Court File No. CV-23-00707394-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TACORA RESOURCES INC.

BOOK OF AUTHORITIES OF CARGILL, INCORPORATED AND CARGILL INTERNATIONAL TRADING PTE LTD.

(Motion to Set Aside Disclaimer and Global Process Motion returnable June 26, 2024)

June 20, 2024

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INDEX

I N D E X

Tab No.	Description
	Jurisprudence
1.	*Bellatrix Exploration Ltd., (Re)* [2020] A.W.L.D. 1317, A.J. No. 329
2.	*Bellatrix Exploration Ltd. (Re)*, 7 July 2022, Calgary 1901-13767
3.	CRA Ruling 2002-0151343
4.	*Plasco Energy (Re)*, (July 17, 2015), CV-15-10869-00CL
	Articles
5.	*Beaudry, M.A., and D. Krause, "Selected Income Tax Considerations in Court-Approved Debt Restructurings and Liquidations", Report of the Proceedings of the Sixty-Seventh Tax Conference, 2015 Conference Report (Toronto: Canadian Tax Foundation, 2016)*

1

2020 CarswellAlta 350
Alberta Court of Queen's Bench

Bellatrix Exploration Ltd., Re

2020 CarswellAlta 350, [2020] A.W.L.D. 1317, [2020] A.J. No. 329, 316 A.C.W.S. (3d) 411, 77 C.B.R. (6th) 230

IN THE MATTER OF THE COMPANIES' CREDITOR ARRANGEMENTS ACT, R.S.C. 1985, C. C-36, as Amended

IN THE MATTER OF THE COMPROMISE OR ARRANGEMENT OF BELLATRIX EXPLORATION LTD.

Jones J.

Heard: February 4, 2020
Judgment: February 4, 2020
Docket: Calgary 1901-13767

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Subject: Contracts; Insolvency

APPLICATION by purchaser for declaration that contract constituted Eligible Financial Contract under *Companies' Creditors Arrangement Act*.

***Jones J.*:**

1 THE COURT: This is my oral decision in connection with the application that I heard on January 23rd, 2020. I will obtain a transcript, edit it for punctuation, grammar and format and then the edited version will be released and will constitute my formal decision.

Background

2 BP Canada Energy Group ULC (BP) applies for relief in connection with certain actions taken by Bellatrix Exploration Ltd. (Bellatrix). On October 2, 2020, Bellatrix obtained protection from its creditors under the Companies' Creditors Arrangement Act (CCAA). I appointed PriceWaterhouseCoopers Inc. as Monitor for the purposes of *CCAA* proceedings.

3 BP and Bellatrix are parties to certain contracts for the purchase and sale of natural gas. I describe those agreements in more detail below. I refer to the combination of agreements that constitute the totality of arrangements between the parties, for purposes of the matter before, me as the "Contract".

4 On November 25, 2019, while under *CCAA* protection, Bellatrix, on notice to BP, purported to disclaim the Contract (the "Disclaimer"). The Disclaimer was to be effective on December 25, 2019.

5 Further, on November 26, 2019, Bellatrix ceased delivery of natural gas under the Contract. BP argues that the Disclaimer Notice was a nullity, alleging it to be of no force and effect. Bellatrix argues that, having first obtained the approval of the Monitor, it was entitled to disclaim the Contract.

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6 At this stage of proceedings, the issue for determination is whether or not the Contract constitutes an Eligible Financial Contract ("EFC") for *CCAA* purposes. If the Contract is an EFC, then Bellatrix was not permitted to disclaim it. If the Contract is not an EFC, then Bellatrix may, subject to certain qualifications discussed below, disclaim or resiliate the Contract. For convenience, in the balance of this decision I use the terms "disclaim" and "disclaimer" to refer to both a disclaimer and resiliation.

7 Bellatrix wants to disclaim the Contract. Garrett K. Ulmer, Chief Operating Officer of Bellatrix, swore an Affidavit on January 9, 2020 ("Ulmer Affidavit"). At paragraph 31 of that Affidavit, Ulmer states that Bellatrix estimates it can realize an additional $14.2 million if, instead of continuing to deliver natural gas to BP under the Contract, it disclaims the Contract and sells that volume of gas locally in Alberta.

8 Ulmer notes that Bellatrix's estimate is based on AECO spot price forecasts for natural gas for the period comprising December 25, 2019, the effective date of the Disclaimer, to the end of the term of the two Transaction Confirmations, as that term is described below, being October 31, 2020. Bellatrix is betting that the AECO price it would be able to get under new natural gas sale contracts will be higher than the price it expects to receive for its natural gas under the Contract.

BP's Application

9 BP's application came before me on January 23, 2020. BP seeks an Order providing, among other things, for the following: (as read)

> (1) Declaring the Contract to be an eligible financial contract within the meaning of the *CCAA*.
>
> (2) Declaring the Notice of Disclaimer served on November 25, 2019 by Bellatrix upon BP purporting to disclaim the Contract effective December 25, 2019 to be a nullity and of no force and effect.
>
> (3) In the alternative, directing pursuant to s. 32(2) of the CCAA, that the Contract cannot be disclaimed or resiliated from by Bellatrix.
>
> (4) Enjoining Bellatrix from unilaterally suspending deliveries of volumes it is required to deliver to BP under the Contract and directing Bellatrix to comply with the Contract for so long as the same shall remain binding and in force and ordering Bellatrix to forthwith remedy any existing default.

10 In addition to the above, BP sought other relief which, to some extent, is consequential upon a determination of EFC status or non-EFC status. However, given the limited time available on January 23, 2020 for argument on BP's various requests for relief, counsel for BP agreed to limit the scope of my inquiry to whether or not the Contract is an EFC.

11 Accordingly, the issue of EFC status is the only issue I consider in this decision. A different discussion is engaged if the Contract is found not to be an EFC.

