual" terms is required to be incorporated in agreements between the holders of harvesting licences granted by the Crown, and the contractors they in turn retain to carry out the logging. Most aspects of the relationship are either provided for in the mandatory terms or must be resolved by arbitration, the principles and procedures of which are also regulated by the Act. Most importantly, a licence holder must agree that when such an agreement expires, it will be renewed (or in the statutory terminology, "replaced") on terms substantially the same as those of the expired contract, assuming the contractor has performed its obligations thereunder. In this way, the legislation seeks to provide contractors with a degree of "security" analogous to the security of tenure implicit in a Crown harvesting licence, and to achieve greater fairness between the licence holder and its contractors.

3 In the case of the CCAA, the fairness analysis required to be carried out by the court generally refers to fairness as between classes of creditors. That analysis is tempered by the starker realities of whether the proposal before the court offers a chance of survival to the debtor corporation and whether it will be acceptable to the requisite majority of creditors. Unlike the detailed provisions of the *Forest Act* and regulations thereto, the CCAA is a brief set of "broad-brush" provisions that leave wide avenues of discretion to be exercised by courts in circumstances that may not permit the fine weighing of individual interests. As observed in *Keddy Motor Inns Ltd., Re* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.), at 258, the legislation contemplates "rough-

and-tumble negotiations between debtor companies desperately seeking a chance to survive and creditors willing to keep them afloat but on the best terms they can get."

4 The substantive question raised by this appeal is to what extent considerations of fairness between individual logging contractors who have replaceable contracts with a corporation in CCAA proceedings, should figure in the "rough-and-tumble" considerations applicable to a large corporate insolvency. Looked at another way, does the desirability of staving off a bankruptcy which could have disastrous consequences for many individuals, local governments and communities, supplant considerations of fairness between the holders of replaceable logging contracts to which the debtor corporation is a party?

FACTUAL BACKGROUND

5 The insolvent corporation in this case is Skeena Cellulose Inc. ("Skeena"). At all material times, it owned and operated a pulp mill and three sawmills, and held related forest tenures, mainly in north-western British Columbia. It was a large employer in that region and was one of the major manufacturers of bleached softwood kraft pulp in North America.

6 Skeena has experienced financial difficulties for many years. It underwent a financial restructuring under the CCAA in 1997. Although many of the positive results hoped for from that arrangement improved Skeena's long-term prospects, it appears that various other factors prevented full recovery. In August 2001, the Toronto-Dominion Bank demanded payment of more than $350,000,000 from Skeena and its subsidiaries, froze their operating lines and began to refuse to honour their cheques, including payroll cheques. Other creditors followed suit, and on September 5, 2001, Skeena and its subsidiaries petitioned the Supreme Court of British Columbia for a stay of proceedings under the CCAA.

7 The petition alleged, and it is not disputed, that Skeena owed over $409,000,000 (exclusive of interest) mainly to the Toronto-Dominion Bank and to corporations owned by the Province, which also held over 70 percent of its common shares. This debt was represented by bonds issued under a trust deed secured by charges on all of Skeena's assets, present and future. The petition stated that Skeena and its subsidiaries were insolvent and described the impact their bankruptcy could have on the provincial economy:

> 50. If the Petitioners were to totally cease operations or go into liquidation, the direct loss of jobs in British Columbia would be enormous, including the approximately 1,050 existing Skeena employees and, at least 1,000 employees of logging contractors, road building and silviculture contractors. It would also directly and indirectly impact service industries and business which rely on Skeena for a source of revenue. By the Petitioners' estimate, as many as 7,000 additional jobs in British Columbia would be affected.
>
> 51. A liquidation of the Petitioners would be particularly devastating to the communities of Terrace, South Hazelton, and Prince Rupert. Skeena is the largest employer in those communities, and many hundreds of families depend on Skeena for their livelihoods in those communities.
>
> 52. The loss of this number of jobs would also, of course, have a generally damaging effect on the British Columbia economy, given the spillover effect of lost wages and lost purchases.
>
> 53. Skeena is currently in good standing under its collective agreements and other employment relationships. However, if some or all of the employees would be terminated, severance claims, including payments for group termination under the Employment Standards Act, could be significant.

8 Chief Justice Brenner, who I understand heard most if not all the applications in this matter in Supreme Court, granted an initial order *ex parte* on September 5, 2001, staying proceedings against Skeena and its subsidiaries for 30 days and appointing Arthur Andersen Inc. as Monitor. On October 5, he granted a "Come-back Order" which extended the stay and contemplated that the petitioners would file a formal plan of compromise or arrangement (entitled the "Reorganization Plan") with their creditors on or before November 5; that they would file a formal plan of arrangement (entitled the "Plan of Arrangement") with their shareholders under the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44; and that meetings of their creditors would be called to vote on the Reorganization Plan. Under the heading "Post-Filing Operations", the Order stated:

11. The Petitioners shall remain in possession of the Assets and shall continue to carry on business in the ordinary course provided that they shall have the right with the approval of the Monitor, or this Court, to proceed with an orderly disposition of such of the Assets as they deem appropriate, either with the consent of any creditor holding security against such Assets or pursuant to an Order of this Court, in order to facilitate the downsizing and consolidation of their business and operations (the "Downsizing").

12. To facilitate the Downsizing, the Petitioners may:

(a) terminate the employment of such of the Petitioners' employees or temporarily lay off such of the Petitioners' employees as they deem appropriate;

(b) terminate such of the Petitioners' supplier or service arrangements or agreements as they deem appropriate;

(c) abandon such leases, tenures, contracts, rights, authorizations, franchises, dealerships, permits, approvals, uses or consents as are deemed to be unnecessary for the Petitioners' business; . . .

all without interference of any kind from third parties, including landlords and notwithstanding the provisions of any lease, other instrument or law affecting or limiting the rights of the Petitioners to remove or divest Assets from leased premises, and that any liabilities of the Petitioners arising as a result thereof shall be claims provable in these proceedings in the same manner as all creditor claims existing as at the Filing Date and provided that:

(f) the Monitor shall have submitted to the Court a report of any proposed termination of any Forest Act Replacement Contract under the foregoing sub-paragraph (b) at least 21 days before such plan is implemented;

(g) the implementation of any of the plans and procedures contemplated by the foregoing sub-paragraphs (a)-(d) including any termination or partial termination of any contract, shall be without prejudice to the claims of any counter party to such contract to file a proof of claim in such manner as may be provided for in the Reorganization Plan;

(h) the Petitioners shall provide 3 days' written notice of any termination of any executory agreements under the foregoing sub-paragraphs (b) or (c); and

(i) the counter party or parties to any agreements proposed by the Petitioners to be terminated in accordance with the foregoing, including the counter party or parties to any Forest Act Replacement Contracts, may during the applicable 3 day notice period, in the case of executory contracts, or within 21 days of the filing of the Monitor's report, in the case of the Forest Act Replacement Contracts, apply to the Court in this proceeding to show cause why such agreement or agreements should not be terminated or for such directions as to the termination of such agreements as may be appropriate. [Emphasis added.]

9 The deadline for the filing of the Reorganization Plan was extended by the Court on several occasions while solutions to Skeena's difficulties were sought and potential purchasers were pursued. Finally, on February 28, 2002, a Plan was filed which proposed that an outside buyer, NWBC Timber & Pulp Ltd. ("NWBC"), would acquire the interests of the secured lenders for $8,000,000. Of this, $2,000,000 would be paid to the Monitor for distribution to the unsecured creditors, so that the secured creditors would receive $6,000,000 on debt in excess of $400,000,000. The claims of governmental bodies for property taxes would be compromised, and the holders of existing common shares would surrender them for no consideration. Skeena would then issue new common shares to NWBC. The Plan was of course subject to many conditions, including approval by the specified classes of creditors and shareholders and the passing of applicable appeal periods in respect of the Court's order. After some amendments, the Plan was approved by the Court on April 4, 2002. Once the conditions contained in the Order were met, NWBC completed its purchase of the shares and secured debt of Skeena in early May.

The Appellants' Logging Contracts

10 The appellants or their predecessors had been performing logging services under contract with Skeena or its predecessors since the 1960s. In 1991, their contracts became "replaceable logging contracts" under new provisions of the *Forest Act*. At the time Skeena's financial difficulties became manifest in 2001, the corporation had five such contracts. All five were due to expire on December 31, 2001, and Skeena was required to offer replacement contracts to the contractors thereunder no later than September 30 of that year.

11 Skeena did not offer replacement contracts to the appellants, but did renew those of its three other logging contractors. Mr. Veniez, the president and chief executive officer of NWBC and Skeena following the Reorganization, explained this decision by reference, at least in part, to the fact that whereas the *Forest Act* scheme requires a licence holder to cut at least 50 percent of its allowable annual cut ("AAC") through replaceable contracts, Skeena had entered into such contracts for approximately 65 percent of its AAC. Moreover, the change in control of Skeena contemplated by the Reorganization would result in a five percent reduction of its AAC, absent a ruling to the contrary by the Ministry of Forests. Mr. Veniez deposed in these proceedings that:

> 17. As part of its efforts to ensure the economic viability of Skeena, NWBC determined, in consultation with Skeena management at the time, that it would be desirable to reduce the amount of timber required to be harvested under replaceable contracts to the current statutory minimum of 50% of Skeena's AAC.
>
> 18. Because NWBC's acquisition of Skeena represents a change of control, I knew that Skeena's Terrace Woodlands' AAC would be reduced by 5% to approximately 878,000 m^3. Therefore, in consultation with Skeena management, I determined that it would be appropriate to reduce the volume of timber allocated to evergreen contractors to 439,000 m^3, representing a reduction of approximately 160,000 m^3.
>
> 19. I was advised by Skeena management that, until the terminations of Clear Creek and Jasak, Skeena's five evergreen contractors held the following volumes:

Contractors	**Volume**
Don Hull & Sons	166,239 m{3}
K'Shian Logging	166,239 m{3}
Main Logging	99,828 m{3}
Clear Creek	83,331 m{3}
Jasak	83,331 m{3}

> 20. In consultation with Skeena management and the Province, NWBC determined that it would be appropriate to terminate the Clear Creek and Jasak contracts, representing a reduction of "evergreen" volume of approximately 166,662 m^3.
>
> 21. I recognize that by terminating these two contracts, Skeena will be slightly below the 50% allowable minimum under the Contract Regulation, but it is Skeena's intention to re-tender the approximately 6,000 m^3 difference in the form of a new evergreen contract. The approximately 160,000 m^3 balance will be tendered on the open market (as opposed to have to negotiate rates with its existing evergreen contractors). I expect that this tendering process will result in substantial savings to Skeena and significantly reduce its delivered wood costs for this 160,000 m^3. (If the cost differential is \$3.90/m^3, the savings could be as much as \$624,000 per year).
>
> 22. Moreover, a tendering process for this volume of wood will help to establish more accurate fair market values for both evergreen and non-evergreen contracts (in this regard, I am advised by Mr. Curtis that historically it has been difficult to establish these values in light of the predominance of evergreen contracts).
>
> 23. In deciding to terminate certain of Skeena's evergreen contracts, I reasoned that this would better allow Skeena to reorganise the size (volume) and equipment configurations for its different contracts. (Skeena does have the right to insist

> that its current evergreen contractors log by whatever methods Skeena stipulates, but historically it has been more cost-efficient for Skeena to introduce new logging methods via an open tendering process than by introducing changes to existing replaceable contracts).
>
> 24. Finally, I was advised by Skeena management that Clear Creek and Jasak had, historically, been more expensive than the three other evergreen contractors listed above. That is, through a combination of the rates charged by those two contractors, and their relative efficiency, the cost to Skeena of logs produced by Clear Creek and Jasak was greater than for the other three evergreen contractors above.
>
> 25. With the foregoing considerations in mind, I, on behalf of NWBC, advised Skeena's management at the time that NWBC would require, as a condition of going forward with the acquisition of Skeena, that Skeena take steps within the context of the CCAA proceedings to terminate the Clear Creek and Jasak contracts.
>
> 26. By asking Skeena to terminate those contracts, NWBC was in no way motivated to frustrate the objectives of the *Forest Act*. On the contrary, for the reasons set out above, NWBC perceives these terminations to be an important aspect of what I hope and fully expect will be a successful reorganization of Skeena. [Emphasis added.]

12 On or about March 1, 2002, each of the appellants received a letter from Skeena purporting to terminate its replaceable contract, effective immediately. Neither the Court nor the appellants had received prior notification from Skeena or the Monitor — even though under the terms of the Come-back Order, the Monitor was required to submit to the Court "a report of any proposed termination of any Forest Act Replacement Contract . . . at least 21 days before such plan is implemented" and even though within 21 days of the filing of the Monitor's report, the parties to such contracts were to be entitled to apply to the Court to "show cause why such agreement or agreements should not be terminated or for such directions as to the termination of such agreements as may be appropriate." Two weeks later, in its Eleventh Report to the Court, the Monitor referred to the terminations as *faits accomplis*:

> We have been advised that the petitioner has terminated replaceable logging contracts with Jasak Logging Ltd. and Clear Creek Contracting Ltd. in accordance with the Order. Copies of the letters of termination to each of the contractors dated March 4, 2002 and March 1, 2002, respectively are attached.
>
> These replaceable logging contracts have been terminated in accordance with the terms of the Purchase Agreement between NWBC Timber & Pulp Ltd., 552513 British Columbia Ltd. and Skeena Cellulose Inc. dated February 20, 2002.

13 It is not clear to me what "plan" was being referred to in subpara. 12(f) of the Come-back Order quoted above, nor whether it was necessary to "terminate" contracts that had not been renewed. On appeal, however, Skeena acknowledged that the Monitor's report had been filed two weeks after the termination letters were issued and that the "creditors' meeting to vote on the Plan took place before the 21-day time period referred to in the Come-back Order had expired." Thus counsel did not take issue with the Chief Justice's conclusion that Skeena had not complied strictly with the Come-back Order.

14 Upon receiving the letters of termination, the appellants' solicitors wrote to the Monitor's solicitors objecting that that the Come-back Order had not been complied with. They explained:

> Our clients are in a position where they cannot file proofs of claim on March 25 as their contracts are not terminated yet and they do not know if the contracts will be terminated and, if there is a termination, what class of creditor they will be. Due to the failure to deal with this matter in a timely fashion, it appears that the parties have no choice but to postpone the deadline for filing claims to the middle of April with a vote of creditors to take place in early May.

The appellants asked the Monitor for information as to how the termination would result in lower costs to Skeena and requested a copy of the contract of purchase between Skeena and NWBC. The Monitor declined to provide a copy of this agreement on the basis that it was confidential. The agreement was never adduced into evidence.

15 In further correspondence, Skeena characterized its earlier letters to the appellants as having "served to clarify that the previously expired contract with Jasak and Clear Creek <u>would not be reinstated</u>." (My emphasis.) Again, however, since that characterization of the letters was not pursued by counsel in this court or the court below, I will proceed on the footing that the contracts were terminated, as opposed to not having been renewed. (In law, the distinction in this case may be insignificant.) The appellants were told that if they wished to vote on Skeena's Reorganization Plan, they would have to file proofs of claim by March 22. At the same time, Skeena told the appellants it was prepared to discuss future arrangements with them "for the continuation of their services to Skeena."

16 By March 22, the appellants did file conditional proofs of claim in the CCAA proceeding, claiming indebtedness in the amount of $2,925,315.14 in the case of Jasak Logging Ltd., and $2,896,680 in the case of Clear Creek Contracting Ltd. (Mr. Forstrom advised us that these amounts represented the present value of the income stream which the appellants stood to earn under their contracts over the next 50 years or so. I understand that apart from these 'future' losses, nothing was owing by Skeena to the appellants under their expired contracts.) The Monitor disallowed a portion of each claim and instead allowed a claim of $172,430.47 to Jasak and $166,670 to Clear Creek. The appellants notified the Monitor that they disagreed with its position.

17 On March 28, Jasak and Clear Creek filed a motion in Supreme Court seeking an order restraining Skeena from terminating their contracts and declaring them "in full force and effect and are binding upon the parties thereto". Alternatively, they sought the summary determination of the value of their respective claims as creditors in Skeena's plan of arrangement. However, before the motion could be heard, the meeting of Skeena's creditors took place and the Reorganization Plan was approved by the requisite numbers of each class. The appellants did not attend or vote at the meeting. On April 4, 2002 Skeena applied for and obtained court approval of the Plan. As earlier mentioned, NWBC closed its purchase of the shares of Skeena in accordance with the Reorganization Plan in early May. We are told that it has not yet resumed its logging operations.

18 The appellants' motion to have the termination of their contracts declared invalid was heard in Chambers on June 17 and was dismissed by the Chief Justice on September 4, 2002. His reasons are now reported at (2002), 5 B.C.L.R. (4th) 193 (B.C. S.C.).

The Chief Justice's Reasons

19 After reciting the facts before him, the Chief Justice briefly summarized the purpose of the replaceable contract scheme and the nature of replaceable contracts. He noted that in Skeena's CCAA proceeding in 1997, Thackray J. (as he then was) had determined that the Court had the authority under the CCAA to allow Skeena to terminate replaceable logging contracts notwithstanding their unusual 'statutory' aspects. (See *Repap British Columbia Inc., Re* (June 11, 1997), Doc. Vancouver A970588 (B.C. S.C.).) Thackray J. had observed:

> I do not accept that allowing the petitioner to terminate renewable contracts is a striking down of the Provincial legislation. I mentioned several times to Mr. Ross that I could and do go so far as to find that there is legislat[ive] involvement in replaceable contracts under the *Forest Act*. However, I cannot accede to the position taken by Mr. Ross that these contracts attain some classification that makes them almost statutory contracts and thereby subject to some different rule of the law than general commercial contracts. There is no doubt that the parties are governed by the regulation and that the regulations forming part of the contract will govern many events by parties to the contracts. However the issue here is whether or not the contract is subject to the particular order that I gave under the *Companies' Creditors Arrangement Act*. I am of the opinion that it is subject to the order which I gave and that this Court had the jurisdiction to give that order. [para. 7]

20 The Chief Justice then turned to the questions of whether on <u>this</u> occasion, Skeena had complied with the "procedures and conditions" stipulated in the Come-back Order and whether the termination conformed to the "broader principles of economic necessity and fairness" underlying the Court's discretionary authority under the CCAA. In connection with the first question, he noted that the Come-back Order had authorized the termination of arrangements and agreements by Skeena only for the purpose of facilitating the "downsizing and consolidation of their business and operations (the 'Downsizing')". He noted the appellants' submission that although Skeena claimed to be "downsizing" its operations, it had maintained its timber harvesting

rights and was planning to continue to harvest timber from them, presumably to the extent it always had in the past. On the other hand, there was the fact that the change in control of Skeena would result in a five percent reduction of Skeena's AAC, which Skeena proposed to reflect in a reduction in volume of timber allocated to "evergreen" contractors by approximately 160,000 cubic metres. The Chief Justice concluded that this reduction qualified as "Downsizing" for purposes of the Come-back Order. This conclusion was not specifically challenged on appeal.

21 In response to the appellants' objection that Skeena had terminated their contracts without first filing a report of the Monitor, the Chief Justice agreed that the letters of termination had been "issued untimely". He concluded, however, that since the appellants had had "clear and unequivocal notice", prior to the creditors' meeting, of Skeena's intention to terminate their contracts and to treat their claims as compromised under the Plan, they had not been prejudiced by the lack of strict compliance. (para. 41.)