The Contract

12 The parties disagree over the proper characterization of the Contract. Copies of the various documents which comprise the Contract are attached as Exhibit "A" to an Affidavit of BP's representative, Gerry Hrap, filed January 2, 2019 ("Hrap Affidavit").

13 I turn now to its essential elements and provisions. It becomes important to note that the Contract does not specify a fixed price, established at the commencement of the Contract, for the delivery of natural gas. The price for natural gas paid by BP is based on fluctuating natural gas spot prices in referenced downstream gas markets for the month during which natural gas is delivered.

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14 As Bellatrix notes in its brief, these spot prices are neither determined nor fixed at that commenced of the Contract. Rather, they continue to change in the various relevant markets throughout the term of the Contract. The Ulmer Affidavit states at paragraph 38 as follows: (as read)

> Because the contract price per MMBtu is calculated based on a monthly market prices at the beginning of each delivery month, the contract prices under the Delivery Agreements are not fixed, but instead vary as the various market prices for natural gas vary.

15 As noted above, the agreement between Bellatrix and BP is to be found in a collection of related provisions which I have referred to as the Contract. At least as presented to the Court by way of the Hrap Affidavit, it consists of four components. They are: (as read)

> GasEDI Base Contract for Short-Term Sale and Purchase of Natural Gas Cover Sheet (the "Cover Sheet");
>
> GasEDI Base Contract for Short-Term Sale and Purchase of Natural Gas General Terms and Conditions (the "Terms and Conditions");
>
> Special Provisions for GasEDI Base Contract (the "Special Provisions"); and
>
> Transaction Confirmations for Immediate Delivery relating to a trade date of December 12, 2017 and for a trade date of February 9, 2018 (the "Transaction Confirmations").

16 In each case, the Transaction Confirmations appear to consist of an original Transaction Confirmation, together with the current applicable Transaction Confirmation, there having been amendments and restatements thereto.

17 I now deal briefly with each of these four components, to the extent their contents are relevant to the issue before the Court.

The Cover Sheet

18 The Cover Sheet consists of two pages. Page one provides details of contract information and financial settlement details. The Cover Sheet is signed by the parties. The introduction to the execution portion reads as follows: (as read)

> In witness whereof, the parties hereto have executed this Base Contract in duplicate.

19 Also, section 2.1 of the Terms and Conditions defines Base Contract to mean: (as read)

> A contract executed by the parties that incorporates these General Terms and Conditions by reference; that specifies the agreed selections of provisions contained herein, and that sets forth other information required herein.

20 The Cover Sheet appears to meet the specifications referred to in this definition and therefore I interpret references to Base Contract in the various documents comprising the Contract to be references to the Cover Sheet.

21 Page 2 of the Cover Sheet stipulates that the Contract incorporates the Terms and Conditions. The Terms and Conditions consist of numbered clauses. Page 2 of the Cover Sheet requires boxes to be checked in respect of concepts or terms referred to in certain of the numbered clauses in the Terms and Conditions. By checking a particular box, the parties reflect a particular understanding of how the Contact is to apply.

22 For example, section 7 of the Terms and Conditions deals with billing, payment and audit. Section 7.2 of the Terms and Conditions provides that the Buyer must pay for natural gas on or before the later of the Payment Date or 10 days after receipt of the invoice by the Buyer. Page 2 of the Cover Sheet contains a box referring to Section 7.2 and indicates that the parties have agreed that the Payment Date is to be the 25th day of the month following the month of delivery.

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23 Page 2 of the Cover Sheet also refers to Special Provisions consisting of five attached pages. The Special Provisions modify certain of the Terms and Conditions.

24 In essence, the Cover Sheet might be referred to as "the Contract at a glance". I am advised that the Contract is in a form widely used in the industry. The Cover Sheet would thus serve to inform persons familiar with these types of agreements of certain data they may require to administer the Contract on an ongoing basis.

Terms and Conditions

25 Some provisions of the Terms and Conditions, as modified by the Special Provisions, warrant mention.

26 A "Transaction" is defined to mean any gas sale, purchase or exchange agreement effected pursuant to the Base Contract: section 2.1.

27 The Confirming Party (BP) shall confirm any "Transaction" by sending the other party (Bellatrix) a Transaction Confirmation: section 1.2.a.

28 As modified by the Special Provisions, section 1.2.d. of the Terms and Conditions provides that the entirety of the agreement between the parties consists of (i) an effective Transaction Confirmation, (ii) any oral or electronic agreement between the parties, evidenced as prescribed therein (iii) the Base Contract and (iv) the General Terms and Conditions. Section 1.2.d refers to this collection of documents as the "Contract". That is why I have adopted that terminology.

29 An "Event of Default" under the Terms and Conditions, as modified by the Special Provisions, includes, *inter alia*, the filing of a petition or otherwise commencing, authorizing, or acquiescing in the commencement of a proceeding or cause under any bankruptcy or insolvency (however evidenced) or the inability to pay debts as they fall due.

30 Again, as modified by the Special Provisions, an Event of Default also includes a party's failure to deliver natural gas on what is referred to as a "Firm basis". "Firm" is defined in section 2.1 of the Terms and Conditions. The concept of Firm addresses the circumstances in which a party may interrupt its performance of the Contract without liability.

31 It is clear that Bellatrix, by virtue of these CCAA proceedings, has incurred an "Event of Default". Its cessation of delivery of natural gas on November 26, 2019 would also appear to constitute an Event of Default.

32 In this situation, the Cover Page indicates that the parties have agreed to what is referred to as a "Cover Standard". A Cover Standard is relevant to the determination of an appropriate remedy if a party breaches the Contract: section 3.2 of the Terms and Conditions.

33 Section 3.2 of the Terms and Conditions provides, among other things, for a payment by the Seller to the Buyer if the Seller is in breach of the Contract. Very generally, the quantum of that payment, if any, is determined with reference to what is referred to as the Cover Standard for replacement natural gas and what is referred to as the Contract Price. Quantum of required payment also takes into account the difference between the quantity of natural gas the Seller agreed to deliver and the quantity it actually delivered.

34 "Cover Standard" is defined in section 2.1 of the Terms and Conditions. Without descending into the minutae of that definition, it specifies what a Performing Party may do in the event of a default by the other party. At a high level, it contemplates that the Performing Party will take commercially reasonable efforts to either buy or sell natural gas, as the case may be.

35 It is Bellatrix's responsibility to deliver natural gas to "Delivery Point(s): section 4.1 of the Terms and Conditions. "Delivery Point(s) are defined to mean such point(s) as are mutually agreed upon between Seller and Buyer as forth in the Transaction Confirmation: section 2.1. My understanding is that the Delivery of natural gas by Bellatrix under the Contract takes place in Alberta.

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36 Subject to certain limitations, the Terms and Conditions provide for netting out all same currency amounts due and owing, as determined by the provisions of the Contract, by one party to the other: section 7.6 of the Terms and Conditions.

37 Upon the occurrence of an Event of Default, the Non-Defaulting Party may, *inter alia*, withhold amounts owed to the Defaulting Party and setoff against such withheld amounts any amounts owed the Non-Defaulting Party: section 10.2 of the Terms and Conditions.

38 Upon the occurrence of an Event of Default, the Non-Defaulting Party may, subject to limitations, terminate and liquidate all Transactions then outstanding or not yet commenced. The Non-Defaulting Party is permitted to designate an Early Termination Date (between 1 and 20 business days after the Event of Default): section 10.3 of the Terms and Conditions.

39 The Non-Defaulting Party which designates an Early Termination Date must calculate the Total Termination Payment and advise the Defaulting Party, providing detailed support for its calculation: section 10.3 of the Terms and Conditions.

40 Section 2.1 of the Terms and Conditions defines "Total Termination Payment" to be the sum of the Termination Payments for all Transactions terminated pursuant to section 10 of the Base Contract. I return to the calculation of Termination Payments below.

41 The Non-Defaulting Party may net the Total Termination Payment against all other amounts between the parties under the Contract. The net amount is referred to as the "Liquidation Amount" and, depending on who has the resulting payment obligation, is payable on a prescribed date following the Event of Default. For a Defaulting Party, that prescribed date is within 2 Business Days: section 10.4 of the Terms and Conditions.

42 Section 2.1 of the Terms and Conditions defines Termination Payment for a Transaction, which is the basis for determining Total Termination Payment and, thus, the Liquidation Amount.

43 Termination Payment for a Transaction is defined to be the difference between the Market Value and the Contract Value, adjusted for Costs, as of the Early Termination Date: section 2.1 of the Terms and Conditions.

44 Market Value and Contract Value are both defined in section 2.1 of the Terms and Conditions. Market Value, as modified by the Special Provisions, is the discounted present value of the product of two amounts. The first amount is the quantity of gas remaining under a Transaction. The second amount is a "market price for a similar transaction" considering the remaining Delivery Period, Contract Quantity and Delivery Point.

45 To determine the "market price", for the purpose of determining "Market Value", the Non-Defaulting Party may consider a number of indicia, including any or all of the settlement prices of NYMEX Gas futures contacts, quotations from leading dealers in energy swap contracts or physical gas trading markets, similar sales or purchases and any other bona fide third-party offers, as adjusted.

46 Contract Value of a Transaction is defined as the discounted present value of the product of two amounts. The first amount is the quantity of natural gas remaining to be transacted between the parties under a Transaction. The second amount is the Contract Price.

47 Contact Price, defined in section 2.1 of the Terms and Conditions, is stated to be determined on the basis of whether the Delivery Point is in Canada or in the United States. The Delivery Point is specified in the Transaction Confirmation.

48 Each Transaction Confirmation provides for the specification of a Contract Price. I examine the determination of Contract Price in more detail below.

49 The point here is that, in case of an Event of Default, BP may terminate, but is not required to. A determination of net amounts owing from one party to the other is made. Net amounts owing must be paid within a certain time.

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50 In my view, the key point which emerges from the above analysis is that the Contract provides a mechanism by which an amount, if any, is determined to be owing by a Defaulting Party, Bellatrix in this case, and which is made payable within a prescribed time. This is so even though the price for natural gas which would have ultimately been paid if the Transaction had been fully performed cannot have been determined because that reference price was to be determined during the term of the Contract at the time of delivery.

51 The Contact allows for prompt set-off or netting based on the determination of a Liquidation Amount. There is no requirement to wait until the end of a Contract term to perform that calculation.

52 While the Contract may not, itself, be a hedge contract, as that term is normally applied, it contemplates netting or set-off in the event of a default based on market prices prevailing at the date of default. As discussed by the Court of Appeal in *Blue Range Resource Corp., Re*, 2000 ABCA 239 (Alta. C.A.) *(Blue Range)* and in *Calpine Canada Energy Ltd., Re*, 2006 ABQB 153 (Alta. Q.B.), *(Calpine)*, the ability to set-off or net under a contract is one indicia pointing to EFC status.

53 The provisions of the Contract, with its provisions for determining Total Termination Payments and Liquidation Amounts, provide a party with certainty that, in the Event of Default, calculation of monetary damages will be possible. The Contract may not be a hedge contract as that term is generally understood, but in entering into it, Bellatrix nevertheless is betting that the pricing mechanism provided for in the Contract will give it greater financial return than would be the case if it selected the AECO price in Alberta as the Contract Price.

54 Bellatrix acknowledged before me that Bellatrix enters into hedge contracts. It argued, however, that it is not possible for Bellatrix to hedge or manage its risk under this Contract because the price for the natural gas it sells is a moving target.