22 The remaining question framed by the Chief Justice was whether Skeena's termination of two of its five replaceable logging contracts constituted an "inappropriate differentiation of treatment between the applicants and other [Skeena] creditors." (para. 42.) He noted that one of the unfortunate results of insolvency restructurings is that some persons suffer hardship. In this case, Skeena had had to terminate the employment of many individuals, its unsecured and secured creditors stood to recoup only a small fraction of their claims, and the Court had already dismissed an application brought by the Pulp, Paper and Research Institute of Canada similar to that brought by the appellants. The Court noted the comments of LoVecchio J. in *Blue Range Resource Corp., Re*, [1999] A.J. No. 788 (Alta Q.B.), to the effect that an order authorizing the termination of a contract is appropriate in a restructuring since, like others dealing with the insolvent corporation, the contracting party will have its claim for damages. But that claim should not be elevated above those of other contracting parties; as LoVecchio J. had stated:

> 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 sympathise 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. [paras. 37-8]

23 Similarly in this case, the Chief Justice concluded that the applicants before him were "seeking to be put in a position superior to [Skeena's] other creditors." (para. 50.) In the result, since Thackray J. had already ruled that replaceable contracts could be terminated as part of a CCAA reorganization, and the appellants had had "full knowledge prior to the creditors' meetings that they would have claims under the Plan if their contracts were to be terminated", the Chief Justice saw no reason why the appellants should "in effect, be placed in a better position than other creditors." (para. 53.)

ON APPEAL

24 On appeal, the appellants challenged both the Court's ruling on the question of notice and its substantive ruling that the Come-back Order validly permitted Skeena to terminate the appellants' "evergreen" contracts. Since Mr. Forstrom, counsel for the appellants, focussed on the second argument in his oral submissions in this court — and rightly so in my view — I will deal with it first. It is linked to the argument made by the intervenor, the Truck Loggers' Association, which challenges the court's constitutional and statutory jurisdiction to "permit" Skeena to terminate <u>any</u> replaceable logging contracts, contrary to what Mr. Maclean says is the intention of the *Forest Act*. Mr. Maclean submits that this legislation must prevail over what he

characterized as the exercise of the court's "inherent jurisdiction" under the CCAA when the court approves an arrangement which includes the termination of a lease or other contract.

25 It may be useful at this point to review in greater depth the unusual scheme of replaceable contracts imposed by the *Forest Act*, and then to review the CCAA and the "inherent" or 'supervisory' jurisdiction exercised by the courts thereunder.

The Forest Act Scheme

26 The Province first introduced a regime of statutorily-mandated logging contracts in 1991. The initial legislation was revised somewhat in 1996 when the present Regulation 22/96 to the *Forest Act* was enacted. Speaking in the Legislative Assembly in June 1991, the then Minister of Forests stated that the purposes of the legislation were to "address logging-contractor security in British Columbia", to "improve the balance in . . . contractual relationships" between holders of timber rights and logging contractors, and to provide a quick and inexpensive system for resolving disputes between them. The Minister drew an analogy between the desire of long-term licence holders for security of tenure from the Crown, and the needs of logging contractors and subcontractors, who also make large capital investments in logging equipment, for similar security vis-à-vis the licence holders. Accordingly, the *Forest Amendment Act, 1991*, c. 11, permitted the imposition of a series of requirements on the holders of certain classes of timber licences with respect to logging contracts already in existence, and logging contracts entered into thereafter.

27 Most of the provisions relevant to this appeal are contained in Regulation 22/96. Part 2, headed "Written Contracts and Subcontracts Required", states that persons entering into a timber harvesting contract or subcontract must do so in writing. If the terms of a contract do not comply with the Regulation, the parties are required to make reasonable efforts to cause the contract to do so. Every "replaceable contract" (defined in s. 152 of the Act) must provide that the contractor's interest thereunder is assignable, subject to the consent of the licence holder, which consent may not be unreasonably withheld. As well, every contract must provide that all disputes between the parties in connection with the contract "will be referred to mediation and, if not resolved by the parties through mediation, will be referred to arbitration." (The Regulation leaves unsaid the apparent intention that neither party will have recourse to courts of law to resolve such disputes.) The *Commercial Arbitration Act*, R.S.B.C. 1996, c. 55, applies to such arbitrations, but there are also detailed rules in Regulation 22/96 for the mediation and arbitration proceedings and for the keeping of a publicly available "Register of Timber Harvesting Contract and Subcontract Arbitration Awards" by the Ministry of Forests.

28 Part 5 of the Regulation is headed "Replaceability of Contracts and Subcontracts". It requires that the holders of Crown licences carry out specified proportions of their timber harvesting operations by means of replaceable contracts. Different requirements apply to different classes of licence and to operations in the Coastal and Interior regions respectively. As I noted earlier, since Skeena operates in the Coastal region, it is required to harvest at least 50 percent of its timber by means of replaceable contracts.

29 Sections 13-15 of the Regulation deal with the commencement and expiration of replaceable contracts in the following terms:

> 13 (1) A replaceable contract must provide that
>
> > (a) if the contractor has satisfactorily performed its obligations under the contract, and conditional on the contractor continuing to satisfactorily perform the existing contract, <u>the licence holder must offer a replacement contract to the contractor</u>, and
> >
> > (b) the replacement contract must
> >
> > > (i) <u>be offered 3 months or more before the expiry of the contract being replaced</u>,
> > >
> > > (ii) provide that it commences on or before the expiry of the contract being replaced,

(iii) provide for payment to the contractor of amounts in respect of timber harvesting services as agreed to by the parties or, failing agreement, as determined under section 25, and

(iv) otherwise be on substantially the same terms and conditions as the contract it replaces.

(2) If a replaceable contract does not provide for an expiry date, the contract expires on the second anniversary of the date on which the contract commenced.

14(1) A replaceable contract must provide that, upon reasonable notice to the contractor, the licence holder may require, for bona fide business and operational reasons, that the contractor

(a) use different timber harvesting methods, technology or silvicultural systems,

(b) move into a new operating area, or

(c) undertake any other operating change necessary to comply with a direction made by a government agency or lawful obligation imposed by any federal, provincial or municipal government.

(2) A replaceable contract must provide that if a requirement made pursuant to subsection (1) results in a substantial change in the timber harvesting services provided by the contractor, <u>the contractor may, within 60 days of receiving notice under subsection (1), elect by notice in writing to the licence holder to terminate the replaceable contract</u> without incurring any liability to the licence holder.

(3) A replaceable contract must provide that, if a requirement is made pursuant to subsection (1) and the contractor does not elect to terminate the replaceable contract as provided for in subsection (2), either party may, within 90 days of the contractor receiving notice under subsection (1), request a review of the rate then in effect.

(4) If, after any changes in timber harvesting services required by the licence holder under subsection (1), the parties are unable to agree upon the rate to be paid for timber harvesting services, a rate dispute is deemed to exist.

15 A replaceable contract must provide that the contract terminates, to the extent that it relates to the licence, upon the cancellation, expiry or surrender of a licence under which the timber harvesting services provided by the contractor are carried out. [Emphasis added.]

30 The Regulation stipulates that if a dispute arises regarding the amount of work to be specified in a replaceable contract, the matter may be referred to arbitration under s. 24. The same is true of any dispute regarding the rates chargeable by the contractor for its work. The arbitrator must determine a rate that is reasonable and competitive by industry standards and which "would permit a contractor operating in a manner that is reasonably efficient in the circumstances in terms of costs and productivity to earn a reasonable profit."

31 Division 5 of the Regulation deals with reductions in work under a replaceable contract due to a reduction in AAC. If the Crown reduces the AAC under a harvesting licence, the holder "must apportion the effect of the reduction in AAC . . . proportionately among (i) all contractors holding replaceable contracts, and (ii) any company operations in respect of the licence." (s. 28(2)(d).) Alternatively, the holder may make a proposal either to reduce the AAC covered by one or more of its replaceable contracts or to terminate one or more such contracts. If the proposal is objected to by one or more of the affected contractors, a "dispute is deemed to exist" between the licence holder and the contractor(s). If not settled by mediation, this dispute must also be arbitrated in accordance with s. 32, which states in part:

(g) an arbitrator must resolve the dispute in the manner that the arbitrator believes most fairly takes into account <u>each of the AAC reduction criteria</u>; [and]

(h) for greater certainty, in making a decision with respect to the dispute

(i) an arbitrator is not restricted to choosing between any of the various AAC reduction proposals made by the parties to the arbitration, and

(ii) an arbitrator may make an award that includes the termination of one or more of the replaceable contracts, or reduces the amount of work available to any contractor or company operation in a manner that is not proportionate to the reduction in AAC. [Emphasis added.]

The Regulation defines the term "AAC reduction criteria" to mean each of the following factors:

(a) the amount of work specified in each replaceable contract to which the proposal relates;

(b) the relative seniority of each contractor with a replaceable contract;

(c) the economic impact of the proposal on the timber harvesting operations carried out under that licence by each contractor with a replaceable contract;

(d) the impact of the proposal on employment;

(e) the economic impact of the proposal on the licence holder; [and]

(f) the impact of the proposal on community stability; . . .

32 As Mr. Forstrom points out, then, the statutorily-mandated terms of replaceable logging contracts "tie" them in a sense to Crown licences themselves. A licence holder must carry out a specified percentage of its logging through contractors under replaceable contracts. If the AAC under the licence is reduced, the work committed to by the licence holder in its replaceable contracts may also be reduced. If the licence is cancelled or surrendered, any replaceable contract referable thereto also terminates. Mr. Forstrom and Mr. Maclean go further, however, and argue that the "tie" confers a "special status" on the contractor and that the status must be recognized in the event of a breach of the obligation to renew or continue the contract, and must be reflected in any CCAA arrangement. I will return below to these arguments.

The CCAA

33 Unlike the *Forest Act* and Regulation, the CCAA is very brief. It operates substantially through judge-made law interpreting and applying its 22 sections. For purposes of this appeal, the key ones are the following:

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

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

* * *

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

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

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

* * *

11. (1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

(2) An application made for the first time under this section in respect of a company, in this section referred to as an "initial application", shall be accompanied by a statement indicating the projected cash flow of the company and copies of all financial statements, audited or unaudited, prepared during the year prior to the application, or where no such statements were prepared in the prior year, a copy of the most recent such statement.

(3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days,

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

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

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

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

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

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

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

. . . . .

(6) The court shall not make an order under subsection (3) or (4) unless

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

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

34 There is now a large body of judge-made law which "fills the gaps" between these provisions. Most notably, courts appear to have given full effect to the "broad public policy objectives" of the Act, which in the phrase of a venerable article on the topic (Stanley E. Edwards, "Reorganizations under the Companies' Creditors Arrangement Act", (1947) 25 *Can. Bar Rev.* 587) are to

"keep the company going despite insolvency" for the benefit of creditors, shareholders and others who depend on the debtor's continued viability for their economic success. As the author commented:

> Hon. C.H. Cahan when he introduced the bill into the House of Commons indicated that it was designed to permit a corporation through reorganization to continue its business, and thereby to prevent its organization being disrupted and its goodwill lost. It may be that the main value of the assets of a company is derived from their being fitted together into one system and that individually they are worth little. The trade connections associated with the system and held by the management may also be valuable. In the case of a large company it is probable that no buyer can be found who would be able and willing to buy the enterprise as a whole and pay its going concern value. The alternative to reorganization then is often the sale of the property piecemeal for an amount which would yield little satisfaction to the creditors and none at all to the shareholders.
>
> Reorganization may give to those who have a financial stake in the company an opportunity to salvage its intangible assets. To accomplish this they must ordinarily give up some of their nominal rights, in order to keep the enterprise going until business is better or defects in the management can be remedied. This object may be furthered by providing in the reorganization plan for such matters as a shift in control of the company or reduction of the fixed charges to such a degree as to make it possible to raise new money through new issues of bonds or shares. It may therefore be in the interest of all parties concerned to give up their claims against an insolvent company in exchange for new securities of lower nominal amount and later maturity date.
>
> *Public Interest*
>
> Another reason which is usually operative in favour of reorganization is the interest of the public in the continuation of the enterprise, particularly if the company supplies commodities or services that are necessary or desirable to large numbers of consumers, or if it employs large numbers of workers who would be thrown out of employment by its liquidation. This public interest may be reflected in the decisions of the creditors and shareholders of the company and is undoubtedly a factor which a court would wish to consider in deciding whether to sanction an arrangement under the C.C.A.A. [at 592-3]

(See also Duff, C.J.C. in *Reference re Companies' Creditors Arrangement Act (Canada)* [1934] S.C.R. 659 (S.C.C.).)

35 In accordance with these objectives, Canadian courts have adopted a "standard of liberal construction" that serves the interests of a "broad constituency of investors, creditors and employees" and reflects "diverse societal interests." (See *Smoky River Coal Ltd., Re* (1999), 175 D.L.R. (4th) 703 (Alta. C.A.), at 721-2.) In *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.), for example, this court held that security granted under s. 178 of the *Bank Act* was not exempt from the CCAA provisions applicable to "security" and secured creditors, since otherwise a single creditor (in that case, a bank) could frustrate the objectives of the statute. Gibbs J.A. observed:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. It is available to any company incorporated in Canada with assets or business activities in Canada that is not a bank, a railway company, a telegraph company, an insurance company, a trust company, or a loan company. When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.
>
> There is nothing in the C.C.A.A. which exempts any creditors of a debtor company from its provisions. The all encompassing scope of the Act qua creditors is even underscored by s. 8 which negates any contracting out provisions in a security instrument. And Chef Ready emphasizes the obvious, that if it had been intended that s. 178 security or the holders of s. 178 security be exempt from the C.C.A.A. it would have been a simple matter to say so. [at 88-9]

36 In connection with other "priority" issues — the power to grant priority to persons advancing debtor-in-possession ("DIP") financing and to the Monitor for the payment of its fees and disbursements before the payment of secured creditors — this court has called in aid Equity's ability to adapt to changing circumstances in order to achieve the objectives of the statute. In *United Used Auto & Truck Parts Ltd., Re* (2000), 16 C.B.R. (4th) 141 (B.C. C.A.), this court declined to follow an earlier case in which the Ontario Court of Appeal had ruled that the receiver of a partnership had no authority to subordinate the interests of secured creditors to liability for the receiver's disbursements, unless one of three exceptions applied. (See *Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd.* (1975), 21 C.B.R. (N.S.) 201 (Ont. C.A.).) Mackenzie J.A. commented:

> Houlden J.A. stated that these three exceptions were not exhaustive. Nonetheless the *Kowal* statement of exceptions has been influential in subsequent cases and they were applied by this Court in *Lochson Holdings Ltd. v. Eaton Mechanical Inc.* (1984), 55 B.C.L.R. 54 (C.A.). But as Macdonald J. observed in *Westar Mining*, supra at 93-94, different considerations apply under the *CCAA*. The court is concerned with the survival of the debtor company long enough to present a plan of reorganization. That is a broader interest than that of creditors alone. The jurisdiction must expand from the *Kowal* exceptions to serve that broader interest.
>
> Thus the receivers' jurisdiction and the monitors' jurisdiction are analogous to the extent that they are both rooted in equity but they diverge to the extent that the monitors' jurisdiction serves a broader statutory objective under the *CCAA*. In my opinion the jurisdiction under the *CCAA* cannot be restricted to the *Kowal* exceptions. [paras. 21-22; emphasis added.]

In conclusion, he stated:

> In my opinion, an equitable jurisdiction is available to support the monitor which is sufficiently flexible to be adapted to the monitor's role under the *CCAA*. It is a time honoured function of equity to adapt to new exigencies. At the same time it should not be overlooked that costs of administration and DIP financing can erode the security of creditors and *CCAA* orders should only be made if there is a reasonable prospect of a successful restructuring. That determination is largely a matter of judgement for the judge at first instance and appellate courts normally will be slow to interfere with an exercise of discretion.
>
> In my opinion, super-priority for DIP financing rests on the same jurisdictional foundation in equity. Priority for the reasonable restructuring fees and disbursements could have been allowed as part of DIP financing. It is immaterial that they have been allowed here as part of the administration charge. [paras. 30-31; emphasis added.]

(I understand that leave to appeal *United Used Auto & Truck Parts Ltd.* was granted by the Supreme Court of Canada [*United Used Auto & Truck Parts Ltd., Re*, 2000 CarswellBC 2132 (S.C.C.)], but that the case settled before the appeal was heard.)

37 In the exercise of their 'broad discretion' under the CCAA, it has now become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights. Most notably, in *Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]), Farley J. followed several other cases in holding that in "filling in the gaps" of the CCAA, a court may sanction a plan of arrangement that includes the termination of leases to which the debtor is a party. (See also the cases cited in *Dylex*, at para. 8; *Re T. Eaton Co.* (1999), 14 C.B.R. (4th) 288 (Ont. S.C.), at 293-4; *Smoky River Coal Ltd.*; *supra*, and *Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.), at para. 13.) In the latter case, R.A. Blair J. said he saw nothing in principle that precluded a court from "interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices." In its recent judgment in *Mine Jeffrey inc., Re*, [2003] Q.J. No. 264 (Que. C.A.), the Quebec Court of Appeal observed that "A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings under s. 11." (para. 74.)

38 But in approving and implementing compromises and arrangements under the statute, courts are concerned with more than the efficacy of the plans before them and their acceptability to creditors. Courts also strive to ensure fairness as between the unsecured, secured and preferred creditors of the corporation and as between the debtor and its creditors generally. In the article from which I have already quoted, Stanley Edwards also wrote:

> In addition to being feasible, <u>a reorganization plan should be fair and equitable as between the parties</u>. In order to make the Act workable it has been necessary to permit a majority of each class, with court approval, to bind the minority to the terms of an arrangement. This provision is justified as a precaution that minorities should not be permitted to block or unduly delay the reorganization for reasons that are not common to other members of the same class of creditors or shareholders, or are contrary to the public interest. If small groups are placed in too strong a position they become capable of acquiring a nuisance value which will make it necessary for the reorganizers to buy them off at a high price in order to effectuate the plan successfully. However, <u>care should be taken that this statutory power of binding minorities should not be utilized to confiscate the legitimate claims of those minorities or of any class of creditors or shareholders</u>. [at 595; emphasis added.]

39 This theme has been repeated and refined in various cases over the years as CCAA courts have struggled with increasingly complex forms of debt and security and with increasingly complicated plans of arrangement. In current terms, the principle of equity is expressed as a concern to see that a plan of arrangement is fair and reasonable and represents an attempt to "balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights". (*Per* Farley J. in *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]), at 173.) Elsewhere, it has been said that one measure of what is "fair and reasonable" is the "extent to which the proposed Plan treats creditors equally in their opportunities to recover, consistent with their security rights, and whether it does so in a non-intrusive and as non-prejudicial a manner as possible." (*Per* Blair J. in *Olympia & York Developments Ltd.* (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.), at 513.) At the same time, fairness and reasonableness are not "abstract notions, but must be measured against the available commercial alternative." Thus in *Canadian Airlines Corp., Re*, [2000] A.J. No. 771, [2000] 10 W.W.R. 269 (Alta. Q.B.), the Court summarized the interaction between the objectives of a CCAA arrangement and the principles of fairness and reasonableness as follows:

> In determining whether to sanction a plan of arrangement under the CCAA, the court is guided by two fundamental concepts: "fairness" and "reasonableness". While these concepts are always at the heart of the court's exercise of its discretion, their meanings are necessarily shaped by the unique circumstances of each case, within the context of the Act and accordingly can be difficult to distill and challenging to apply. Blair J. described these concepts in *Olympia and York Dev. Ltd. v. Royal Trust Co.*, *supra*, at page 9:
>
>> "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction - although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise an exercise in equity - and "reasonableness" is what lends objectivity to the process.
>
> The legislation, while conferring broad discretion on the court, offers little guidance. However, the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and, in many instances, a much broader constituency of affected persons. Parliament has recognized that reorganization, if commercially feasible, is in most cases preferable, economically and socially, to liquidation: *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, [1989] 2 W.W.R. 566 at 574 (Alta. Q.B.); *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, [1989] 3 W.W.R. 363 at 368 (B.C.C.A.).
>
> The sanction of the court of a creditor-approved plan is not to be considered as a rubber stamp process. Although the majority vote that brings the plan to a sanction hearing plays a significant role in the court's assessment, the court will consider other matters as are appropriate in light of its discretion. In the unique circumstances of this case, it is appropriate to consider a number of additional matters:
>
>> a. The composition of the unsecured vote;
>>
>> b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;
>>
>> c. Alternatives available to the Plan and bankruptcy;

d. Oppression;

e. Unfairness to Shareholders of [the debtor]; and

f. The public interest. [paras. 94-96]

40 Of course, there are also statutory and constitutional limitations on the court's exercise of its authority under the CCAA. The Supreme Court of Canada's decision in *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.* (1975), [1976] 2 S.C.R. 475 (S.C.C.) confirmed that it is beyond the authority of a CCAA court to provide for a priority that runs contrary to the express terms of a statute (in that case, the *Mechanics Lien Act* of Manitoba.) Thus in *Baxter*, the fact that the provincial legislation created a lien having priority over "all judgments, executions, assignments, attachments, garnishments and receiving orders", precluded an order granting CMHC priority for new advances over and above all prior registered liens. Dickson J. (as he then was) stated for the Court:

> . . . the inherent jurisdiction of the Court of Queen's Bench is not such as to empower a judge of that Court to make an order negating the unambiguous expression of the legislative will. The effect of the order made in this case was to alter the statutory priorities <u>which a Court simply cannot do</u>. [at 480; emphasis added.]

41 *Baxter* continues to be applied today: see *Royal Oak Mines Inc., Re* (1999), 7 C.B.R. (4th) 293 (Ont. Gen. Div. [Commercial List]) and *Westar Mining Ltd., Re* (1992), 70 B.C.L.R. (2d) 6 (B.C. S.C.). However, the Court in *United Used Auto & Truck Parts Ltd.* distinguished *Baxter* on the basis that the former did not involve an express statutory priority that could not be overcome by the Court's equitable jurisdiction. Mackenzie J.A. noted that the receiver's jurisdiction originates in the "equitable jurisdiction of the Court of Chancery and [that] while that jurisdiction cannot be exercised contrary to a statute, nothing precludes its exercise to supplement a statute and effect a statutory object." (para. 18.)

42 It may be unnecessary to add that in cases of direct or express conflict between the CCAA itself and a provincial statute, the doctrine of paramountcy would apply and the federal statute would prevail. The only case brought to our attention which, on its face at least, applied the doctrine of paramountcy in the CCAA context was *Sulphur Corp. of Canada Ltd., Re*, [2002] A.J. No. 918 (Alta. Q.B.). In addressing the question of whether the Court had the authority to permit DIP financing ranking in priority to liens registered under the *Builders' Lien Act* of British Columbia, LoVecchio J. distinguished *Baxter* and *Royal Oak Mines Inc.*, *supra*, on the basis that the discretion to grant priority for DIP financing was grounded in s. 11 of the CCAA rather than purely in the court's inherent jurisdiction. (This, at least, is what I draw from the Court's comments at paras. 35-37.) Seeing the case before him as involving a conflict between a federal <u>statute</u> and a provincial <u>statute</u>, LoVecchio J. ruled that the former prevailed and that in exercising its jurisdiction under the CCAA, the Court could grant priority for DIP financing. (See also *Pacific National Lease Holding Corp. v. Sun Life Trust Co.* (1995), 10 B.C.L.R. (3d) 62 (B.C. C.A.).)

The Issues in this Case

43 Against this background, I turn at last to the substantive questions raised by the intervenor and the appellants respectively — did the Chambers judge have the jurisdiction to include in the Come-back Order provisions which contemplated the termination of <u>any</u> replaceable logging contracts; and if so, did he err by failing to consider whether the appellants would be treated fairly in relation to Skeena's other replaceable contractors or by failing to consider whether the termination of the appellants' contracts was, in their words, "a necessary or justifiable part of [Skeena's] reorganization plan at all"?

Jurisdiction

44 On behalf of the Truck Loggers' Association, Mr. Maclean contended that the Chambers judge had strayed outside his jurisdiction because nothing in s. 11 of the CCAA (which permits the granting of a stay) extends to the termination of a contract. On this view, any authority to sanction a termination must originate not in the statute, but in the Court's inherent jurisdiction. Based on the authority of *Baxter*, *Royal Oak Mines Inc.* and *Westar Mining Ltd.*, the intervenor submits that the court's inherent jurisdiction cannot be used to override legislation such as the *Forest Act* and Regulation 22/96.

45 It is true that in "filling in the gaps" or "putting flesh on the bones" of the CCAA — for example, by approving arrangements which contemplate the termination of binding contracts or leases — courts have often purported to rely on their "inherent jurisdiction". Farley J. did so in *Dylex*, for example, at para. 8, and in *Royal Oak Mines Inc.*, *supra*, at para. 4, the latter in connection with the granting of a "superpriority"; and Macdonald J. did so in *Westar Mining Ltd.*, *supra*, at 8 and 13. The court's use of the term "inherent jurisdiction" is certainly understandable in connection with a statute that confers broad jurisdiction with few specific limitations. But if one examines the strict meaning of "inherent jurisdiction", it appears that in many of the cases discussed above, the courts have been exercising a discretion given by the CCAA rather than their inherent jurisdiction. In his seminal article, "The Inherent Jurisdiction of the Court", (1970) 23 *Current Legal Problems*, Sir J.H. Jacob, Q.C., writes that the inherent jurisdiction of a superior court of law is "that which enables it to fulfill itself as a court of law." The author explains:

> On what basis did the superior courts exercise their powers to punish for contempt and to prevent abuse of process by summary proceedings instead of by the ordinary course of trial and verdict? The answer is, that the jurisdiction to exercise these powers was <u>derived, not from any statute or rule of law, but from the very nature of the court as a superior court of law, and for this reason such jurisdiction has been called "inherent."</u> This description has been criticized as being "metaphysical," but I think nevertheless it is apt to describe the quality of this jurisdiction. For the essential character of a superior court of law necessarily involves that it should be invested with <u>the power to maintain its authority and to prevent its process being obstructed and abused</u>. Such a power is intrinsic in a superior court; it is its very life-blood, its very essence, its immanent attribute. Without such a power, the court would have form but would lack substance. . . . The juridical basis of this jurisdiction is therefore <u>the authority of the judiciary to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner</u>. [at 27-28; emphasis added]

The author also notes that unlike inherent jurisdiction, the source of statutory jurisdiction "is of course the statute itself, which will define the limits within which such jurisdiction is to be exercised, whereas the source of inherent jurisdiction of the court is derived from its nature as a court of law, so that the limits of such jurisdiction are not easy to define, and indeed appear to elude definition." (at 24.)

46 Applying this distinction to the issue at hand, I think the preferable view is that when a court approves a plan of arrangement under the CCAA which contemplates that one or more binding contracts will be terminated by the debtor corporation, the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it <u>by the CCAA</u>. (As to the meaning of "discretion" in this context, see S. Waddams, "Judicial Discretion", (2001) 1 *Cmnwth. L.J.* 59.) This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above, rather than the integrity of their own process.

47 In saying this, I leave to one side the jurisdiction of the court to make special provision for the payment of the fees and expenses of a monitor appointed under the CCAA. The monitor's functions are of course analogous to those of a receiver — traditionally a creature of Equity. I suspect that this particular power may be properly described as both an equitable jurisdiction and a statutory discretion. As this court said in *United Used Auto*, nothing precludes the exercise of the equitable jurisdiction of the Court of Chancery to "supplement a statute and effect a statutory object." (para. 18.) In any event, the distinction between these two sources of authority is one that, in my mind at least, 'eludes definition'.

48 Returning, then, to the intervenor's argument, the first question posed by it must in my view be revised to whether the Chief Justice erred in purporting to exercise the <u>statutory discretion</u> given by the CCAA in a manner that conflicts with the *Forest Act*. But the second branch of the question also incorporates an assumption that is problematic. Can it be said that the Come-back Order conflicts with the *Forest Act* or the scheme created thereby? It is true that the Act and Regulation contemplate a perpetual series of contracts (provided the contractor fulfils its obligations thereunder) and contemplate the termination of a replaceable contract only in the event of a reduction in AAC or the expiration or surrender of the licence. But nothing in the legislation to which we were referred purports to <u>invalidate</u> a termination of a replaceable logging contract by the licence holder or to require that a court make an order for specific performance in the event of such a termination. (In a CCAA context, such

an order would be very unlikely, as well as futile.) The licence holder will of course be liable in damages for breach of contract, giving rise to a "claim" against the debtor corporation under the CCAA. The licence holder may also be in breach of one or more of its obligations under the Act; but ultimately, a logging contract is still a "contract" at law, notwithstanding that many of its terms are dictated by the legislation for the protection and security of the contractor.

49 Thus I disagree with the intervenor's assertion that the effect of the Come-back Order was to "eliminate" the licence holder's "statutory obligation under the *Forest Act* to replace the contract and to eliminate the other conditions that are required by the Regulation to be included in the contract." In fact, the renewal of the appellants' contracts was not required by the Act *per se*; what the Act required was that each of their contracts contain a clause requiring renewal. It was those contractual terms which were breached. The licence holder's obligations, mandated by the scheme, were not "eliminated" by the Come-back Order or even by Skeena: having been breached, the obligations are recognized as giving rise to claims against the corporation either for specific performance or for damages.

50 It follows in my view that in approving an arrangement in which the debtor corporation terminates a replaceable logging contract, a CCAA court is not overriding "provincial legislation" as the intervenor contends. Nor is the court "overriding" the terms of the contract: it is merely exercising the discretion given to it by the statute to approve a plan of arrangement. The breach of contract is recognized as a matter of fact by the court, but is not "permitted" in the sense that the licence holder is somehow immunized from the usual consequences of its breach at law or in Equity. Finally, even if the *Forest Act* or Regulation did prohibit the termination of replaceable contracts, the federal government's powers with respect to bankruptcy and insolvency would become applicable once the CCAA was invoked and the doctrine of paramountcy would operate to resolve any direct conflict.

The Exercise of the Court's Discretion

51 The appellants and the intervenor argued that even if the Court did have the authority to grant the Come-back Order on the terms it did, the Chief Justice erred in failing to exercise his discretion so as to achieve "fairness" between the appellants and Skeena's three other logging contractors, whose contracts were, in theory at least, unaffected by the Reorganization Plan. As I mentioned earlier, both the appellants and the intervenor contend that contractors under replaceable contracts have "special status" as persons entitled to share in the benefits of a Crown resource (timber) and that the *Forest Act* scheme is predicated on fairness between them, and between them and the holders of Crown licences. They note that the Chief Justice referred in his "fairness" analysis only to the question of whether the Order differentiated inappropriately "between the applicants and other [Skeena] creditors" and made no reference to fairness as between the appellants and the other three contractors or as between the appellants and Skeena itself. In Mr. Forstrom's submission, it is unfair that his clients should suffer the loss of their very significant income streams under the replaceable contracts when the other three contractors will suffer no such loss, and when the licence holder itself suffers only the loss of five percent of its AAC under the *Forest Act*. (In fact, it is possible the Minister may revoke that reduction upon application by Skeena under s. 56.1 of the Act.) In essence, the argument of the appellants is "Why us?"

52 It is trite law that the scope of review open to an appellate court in respect of the exercise of discretion of a CCAA court (or any other court) is narrow. In *Pacific National Lease Holding Corp., Re* (1992), 72 B.C.L.R. (2d) 368 (B.C. C.A. [In Chambers]), Macfarlane J.A. (in Chambers) observed that this court should exercise its powers "sparingly" when asked to intervene in this context. In his words:

> In supervising a proceeding under the C.C.A.A. orders are made, and orders are varied as changing circumstances require. . . . In that context appellate proceedings may well upset the balance, and delay or frustrate the process under the C.C.A.A. [para. 32]

Macfarlane J.A.'s comments were echoed by the Alberta Court of Appeal in *Smoky River Coal*, *supra*, where Hunt J.A. noted at para. 61 that ". . . Parliament, mindful that CCAA cases often require quick decision-making, intended that most decisions be made by the supervising judge. This supports the view that those decisions should be interfered with only in clear cases."

53 Another principle informing the court's task flows from the fact that a plan of arrangement approved by the court is not the plan of the court. It is a compromise arrived at by the debtor company and the requisite number of its creditors. The court should not readily interfere with their business decision, especially where the plan has been approved by a high percentage of creditors. As observed by Blair J. in *Re Olympia & York*, *supra*, "[I]t is not my function to second guess the business people with respect to the 'business' aspects of the Plan, descending into the negotiating arena and substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas." (at 510.) (See also *Sammi Atlas Inc., Re*, *supra*, at para. 5, and *Northland Properties Ltd., Re* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), at 205, *per* McEachern C.J.B.C.)

54 In this case, the chief executive officer of NWBC and Skeena provided the Chambers judge below with an explanation as to why they chose to reduce the volume of timber allocated to Skeena's evergreen contractors, and why they chose to terminate the contracts of the appellants rather than to terminate all five contracts or reduce the work allocated to all five. I have already mentioned Mr. Veniez's affidavit evidence (see para. 11 above) that the cost to Skeena of logs produced by each of the appellants was greater than those produced by the other three contractors and that NWBC made it a "condition of going forward with the acquisition of Skeena, that Skeena take steps within the context of the CCAA proceedings to terminate the Clear Creek and Jasak contracts."

55 In this court, Mr. Forstrom asked us to discount Mr. Veniez's evidence, contending that since the appellants' objections to the Come-Back Order had been known to NWBC when it completed its purchase of the Skeena shares, NWBC must be taken to have effectively "waived" this condition. I am not persuaded that such an inference necessarily follows from NWBC's completion of the Plan. At that time, the Come-back Order clearly authorized the termination of replaceable logging contracts, and the validity of a similar order had been upheld by Thackray J. in 1997. It may be that in deciding to proceed, NWBC undertook a risk that the appellants would be successful either before the Chief Justice or on appeal, but we have no evidence as to what concessions NWBC may have obtained to protect against that risk.

56 As for the argument that the appellants' contracts were no less costly to Skeena than those of the other three contractors (since the rates chargeable under all five contracts were subject to arbitration), Mr. Veniez deposed:

> 13. I acknowledge that the Contract Regulation dictates that any rates determined according to this process must be determined according to what a licence-holder and a contractor acting reasonably in similar circumstances would agree is a rate that is competitive by industry standards. However, this provides little comfort to licence-holders such as Skeena, because ultimately rates under the Contract Regulation are determined on a cost-plus reasonable profit for replaceable contractors basis which, in my view, acts as a significant disincentive for replaceable contractors to be cost effective on an ongoing basis.
>
> 14. On the contrary, the Contract Regulation in my view creates a legislated disincentive for evergreen contractors to control their cost structures, because volumes under these contracts are guaranteed. This results in high costs being passed on to Skeena.
>
> 15. Prior to NWBC's acquisition of Skeena, and the termination of the replaceable contract that has given rise to this application, I was advised that Skeena, on average, paid approximately 10% more for work done under replaceable contracts than work done pursuant to contracts issued after a competitive bid process. Indeed, I am advised by Derrick Curtis, Skeena's Terrace Woodland's Manager, that in March 2001 Skeena put out to tender a harvesting contract (Setting S83303), consisting of roughly 20,000 m^3, and received tenders from both evergreen and non-evergreen contractors. The latter offered significantly lower rates (\$23.95/m^3 vs. \$27.85/m^3, a difference of \$3.90/m^3), resulting in a 14% reduction in costs to Skeena. [Emphasis added.]

57 There was, then, a "business case" for the actions taken by Skeena and NWBC vis-à-vis the appellants. Clear Creek and Jasak did not apply to cross-examine Mr. Veniez on this evidence, and did not bring anything to our attention which would cast doubt on his statements. In these circumstances, the Chambers judge was entitled to take seriously the assertion that the

termination of the appellants' contracts would save Skeena a considerable sum per year and that that fact was important to the only purchaser willing to make an offer acceptable to the requisite number of creditors. In the terminology used by Mr. Forstrom, there was a "causal link" between the terminations and the chances of success of the Reorganization Plan. For this reason, I do not agree with his submission that *Dylex* is different in principle from the case at bar: the appellants' contracts in particular were said to be too costly for Skeena to continue operating under them, in the same way the terminated leases were said to be too costly for Dylex to continue leasing under them. And, weighing Dylex's precarious financial position against that of the landlord (which was described as "less than robust"), the Court 'gave the nod' to the insolvent corporation, rejecting the proposition that Dylex should have to prove that without the three proposed closures (of leases), its proposal would not be viable. (*supra*, para. 10.)

58 In this case, the appellants deposed that the evergreen contracts were important to them, particularly for financing purposes. Mr. Rigsby, the controller of Clear Creek, for example, deposed:

> 26. Clear Creek requires its Replaceable Contract in order to obtain financing for capital costs. Lending institutions require that Clear Creek has a replaceable contract when considering lending money to, or financing equipment for, Clear Creek. Within the logging industry, it is very difficult to obtain financing without the security of a replaceable contract.
>
> . . . . .
>
> 30. Clear Creek remains capable of properly capitalising itself, and maintaining its own equipment and other capital investments in good working order, provided that it has a replaceable contract. If Clear Creek's replaceable contract remains in place, Clear Creek will be able to provide competitive, cost-effective, and efficient services and rates to [Skeena] . . . .

59 This evidence brings us squarely to the question of fairness. As already noted, for purposes of the CCAA, the court must be satisfied that the arrangement proposed is "fair, reasonable and equitable." Courts have made it clear that "equity" is not necessarily "equality"; in the words of Farley J. in *Sammi Atlas Inc., Re*:

> A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment. One must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights . . . . [para. 4]

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 in 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 $400,000,000 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. As the Chief Justice noted, many individuals and corporations, as well as the Province, incurred major losses under the Plan. Each of them might also ask "Why me?" However, as he also noted, that is a frequent and unfortunate fact of life in CCAA cases, where the only "upside" is the possibility that bankruptcy and even greater losses will be averted.

61 As has been seen, the purchaser required as a condition of proceeding with the Reorganization Plan that the appellants' contracts be terminated. In the absence of evidence that Skeena or the purchaser was motivated by anything other than a desire to improve the debtor corporation's financial prospects for survival post-arrangement, it cannot in my view be said that the

Chambers judge erred in ruling that the termination of the appellants' replaceable contracts was a valid part of the Reorganization Plan in this case.

Procedural Question

62 The second ground of appeal advanced by the appellants was that since Skeena had failed to comply strictly with the requirements of the Come-back Order in relation to the termination of their contracts, the terminations were null and void. In response to the Chief Justice's conclusion that the appellants had not been prejudiced by the failure to give timely notice, the appellants submitted that the terminations could not have been effective until 21 days after they received the Monitor's Eleventh Report. In the meantime, the creditors' meeting took place. The appellants contend that since there was uncertainty as to whether their contracts had been validly terminated or would be terminated, it was unclear whether they were entitled to vote at the meeting. Accordingly, they submit that they:

> . . . were effectively disenfranchised in the *CCAA* proceeding. The Come-Back Order contemplates that the effectiveness of any proposed termination of a replaceable logging contract will be determined in a timely way, before the Plan of reorganisation is submitted to the creditors for approval. By failing to give proper notice, [Skeena] created uncertainty about both when and if the Appellants' contracts would be terminated. The Appellants were only entitled to vote in relation to the Plan if they acknowledged that the termination of their contracts was effective when the initial (and clearly invalid) notice was given on March 1, 2002.
>
> This placed the Appellants on the horns of a dilemma. Had the Appellants exercised the right to vote on April 2,2002, based on the premise that their contracts had been terminated, they would be guilty of approbation and reprobation in relation to their position that no valid notice of termination had yet been given and that their contracts remains in force. [Skeena] structured the approval process in such a way that the Appellants would effectively be required to waive their right to proper notice of termination under the Come-Back Order in order to vote on the Plan.

63 In response, Skeena emphasizes that the appellants did file proofs of claim with the Monitor prior to the creditors' meeting. Skeena says the Chief Justice was correct in concluding that the appellants were not prejudiced in fact, since if it is ultimately determined that the replaceable logging contracts were not validly terminated, the appellants will be free to withdraw their proofs of claim; and if the contracts were validly terminated, the appellants will share *pro rata* under the Plan with Skeena's other unsecured creditors once the amounts of all claims have been finally determined.

64 As for the proposition that the appellants could not both reprobate and approbate, Skeena notes that "conditional voting" was permitted by the Monitor in light of the time pressures attendant upon the approval of the Plan. These led the Monitor to allow voting even by those claimants whose claims it had disallowed. The Monitor noted their particular ballots as "objected to" in case the votes cast by them ultimately had an impact on the outcome of the vote for the applicable class. Mr. Zuk, the chair and claims officer for the meeting, deposed that even if all of the disallowed claims were reversed and the appellants' votes were counted, the result would not have been affected. This statement was not challenged by the appellants.