55 Bellatrix readily concedes that the Contract seeks to achieve what it refers to as "price diversification", but it is not a hedging contract.

56 Interestingly, the Special Provisions add the following section 10.7: (as read)

> The parties specifically agree that this Contract and all Transactions pursuant hereto constitute an "eligible financial contract" within the meaning of the *Banhuptcy and Insolvency Act (Canada)* and the *Companies' Creditors Arrangements Act (Canada)* and similar Canadian legislation.

57 What, if any, significance may be attached to this provision in light of the purposes of CCAA? The decision of the Ontario Court of Appeal in the matter of Androscoggin Energy LLC, Re [2005 CarswellOnt 589 (Ont. C.A.)] might suggest not much.

58 In that case, the Court commented on the decision of our Court of Appeal in *Blue Range*. With reference to provisions for termination, set-off and netting found in the agreements in issue in *Blue Range*, the Ontario Court of Appeal noted that: (as read)

> Unlike the contracts found to be EFCs in Blue Range, supra, the contracts in issue here possess none of these hallmarks and cannot be characterized as EFCs. However, the mere pro forma insertion of such terms into a contract will not result in its automatic characterization as an EFC. Regard must be had to the contract as a whole to determine its character.

59 Bellatrix argues that I should ignore the provisions of the Contract affirming EFC status. BP argues that even in CCAA, a Court should still be mindful of what the parties expressed their intention to be.

60 The contracts in *Androscoggin* did not, to my knowledge, state that they were EFCs. This Contact does state that it is an EFC. As will emerge from the discussion below, I find that statement to be of some, but not overwhelming, significance. The Court's job here is to determine if the Contract should or should not enjoy the special status attributable to EFCs.

61 I do not believe the parties should be permitted to attempt to contract in or out of the application of a statute which otherwise clearly applies or does not apply, unless the statute expressly permits that to happen. I am not aware of any such permissive provision in the *CCAA*.

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The Transaction Confirmations

62 Turning finally to the Transaction Confirmations, they complete the Contract. Exhibits "B" and "C" to Hrap Affidavit contain copies of Transaction Confirmations.

63 Clause 28 of the Ulmer Affidavit notes that the Contract Prices specified for purposes of the two Transaction Confirmations before me are, on the one hand, based on a formula expressed as the average of the California (Malin), Midwest Chicago Citygate and Dawn, Ontario, natural gas spot prices, reduced by a fixed transportation fee, per MMBtu and, on the other hand, on a formula expressed as the Midwest Chicago Citygate natural gas spot price, reduced by a fixed transportation fee, per MMBtu.

64 Clause 7 of the Hrap Affidavit confirms this approach to pricing. Hrap asserts at clause 8 of his Affidavit that: (as read)

> The purpose of the Gas EDI Agreement, and other similar contracts that producers and marketers enter into, is to manage price risk by setting a contract price that is based on an index price representing a market other than the delivery point.

65 Bellatrix's brief nicely summarizes the pricing arrangements under the Contract at paragraph 46: (as read)

> The Agreements in issue here do not provide for any fixed prices for the delivered natural gas, but rather are based on fluctuating natural gas spot prices in the referenced downstream market for the month during which natural gas is delivered.

Discussion

66 Hrap points to Exhibit "D" of his Affidavit. It is a press release issued by Bellatrix on December 14, 2017 ("Press Release"). It states, *inter alia*, that: (as read)

> Bellatrix has recently diversified it natural gas price exposure through physical sales contracts that give the Company access to the Dawn, Chicago and Malin natural gas pricing hubs .... this long-term diversification strategy reduces Bellatrix's exposure to AECO pricing on approximately 26% of the Company's forecast 2018 natural gas volumes. In combination, the market diversification sales and fixed price hedges cover approximately 2/3 of natural gas volumes in 2018.
>
> In aggregate, Bellatrix's hedging program is part of its overall risk management strategy providing reduced commodity price volatility and greater assurance over future revenues and operating funds flow which help drive the capital and reinvestment decisions within our business.

67 It is clear that Bellatrix sought, through the Contract, price diversification. As paragraph 24 of the Ulmer Affidavit notes: (as read)

> Bellatrix entered into the Agreements with BP Canada for exactly this purpose: to have BP Canada transport Bellatrix's natural gas to other markets so that Bellatrix could realize the financial benefit of selling its natural gas in markets outside of Alberta. At the time the Agreements were entered into, AECO prices were significantly lower than the natural gas spot prices available in other North American markets.

68 Part of the explanation for the dilemma Bellatrix finds itself in may be found at paragraph 29 of the Ulmer Affidavit: (as read)

> When the parties negotiated the Delivery Agreements, they calculated transportation fees with reference to the price differential between the AECO spot price, and the downstream market spot prices that formed the basis for the contract price. The applicable transportation fees are well above the actual cost of transportation that is incurred by BP Canada under the Delivery Agreements. As the difference between the AECO spot price and the downstream market spot prices have narrowed since the Delivery Agreements were executed, the transportation fees have become increasingly uneconomical for Bellatrix.

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69 Bellatrix was betting that prices for natural gas referenced to these other markets would be more beneficial than contracts which reflected AECO pricing.

70 Bellatrix acknowledges that its expectations regarding AECO pricing in relation to pricing under the Contract were incorrect.

Scheme of the CCAA

71 Borrowing from a description on the Government of Canada's website, Office of the Superintendent of Bankruptcy: (as read)

> The main purpose of the CCAA is to enable financially distressed companies to avoid bankruptcy, foreclosure or the seizure of assets while maximizing returns for their creditors and preserving both jobs and the company's value as a functioning business.

72 A different page from the same website states as follows: (as read)

> The *CCAA* has a broad remedial purpose, allowing a company to continue in business while it seeks to develop and obtain the approval of compromises or arrangements with its creditors. Canadian courts have held that the main purpose of the *CCAA* is to avoid, where possible, the social and economic consequences of bankruptcy, and to allow a company to carry on business.