65 In these circumstances, I cannot agree with the appellants that the delay in their receipt of notice of the terminations of their contracts and the delay in the processing of their proofs of claim were prejudicial to them. It is certainly unfortunate that these delays occurred, but there is no evidence (as opposed to speculation) that the delays were the result of bad faith or deliberate omission. On the other hand, the appellants could have had little doubt that they faced major difficulties once the initial CCAA order was granted (September 5, 2001) and once the "replacement" deadline of September 30 passed. Ultimately, the effect of the delay in their receipt of formal notice made no difference to the appellants' position and did not influence the approval of the Reorganization Plan one way or the other, especially given the small amount allowed by the Monitor in respect of the appellants' claims in relation to Skeena's indebtedness. The appellants chose not to attend the meeting and not to vote, even on a conditional basis. In these circumstances, the Chief Justice correctly recognized that, as stated by Rowles J.A. for the Court in *Cam-Net Communications v. Vancouver Telephone Co.* (1999), 71 B.C.L.R. (3d) 226 (B.C. C.A.), a supervising court under the CCAA must be alert to the incentive for creditors to "avoid the reorganization compromise" and must "scrutinize carefully any action by a creditor which would have the effect of giving it an advantage over the general body of creditors." (para. 20.)

66 Moreover, the arguments which the appellants would have made at the show cause hearing have now been made in the Supreme Court and in this court. If my analysis is correct, they would have failed even if the Court's approval of the Reorganization Plan had been delayed in accordance with the apparent intent of the Come-back Order.

67 I cannot say the Chief Justice was wrong in concluding that Skeena's failure to give timely notice was anything other than a procedural error without prejudicial consequences. I would dismiss this ground of appeal, as well as the substantive grounds, for the reasons I have given.

***Hall J.A.*:**

I agree.

***Levine J.A.*:**

I agree.

Appeal dismissed.

2002 BCSC 1280
British Columbia Supreme Court

Skeena Cellulose Inc., Re

2002 CarswellBC 2032, 2002 BCSC 1280, [2002] B.C.W.L.D. 927, [2002] B.C.J. No. 2003, 116 A.C.W.S. (3d) 54, 43 C.B.R. (4th) 178, 5 B.C.L.R. (4th) 193

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

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

AND IN THE MATTER OF THE COMPANY ACT, R.S.B.C. 1996, c. 62, as amended;

AND IN THE MATTER OF SKEENA CELLULOSE INC., ORENDA FOREST PRODUCTS LTD., ORENDA LOGGING LTD. and 9753 ACQUISITION CORP.

Brenner C.J.S.C.

Heard: June 17, 2002
Judgment: September 4, 2002
Docket: Vancouver L012405

Proceedings: affirmed *Skeena Cellulose Inc., Re.*, 2003 CarswellBC 1399, 2003 BCCA 344 ((B.C. C.A.))

Counsel: *J. Forstrom*, *R. Attisha*, for Jasak Logging Ltd.
M. Buttery, *J. Sparks*, for Skeena Cellulose Inc.

***Brenner C.J.S.C.*:**

1 In September 2001, the petitioner, Skeena Cellulose Inc. ("SCI") sought protection from its creditors under the Companies' Creditors Arrangement Act ("CCAA").

2 The applicants, Clear Creek Contracting Ltd. ("Clear Creek") and Jasak Logging Ltd. ("Jasak") are logging contractors that harvest timber for SCI under long term contracts. These contracts include terms which require SCI to continually replace them for an indefinite period.

3 The terms of the October 5, 2001 Come-back Order authorized SCI to terminate replaceable logging contracts, provided a Monitor's Report had been submitted to the Court at least 21 days before implementation. In March 2002 SCI terminated the applicants' replaceable logging contracts.

4 Clear Creek and Jasak now apply to the Court for a declaration that the terminations were invalid.

5 SCI enjoys the right to harvest timber pursuant to a replaceable tree farm licence and a replaceable forest licence (together the "Licences") granted under the Forest Act.

6 The applicants provide full phase logging services to SCI under contract. This is their principal business.

7 The applicants' logging contracts with SCI are replaceable in accordance with the provisions of the Timber Harvesting Contract and Subcontract Regulation, (B.C. Reg. 22/96; the "Regulation"). Subject to satisfactory performance, SCI is obliged to replace each contract on expiry upon substantially the same terms and conditions - including the obligation to replace. This is

commonly referred to as an "evergreen" contract. SCI's obligation to replace the contracts continues for as long as it maintains the Licences.

8 There are three other contractors who also hold replaceable contracts from SCI to harvest timber from the Licences. SCI has not terminated any of these contractors under the Come-back Order. Although the evidence in support was disputed on the application, SCI contends that by terminating the applicants' contracts and re-tendering on the open market it can achieve significant savings in operating costs.

9 SCI has not in recent years been a viable economic enterprise.

10 On March 3, 1997, SCI, then known as Repap British Columbia Inc., filed for a CCAA stay of proceedings which was granted by Thackray J. (as he then was) on March 21, 1997 (the 1997 Order).

11 Paragraph 15(c) of the 1997 Order granted SCI the right to "terminate such of its supplier arrangements or sales, marketing or management agreements, or any other agreements as it deems appropriate, subject to paragraph 36 of this Order". Paragraph 36 provided leave to the applicants to seek a declaration that the Court did not have jurisdiction under the CCAA to make an order entitling the petitioner to terminate a *Forest Act* replaceable contract.

12 The applicants, together with the other three replaceable contractors, exercised this opportunity and applied for such a declaration. This was dismissed by Thackray J. on June 11, 1997. An application for leave to appeal was filed in the Court of Appeal but the matter was settled in September 1997 when SCI offered replacement logging contracts to all five of the replaceable contractors, with an initial term of five years from January 1, 1997 to December 31, 2001. All accepted and the appeal from the 1997 order was abandoned.

13 In 2001 SCI returned to the bankruptcy court. On October 5, 2001, this court issued a Come-back Order under the CCAA (the "Come-back Order"). Paragraph 12 of the Come-back Order authorises SCI to terminate service agreements (including *Forest Act* replaceable contracts) "in order to facilitate the downsizing and consolidation of its business and operations".

14 As part of SCI's Plan of Compromise and Arrangement, NWBC Timber & Pulp Ltd. ("NWBC") agreed on February 20, 2002 to purchase the interest of the Province of British Columbia in SCI, held by 552513 British Columbia Ltd. (the "Purchase Agreement").

15 By letter dated March 1, 2002, SCI terminated its replaceable contract with Clear Creek; it sent a similar letter of termination to Jasek on March 4, 2002.

16 The first reference in the Monitor's Reports to these terminations was in the Eleventh Report filed March 14, 2002. The Monitor reported that it had been advised that SCI had terminated the contracts of the applicants.

17 The notice of motion for the present application was filed and delivered to SCI and NWBC on March 28, 2002. In early May, 2002, NWBC closed the Purchase Agreement.

18 The legislation imposing the replaceable contract obligation on licence holders was introduced in 1991. From the Hansard at the time it appears that the legislation was intended to provide security of tenure for contractors which was co-extensive with the security of tenure enjoyed by the licence holder. It was designed to protect the interests of logging contractors, who are typically small businesses that must make significant capital investments in order to service their contracts. It was also designed to provide stability and security to the contractors and the communities that depend on them.

19 This was achieved by imposing an obligation on the holders of replaceable licences issued under the *Forest Act* to harvest a proportion of the timber from the Licences through replaceable or evergreen contracts. An evergreen contract is one which provides, in effect, that a contractor who performs satisfactorily will receive continuous replacement contracts from the licence holder, for as long as the licence subsists. A replaceable contractor has a similar obligation to its sub-contractors.

20 S. 160 of the *Forest Act* provides for a mandatory, deemed amendment of any contracts that do not conform to the basic requirements of the Regulation. If the parties include anything in their agreement that is inconsistent with the requirements of the Regulation, that provision is deemed to be unenforceable.

21 SCI's tree farm licence and forest licence each require that it harvest at least 50 percent of the volume harvested from these licences through the use of contractors with replaceable contracts.

22 The question of whether the Court, by operation of the CCAA, has the power to allow SCI to terminate *Forest Act* replacement contracts was determined by Thackray J. in the earlier CCAA proceeding. In that case he observed:

> [8] The parties before me do not disagree with respect to the objectives of either the *Companies' Creditors Arrangement Act* or the *Forest Act.* I fail to see how the ruling that there may be termination of a replaceable contract results in the court losing jurisdiction on the basis that the order may be contrary to the general principles of the *Forest Act*. If the motivation was demonstrated before the court that that purpose of the termination was to frustrate the objectives of the *Forest Act*, then the court would not sanction the termination. But that is the matter of discretion that is still protected and is still to come under 15(m).

23 However it is also clear that in the absence of the operation of the CCAA, SCI had no power to unilaterally terminate these contracts. The last contract between SCI and Jasak and Clear Creek was for a term of five years expiring December 31, 2001. Subject to satisfactory performance, which is not an issue, SCI was obliged under the expiring contracts to offer a replacement contract conforming to the standard terms set out in the Regulation. Of course by September 30, 2001 when SCI's deadline for offering a replacement contract to the applicants expired, it had been granted an initial CCAA stay by the court.

24 By letters to Clear Creek and Jasak, dated March 1, 2002 and March 4, 2002, respectively, SCI provided notice to the applicants that in reliance upon s. 12 of the Come-back Order their 1997 contracts were "hereby terminated".

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.

26 The first consideration for the court in sanctioning any plan or step taken by a debtor pursuant to a plan, is to consider whether there has been strict compliance with the statute, and whether anything has been done [or purported to have been done] which is not authorised by the CCAA. This consideration has been interpreted to refer not only to the procedural imperatives of the Act, but also to compliance with the procedural and notice requirements set forth in any orders made by the Court in the course of the proceedings. (See *Olympia & York Developments Ltd. v. Royal Trust Co.*, [1993] O.J. No. 545 (Ont. Gen. Div.) p. 6; *Campeau Corp., Re*, [1992] O.J. No. 237 (Ont. Gen. Div.) p. 2.).

27 The Come-back Order authorises SCI to terminate its executory obligations under service or supply agreements, as it deems appropriate. However this general authority can only be exercised to "facilitate the Downsizing" which is defined in paragraph 11 of the Come-back Order to mean the "downsizing and consolidation of [SCI's] business and operations."

28 There is a more specific restriction for replaceable logging contracts. Under the Come-back Order SCI may only exercise the power to terminate "provided that the Monitor shall have submitted to the Court a report of any proposed termination . . . at least 21 days before such plan is implemented".

29 The applicants say SCI has failed to comply with either of these requirements.

30 The Order clearly contemplates that SCI may need to consolidate its operations or divest itself of assets in order to overcome its economic difficulties. One option which SCI may have considered is divesting itself of its timber harvesting tenures, and getting out of the logging business. In this context, there may have been some compelling necessity to terminate its obligations to the Replaceable Contractors, in conjunction with a cancellation or transfer of the Licences.

31 However in this case SCI is maintaining its existing timber harvesting tenures, but it seeks to reduce the number of contractors from five to three by terminating the applicants.

32 Does this exercise fall within the meaning of "downsizing" in the Order? In my view this word must be given an interpretation consistent with the many CCAA authorities which address the purpose of the *Act*. As stated by LoVecchio J. in *Blue Range Resource Corp., Re*, [1999] A.J. No. 788 (Alta. Q.B.) at paras. 36-38:

> 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 the 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 directly. In my view, an order authorizing the termination of contracts is appropriate in a restructuring, particularly given that it does not affect the creditor's right to claim damages.

33 In the case at bar to be able to exercise the right granted in the Order SCI must be engaged in a process of both downsizing and consolidation. By reducing the number of contractors, SCI is clearly engaged in a process of consolidation.

34 But is it also "downsizing"? As used in the Come-back order I interpret the term downsizing to mean: "to reduce the nature or scope of the operations in order to facilitate the petitioner's re-organization".

35 The applicants argue that SCI has maintained its timber harvesting rights under the Licences, and will continue to harvest timber from them and that there is therefore no evidence that it plans to reduce its operations from the Licences.

36 However the affidavit of Mr. Veniez (the CEO of both NWBC and SCI) states that the change in control of SCI will result in a 5% reduction in the Annual Allowable Cut on the Licences. SCI proposes to deal with that reduction by reducing the volume of timber allocated to evergreen contractors by approximately 160,000 cubic metres.

37 In my view this falls within the meaning of the term "downsizing" as used in the Come-back Order.

38 The applicants also contend that the petitioners failed to comply with the Come-back Order by terminating them without first filing a report from the Monitor with the Court.

39 The Order only required such a filing prior to such a Plan being "implemented". On their face, the letters sent to the applicants in March purported to terminate their contracts. However it is clear that such terminations could not become effective until the Monitor's Report was filed. If challenged the terminations would also not become effective unless approved by the court. That is, of course the very subject matter of this application.

40 Here the Monitor's Report was filed some two weeks after the letters purporting to terminate the applicants was issued. Those letters were clearly issued untimely. The creditors meetings occurred before the 21 day time period set out in the Come-back Order had even expired. This raises the issue as to whether the applicants were prejudiced by the failure of SCI to comply with the timetable requirements of the Come-back Order.

41 The applicants did have clear and unequivocal notice that SCI intended to terminate the contracts and treat their claims that would arise from such cancellations as Claims to be compromised under the Plan. In my view since SCI made its intentions clear prior to the creditors' meetings, the applicants were not prejudiced by the lack of timely notification.

42 In my view this application also raises the fundamental question of whether the applicants' position would raise the prospect of an inappropriate differentiation of treatment between the applicants and other SCI creditors.

43 The applicants state that "SCI is a large, multi-million dollar business enterprise." While that is true, SCI has also been struggling for many years to become profitable. There are many people in addition to the applicants who depend on SCI's viability. While the applicants will no doubt be adversely affected by the terminations, they are in no different position in this regard than many other unsecured creditors of SCI who must prove their claims under the Plan and who stand to recoup only a small fraction of their claims. It is to be noted that while the sale price of SCI was $8 million, the applicants have filed proofs of claim in excess of $5 million.

44 It is the unfortunate and generally unavoidable result of an insolvency restructuring that some individuals or entities will suffer hardship. In this case as part of its restructuring, SCI had to terminate numerous employees. They no doubt suffered hardship.

45 Early on during the SCI restructuring, the Pulp Paper and Research Institute of Canada ("Paprican") brought an application for an order that its agreement with SCI not be terminated. Paprican argued that it would suffer financial hardship. Paprican's application was dismissed.

46 In effect what the applicants are seeking here is an order for specific performance. Specific performance can be particularly inappropriate in an insolvency, because its effect generally will be to create a preference over other unsecured creditors.

47 SCI is insolvent. The fact of that insolvency precludes SCI from performing many other contracts. Indeed, SCI is by definition insolvent because it cannot perform all its contracts.

48 The reluctance of the bankruptcy court to grant the remedy of specific performance is seen in *T. Eaton Co.,Re* (1999), 14 C.B.R. (4th) 288 (Ont. S.C.J. [Commercial List]). In that case a party holding a licence from the T. Eaton Company Limited and Sears Canada Inc. applied for specific performance of its contract. Farley J. dismissed the application, citing with approval the reasons of LoVecchio J. in *Blue Range Resource Corp., Re*, [1999] A.J. No. 788 (Alta. Q.B.) at paras. 36-8:

> 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 . . . . 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' right 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.

49 The intention of the CCAA, as expressed in the Come-back Order and the Plan, is for all creditors to be treated equally.

50 While I recognize that the applicants in the case at bar do enjoy the benefit of certain statutory privileges that differentiates them from other unsecured creditors, they are nevertheless seeking to be put in a position superior to SCI's other creditors. In my view those statutory privileges are not sufficient to justify the creation or recognition of such a preference. I believe that this is the conclusion reached by Thackray J. when he considered this point in 1997.

51 The B.C. Court of Appeal has cautioned against the creation of preferences in CCAA proceedings. In *Cam-Net Communications v. Vancouver Telephone Co.* (1999), 71 B.C.L.R. (3d) 226 (B.C. C.A.) Rowles J.A. said at 234:

> The first policy concern of the CCAA regime is ensuring that all claims are properly compromised in the reorganization. Because creditors will typically receive only a fraction of their total claim under reorganization, there is a strong incentive for creditors to attempt to avoid the reorganization compromise and sue for the full value of their claim outside of the CCAA regime. In supervising the CCAA process, courts must remain alert to this incentive and scrutinize carefully any action by a creditor which would have the effect of giving it an advantage over the general body of creditors.

52 Since Thackray J. has previously held that replaceable contracts of this nature may be terminated as part of a CCAA reorganization, I see no basis for allowing Clear Creek and Jasek to avoid the reorganization compromise. This avoidance is the type of activity cautioned against by Madam Justice Rowles in *Cam-Net.*

53 In my view the applicants are creditors of SCI and they have claims under the Plan. The definition of claim includes any present or future right to claim against the Skeena Companies. The applicants had full knowledge prior to the creditors meetings that they would have claims under the Plan if their contracts were to be terminated which SCI has carried out. In my view the applicants have shown no reason as to why they ought to be exempted from the operation of the CCAA and why they ought to, in effect, be placed in a better position than other creditors. Accordingly, the applicants motions will be dismissed.

Application dismissed.

TAB 14

1999 ABQB 1038
Alberta Court of Queen's Bench

Blue Range Resource Corp., Re

1999 CarswellAlta 597, 1999 ABQB 1038, [1999] A.J. No. 788, 245 A.R. 154

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 Blue Range Resource Corporation

LoVecchio J.

Judgment: June 18, 1999
Docket: Calgary 9901-04070

Counsel: None given.

***The Honourable Mr. Justice S.J. LoVecchio*:**

Introduction

1 This decision relates to the applications for advice and directions brought by three gas marketing companies regarding their dealings with Blue Range Resource Corporation. Blue Range is subject to an Order dated March 2, 1999, under the *Companies' Creditors Arrangement Act* [1] .

Background

2 Blue Range is a producer of natural gas. It holds leases for natural gas producing properties and over the years entered into a number of long term natural gas supply agreements with various gas marketing companies. Among these companies are Engage Energy Canada, L.P., Duke Energy Marketing Limited Partnership and Can West Gas Supply Inc.

3 On March 2, 1999, Blue Range petitioned the Court and was granted an order staying proceedings against it pursuant to section 11 of the CCAA. Price water houseCoopers was named the Monitor for Blue Range under the Order. Certain provisions of that Order are germane to this application. They are:

> **3. b**. all Persons having arrangements or agreements, written or oral, with Blue Range for the supply of goods and/or services by or to Blue Range ... are hereby restrained from accelerating, terminating, suspending, modifying or cancelling any such agreements, arrangements or supply of goods and services, and are also hereby restrained from exercising any right of distress, recission, set-off or consolidation of accounts in relation to any indebtedness or obligation in favour of Blue Range ... without the prior written consent of Blue Range ... or leave of this Honourable Court.
>
> **c**. notwithstanding subparagraph 3(b) hereof, this Order shall not prohibit any party to an "eligible financial contract" (as defined in section 11.1(1) of the CCAA), which contract was entered into before the date of this Order, from terminating, amending or claiming an accelerated payment under such eligible financial contract and setting off the obligations between Blue Range and such other party in accordance with its provisions, provided that if the "net termination value" (as defined in section 11.1(1) of the CCAA) determined in accordance with the eligible financial contract is owed by Blue Range to another party to the eligible financial contract the other party shall be deemed to be a creditor of Blue Range with a claim in respect of that net termination value;

16. Blue Range shall have the right to:

a. ...

d. proceed with an orderly liquidation of such of its Property as Blue Range deems appropriate ... provided that any sale of any real or personal property outside the ordinary course of business ... shall require ... the approval of the Court;

e. terminate such of its arrangements or agreements of any nature whatsoever, including without limitation contracts for the purchase or sale of commodities, marketing agreements, transportation agreements, and service agreements, whether oral or written, as Blue Range deems appropriate and to make provision for any consequences thereof in the Plan (as hereinafter defined),

all of the foregoing to permit Blue Range to proceed with an orderly restructuring of its business, property and affairs (the "Restructuring").