73 The following provisions of the *CCAA* are relevant for our purposes:

74 Section 32(1) allows a debtor company to disclaim any agreement to which it is a party on the day on which proceedings commence under the CCAA. The monitor must have approved of the proposed disclaimer. The company's ability to disclaim is, however, subject to notice provisions and other limitations.

75 Section 32(2) is one of those limitations. It confers upon a party receiving notice the right to apply to the Court for an order that the agreement is not to be disclaimed.

76 Section 32(4) provides that if the Court is called upon to respond to a monitor's refusal to approve or the responding party's application to prevent disclaimer, it must perform an analysis taking into account certain factors.

77 Section 32(9) provides that section 32 does not apply to, *inter alia*, an EFC. Since the right to disclaim is provided for in section 32(1), non-application of section 32 means that the right to disclaim set forth in section 32(1) does not apply. That means that if the Contract is an EFC, Bellatrix cannot disclaim it.

The Eligible Financial Contract Regulations (the "Regulation")

78 Section 2 of the Regulation stipulates that certain types of agreements are prescribed for purposes of the definition of "eligible financial contract" in section 2(1) of the CCAA. That means that only the agreements specified in section 2 of the Regulation may be EFCs.

79 Section 2 provides that: (as read)

> The following kinds of financial agreements are prescribed for the purpose of the definition eligible financial contract in subsection 2(1) of the Companies' Creditors Arrangement Act:
>
> (a) a derivatives agreement, whether settled by payment or delivery, that
>
> (i) trades on a futures or options exchange or board, or other regulated market, or

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(ii) is the subject of recurrent dealings in the derivatives markets or in the over-the-counter securities or commodities markets;

(b) an agreement to

(i) borrow or lend securities or commodities, including an agreement to transfer securities or commodities under which the borrower may repay the loan with other securities or commodities, cash or cash equivalents,

(ii) clear or settle securities, futures, options or derivatives transactions, or

(iii) act as a depository for securities;

(c) a repurchase, reverse repurchase or buy-sellback agreement with respect to securities or commodities;

(d) a margin loan in so far as it is in respect of a securities account or futures account maintained by a financial intermediary;

(e) any combination of agreements referred to in any of paragraphs (a) to (d);

(f) a master agreement in so far as it is in respect of an agreement referred to in any of paragraphs (a) to (e);

(g) a master agreement in so far as it is in respect of a master agreement referred to in paragraph (f);

(h) a guarantee of, or an indemnity or reimbursement obligation with respect to, the liabilities under an agreement referred to in any of paragraphs (a) to (g); and

(i) an agreement relating to financial collateral, including any form of security or security interest in collateral and a title transfer credit support agreement, with respect to an agreement referred to in any of paragraphs (a) to (h).

80 Section 1 provides that:

A derivatives agreement means a financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations, debt securities, climatic variables, bandwidth, freight rates, emission rights, real property indices and inflation or other macroeconomic data and includes

(a) a contract for differences or a swap, including a total return swap, price return swap, default swap or basis swap;

(b) a futures agreement;

(c) a cap, collar, floor or spread;

(d) an option; and

(e) a spot or forward.

81 The term "financial agreement" which appears in sections 1 and 2, is not defined.

The Parties' Arguments

82 Bellatrix argues, among other things, that the Contract cannot be an EFC because it does not share the characteristics of a "forward commodity contract", as that concept was examined in *Blue Range* and *Calpine*.

Fixed vs. Variable Pricing

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83 Bellatrix sets forth the indicia of a forward commodity contract mentioned by Fruman JA at paragraph 49 of *Blue Range*, where Fruman JA quoted from an expert report provided by a specialist in energy risk management.

84 However, in its reference to *Blue Range*, Bellatrix appears to misquote that decision. At paragraph 49 of *Blue Range*, Fruman J A noted that a key element of a forward gas contract is a "defined price" or "pricing mechanism". At paragraph 39 of its brief, Bellatrix rephrases this key element to be a "pre-determined" or "fixed price".

85 The Contract does not contain a fixed price, at least in the sense of a price fixed at the outset of the Contract which prevails throughout its term. The Contract Price cannot be said, at least as to the actual dollar amount, to be pre-determined.

86 In my view, the Contract Price under the Contract is determined in accordance with a pricing mechanism. The use of spot prices prevailing from time to time in a reference market may, in my view, also be characterized as a defined price. The Contract Price prevailing from time to time will be "defined" by the determination of the applicable price for natural gas in accordance with the Contract.

87 In the context of pricing Bellatrix places much reliance on paragraph 18 of Justice Romaine's decision in*Calpine*. Justice Romaine's reasoning and insight in *Calpine* are deserving of respect and careful consideration. But what exactly did Justice Romaine say?

88 At paragraph 18 of *Calpine* she says: (as read)

> Analysing the COP Agreement as a whole, it is clear that it lacks the characteristics or hallmarks of an eligible financial contract. It does not fall within the definitions of "forward commodity contracts" cited by Fruman, J.A. in Blue Range when the terms "certain price" and "defined price" in those definitions are read as synonymous with "predetermined" or "fixed" (as I believe is the intent), rather than the broader "able to be determined" meaning submitted by Pengrowth. It is clear that the COP Agreement does not meet the fixed price requirement but instead depends upon market pricing.

89 I have the following observations. First, as noted above, I do not think Fruman JA in *Blue Range* was saying that forward commodity contracts must always have a settlement price which is specified at the outset of the contract. Quoting from another source, she notes at paragraph 17 of *Blue Range*, in reference to forward commodity contracts, that they "are merely contracts to buy or sell gas at a certain price on a future date".

90 She goes on to say, "they are negotiated contracts between private parties to buy and sell a specified quantity of gas at a certain or determinable price on a certain future date."