17. In order to facilitate the Restructuring, Blue Range shall be permitted to carry on its business in the manner and to the extent determined by it, to dispose of any or all of its inventory and other assets, all subject to paragraph 16(d) hereof, wherever situate, and, for greater certainty, Blue Range shall have the right to realize upon its assets in such manner as Blue Range deems suitable or desirable for the purpose of maximizing the proceeds and recovery therefrom.

4 As part of a restructuring plan, Blue Range may sell certain of its petroleum leases the lands and reserves under which were "dedicated" to the supply of natural gas under the aforementioned long term natural gas supply agreements.

5 Some of the agreements provide for the sale of natural gas at prices below today's spot prices for natural gas. As such, the leases might command a higher price if they were sold after the existing contractual supply obligations had been terminated and Blue Range called for bids for the leases based on that assumption.

6 After supplying natural gas in accordance with the terms of the existing contractual supply obligations for both February and March, on March 31, 1999, Blue Range terminated some of its natural gas supply contracts as permitted by paragraph 16.e of the Order including those with Engage, Duke and Can West.

7 While the precise terms of the various contracts may differ slightly, it is generally the case that the payment for a month's supply of natural gas becomes payable on the 25th day of the following month. Thus the payment for the February supply of natural gas was due on March 25th and the payment for the March supply of natural gas was due on April 25th.

8 At the time of the hearing, Duke and Engage had not paid Blue Range for February or March. Duke has, however, reserving its right to argue set-off, paid the amount owing for its February delivery to the Monitor. Engage, while permitted to pay on the same basis, did not. No indication was given at the hearing how Duke or Engage would deal with the payment for March deliveries. The principles of this decision would however be applicable to that payment as well.

9 Payment to the Monitor on this basis had been authorized by the Court pursuant to an order dated March 25th, 1999. The purpose for permitting this mode of payment was twofold. It was to prevent Blue Range from arguing that the creditor was in default for non-payment of natural gas which had been delivered thereby giving termination rights due to that fact and, at the same time, to protect the funds paid by the creditor while the issue of set-off was being decided by the Court.

10 All of the companies may suffer substantial losses as a result of the termination of the existing natural gas supply contracts as, prior to the termination of the agreements, they had the right to purchase natural gas below the current spot market price for natural gas and that natural gas will have to be replaced by purchases of natural gas at prices that at present are higher.

The Applications

11 The different companies have made a number of applications with respect to the March 2nd Order. These applications were all made before Blue Range terminated the agreements.

12 Engage and CanWest have each applied for a declaration that, if any of the leases which are dedicated to their respective supply contracts are sold, the terminations of the contracts are to be declared ineffective with the corresponding result that the leases will remain subject to the pricing provisions and the "dedication" contained in the agreements.

13 In the alternative, Engage and CanWest, joined by Duke, seek a variation of the stay order such that Blue Range would be able to terminate the contracts only on certain conditions. The conditions sought being that Blue Range could only terminate if it was incapable of performing them or that termination is essential to the success of the restructuring.

14 Duke and Engage have also each applied for an order permitting them to set-off the damages that they anticipate suffering, as a result of Blue Range terminating the supply contracts, against the payments due to Blue Range for the February and March deliveries of natural gas.

15 Lastly, Engage and Duke seek to have their respective agreements declared "eligible financial contracts" as defined in the CCAA. This last issue, however, has been adjourned with the agreement of all of the interested parties. This decision is predicated on the assumption that the contracts in question will not be considered "eligible financial contracts".

Issues

16 The relief sought by the various applicants gives rise to three main issues.

> (*1*) Should the "dedication" of the natural gas reserves contained in the pre-existing natural gas supply contracts be found to be an interest running with the land thereby giving rise to an encumbrance on the leases which Blue Range listed for sale?
>
> (*2*) Have CanWest, Engage and Duke satisfied the Court that it is appropriate to vary the Order such that Blue Range should only be permitted to terminate the contracts if Blue Range is found to be incapable of performing them or that termination is essential to the success of the restructuring?
>
> (*3*) Should Engage and/or Duke be entitled to set-off their anticipated damages for non-delivery against the payments that they owe for the natural gas deliveries of February and March?

Decision - Issue (1)

17 For the reasons which follow, the "dedication" of the natural gas reserves contained in the pre-existing natural gas supply contracts does not, in the circumstances of this case, constitute an interest running with the land thereby giving rise to an encumbrance on the leases which Blue Range listed for sale.

Discussion

18 Counsel for CanWest conceded in argument that the natural gas supply contracts in question do not contain the type of words which would normally be associated with either the creation of a security interest or the creation of an interest in land with the result that the entire foundation for their argument is based on the legal interpretation to be given to the word "dedicate" in the contracts. Counsel also candidly agreed that there are at present no authorities in support of the legal position they postulate.

19 The word "dedicate" appears in a slightly different way in the various agreements filed in these proceedings. CanWest provided the various relevant provisions in Exhibit A to the Affidavit of Janet Vellutini.

In certain of the contracts, the following appears:

> Seller herein agrees to dedicate Seller's share of the Remaining Recoverable Reserves to Buyer and Buyer herein agrees to accept such reserve dedication from Seller.

In seven of the nine contracts, the following appears:

> 3. The Assignee [Blue Range] covenants and agrees with CanWest that it now owns and possesses a right, title, interest and estate in the lands and leases formerly owned by the Assigner and dedicated to the Contract(s) as set out in the attached Schedule "A".

In one of the contracts, the following appears:

> Seller shall dedicate sufficient lands and gas reserves in the Silver area attached hereto as Schedule "A",...

20 The ordinary meaning of the word dedicate, according to the Canadian Oxford Dictionary (1998, Oxford University Press, Toronto) includes:

> *b. commit, contribute, or set apart resources etc. for a particular cause or effort.*

This word does not connote a transfer or assignment of an interest. Use of a word which connotes these elements would be more indicative of an intention to create an interest in land. In my view, the word "dedicate" alone, without more, should not be seen as creating anything other than a contractual covenant in favour of the other party to the contract.

21 This word connotes to me only an intention by Blue Range to give an assurance of its ability to perform. By dedicating or setting apart reserves, Blue Range provides comfort to CanWest and the others that it has sufficient reserves so that it will be in a position to perform several years into the future.

22 The necessity for and the value of a covenant of this nature would depend on the particular circumstances. If CanWest were dealing with a company that had very significant volumes of proven and probable reserves and the contracted volumes of CanWest were very small relative to those reserves, then the necessity for such a covenant might be diminished. On the other hand, if CanWest were dealing with a producer whose volumes of proven and probable reserves were not as significant and the contracted volumes represented a significant portion of those reserves then the value of or comfort gained by such a covenant might be increased.

23 I make this observation as, in my view, there is nothing in our law which would prevent the parties if they so desired from using words which would manifest an intention to create an encumbrance in appropriate circumstances thereby giving more than mere comfort from the assurance.

24 This situation is not unlike that in *Scurry-Rainbow Oil Ltd. v. Galloway Estate* [2] in which Hunt J., as she then was, decided that certain royalty interests could amount to interests in land but that it depended on the specific language used. The case was appealed [3] and the Court described her analysis at page 69 as follows:

> ...Firstly, having concluded that the retention of the right of reversion in a give P. & N.G. lease <u>could</u> amount to an interest in land, she held that she then had to look at each of the subject leases to see if in fact that had been done;
>
> ...We find no reversible error in the learned trial judge's analysis...

25 Moreover, according to Paragraph 15 of the Affidavit of Janet Vellutini of CanWest, eight of the nine CanWest contracts contain a restriction on assignment identical or similar to the following provision.

> Each party undertakes to the other party that it shall not assign this Agreement or any of its rights hereunder without the consent in writing of such other party, which consent shall not be withheld, if the proposed assignee undertakes in form satisfactory to such other party that each of its rights acquired by such assignment is subject to the rights, title and interest of such other party herein set forth.

Paragraph 16 of that same Affidavit says that six of the contracts contain a specific restriction on Blue Range disposing of its interest in the petroleum and natural gas leases covered by the Contracts identical or similar to the following provision:

> Seller's undertaking to sell Raw Gas (as set forth in Article VI hereof) is subject to the following reservations:
>
> > e. the right to dispose of Said Lands, or any part thereof, provided that such disposition is made subject to this agreement...

Only one of the nine contracts does not have such a provision. It apparently provides that Blue Range "can assign with consent if all lands [are] acquired" [4] . CanWest argues that these provisions are consistent with an intention to create an interest in land.

26 In my view, these provisions do not assist their argument. Really, the contrary is true. If the word dedicate were found to constitute a legal encumbrance running with the land, there would be no need to have such covenants restricting assignment without consent or requiring a purchaser to honour the covenant. The later requirement, which is contractual in nature, indicates to me that the parties understood such a purchaser would not be so bound without specifically agreeing to be bound.

27 As I said, I would not view the use of the word "dedicate" alone as manifesting such an intention but I see no reason why such an interest could not be created in appropriate circumstances by the use of appropriate language.

28 Counsel referred me to the case of *Bank of Montreal v. Dynex Petroleum Ltd.* [5] , where Rooke J. decided that royalty and net profit interest holders, whose rights were granted by a petroleum lessee, did not have interests in land. At page 70 he concluded that:

> ...the requirement for an interest in land, as held by a number of authorities and jurists in this jurisdiction and the Supreme Court of Canada, is, in simple language, that, as a matter of law, *a lessee of an oil and gas lease* (*which is a profit a prendre*), *which is in itself an interest in land, obtained from a lessor* (*whether the Crown of freehold*), *cannot in law pass on an interest in land to a third party*. [emphasis added]

29 Applying that logic to this situation, the interest which the applicants want me to conclude that the parties intended to create could not have been created. As I have decided that, regardless of the principles in the above passage, the language of the instrument was insufficient to establish an intention to create an interest in land, I need not consider the application of the *Dynex* case to this case. That argument will be left for another day.

Decision - Issue (2)

30 For the reasons which follow, CanWest, Engage and Duke have not satisfied the Court that it is appropriate to vary the Order such that Blue Range should only be permitted to terminate the contracts if Blue Range is found to be incapable of performing them or that termination is essential to the success of the restructuring.

Discussion

31 CanWest and Engage have applied in the alternative, and they are joined in this argument by Duke, for an order either deleting entirely or amending accordingly clause 16.e of the March 2nd Order such that Blue Range would be prevented from terminating any of the applicable contracts without satisfying the Court that certain conditions have been satisfied.

32 In view of my decision on the first issue, this second issue must be addressed in the context of the contracts being ordinary contractual arrangements between the marketing companies and Blue Range.

33 The Applicants submit that it is unfair for Blue Range to be permitted to terminate its contracts pursuant to the March 2nd Order, when Blue Range has the natural gas to deliver and is capable of performing the contracts. The only rationale for

allowing Blue Range to terminate the contracts, they say, is because they are below market and, as a result, Blue Range could increase its cash flow by selling natural gas under new contracts at today's higher rates.

34 CanWest also submits that section 11 of the CCAA does not allow the Court to permit a debtor company to terminate contracts as part of a stay order.

35 On the other hand, Blue Range's position, and it is shared by the Banks, is that the termination of the contracts should not be prevented as it is crucial to the reorganization of Blue Range.

36 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.

37 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 is does not affect the creditors' rights to claim for damages.

38 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 sympathise 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.

39 As I said, one of the objectives of the CCAA is to provide relief to a beleaguered company from its obligations to individual creditors and to allow the detrimental repercussions of that relief to be dealt with as equitably as possible under a court approved plan.

40 I will now turn briefly to CanWest's suggestion that the Court has no jurisdiction to countenance the termination by a debtor of its contracts. This is not the first time that such a provision has been included in a section 11 stay order.

41 In *Dylex Ltd., Re*[6] Farley J. upheld an order which authorised the debtor to break a number of retail leases in shopping malls under which it was the tenant. Farley J. considered the equities of the situation and had regard to the relative commercial stamina of the parties before saying at p.110:

> I am therefore of the view that in weighing the balancing of interests in a CCAA context, the nod should continue to be given to Dylex which is in a precarious position as opposed to Cambridge which is in a sound financial condition...
>
> It is clear that s.11 of the CCAA gives the power to the court to sanction a plan which includes the termination of leases as part of a debtor's plan of arrangement... In the interim between the filing and the approval of a plan, the court has the inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan.

42 The termination of these contracts by Blue Range, as an adjunct to the disposition of the leases on favourable economic terms, is necessary to the company's survival program and I am satisfied that the Court has the necessary jurisdiction to permit termination. As to the broad discretion of the Courts under section 11 of the CCAA, reference should also be made to the discussion under Issue (3).

43 I will now consider the set-off arguments.

Decision - Issue (3)

44 For the reasons which follow, Engage and/or Duke are not entitled to set-off their anticipated damages for non-delivery against the payments that they owe for the natural gas deliveries of February and March.

Discussion

45 Engage and Duke seek to vary the March 2nd Order to allow them to set-off the payments that they owe for February and March, 1999, against anticipated damages arising from Blue Range's future non-performance.

46 Factually the cases of the two companies vary slightly because Duke paid the amounts owing into court on the understanding that it would preserve its right to argue set-off and Engage did not.

47 Further, the Duke contracts provided for the setting-off of anticipated damages from supply replacement against delivery payments upon receiving notice of the anticipated supply failures. The relevant clause of that contract is 6.1(g) which reads:

> (g) Any Alternate Gas Supply Damages payable hereunder shall be paid by Seller to Buyer on the 25th day of each month following the month in which they were incurred. The amount of Alternate Gas Supply Damages properly payable by Seller to Buyer hereunder may be offset by Buyer against amounts payable by Buyer hereunder as contemplated in Section 11.3....

48 Additionally, the Engage contracts provided for a period of delay after non-payment for supply before the expiration of which Blue Range could not terminate the agreements for non-payment.

49 Section 18.1 of the CCAA provides that the law of set-off applies to claims by and against the debtor company. It reads:

> **18.1**. The law of set-off applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

50 This section was added in 1997 by *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act*[7]. It is clear from the wording of this passage that it neither prohibits nor requires the setting-off of obligations by a Court but merely states that the law of set-off, with its usual implications, applies to debtor companies. It is necessary then, to look to the principles of set-off in general.

51 *Quintette Coal Ltd. v. Nippon Steel Corp.*[8] is one of the most helpful cases dealing with set-off in a CCAA context. In that case, the debtor company owned a coal mine which sold coal to a Japanese steel conglomerate. The conglomerate was the sole purchaser of the coal generated by the mine which would otherwise not have been an economic facility. Following a demand for payment of a debt to the conglomerate, the debtor company received CCAA protection with a stay order that, amongst other things, specifically prevented the Japanese conglomerate from exercising rights of set-off.

52 The conglomerate was owed approximately $46 million as a result of favourable decision on a retroactive pricing arbitration and sought to set-off this amount against payments for coal deliveries, some already received and some yet to be received.

53 On an application to vary the specific prohibition and thus allow set-off, Thackray J. of the British Columbia Supreme Court stated:

> Nor do I accept the proposition that the order forces an overpayment by J.S.I. for future coal deliveries. They are obliged to pay, and Quintette is obliged to accept, a price set pursuant to the arbitration award or any variation thereof pursuant to any appeal of that award [the damages owed by the debtor co]. The award has created a debt owed by Quintette to J.S.I. and I see that as completely distinguishable from the debts incurred by J.S.I. for future coal deliveries.

> Mr. G. Muench, in his short but able presentation, said that he could not see why J.S.I. should be treated any differently than any other creditor of Quintette. In spite of the able arguments of Mr. McAlpine, neither can I.[9]

The reasoning underlying this decision also emerges from the following passage:

> Unless there is a sound legal principle for doing so, I must not carve out one portion of the order and give an advantage to one creditor over another[10].

54 The British Columbia Court of Appeal[11] affirmed the decision of Thackray J. One of the issues on the appeal was whether the power to stay set-off rights was granted to a Court by section 11 of the CCAA. The Court held that it was and relied upon the wide discretion conferred upon the Courts to achieve the CCAA's purpose of holding creditors at bay to assist a debtor company in surviving as a going concern.

55 Counsel for Duke and Engage argued that section 18.1 came into being after the *Quintette* decision and that it therefore brings the continued usefulness of the decision into question. While I am inclined to agree with Thackray J. in the B.C.S.C. decision that allowing set-off runs contrary to the purpose of the CCAA by unfairly subordinating the rights of other creditors, I do not, in view of section 18.1, consider that reason as a ground for this decision.

56 Parliament has specifically mandated that, notwithstanding the well known purpose of the Act as a whole, namely to share amongst all of the creditors the asset shortfall, the general law of set-off is to apply to debts owed or claimed by the debtor company.

57 That this is the appropriate way to approach the problem is supported by the analysis of the Ontario Court of Appeal in *Citibank Canada v. Confederation Life Insurance Co.*[12]. In that case, a company sought to set-off against amounts owed by it to a debtor company in liquidation under the *Winding Up Act*[13] part of the debtor's liability to it arising from the termination of certain swap agreements.

58 While the *Winding Up Act* provided for set-off, it is clear that the Court had the same reservations as are expressed here about effectively granting priority to one creditor over the other creditors.

The Court stated:

> Citibank seeks a set-off to have the moneys owing to it paid in full and, in the process, reduce its indebtedness. Citibank would thereby gain a distinct advantage over the other creditors who must stand behind the policy holders and wait to recover pari passu in accordance with the priorities established under the Act. There would be little, if any recovery for the other creditors.
>
> Section 73 of the Winding Up Act preserves the right of set-off on a winding up. It provides as follows:
>
> > 73. The law of set-off, as administered by the Courts, whether of law or equity, applies to all claims on the estate of a company, and to all proceedings for the recovery of debts due or accruing due to a company at the commencement of the winding-up of the company, in the same manner and to the same extent as if the business of the company was not being wound up under this Act.
>
> A right of set-off can arise by agreement, at law or in equity... There is no question of an agreement to set-off in this case. Further, Citibank concedes on this appeal that it cannot meet the test for equitable set-off... Therefore, the question is whether there can be set-off at law[14].

59 The Court of Appeal held that there could be no legal set-off as the claims were not sufficiently certain to be liquidated claims. What is important to note is that, notwithstanding the same policy concerns as to priority, where the legislation had

mandated the applicability of the law of set-off, the Court proceeded to consider whether the claim for set-off should be allowed in the circumstances of the case.

60 Blair J. who heard the application in first instance [15] also discussed the effect of set-off on priorities. After quoting section 73 of the *Winding Up Act*, Blair J. said at paragraph 29:

> This provision - along with a similar (although not identical) provision in section 97(3) of the Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3, as amended - preserves the law of set-off as administered by the courts, in such insolvency situations. In this fashion set-off becomes the policy mechanism whereby the competing "equities" emerging from the dilemma outlined at the beginning of these reasons are balanced.
>
> In insolvency situations, set-off provides a creditor with an advantage which other creditors, ranking pari passu except for the set-off, do not have. It puts the advantaged creditor in what is tantamount to a secured position, something which was not a part of the bargain with the insolvent company in the first place. On the other hand, there is an inherent unfairness where a debtor/creditor is required to pay the liquidator everything that is legitimately owed to the insolvent company but is only able to collect a fraction of what is equally legitimately owing by the insolvent company, if anything.

61 The Court concluded that the legislature had resolved this issue in favour of the application of the general law of set-off and proceeded to apply the law. With the advent of section 18.1 of the CCAA, the same answer holds in this case and I am bound to consider the question of set-off without reference to the policy concern of potentially creating priorities between various creditors.

62 Counsel on all sides rely upon the same authorities and there appears not to be any disagreement as to the principles upon which determinations of set-off are made. It is not contended that legal set-off is available in this case as the claims to be set-off are unliquidated.