91 As alluded to above, at paragraph 48, Fruman JA quotes from an expert in energy risk assessment, Mr. James Joyce. Fruman notes that one of the indicia of a forward contract, as conceived by Joyce, includes "a defined price or pricing mechanism".

92 In my view, it is unnecessary to use both the words "certain" and "determinable" in the same sentence if they both mean "fixed". Similarly, the use of the words "pricing mechanism" as an alternate to the words "a defined price" makes sense to me only if they are intended to convey different thoughts.

93 I would go further and argue that the use of the word "certain" in the phrase "a certain or determinable price" and the word "defined price" in the phrase "a defined price or pricing mechanism" allow for broader interpretation. In my view, the word "certain" does not have to mean "fixed at the outset of the contract". Rather, it can mean a price determined later, as long as it is capable of being determined.

94 In my view, the reference to a "pricing mechanism" is the antithesis of a price fixed at the outset of the contract. All that is needed is the ability under the Contract to determine the applicable price at that time it becomes necessary to determine it. The Contract provides that ability.

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95 In any event, in *Calpine*, Justice Romaine seems to have been tasked with determining if the agreements she was considering qualified for EFC status by virtue of being "forward commodity contracts". I am not limited in that regard, partly because I am required to consider a definition of EFC which, by virtue of legislative amendment post-dating her decision, is different from that which Justice Romaine was operating under.

96 The Regulation does not state that any of the types of agreements contemplated therein must contain a fixed price, though some (but not all) of the contracts referred to in the Regulation likely are based on the concept of a fixed price.

97 I conclude that an EFC does not require a fixed price. I do not think a fair reading of *Blue Range* and the authorities cited therein, or the provisions of the Regulation, require a fixed price for EFC status.

Fairness

98 Bellatrix argues at paragraph 40 of its brief that the Court is to also apply a "fair results" test under which it may determine that even if the form of contract constitutes an EFC and cannot therefore be disclaimed, the court may decline to characterize the contract as an EFC if would be unfair to do so. Bellatrix offers citations from *Blue Range* (paragraph 52) and *Calpine* (paragraph 28) in support of that argument.

99 I do not think either *Blue Range* or *Calpine* stand for the proposition that an agreement which otherwise clearly falls within the definition of an EFC can be excluded as such by this Court because it would, in the Court's view, give rise to an unfair result.

100 Rather, paragraph 52 of *Blue Range* is, in my view, expressing the notion that fairness may enter the analysis of a *CCAA* Court at an earlier stage. That is, at the time the Court is considering if an agreement in question meets the definition of an EFC. That is a different proposition from saying that even though an agreement clearly meets the definition of an EFC it can nevertheless be declared by the Court not to be one. I am not convinced that it is a distinction without a difference.

101 At paragraph 52 of *Blue Range*, Fruman JA refers to the purpose of the *CCAA*. She does so in the context of discussing fairness. Under the auspices of fairness, the inference I would draw from her comments is that the Court has some latitude in deciding the threshold question of whether or not a particular agreement constitutes an EFC if that characterization has implications for the Court's ability to fulfil the objects and purposes of the *CCAA*.

102 In argument before me BP agreed with my analysis, noting that section 11 of the CCAA provides that: (as read)

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

103 BP appears to take the position that section 11 gives me the power, as part of an EFC status eligibility analysis, to consider if it would be fair to determine if a particular agreement did or did not qualify as an EFC.

104 Another interpretation of the scope of section 11 is provided by Fruman JA in *Blue Range*.

105 At paragraph 7, citing authority, she notes that: (as read)

> The court's discretionary powers under s. 11 have been interpreted to restrain any conduct "the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period."

106 In fairness, I believe Bellatrix's counsel ultimately acknowledged that any consideration of fairness enters into the analysis at the stage where EFC status is determined.

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107 Recognizing that an exception for EFC's to the rule permitting disclaimer should be construed narrowly, in order to facilitate attainment of the, arguably, larger objective of facilitating an insolvent entity's restructuring, a *CCAA* Court should err on the side of restraint and caution in deciding if EFC eligibility is met in any particular case. I think Justice Romaine was making a similar point at paragraph 28 of*Calpine*.

108 In the end, I do not accept the argument that section 11 of the CCAA can be considered to have applied "appropriately in the circumstances" if it used to disqualify as an EFC an agreement which the Court concludes otherwise meets the definition in the Regulation. To do otherwise would, in my view, interject an undesirable element of uncertainty into capital markets.

109 It would also appear to have the effect of substantively re-writing the Contract between the parties by ignoring certain provisions that would have otherwise led a reader to conclude that it was an EFC. I think the Court should be cautious about engineering such a result.

110 Lastly, if fairness enters the analysis at the EFC status determination stage, I see no reason why it would be inherently fairer to grant EFC status only to agreements where the settlement price for the commodity was fixed at the outset of the contract. It seems to me that if a fairness analysis involves at least some consideration of the stake which the parties to an agreement have and if, as Bellatrix has acknowledged, the Contract forms part of its price diversification program in conjunction with traditional hedging contracts, then it might be manifestly unfair to disallow EFC status in this case.

111 Suppose the facts were different. Suppose the Contract Price under the Contract was expected to remain sufficiently above the AECO price to make it desirable for the Contract to remain in place. Bellatrix might be happy to see the Contract continue. Surely the issue of fairness should not fall to be determined on the basis of which side of a bet on future pricing the insolvent party to an agreement ended up on.

112 I think there is another reason to be sceptical of the Court's power to use section 11 of the CCAA to deny EFC status in respect of an agreement that would otherwise appear to meet the requirements for an EFC, by looking through a "fairness lens".

113 In my view, the legislation imposes two impediments to unrestrained disclaimer. The first is section 32(9) which has the effect of removing an EFC from a debtor company's power to disclaim.

114 The second is section 32(4), which directs the Court to consider various factors in deciding whether or not an non-EFC should or should not be disclaimed.

115 In my view, the cumulative effect of these two sections suggests quite the opposite conclusion to that arrived at by Bellatrix. One may argue that imposing two barriers to disclaimer, the first being the outright prohibition arising from EFC status and the second being a requirement to satisfy the Court on the basis of factors such as those found in *CCAA* 32(4), manifest a direction to the Courts from the legislator that, while disclaimer by the insolvent corporation potentially reflects the objectives of a *CCAA* restructuring, the ability to disclaim is not unfettered.

116 To suggest that a Court should be permitted to substitute its view of fairness for that apparently reflected in Parliament's decision to provide an exception to disclaimer for EFCs, is, in my view, problematic. I accept the notion that a *CCAA* Court must be flexible, applying exceptions to the broad policy objective of facilitating restructurings narrowly.

117 At some point, however, that flexibility must not unduly compromise certainty. It seems to me that if there is to be an exception to disclaimer for EFCs, parties to agreements must be able to count on that exception meaning something. Agreements, such as the Contract. negotiated at considerable expense, reflective of industry practice and understanding, which themselves potentially engineer other agreements, such as hedge contracts, and the industry created to support those arrangements, cannot be subject to effective wholescale revision by a *CCAA* Court, such that the parties legitimate expectations are always going to be at risk of a *CCAA* Court finding unfairness.

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118 Thought of another way, to allow a *CCAA* Court to find an agreement that otherwise clearly fits within the definition of an EFC to not be an EFC, is to allow a *CCAA* Court to effectively rewrite that agreement. I do not understand a *CCAA* Court to have that authority.

119 A concluding thought on fairness. What of those who have taken the opposite bet to Bellatrix under hedge agreements? What of those whose livelihood or ability to manage capital depends on the certainty of knowing that contracts, such as the Contract, will, even in the event of insolvency, be enforceable in accordance with their terms.

120 Bellatrix and BP agreed in the Contract that it would be an EFC. I think it a reasonable inference that parties to agreements with Bellatrix and BP, who paid money to create arrangements with either Bellatrix or BP, might have based their positions at least to some extent on the fact that the Contract was expressly stated to an EFC for *CCAA* purposes.

Purpose of the Contract

121 To be an EFC, a derivatives agreement must first be a financial agreement.

122 Bellatrix argues that the Contract is not a financial agreement, as that term is used in the Regulation. Rather, it is an agreement for the sale of natural gas, which just happens to allow for price diversification.

123 I note that in *Blue Range*, Fruman JA concluded that agreements for the physical delivery of gas could be forward commodity contracts and, under the legislation prevailing at the time of her decision, EFCs. The notion of a "forward" as an EFC was retained in the Regulation.

124 I conclude that an agreement for physical delivery of natural gas is not, *a priori*, disqualified as an EFC. The reasoning in *Blue Range* confirms that conclusion.

125 In my view, a financial agreement is one which serves an important financial purpose. In *Blue Range*, the Court of Appeal found that a forward commodity contract did serve an important financial purpose, unrelated to physical settlement, because it is a risk management tool. Indeed, Fruman characterized the forward commodity contracts in that case as "hedges".

126 Of course, Bellatrix argues the Contract is not a hedge, and cannot be a hedge because it does not utilize a fixed price.

127 I think the Contract is a financial agreement because it serves an important financial purpose. What is the important financial purpose here? Bellatrix acknowledges that the Contract seeks to achieve price diversification. In my view, that is a financial purpose.

128 Is price diversification important to Bellatrix? It seems important enough to have been mentioned in the Press Release.

129 In analyzing if the Contract serves a "financial purpose" it makes no sense to me to consider the Contract in isolation from Bellatrix's other actions. The Press Release mentions the Contract in the context of Bellatrix's "long term diversification strategy".

130 Is that strategy one which seeks to avoid the risk of contractually agreeing to deliver gas it cannot produce? No, it notes that this strategy seeks to reduce exposure to AECO pricing.

131 Importantly, in my view, the Press Release refers to the importance of the "combination" of "the market diversification sales and fixed price hedges", which it states, "cover approximately 2/3 of natural gas volumes in 2018".

132 Immediately after these quotations, it goes on to say that: (as read)

> In the aggregate, Bellatrix's hedging program is part of its overall risk management strategy providing reduced commodity price volatility and greater assurance over future revenue and operating funds flow which help to drive the capital and reinvestment decisions within our business.

133 The inescapable conclusion is that the Contract, in conjunction with fixed price hedges, sought what Bellatrix considered to be a pricing arrangement more favourable to its financial risk management, cash flow and capital budgeting objectives.

134 Bellatrix would argue that its fixed price hedging contracts are financial agreements but that they are different from the Contract. The Contract, Bellatrix argues, is simply not a hedging contract.

135 There is no end to the number of definitions of a hedging contract. Having reviewed many of them, a common theme emerges. They seek to manage financial risk.

136 I think Bellatrix's Press Release, when it refers to Bellatrix's "hedging program" is referring to the combination of the Contract and its fixed price hedge contracts. Together, they work to achieve financial risk management. In my view, one would have limited utility in achieving Bellatrix's objectives without considering the impact of the other.

137 The Press Release indicates that the Contract serves to diversify Bellatrix's natural gas price exposure. Surely that is an effort in financial risk management.

138 Bellatrix argues that BP attempts to misconstrue the Press Release, suggesting that it confirms Bellatrix's view that the Contract is financial in nature. Bellatrix argues that the Press Release clearly distinguishes between its hedging arrangements and its efforts to diversify natural gas price through physical sale agreements.

139 I believe that the Contract is part of Bellatrix's hedging program. Indeed, without it, there would appear to be no need for fixed price hedge contracts. It is an important part of collection of agreements that play a role in Bellatrix's financial management undertakings.