63 Conversely, "equitable set-off is available where there is a claim for a money sum whether liquidated or unliquidated" [16]. With respect to equitable set-off. Counsel refer to the Supreme Court of Canada's application of the law of equitable set-off as found in *Telford v. Holt* [17]. In that case, two parties exchanged two parcels of land and granted each other mortgages with the difference to be set-off and netted-out. However, before closing, one party assigned its mortgage to a third party who subsequently foreclosed on the property and sought to enforce the entire amount of the mortgage.

64 The Supreme Court found that equitable, but not legal, set-off applied to the claim. I note that that case and the authorities discussed therein are concerned primarily with the application of equitable set-off to situations in which one of the two parties to a contract (usually a mortgage) has assigned its rights under that contract to a third party.

65 Counsel for both the Banks and for Duke refer to five enumerated principles found at page 398 of that case as standing for the state of the law of equitable set-off.

> • 1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands: *Rawson v. Samuel* (1841), Cr. & Ph. 161, (1841), 41 E.R. 451 (Eng. Ch. Div.).
>
> • 2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed: [*British Arzani (Felixstowe) Ltd. v. International Marine Management (U.K.) Ltd.* (1979), [1980] Q.B. 137, [1979] 3 W.L.R. 451, [1979] 2 All E.R. 1063 (Eng. Q.B.)]
>
> • 3. A cross-claim must be so clearly connected with the demand of the plaintiff that it would be manifestly unjust to allow the plaintiff to enforce payment without taking into consideration the cross claim: [*Federal Commerce & Navigation Co. v. Molena Alpha Inc.*, [1978] Q.B. 927, [1978] 3 W.L.R. 309, [1978] 3 All E.R. 1066 (Eng. Q.B.)].
>
> • 4. The plaintiff's claim and the cross-claim need not arise out of the same contract: *Bankes v. Jarvis*, [1903] 1 K.B. 549 (Eng. Div. Ct.); *British Arzani*.

• 5. Unliquidated claims are on the same footing as liquidated claims: [*Newfoundland v. Newfoundland Railway* (1888), 13 App. Cas. 199 (Newfoundland P.C.)].

66 I should point out that those principles appeared in the Court's discussion of prior cases as part of a quote from the British Columbia Court of Appeal's decision in *Coba Industries Ltd. v. Millie's Holdings (Canada) Ltd.*[18].

67 Nevertheless, both counsel contend that it is a correct statement of the law to be applied to the issues at hand and I concur. The Court decided that the debts should be set-off since they arose out of the same contract or closely interrelated contracts such that it would be unfair to enforce only one side of the land exchange a agreement[19].

68 It is clear that the overriding concern for a court faced with an application for equitable set-off is fairness whether it be formulated as "manifestly unfair[20]", "unfair[21]", "unjust and unreasonable[22]", "unconscionable[23]" or as any of the other descriptions that have been invoked in support of the doctrine's application.

69 Counsel for Duke favours the formulation found in *British Arzani (Felixstowe) Ltd. v. International Marine Management (U.K.) Ltd.*[24] in which Forbes J. stated at p.1076 that:

> It would in my view be manifestly unjust to allow the landlord to recover his rent without taking into account the damages which it is alleged the tenant has suffered through failure by the landlord to perform his part of the agreement.

Spry, *The Principles of Equitable Remedies* fifth ed. (1997, Carswell, Agincourt) at p. 173 introduces the topic of equitable set-off with the following words at page 173:

> ...To decide that there is an equitable set-off is to decide that, on grounds that are set out hereunder, it would be unjust to order the specific enforcement of a particular obligation without lessening or reducing it by reference to a related obligation of the plaintiff to the defendant or making specific enforcement conditional on performance of that related obligation.

70 A passage from the fourth edition is quoted by the Alberta Court of Appeal in *420093 B.C. Ltd. v. Bank of Montreal*[25].

71 The case was predominantly concerned with the operation of the doctrine of res judicata and the Court decided that if the claims could have been raised as matters of equitable set-off, the claims were res judicata. The Court, did, however, at page 500 make the following comments by way of *obiter dicta*:

> The nature of equitable set-off is explained in I.C.G. Spry, *The Principles of Equitable Remedies*, 4th ed. (Toronto: Carswell, 1990). After observing that it is not sufficient to assert an unrelated cross-claim or even to plead a claim which arises out of the same transaction as the plaintiff's claim, the author states at p. 174:
>
>> What must be established is a relationship between the respective claims of the parties which is such that the claim of the defendant has been brought about by, or has been contributed to by, or is otherwise closely bound up with, the rights that are relied on by the plaintiff and which is also such that it would be unconscionable that he should proceed without permitting a set-off. Thus if conduct of the plaintiff is such as to induce the defendant to induce an obligation in favour of the plaintiff, and the conduct itself is fraudulent, negligent or otherwise wrongful so as to give a cause of action to the defendant, the plaintiff is not ordinarily permitted to proceed until he has made good the material claims of the defendant.
>>
>> In other cases also it will, where appropriate, be held that an equitable set off lies, provided that it appears that the claim of the defendant does in truth impeach that of the plaintiff, for the application of the principles that are here in question should not be arbitrarily restricted. Thus the better view is that this category of equitable set-offs extends to cases where a relevant claim is, not for a sum of money, but for the possession of property or some other non-pecuniary item.

> In *Bank of Boston Connecticut v. European Grain and Shipping Ltd.*, [1989] 2 W.L.R. 440, the House of Lords held at p.452 that the test is to determine whether the cross-claim in question is one "flowing out of and being inseparably connected with the transaction", that is, the transaction giving rise to the plaintiff's claim. *Spry says that this apparently new and more generous test is merely an instance of the traditional one which requires the defendant's claim to be* "*so closely connected with his* [*the plaintiff's*] *demands that it would be manifestly unjust to allow him to enforce payment without taking into account the cross claim*": (*p.176*). [emphasis added]

72 Therefore, I conclude that the question to be asked is whether the anticipated damages are so closely connected to the payments for February and March natural gas that it would be manifestly unjust or unfair to require Duke and Engage to pay Blue Range for the natural gas without permitting Duke and Engage to set-off their claims for unliquidated damages.

73 The obligation to pay for the gas delivered in February and March arose upon its delivery. At the point in time of each of the deliveries, there were no damages. Thus, Engage and Duke had a contractual obligation to pay for the natural gas at a point in time when they had suffered no damages albeit there was trouble on the horizon.

74 The anticipated damages for the higher cost of replacement natural gas only arise later and the cause of them is the prospective termination of the contract with the resulting failure of the delivery of natural gas from April onwards. They do not arise from a problem with the February and March deliveries.

75 Fundamentally, Engage and Duke contracted to buy natural gas from Blue Range. They contracted to pay for it on a month to month basis. They were delivered natural gas. They accepted the natural gas delivered and have sold or otherwise utilized the natural gas received.

76 Now, when payment is due they do not want to pay for it. The reason they give is that Blue Range's suspension of future deliveries will make them incur future damages. In my view, the future damages from the non-deliveries are sufficiently independent that it is not manifestly unjust to require Engage and Duke to pay for the natural gas that they have received.

77 Counsel for Duke, in argument, cited the Duke contract which provided for the setting-off of replacement cost damages against delivery payments. There was, however, notwithstanding this clause, no serious attempt to argue contractual set-off. This, I presume, is because the provision allowed for damages *for a given month* to be set-off only against payments *for the same month*.

78 If anything, this provision serves to reinforce the view that damages for future non deliveries are not so closely connected to past deliveries that fairness demands their being set-off against payments for previous deliveries.

79 While Counsel for Engage and Duke have endeavoured valiantly to distinguish the *Quintette* case, they have not succeeded on one part of the decision. It is to be remembered that the purchasing company wanted to set off *past* debts of the insolvent company (from the retroactive price review) against their *future* obligation to pay the insolvent company for ongoing coal deliveries. This was the exact inverse of the situation at bar where the companies wish to set off *future* damages owed them against their *past* payment obligations.

80 In my view, while the chronology is reversed, the principle is the same. The situation in that case led the Supreme Court to say, at p.296:

> The award has created a debt owed by Quintette to J.S.I. and I see that as completely distinguishable from the debts incurred by J.S.I. for future coal deliveries.

81 This observation is not affected by the change in the CCAA provisions to allow set-off. The legislature has spoken. In this case, the principles of set-off are to be applied. The issue for the Court is whether through the application of those principles a set-off should be permitted in the circumstances of this case.

82 The anticipated damages arise after the completion of the deliveries. They arise after the stay order. They become an unsecured claim just like the claim of any other unsecured creditor of Blue Range and lack the necessary relatedness to the deliveries and the consequent unfairness to take them out of this category.

83 Quite to the contrary, the applicants should share with the other unsecured creditors the burden of the reorganization and to hold otherwise would be potentially unfair to the other creditors.

84 In any event, although this was not argued before me with much emphasis (other than indirectly at paragraph 4.c. of the Blue Range Brief), as regards the March deliveries (which for all but one day occurred after the order was issued), it seems to me that it ought to have been well known to both Engage and Duke that trade taking place with a debtor company in CCAA protection after the implementation of a stay order is generally conducted on a cash basis.

85 Indeed paragraph 34 of the March 2nd Order stipulates that post-petition creditors supplying goods or services to Blue Range after the order are entitled to be paid in accordance with their terms of credit. It further provides that, where the supply spans time before and after the order, they are a post-petition creditor only for the portion of the supply made after the order. In short, trade is to be conducted on a cash basis.

86 Since Blue Range is not purely a consumer of goods and supplies it is implicit in this paragraph of the order that sales *by* Blue Range will be conducted on the same cash basis as sales *to* Blue Range. This would require Engage and Duke to pay their post-order delivery debts as they became due, notwithstanding any potential damage claims.

Conclusion

87 The applications made by Can West, Engage and Duke are denied.

Costs

88 While Blue Range has been put to the expense of contesting these applications, Blue Range will benefit significantly from the result in that it will be entitled to receive significant payments for the February and March deliveries. On the other hand, Duke and Engage have raised significant issues of more general import and will potentially suffer significant costs in finding replacement natural gas. This being so, it is not my intention to award any costs in these applications to any of the parties who appeared and made representations.

Application dismissed.

Footnotes

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

2 (1993), 138 A.R. 321 (Alta. Q.B.).

3 This decision is reported at (1994), 157 A.R. 65 (Alta. C.A.).

4 Page 2 to Exhibit B of the Vellutini Affidavit.

5 (1995), 39 Alta. L.R. (3d) 66 (Alta. Q.B.).

6 (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List]).

7 S.C. 1997 c. 12, s.125.

8 (1990), 2 C.B.R. (3d) 291 (B.C. S.C.) and (1990), 51 B.C.L.R. (2d) 105, 2 C.B.R. (3d) 303 (B.C. C.A.) .

9 Ibid at page 296.

10 Ibid at page 297.

11 This decision is reported at (1990), 2 C.B.R. (3d) 303 (B.C. C.A.).

12 (1998), 37 O.R. (3d) 226 (Ont. C.A.).

13 R.S.C. 1985, c. W-11.

14 At page 2 of the Quicklaw text.

15 (1996), 42 C.B.R. (3d) 288 (Ont. Gen. Div.).

16 *Telford v. Holt* infra, at p.394.

17 (1987), 41 D.L.R. (4th) 385 (S.C.C.), at 398.

18 (1985), 20 D.L.R. (4th) 689, [1985] 6 W.W.R. 14 (B.C. C.A.); at 696-7 and at 22.

19 P.401.

20 *British Arzani*.

21 *Telford v. Holt*.

22 Spry, *The Principles of Equitable Remedies*, 2nd ed. (1980) at p. 168.

23 Ibid. at p. 170-1.

24 [1979] 2 All E.R. 1063 (Eng. Q.B.).

25 (1995), 128 D.L.R. (4th) 488 (Alta. C.A.).

TAB 15

2020 ABCA 364
Alberta Court of Appeal

Repsol Canada Energy Partnership v. Delphi Energy Corp

2020 CarswellAlta 1855, 2020 ABCA 364, [2020] A.W.L.D. 3229, [2020] A.W.L.D. 3292, 324 A.C.W.S. (3d) 134

In the Matter of the Companies' Creditors Arrangement Act, RSC 1985, c C-36, as amended

And In the Matter of a Plan of Compromise or Arrangement
of Delphi Energy Corp. and Delphi Energy (Alberta) Limited

Repsol Canada Energy Partnership and Repsol Oil & Gas Canada Inc. (Applicants) and Delphi Energy Corp. and Delphi Energy (Alberta) Limited (Respondents) and PricewaterhouseCoopers Inc. and Luminus Management LLC (Interested Parties)

Marina Paperny J.A.

Heard: October 7, 2020
Judgment: October 15, 2020
Docket: Calgary Appeal 2001-0193-AC

Counsel: J.W. Reid, for Applicants
R.S. Van de Mosseler, T. Sandler, for Respondents
J.G.A. Kruger, Q.C., for PricewaterhouseCoopers Inc.
J.L. Oliver, J.W. Hocher, J.J. Bellissimo, for Luminus Management LLC

***Marina Paperny J.A.*:**

1 The applicants, Repsol Canada Energy Partnership and Repsol Oil & Gas Inc. (collectively, Repsol), seek leave to appeal certain provisions of a Sanction Order granted by the supervising judge under the Companies' Creditors Arrangement Act, RSC 1985, c C–36 (CCAA).

2 The Sanction Order relates to a plan of compromise and arrangement under the *CCAA* (the Plan) of the respondents, Delphi Energy (Alberta) Limited and Delphi Energy Partnership (collectively, Delphi). The background of the Plan is more thoroughly dealt with in the companion decision of *Trican Well Service Ltd v. Delphi Energy Corp*, 2020 ABCA 363 (Alta. C.A.), and is briefly summarized below.

3 Delphi and Repsol are both oil and gas producers and hold certain petroleum and natural gas rights jointly. Delphi is the operator pursuant to the Joint Operating Agreement, which is governed by the CAPL operating procedure. Between December 2019 and March 2020, Delphi undertook independent operations to drill three wells on the joint lands, with respect to which Repsol elected not to participate.

4 The combination of the collapse of oil prices and the COVID-19 pandemic led to Delphi's financial wherewithal becoming seriously imperiled. As a result, on April 14, 2020, Delphi filed for and received an order for protection pursuant to the *CCAA* (the Filing Date). Shortly thereafter, numerous builders' liens were filed against the joint lands respecting work on Delphi's independent operations completed before the Filing Date.

5 The Plan provides for a compromise and release of all "Affected Claims" as against Delphi, and was approved by the requisite majorities on September 9, 2020. On September 10, the day before the hearing to sanction the Plan, Repsol served

materials opposing paragraph 33(i) of the Sanction Order, arguing it "improperly impacts the post-filing rights of Repsol's Unaffected Claims" under the Plan. The issue was whether Repsol's potential indemnity claim against Delphi arising from the builders' liens, and under the Joint Operating Agreement and CAPL operating procedures, is a pre-filing claim for purposes of the *CCAA.* If the potential indemnity claim is a pre-filing claim as defined in s.19 of the CCAA, then it is an "Affected Claim" under the Plan.

6 The supervising judge determined the indemnity claim against Delphi arising from the builders' liens was a pre-filing claim and therefore an Affected Claim.

7 Repsol seeks leave to appeal the Sanction Order. It submits that the paragraph of the Sanction Order that extinguishes the claims of joint interest owners arising from the builders' lien claims renders useless the indemnity provisions in the CAPL operating procedures. At the very least, the decision of the supervising judge creates uncertainty for the ability of joint interest owners to rely on the provisions in their Joint Operating Agreement.

8 The test for leave to appeal is well known. It requires "serious and arguable grounds that are of real and significant interest to the parties", which can be assessed by considering four factors (see *Liberty Oil & Gas Ltd., Re*, 2003 ABCA 158Alta. C.A. at paras 15–16, 200344 C.B.R. (4th) 96(Alta. C.A.); *Bellatrix Exploration Ltd v. BP Canada Energy Group ULC*, 2020 ABCA 178 (Alta. C.A.) at para 16):

1. whether the point on appeal is of significance to the practice;

2. whether the point raised is of significance to the action itself;

3. whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and

4. whether an appeal will unduly hinder the progress of the action.

9 In considering whether to grant leave to appeal, appellate courts must appreciate that decisions of a supervising judge are accorded considerable deference and will be interfered with only if the judge acted unreasonably, erred in principle, or made a manifest error: *Royal Bank v. Fracmaster Ltd.*, 1999 ABCA 178 (Alta. C.A.) at para 3, (1999), 244 A.R. 93 (Alta. C.A.); *9354-9186 Québec inc. v. Callidus Capital Corp.*, 2020 SCC 10 (S.C.C.) at para 53.

10 The first aspect of the test for leave requires consideration of whether the issue is of importance to the practice, or in this case the industry, which here includes insolvency practitioners and those in the oil and gas business. The question raised on this appeal is important, but, as is discussed further below, whether it warrants an appeal to this court depends on the extent to which there is no binding or guiding precedent on the point at issue.

11 The second factor concerns whether the point is significant to the action. In a *CCAA* context, the answer to this question is generally "yes", as issues raised on appeal often will have important consequences to the *CCAA* plan in question and to all stakeholders involved. In this case, whether the claim to indemnity is a pre- or post-filing claim impacts the entirety of the Plan.

12 The third inquiry, whether the appeal is *prima facie* meritorious, is in this case directly related to the first factor. The third factor involves consideration of whether there appears to be an error in principle of law, or a palpable and overriding error of fact, or an improper exercise of discretion, for example by taking into consideration irrelevant factors or failing to consider relevant factors: *Liberty Oil & Gas* at para 19. The key point in this case is whether the issue is one of settled or unsettled law.

13 Repsol submits that the determination of when its claim for indemnity arises ought to be guided by the terms of the indemnity agreement, and not by when a claim arises under the Builders' Lien Act, RSA 2000, c B–7. Repsol relies on *Dean v. Kociniak*, 2001 ABQB 412 (Alta. Q.B.) and *Condominium Plan No. 9512180 v. Prairie Land Corp.*, 2008 ABQB 269 (Alta. Q.B.), decisions from the Court of Queen's Bench that deal with when a contractual claim for contribution and indemnity arises for purposes of the Limitations Act, RSA 2000, c L–12.

14 With respect, I cannot agree. Section 19(1) of the CCAA defines pre-filing claims as:

19 (1) Subject to subsection (2), the only claims that may be dealt with by a compromise or arrangement in respect of a debtor company are

(a) claims *that relate to debts or liabilities, present or future, to which the company is subject* on the earlier of

(i) the day on which proceedings commenced under this Act, and

(ii) if the company filed a notice of intention under section 50.4 of the *Bankruptcy and Insolvency Act* or commenced proceedings under this Act with the consent of inspectors referred to in section 116 of the *Bankruptcy and Insolvency Act*, the date of the initial bankruptcy event within the meaning of section 2 of that Act; and

(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).

[emphasis added]

15 Delphi submits, and I agree, that the section provides that any claim that relates to a debt or liability to which a company may become subject by reason of an obligation incurred by the company prior to the *CCAA* filing date is a pre-filing claim, regardless of when the damage was suffered or the claim itself arose. The section is clear and is directed at facilitating a plan of arrangement.

16 In determining whether something is a pre-filing claim under the *CCAA*, regard must be had to the wording of the *CCAA* itself. Analysis of the issue in the context of the *Limitations Act* of a particular jurisdiction, while interesting, cannot provide guidance if it is directly in contradiction to what the *CCAA* provides. The specific provisions of s 19 were designed to capture claims that are broader than crystallized causes of action. Those claims include present and future liabilities to ensure that all stakeholders understand the contingent or unliquidated claims that might arise so they can determine their position on the plan and, in particular, whether the plan is fair and reasonable having regard to all the circumstances. Not the least of those circumstances is the viability of the company post-arrangement.

17 This purposive interpretation accords with the analysis of Romaine J in *SemCanada Crude Co., Re*, 2012 ABQB 489 (Alta. Q.B.), leave to appeal denied 2012 ABCA 313 (Alta. C.A.), where she held at para 24:

> This interpretation of Section 19(1) ignores the words "that relate to liabilities, present or future" that modify the term "claims". It is clear that SemCAMS was subject to the possibility of liability under the IGPA before the CCAA proceedings commenced. The claims for suspension damages are claims that relate to the IGPA and to the suspension of the IGPA that occurred as a result of the CCAA proceedings. Section 19(1) does not limit the claims that may be dealt with by a Plan under the CCAA to presently existing liabilities. This is made clear by the addition of the word "future" in both Section 19(1)(a) and Section 19(1)(b).

18 As was noted by Romaine J at para 25 of *SemCanada*, a "claim" for the purpose of the *CCAA* includes any "indebtedness, liability or obligation that would be provable under the Bankruptcy and Insolvency Act, RSC 1985, c B–3". Section 121(1) of the BIA defines "provable claims" as "all debts and liabilities, present and future, to which the bankrupt is subject . . . , or to which the bankrupt may become subject... by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt..."; s 121(2) of the BIA makes clear that this includes contingent or unliquidated claims: *SemCanada* at paras 25-26.

19 The Supreme Court of Canada has confirmed that a claim may be provable in bankruptcy even if it is a contingent claim: see *AbitibiBowater Inc., Re*, 2012 SCC 67 (S.C.C.) at para 28; *Orphan Well Association v. Grant Thornton Ltd.*, 2019 SCC 5 (S.C.C.) at para 36. "A 'contingent claim is 'a claim which may or may not ever ripen into a debt, according as some future event does or does not happen"": *Orphan Well Association*, citing *Peters v. Remington*, 2004 ABCA 5 (Alta. C.A.) at para 23.

20 More recently, the Quebec Court of Appeal commented that "post-debts are only those incurred after and also resulting from an obligation originating after Determination", and that "an obligation can be contingent, unliquidated, or not exigible as at the day of Determination, but existing and able to give rise to a claim if a court decision 'deems it provable'": *Arrangement relatif à Métaux Kitco inc.*, 2017 QCCA 268 (C.A. Que.) at para 77-78 [unofficial English translation].

21 In light of the plain language of s 19, and the authorities interpreting that provision and conducting a similar analysis under the *Bankruptcy and Insolvency Act*, I am not satisfied that the issue raised is sufficiently meritorious to warrant an appeal. Accordingly, the application for leave to appeal is dismissed.

Application dismissed.

TAB 16

2017 QCCA 268
Court of Appeal of Quebec

Arrangement relatif à Métaux Kitco inc.

2017 CarswellQue 4198, 2017 CarswellQue 791, 2017 QCCA 268, [2017]
G.S.T.C. 11, 276 A.C.W.S. (3d) 24, 46 C.B.R. (6th) 173, EYB 2017-276534

(500-09-025913-161) Agence du revenu du Québec, Appellant-creditor-respondent v. Kitco Metals Inc., Respondent-debtor-applicant and Attorney General of Canada, Impleaded Party-creditor-respondent and Attorney General of Quebec, Impleaded Party-impleaded party and Richter LLP, Impleaded Party-monitor/impleaded party and Heraeus Metals New York LLC, Impleaded Party-impleaded party and Canadian Association of Insolvency and Restructuring Professionals (CAIRP), Intervener

(500-09-025914-169) Attorney General of Canada, Appellant-creditor-respondent v. Kitco Metals Inc., Respondent-debtor-applicant and Richter LLP, Impleaded Party-monitor-impleaded party and Heraeus Metals New York LLC, Impleaded Party-impleaded party and Attorney General of Quebec, Impleaded Party-impleaded party and Agence du revenu du Quebec, Impleaded Party-creditor-respondent and Canadian Association of Insolvendy and Restructuring Professionals (CAIRP), Intervener

Giroux J.C.A., Vézina J.C.A., Parent J.C.A.

Heard: November 8, 2016
Judgment: February 20, 2017
Docket: C.A. Qué. Montréal 500-09-025913-161, 500-09-025914-169

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***Vézina J.C.A.; Giroux J.C.A.; Parent, J.C.A.*:**

[UNOFFICIAL ENGLISH TRANSLATION]

1 The appellants, the Agence du revenu du Québec and the Attorney General of Canada, appeal from a judgment rendered on February 1, 2016, by the Superior Court, District of Montreal (the Honourable Madam Justice Marie-Anne Paquette), which condemned them respectively to pay Kitco $1,443,713.16 and $335,866.78, as refunds of the Goods and Services Tax (GST) and the Quebec Sales Tax (QST) owed to Kitco up to November 30, 2015, with interest and the additional indemnity.

2 For the reasons of Vézina, J.A., with which Giroux and Parent, JJ.A. agree, *THE COURT*:

3 *DISMISSES* the appeals with legal costs in favour of the respondent (Kitco) and the impleaded parties (Richter LLP and Heraeus Metals New York LLC), with but no costs against the intervener (CAIRP).

***Vézina J.C.A.*:**

4 The debtor "company" Kitco Metals Inc. purchases scrap gold (jewelry, chains, cutlery, etc.), and extracts the pure gold, which it subsequently sells.

5 Scrap metal purchases are subject to the Goods and Services Tax (GST) and the Quebec Sales Tax (QST), whereas pure gold transactions are exempt. The Agence du revenu du Québec (ARQ) collects both taxes, which explains why the attorney generals of Quebec and Canada are speaking with a single voice in the present proceedings, with the ARQ.

6 The tax collection system includes a refund mechanism that operates as follows. Upon the purchase of scrap metal, which constitutes an [TRANSLATION] "input" in its operations, Kitco must pay the taxes to its suppliers, which remit them to the ARQ. When pure gold is sold, however, since the law exempts buyers from paying the GST and QST on it, Kitco is entitled to a refund of the tax paid when it purchased the input.

7 In this way, in 2010 and 2011, Kitco claimed and obtained tax refunds of over $300 million from the ARQ.

8 The problem is that Kitco's suppliers allegedly used a fraudulent billing scheme and remitted no taxes at all to the ARQ. Therefore, the ARQ "refunded" Kitco for taxes never collected.

9 When the ARQ discovered the scheme, it concluded that Kitco was party to it. Kitco had repeatedly sold its pure gold to its own suppliers, resulting in a surprisingly high sales volume. According to the ARQ, this was a fraudulent cycle set up to defraud the ARQ. The suppliers incorporated the pure gold into crude jewelry that they immediately sold as scrap gold to Kitco. By increasing the transactions, they increased their refunds of taxes that had in fact never been collected by the ARQ in the first place.

10 Following its investigation, the ARQ sent Kitco an assessment for the millions it had swindled out of the Agency.

11 Kitco protests strenuously that it was innocent and contests all of the assessments. It writes:

> To Kitco's understanding, the ARQ [l'Agence] claims that, for several years, some companies linked to the goldsmith trade have been using a fraudulent scheme to wrongfully avoid the remittance of the GST and QST paid to them by Kitco or others, and that Kitco is somehow part of this scheme (an allegation that Kitco has always strongly denied);
>
> Prior to even receiving the draft notices of assessment, Kitco supplied the ARQ with all the useful and relevant information to demonstrate that it is not and could not be part of the alleged scheme contemplated by the ARQ;

12 It is well known that assessed taxes are nevertheless payable immediately, even when they are contested.[1] On June 7, 2011, the ARQ proceeded with compulsory execution.

13 The next day, on June 8, 2011, Kitco filed a notice of intention to make a proposal under section 50.4 of the *Bankruptcy and Insolvency Act*,[2] which stayed any "remedy against the insolvent person or the insolvent person's property" by its creditors (s. 69 *BIA*), including the ARQ's execution proceedings.

14 Then, on July 7, 2011, Kitco obtained an "initial order" under the *Companies' Creditors Arrangement Act* (*CCAA*)[3] continuing the stay, which still holds today and will remain in effect until May 31, 2017. The Court could continue it if it considers it appropriate.

15 The question of whether or not Kitco participated in the fraudulent scheme against the ARQ is now before a criminal court. The trial is underway, and it looks like it could go on for months or even longer. The validity of the assessments of the taxes owed by Kitco depends on the outcome of the trial. Until then, the company remains under the protection of the *CCAA*, unless the Court issues a new order.

16 In the meantime, since June 8, 2011, Kitco has continued operating - at a reduced volume, we are told - and pays taxes on inputs and then claims refunds from the ARQ, which acknowledges owing Kitco over $1.7 million. The ARQ does not remit that amount to Kitco, however, but applies it as compensation against the amounts assessed.

17 Kitco, which considers the compensation illegal, filed a motion to compel the ARQ to refund it the $1.7 million. The Superior Court ruled in Kitco's favour [4] and ordered the refund. This is the reason for the ARQ's appeal.

18 The following reason appears in that judgment:

> [TRANSLATION]
>
> [118] . . . the *CCAA*, as interpreted by the jurisprudence, does not allow compensation between the Disputed Fiscal Debt, which was incurred before the insolvency proceedings, and the debt related to the Undisputed Credits, which was incurred after those proceedings.

19 According to the ARQ, this reason is unfounded because the wording of the provision permitting compensation (s. 21 *CCAA*, *infra*) does not limit it to debts arising before the insolvency proceedings. It writes:

> [TRANSLATION]
>
> The trial judge was wrong to conclude that, according to the wording of section 21 *CCAA*, the two compensating claims have to arise before proceedings are instituted.

20 In my opinion, the ARQ's literal interpretation is not correct because it creates an obstacle to the restructuring of large companies in difficulty, which is the primary objective of the *CCAA*, and also goes against the well-established principle in insolvency law of treating unsecured creditors equally. The ARQ also submits a ground based on the hypothesis that Kitco will fail to submit a plan of arrangement.

21 In my opinion, the judge's reason is well founded and is sufficient to uphold the judgment. The following is my four-part analysis:

(A) The reason, with a few clarifications;

(B) Compensation versus corporate restructuring;

(C) Compensation versus treating unsecured creditors equally;

(D) The potential failure of Kitco to submit a plan of arrangement.

(A) The reason, with a few clarifications

22 To begin with, it is useful to explain the contents of the judge's reason, to wit: (1) "The *CCAA*," (2) The "Disputed Fiscal Debt," (3) The "Insolvency proceedings" and (4) A debt "incurred before the insolvency proceedings" and another "incurred after" those proceedings.

(1) "The *CCAA*

23 First, the provision in question is section 21, which permits compensation. The act as a whole, however, is the source of the underlying objectives and principles that must be taken into account to ensure an accurate interpretation of the provision in accordance with the recognized modern approach.

24 Section 21 *CCAA* reads as follows:

21 Les règles de compensation s'appliquent à toutes les réclamations produites contre la compagnie débitrice et à toutes les actions intentées par elle en vue du recouvrement de ses créances, comme si elle était demanderesse ou défenderesse, selon le cas

21 The law of set-off or compensation applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

25 As it is in my view important to point out the close relationships between the *CCAA* and the *BIA*, here is the provision of the latter statute respecting compensation, which is to the same effect:

Compensation

97 (3) Les règles de la compensation s'appliquent à toutes les réclamations produites contre l'actif du failli, et aussi à toutes les actions intentées par le syndic pour le recouvrement des créances dues au failli, de la même manière et dans la même mesure que si le failli était demandeur ou défendeur, selon le cas, sauf en tant que toute réclamation pour compensation est atteinte par les dispositions de la présente loi concernant les fraudes ou préférences frauduleuses.

Law of set-off or compensation

97 (3) The law of set-off or compensation applies to all claims made against the estate of the bankrupt and also to all actions instituted by the trustee for the recovery of debts due to the bankrupt in the same manner and to the same extent as if the bankrupt were plaintiff or defendant, as the case may be, except in so far as any claim for set-off or compensation is affected by the provisions of this Act respecting frauds or fraudulent preferences.

(2) "Disputed Fiscal Debt

26 This refers to the notices of assessment that the ARQ issued against Kitco, which Kitco is contesting.

27 With respect to the contestation, another point debated in appeal should be eliminated.

28 For compensation to be effected between debts, the *Civil Code* requires that the debts be "certain" (art. 1673). Does the fact that the assessments are contested make them uncertain, or does the fact that they are immediately exigible make them certain within the meaning of that provision?

29 That question need not be answered, because, even if we adopt the hypothesis favourable to the ARQ whereby the assessments are certain, the question remains whether compensation can be effected between the two debts where one is incurred before the insolvency proceedings and the other is incurred after. The answer to that question will be sufficient to decide the dispute.

(3) The "Insolvency proceedings

30 These are the proceedings instituted in accordance with the *CCAA* or the *BIA*, which are the two laws that shape the integrated body of insolvency law.

31 In this case, the first proceeding was the notice of intention (*BIA*) dated June 8, 2011, followed by the second, the order (*CCAA*) dated July 7, 2011. The first stayed the creditors' remedies and the second continued that stay. This constitutes another close connection between the two statutes.

32 The creditors' claims were also established and evaluated as at June 8, pursuant to the *CCAA*, which refers to the *BIA*:

(CCAA)

Réclamations

19 (1) Les seules réclamations qui peuvent être considérées dans le cadre d'une transaction ou d'un arrangement visant une compagnie débitrice sont :

a) celles se rapportant aux dettes et obligations, présentes ou futures, auxquelles la compagnie est assujettie à. . .

(ii) la date de la faillite, au sens de l'article 2 de la *Loi sur la faillite et l'insolvabilité*, si elle a déposé un avis d'intention sous le régime de l'article 50.4 de cette loi ou. . .

Claims

19 (1) Subject to subsection (2), the only claims that may be dealt with by a compromise or arrangement in respect of a debtor company are

(a) claims that relate to debts or liabilities, present or future, to which the company is subject. . .

(ii) if the company filed a notice of intention under section 50.4 of the *Bankruptcy and Insolvency Act* or. . .

(BIA)

Définitions

2 Les définitions qui suivent s'appliquent à la présente loi.

. . .

ouverture de la faillite Relativement à une personne, le premier en date des événements suivants à survenir :

. . .

c) le dépôt d'un avis d'intention par elle;

. . .

Definitions

2 In this Act,

. . .

date of the initial bankruptcy event, in respect of a person, means the earliest of the day on which any one of the following is made, filed or commenced, as the case may be:

. . .

(c) a notice of intention by the person,

. . .

33 This led to the Court order of April 18, 2012, which states:

e) Claim" means any rights [[TRANSLATION] of a creditor] existing prior to the Determination Date, or which would have been claims provable in bankruptcy had the Petitioner become bankrupt on the Determination Date, and. . .

. . .

n) Determination Date" means June 8, 2011;

o) Excluded Claims" means any right of any Person against the Petitioner in connection with (i) any indebtedness, liability or obligation of any kind which came into existence after the Determination Date and . . . .

34 June 8 is thus the date of institution of proceedings in insolvency and of the stay of the creditors' remedies, as well as the date when their claims must be established (the Determination Date or Determination).

(4) A debt "incurred before the insolvency proceedings" and another "incurred after" those proceedings

35 In appeal, the parties take up the distinction drawn by the trial judge between the debts incurred before the Determination and those incurred after it, referring to [TRANSLATION] "pre-" and [TRANSLATION] "post-" debts, which simplifies the wording.

36 Since the claims were established as at the Determination Date, they are all pre-debts, to which the "law of set-off or compensation applies" (s. 21 *CCAA* and s. 97(3) *BIA*).

37 Here, the parties admit that the ARQ's claim based on the assessments is a pre-debt, to which compensation applies.

38 According to the ARQ, the $1.7 million refund claimed by Kitco is a post-debt against which compensation can also be effected. It argues that [TRANSLATION] "[c]ompensation of a claim by a debt arising during the *status quo* is permitted." The phrase [TRANSLATION] "during the *status quo*," means arising in the period from the day of Determination and as long as the stay of the creditors' remedies ordered by the Court continues.

39 It argues that, while its claim must be "pre" for compensation to be effected, the same is not true of its debt to the debtor, which can be "post." It writes:

[TRANSLATION]

> Naturally, the compensated claim must be related to a debt or liability of the debtor prior to the institution of insolvency proceedings. It can, however, be compensated against "any action instituted by the debtor for the recovery of debts" with no regard for the point in time when the underlying rights arose.

40 It is a fact that, as at the day of Determination, Kitco had no right to the claimed refund. That right arose from the continuation of its business and the taxes it has paid to its suppliers on the input for its operations since Determination. The refund is indeed a post-debt.

41 It will be necessary to revisit this distinction between pre- and post-debts through a review of the case law, as there is some confusion in this respect.

(B) Compensation in relation to corporate restructuring

42 The ARQ submitted an interpretation of section 21 that follows the text very closely, which is not an unreasonable approach. Since the "law of set-off or compensation applies to . . . all actions instituted by [the debtor company] for the recovery of debts . . . ," the ARQ can invoke compensation as a defence against Kitco's claim for a tax refund of $1.7 million.

43 In my opinion, this literal interpretation goes against the primary objective of the *CCAA*, which is the restructuring of large companies in difficulty to ensure their survival, because it undermines the *status quo* period intended by the statute during which the company can develop a plan of arrangement to be presented to its creditors. In *Century*,[5] the Supreme Court wrote:

• On the necessity of the *status quo*:

[60] Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed . . .

[Citations omitted.]

• On the importance of the survival of companies:

[60] . . . In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company . . . In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed . . .

[Citations omitted.]

44 The objective of restructuring is so important that the *CCAA* even allows debtors to borrow, subjecting their property to a security that ranks in priority over the claim of any secured creditor.

45 To explain how a literal interpretation of section 21 creates an obstacle to the objective of restructuring, I will borrow from "Recent Developments in the Law of Set-off" [6] by Anderson, Gelbman and Pullen, in which they ask "whether set-off is available in the *CCAA* context as between pre-filing debts and post-filing debts."

46 In the article, the authors analyse *Re Air Canada*, [7] referred to by the ARQ, which they assert wrongly opens the door to compensation between pre- and post-debts. They describe "the following typical scenario": [8]

• A and B are in a trading relationship, and each month either party could be a net payor;

• A becomes insolvent and seeks court protection pursuant to the *CCAA*;

• As of the filing date, A owes B a pre-filing debt;

• A and B continue commercial relations in the ordinary course post-filing; and

• Post-filing, B becomes a net payor and purports to set off the amount it owes to A against the pre-filing amounts owed by A to B, potentially until the entire pre-filing debt is extinguished.

If *Air Canada* stands, it would appear that a set-off would be allowed in the scenario. However, the mischief created by such a set-off is clear; it creates an incentive for a creditor with a pre-filing claim to procure goods or services from the debtor company in the post-filing period and withhold payment for such goods or services to retire the pre-filing debt. At the same time, it creates a disincentive for the debtor company to continue to do business with its suppliers or customers to avoid having to "work off" the pre-filing debt, an action which, depending on the amounts involved, could dissipate significant assets and jeopardize a successful restructuring.

47 This scenario corresponds to the situation before us, in which the ARQ owes a post-debt, namely, tax refunds, which it uses to effect compensation against the assessments, which are pre-debts. The post-debt accounts for 15% of Kitco's sales revenue, such that, if the *status quo* persists - which is to be feared - the compensation will continue "until the entire pre-filing debt is extinguished."

48 How can Kitco keep its business going if, like its competitors, it pays 15% in taxes on its inputs, but, unlike them, it does not receive a refund? This is an untenable situation. The authors write: [9]

> If a debtor company provides goods or services and receives no payment in return, the restructuring process will be rendered impossible. This result is especially true if multiple creditors are involved. It is difficult to imagine that the legislators of the day intended that result.

49 The authors quote the leading authorities in insolvency law, Houlden, Morawetz and Sarra, who come to the same conclusion: [10]

> It is customary in a proposal to provide that creditors dealing with the debtor after the filing of a notice of intention or a proposal shall have no right of set-off. This is done to prevent creditors from purchasing goods from the debtor and claiming a right of set-off against the amount owing to them by the debtor. Even if such a term is not contained in a proposal, it would appear that there is no right of set-off, since if such were allowed it would be a fraud on the bankruptcy law. . .
>
> If set-off were allowed, it would make it difficult, if not impossible, for a trading company to make a successful proposal.

50 The correct interpretation of section 21 must be consistent with the objective of restructuration.

(C) Compensation in relation to treating unsecured creditors equally

51 To begin with, it is useful to focus on the close links between the *CCAA* and the *BIA*, which mean that case law and scholarly opinion can be applied to both equally.

52 These laws form a part of an integrated body of insolvency law, as the Supreme Court has said: [11]

> [78] Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms . . .

53 The "two statutory schemes for reorganization" are, first, the entire arrangement procedure under the *CCAA*, and, second, the "proposals" under Part III *BIA* with a view to an arrangement. An arrangement is a contract with the creditors to erase past deficits and relaunch the company.

54 The two schemes prescribe a combined procedure that ensures maintenance of the *status quo* by the stay of creditors' individual remedies for the time needed to prepare a restructuring plan to be presented to them with a view to an arrangement or compromise.

55 In *Century*, [12] the Supreme Court restored the trial decision that "fostered a harmonious transition" between the two laws in order to provide a "single collective proceeding" with respect to insolvency. It wrote:

> [77] The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

56 There are two schemes: the *BIA*, which is directed at SMEs, , and the *CCAA*, which is directed at large businesses. Since SME proposals are numerous and have more common elements, the *BIA* sets out a number of rules for dealing with them. In

cases of large businesses in difficulty, which are fortunately less common, every situation is unique, and the *CCAA* accordingly provides for greater flexibility to ensure the solution is tailored to the situation.

57 The two schemes are integrated, as can be seen from their many corresponding provisions, such as the rules for compensation, the definition of provable claims and the manner they are dealt with, and the stay of creditors' remedies that begins under one scheme and continues under the other.

58 It should also be noted that section 97(3) *BIA*, which provides for compensation in the event of bankruptcy, also applies to proposals under section 66(1) *BIA*.[13]

59 In addition to these provisions, there are also those covering the notion of a secured creditor, which are the same: "a person holding a mortgage, hypothec, pledge, charge or lien on or against the property of the debtor or any part of that property." (See the definitions in section 2 of both laws.)

60 The ARQ itself draws attention to these close ties by employing the expression [TRANSLATION] "the plan or proposal" a number of times. For example, noting the common objective of the two schemes, it writes:

> [TRANSLATION]
>
> Under the *CCAA* or a proposal, a stay of proceedings is established to allow the debtor to restructure and present its creditors with a plan or proposal.*
>
> * Section 11.2 *CCAA* and sections 69 and 69.1 *BIA*.

61 This concordance now established, we may consider the Supreme Court's comments on the rule of compensation in insolvency cases. In *D.I.M.S. Construction inc. (Trustee of) v. Québec (Attorney General)*,[14] it writes:

> > [55] . . . Since s. 97(3) *BIA* is an exception to the rule of equality between creditors, it must be interpreted narrowly. . . .
> >
> > [56] . . . The general principles of the *BIA* preclude any transaction that would have the effect of granting a security that did not exist before the bankruptcy. . . .

62 Equal treatment of creditors, subject to the priorities set out in the statute, is a recognized principle of insolvency law.

63 The ARQ claims, however, that it has priority by virtue of compensation. It writes:

> [TRANSLATION]
>
> In *Husky Oil Operations Ltd. v. M.N.R.*[15] [*Husky Oil*], the Supreme Court recognized that compensation creates a form of priority permitted in the context of insolvency. Parliament thus authorizes the party that invokes it to change the established order of priority.
>
> ________
>
> [15] [1995] 3 SCR 453 at paras. 60-61.

64 Further on in *Husky*:

> [Emphasis added.]
>
> [57] In the bankruptcy context, a right to set-off necessarily has the effect of securing the claim of the party claiming set-off against assets of the bankrupt's estate. . . .
>
> . . . .

> [59] Indeed, as a result of creating <u>a type of security</u> interest in the estate, the operation of set-off in bankruptcy has been the subject of academic criticism. . . .
>
> [60] . . . in the bankruptcy context, the law of set-off allows a debtor of a bankrupt who is also a creditor of the bankrupt to refrain from paying the full debt owing to the estate, since it may be that the estate will only fulfil a portion, if that, of the bankrupt's debt. Consequently, <u>in this limited sense</u> the party claiming set-off has Parliament's blessing for the « reordering » of his priority in bankruptcy by virtue of the operation of the law of set-off.

65 In the civil law, this "priority" created by set-off is difficult to understand because compensation "is effected by operation of law upon the coexistence of debts . . . " (art. 1673 *CCQ*), essentially automatically. It is easier in the common law, where the operation is not automatic and the two debts exist independently and survive in parallel when bankruptcy occurs.

66 In the civil law, on the day of Determination, compensation is effected and a balance is calculated in favour of the creditor or the debtor, if the two debts are liquid and exigible. It is also effected if the debt is not exigible since a "debtor loses the benefit of the term if he becomes insolvent" (art. 1514 *CCQ*). Lastly, if judicial liquidation is required (art. 1672 *CCQ*), the balance is calculated retroactively to the day of Determination, since the claims must be established as at that date.

67 In the common law, the two debts survive Determination. Owing to the cleavage between the bankrupt's assets and liabilities, creditors retain provable claims for the entire amount owing to them but, in return, the entire amount of their debt must be paid to the trustee. This [TRANSLATION] "shocking" result is fortunately averted by the fact that both insolvency regimes allow for compensation.

68 In this common law context, compensation can be seen as a form of priority security. The creditor is secured, but with respect to only one piece of the debtor's property controlled by the trustee, namely, the debtor's claim against the creditor. Once that security is received by way of a reduction in the amount of the debtor's debt by the amount of the debtor's claim, however, the creditor becomes an ordinary creditor with respect to the balance, with no security on any of the debtor's other property.

69 How does this apply to the ARQ's claim on Kitco's property?

70 As at the day of Determination, the ARQ was one of Kitco's creditors for the amounts assessed, but it was also one of Kitco's debtors since it owed a tax refund for prior operations (not including the $1.7 million for operations subsequent to Determination). The compensation was effected. The ARQ reduced the assessments by the amount of the refund, which it did not pay to Kitco, thus realizing its security on that piece of Kitco's property by trading its claim for a refund. Once its security was realized through compensation, it no longer held any security on Kitco's other property, and Kitco could keep that property to maintain its operations and restructure its business.

71 When the ARQ later seeks to effect another compensation for $1.7 million, it is clear that it is claiming a security interest on other property belonging to Kitco and assigning itself priority to the detriment of other ordinary creditors. This is an operation prohibited under the statute, as the Supreme Court notes in the passage from *D.I.M.S.*, cited above:

> [56] . . . The general principles of the *BIA* preclude any transaction that would have the effect of granting a security that did not exist before the bankruptcy. . . .

72 Once again the ARQ argues that the case law allows compensation to be effected between pre- and post-debts. I will not revisit *Air Canada*, the judgment criticized in the commentary.

73 According to the ARQ, the compensation rule in bankruptcy matters must be given a broad interpretation. It writes:

> [TRANSLATION]
>
> . . . since *D.I.M.S. Construction inc. (Trustee of) v. Québec (Attorney General)* [*D.I.M.S.*], it has been established that equitable set-off is no longer applicable in Quebec.

This is what led this Court, in *Daltech Architectural inc. (Syndic de)* [*Daltech*], to conclude that legal compensation under the *CCQ* must be interpreted broadly: . . . .

Compensation of related debts that are not necessarily certain, liquid or exigible as at the date of institution of insolvency proceedings is thus permitted under Quebec civil law. This right was in fact reaffirmed by the Court in *Commission de la santé et de la sécurité du travail v. Dolbec Transport inc.* [15] . . .

[Citations omitted.]

74 So far, so good. But problems arise when, at the end of the last paragraph cited, the ARQ adds:

[TRANSLATION]

Regarding this aspect, the trial judge failed to take into account any of the foregoing judgments; she erred.

75 According to the ARQ, the [TRANSLATION] "broad interpretation" of the case law would have led the Court in *Dolbec* to allow compensation to be effected between pre- and post-debts. This is not the case.

76 In *Dolbec*, the Court noted that both of the debts to which set-off was applied were incurred before Determination. It wrote:

[TRANSLATION]

[37] This is why, although, following approval by the Court and payment of a dividend, the CSST was bound by the proposal and could no longer claim the balance of its debt under section 62(2) *BIA*, the Court is nevertheless of the opinion that, to defend itself against Dolbec's action, the CSST could still avail itself of the provisions of section 97(3) *BIA* and effect compensation against the balance of the debt since there is nothing in the proposal to prevent this, the debts are related, and both occurred after Dolbec had filed its notice of intention to make a proposal under the *Bankruptcy and Insolvency Act*.

77 The source of the error lies in the fact that the pre-debts include those *incurred after* Determination where they result from an obligation that originated *before Determination*. Post-debts are only those incurred after and also resulting from an obligation originating after Determination, such as the $1.7 million tax refund claimed after Determination and resulting from the company's post-Determination operations.

78 Certainly, an obligation can be contingent, unliquidated, or not exigible as at the day of Determination, but existing and able to give rise to a claim if a court decision "deems it provable," as provided in sections 121(1) and (2), which refer to 135(1.1) and (4) *BIA*.

Art. 121 (1)

Réclamations prouvables

121 (1) Toutes créances et tous engagements, présents ou futurs, auxquels le failli est assujetti à la date à laquelle il devient failli, ou auxquels il peut devenir assujetti avant sa libération, en raison d'une obligation contractée antérieurement à cette date, sont réputés des réclamations prouvables dans des procédures entamées en vertu de la présente loi.

Décision

(2) La question de savoir si une réclamation éventuelle ou non liquidée constitue une réclamation prouvable et, le cas échéant, son évaluation sont décidées en application de l'article 135.

135 . . .

Réclamations éventuelles et non liquidées

(1.1) Le syndic décide si une réclamation éventuelle ou non liquidée est une réclamation prouvable et, le cas échéant, il l'évalue; sous réserve des autres dispositions du présent article, la réclamation est dès lors réputée prouvée pour le montant de l'évaluation.

. . .

Effet de la décision

(4) La décision et le rejet sont définitifs et péremptoires, à moins que, dans les trente jours suivant la signification de l'avis, ou dans tel autre délai que le tribunal peut accorder, sur demande présentée dans les mêmes trente jours, le destinataire de l'avis n'interjette appel devant le tribunal, conformément aux Règles générales, de la décision du syndic.

Section 121 (1)

Claims provable

121 (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

Contingent and unliquidated claims

(2) The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135.

135 . . .

Determination of provable claims

(1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.

. . .

Determination or disallowance final and conclusive

(4) A determination under subsection (1.1) or a disallowance referred to in subsection (2) is final and conclusive unless, within a thirty day period after the service of the notice referred to in subsection (3) or such further time as the court may on application made within that period allow, the person to whom the notice was provided appeals from the trustee's decision to the court in accordance with the General Rules.

79 Even though date of the court's ruling is long after Determination, such an obligation is nonetheless a "provable claim" as of that day, to which compensation can apply.

80 In *Daltech* [16] as well, the Court reiterated that the mutual obligations at the source of the debts to be compensated must exist on the day of Determination. In that judgment, we read:

[TRANSLATION]

[58] In *D.I.M.S. Construction inc. (Trustee of) v. Québec (Attorney General)*, Deschamps, J. interpreted section 97(3) *BIA*. " . . . as implicitly requiring that the mutual debts come into existence before the bankruptcy". In this case, I share the

opinion of the trial judge that compensation applies because, prior to the bankruptcy, the bankrupt had a claim against the respondent, as evidenced by the right of retention set out provided in the Contract. At the time of the bankruptcy, both parties were mutually creditor and debtor.

81 For compensation to be possible, the question is not whether there is a debt, or whether it is liquid or exigible, or related to another debt, but whether it is a provable claim duly proved or "deemed a proved claim".

82 In my opinion, sections 21 *CCAA* and 97(3) *BIA*, which provide that the "law of set-off or compensation applies to all claims . . . ", thereby identify the point in time when compensation is effected, or in other words, the moment at which the claims must be established: it is on the date of Determination that temporal reciprocity is established.

83 Thus, a creditor establishes its claim as at Determination, at which time it subtracts its own debt to the debtor. If the balance is in the creditor's favour, it establishes its provable claim. Otherwise, if the balance is in the debtor's favour, the latter is entitled to claim the balance, but not more.

84 The judge also based her judgment on the principle of equality between creditors, from which compensation must not stray. She wrote:

> [TRANSLATION]
>
> [102] In accordance with these preoccupations and this reasoning, the Supreme Court specifically stated in *D.I.M.S.* that section 97(3) *BIA*, which allows compensation in the context of bankruptcy, implicitly requires that the <u>mutual</u> debts be incurred before the bankruptcy.
>
>> [55] Few commentators have shown an interest in the effects of subrogation in bankruptcy matters, and <u>the principles of Canadian bijuralism do not permit the importation of common law rules</u> . . . Section 97(3) *BIA* does not provide that a claim may be transferred from one creditor to another so as to permit compensation where it could not otherwise be set up. <u>Since</u> s. 97(3) *BIA* <u>is an exception to the rule of equality between creditors, it must be interpreted narrowly</u>. . . . .

85 I read *D.I.M.S.* in the same way. Another passage from that judgment reads:

>> [40] . . .
>
> Thus, a creditor who wishes to effect compensation must be able to prove the bankrupt was subject to a debt by reason of an obligation incurred before the bankruptcy.
>
> . . .
>
>> [55] . . . [Section 97(3) *BIA*] must therefore be read in conjunction with ss. 121, 136(3) and 141 *BIA* as implicitly requiring that the mutual debts come into existence before the bankruptcy.

86 In a similar vein, the judge added:

> [TRANSLATION]
>
>> [103] Moreover, the Court of Appeal of Québec has abided by this rule in a number of decisions. [63]
>>
>> [104] In 2004, in accordance with that rule and in a context similar to that of the current dispute, the Court of Appeal for Ontario ruled [64] that Canada Revenue Agency cannot assign refunds owing to a debtor for tax overpayments made <u>after</u> a proposal to the payment of a debt incurred by the debtor toward Revenue Canada for taxes unpaid <u>before</u> the proposal.

[105] Given the strong similarity between sections 97(3) *BIA* and 21 *CCAA*, and the fact that both laws are part of an integrated body of insolvency law, that conclusion applies just as well to set-off in a context of restructuring. There is no reason to differentiate between the set-off mechanism in the context of a bankruptcy or proposal and in the context of an arrangement.

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63 *CSST c. Dolbec Transport inc*., 2012 QCCA 698 at para. 37; *Daltech Architectural Inc. (Syndic de),* 2008 QCCA 2441, paras. 58, 61; *2945-2802 Québec c. Ville de St-Léonard*, J.E. 98-2341 at paras. 22, 23, 25 (C.A.).

64 *Re Jones*, (2004) 45 C.Q.B. (4th) 263 at para. 19.

65 *Century Services Inc. v. Canada (Attorney General)*, [2010] 3 S.C.R. 379 at paras. 15, 22-24, 78.

87 Rulings prior to *D.I.M.S.* now have less weight.

88 In short, the interpretation in the case law of section 21 *CCAA* does not go in the direction that the ARQ would like.

(D) The potential failure of Kitco to submit a plan of arrangement

89 The ARQ bases this additional ground on an alternative hypothesis, depending on whether the proceeding ends with or without an arrangement. It writes:

[TRANSLATION]

In the event of the approval of the plan or proposal, a new contract will bind the creditors. This is the cut-off date after which compensation of a debt incurred before insolvency proceedings by a debt incurred after the proceedings must cease, unless the parties have agreed otherwise.[61] If the plan or proposal is not approved, bankruptcy will take place at the proposal stage, or the stay will be lifted and bankruptcy will take place at the arrangement stage, and this is when the cut-off date will be established. Any compensation that will have been effected at that point will be the compensation of debts incurred before the bankruptcy.

---

[61] Note that the compensation of debts incurred before the institution of proceedings can be effected at any time, even after approval of the proposal - *Dolbec*, *supra* note 21.

90 In the footnote, the ARQ rightly recognizes that compensation can be effected even after an arrangement has been established.

91 An arrangement does not change compensation. It binds all creditors with provable claims (s. 2 *BIA*) as at Determination, claims which will have already been reduced by the amount of the creditor's own debt to the debtor, or which will be a defence against an action by the debtor, even if that action is subsequent to the arrangement agreement. This is what was established in *Dolbec*.

92 The possibility of a potential arrangement is not helpful in interpreting section 21 *CCAA* or in determining how to apply it during the present *status quo* period.

93 The ARQ considers it more probable that Kitco will default. It writes:

[TRANSLATION]

Note that Kitco has not filed a plan and seems not to have the intention to file one, at least not until the tax dispute is resolved. Consequently, the only purpose of the *CCAA* protection is to prevent the remedies of the tax authorities.

94 The hypothesis that the proceedings will fail and end with no arrangement does not help us to see clearly either. In the following excerpt, the ARQ uses the future perfect tense, which implies retroactivity:

[TRANSLATION]

All of the compensation that will have been effected at that point will be the compensation of debts incurred before the bankruptcy.

95 Of course, if the assessments are confirmed, we may anticipate that the proceedings underway pursuant to the *CCAA* will fail and that Kitco will go into bankruptcy in the following days. The provable claims in the bankruptcy will be established "on the day on which the bankrupt becomes bankrupt" (s. 121(1) *BIA*). The ARQ's present claim, established as at June 8, will no longer be valid, and its new claim will be cut off at the date of bankruptcy.

96 At that point, compensation will again come into play (s. 97(3) *BIA*), and all of the reciprocal debts up to that new date will be taken into account. It is true that, on that future day, the ARQ will be entitled to compensate its assessments with the tax refunds owed to Kitco, including the claimed refund of $1.7 million, if it is not yet paid.

97 I do not see, however, how this new application of compensation on the occasion of hypothetical new bankruptcy proceedings would change the rules of compensation that are applicable now, during the *status quo*.

98 In short, the ARQ will perhaps be entitled to compensation of a post-Determination debt under the *CCAA* if these proceedings end without an arrangement, but the ARQ cannot invoke this future right to establish a present right to compensation.

99 This additional ground of appeal has no merit.

100 In conclusion, the Judge was right to rule that compensation between pre- and post-debts is not permitted.

101 For these reasons, I am of the opinion that the Court should dismiss these appeals, with legal costs in favour of the respondent (Kitco) and the impleaded parties (Richter LLP and Heraeus Metals New York LLC), but without costs against the intervener (QAIRP).

Footnotes

1 See section 315 of the *Excise Tax Act* (ETA) R.S.C. (1985), c. E-15, and section 2701 of the *Tax Administration Act* (TAA), CQLR, c. A-6.002.

2 R.S.C. (1985), c. B-3.

3 R.S.C. (1985), c. C-36.

4 Judgment of the Superior Court, 2016 QCCS 444.

5 *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, [2010] 3 S.C.R. 379.

6 Robert Anderson, Thomas Gelbman and Benjamin Pullen, "Recent Developments in the Law of Set-off," (2009) *Ann. Rev. Insol.* 1 at 22.

7 *Re Air Canada* (2003), 2003 CarswellOnt 4016, 45 C.B.R. (4th) 13 (Ont. S.C.J.) [Commercial list].

8 *Supra* note 6 at 23.

9 *Supra* note 6 at 29.

10 L.W. Houlden, G.B. Morawetz & J.P. Sarra, *Bankruptcy and Insolvency Law of Canada*, 3d ed. Rev., vol. 3, looseleaf (Toronto: Carswell, 2009) at E§ 64.

11 *Supra* note 5.

12 *Supra* note 5.

13 LFI, art. 66 (1) Toutes les dispositions de la présente loi, sauf la section II de la présente partie [Proposition de consommateur], dans la mesure où elles sont applicables, s'appliquent, compte tenu des adaptations de circonstance, aux propositions faites aux termes de la présente section.

BIA, s. 66 (1) All the provisions of this Act, except Division II of this Part, in so far as they are applicable, apply . . . , with such modifications as the circumstances require, to proposals made under this Division.

14 2005 SCC 52, [2005] 2 SCR 564.

15 *Commission de la santé et de la sécurité du travail* v. *Dolbec Transport inc.*, 2012 QCCA 698.

16 *Daltech Architectural inc. (Syndic de)*, 2008 QCCA 2441.