140 That makes it a financial agreement for purposes of the Regulations.

141 In any event, the Contract does not have to be a forward commodity contract, or a hedge, to be an EFC. I have no difficulty concluding that the Contract is a financial agreement. But is it a derivatives agreement?

142 Before addressing that question, I note that there is more than one potential path to EFC status.

143 Working through the Regulation set forth above, the Contract will be an EFC if is:

a "financial agreement": section 1;

a financial agreement which is a derivatives agreement: section 1;

a derivatives agreement settled either by payment or delivery: section 2;

144 Which derivatives agreement either:

trades on a futures or options exchange or board or other regulated market, or

is the subject of recurrent dealings in the derivatives markets or in the over-counter securities or commodities markets: section 2.

145 Paragraphs (a) to (e) of Section 1 of the Regulation provide a non-exhaustive list of various types of agreements which, by virtue of their inclusion in those paragraphs, are considered to be both financial agreements and also derivatives agreements. With the exception of the Contract possibly being a "forward", I do not believe the Contract falls within paragraphs (a) to (e) of the definition of "derivatives agreement". I do not examine that path to EFC status further.

146 As noted in the excerpt of the Regulation cited above, paragraph (b) of section 2 of the Regulation provides another path to EFC status.

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147 The Contract provides for physical delivery of natural gas. The agreements contemplated in paragraph (b) of section 2 of the Regulation do not appear to me to address this type of agreement. A possible exception would be subparagraph 2(b)(ii) which contemplates an agreement to clear or settle derivatives transactions. However, I do not consider it necessary to examine that potential path further.

148 EFCs include a master agreement so far as it is in respect of a derivatives agreement otherwise qualifying under Regulation 2(a): Regulation 2(f).

149 Pursuant to Regulation 1, a "derivatives agreement" means: (as read)

> A financial agreement whose obligations are derived from, referenced to, or based on, one or more underlying reference items such as interest rates, indices, currencies, commodities, securities or other ownership interests, credit or guarantee obligations or debt securities, climactic variables, bandwidth, freight rates, emissions rights, real property indices and inflation or other macroeconomic data.

150 As noted above, for greater certainty, certain types of agreements are specifically identified as derivatives agreements.

151 Can the Contract be said to be an agreement whose obligations are derived from, referenced to or based on an underlying reference item, such as a commodity? Noting paragraph 23 of *Blue Range*, can the Contract be said to be an investment tool whose value depends on, or is derived from, the performance of some underlying asset such as stocks, bonds, commodities, currencies or indices?

152 It is not entirely clear to me what kind of market exists for the Contract (as opposed to the natural gas itself). Section 13 of the Terms and Conditions provides that, with the exception of transfers to parent or affiliated entities, the consent of the other party is required for an assignment of the Contract. Consent is not to be unreasonably withheld.

153 BP argues that the Contract is an agreement which is the subject of recurrent dealings in the over-the-counter commodities market, thus fitting within subparagraph 2(a)(ii) of the Regulation. I return to that particular provision below, because it is critical to my analysis.

154 The obligations under the Contract are based on a commodity, natural gas. Bellatrix agues, however, that the Contract cannot be a derivative agreement It argues that *Blue Range* stands, *inter alia*, for the proposition that to be a derivatives agreement the transaction must be settled at a fixed price.

155 That assertion may be correct as it relates to the characterization of an agreement as a forward commodity contract, which is what I think Fruman JA was engaged in analyzing. In my view, it is not, for at least two reasons, correct to say that a fixed price is a requirement of a derivatives agreement.

156 First, the definition of derivatives agreement in section 1 of the Regulation makes no mention of a fixed price. I acknowledge that the examples given in paragraphs (a) to (e) suggest agreements where a fixed price is stipulated.

157 However, as BP pointed out in argument, if a fixed price was essential to derivatives agreement status, the legislator could have stipulated that.

158 Secondly, while certain types of hedge contracts may be based on a fixed price of some underlying commodity at a future date, I remain to be persuaded that it would be impossible to construct a risk management agreement tool that was based on a price of an underlying commodity which fluctuated constantly. As long as the price of that underlying commodity was capable of determination at the date of delivery, the rest seems to me like an exercise in price forecasting and, in combination with other arrangements, hedging, as Bellatrix has done.

159 Restated, if the essence of an EFC is that it is a tool which assists in managing financial risk (such as the possibility of getting a lower price for your gas delivered in Alberta, when you expect prices to be higher in other reference jurisdictions),

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it seems to me that an agreement which provides for a variable price simply adds an additional degree of complexity and speculation to your financial risk management program. It should not make that program impossible.

160 I conclude that the Agreement is, first, a financial agreement and also a derivatives agreement. But is it the type of derivatives agreement which should enjoy EFC status?

161 Examining Regulation 2(a), it is acknowledged that the Agreement is settled by delivery of natural gas and payment for that natural gas. Of course, *Blue Range* noted that either settlement arrangement could give rise to a forward commodity contract. The risk management character of the agreements in issue in *Blue Range* were more important to the Court's conclusions than how they were settled.

162 Examining Regulation 2(a)(i), no evidence was provided which suggests that the Contract itself trades on a futures or options exchange or board, or other regulated market.

163 We are left with Regulation 2(a)(ii). It clothes a financial agreement which constitutes a derivatives agreement with EFC status if that agreement: (as read)

> Is the subject of recurrent dealings in the derivatives market or in the over-the-counter securities or commodities market?

164 BP takes the position that this provision does not require there to be transactions, frequent or otherwise, pursuant to which parties effect dispositions and acquisitions of interests under the Contract. It points to a 2008 article by Robert Anderson and Kelly Bourassa which considered the Regulation shortly after it was issued.

165 Anderson and Bourassa conclude that: (as read)

> In our view, a derivatives agreement that "is the subject of recurrent dealings" in the over-the-counter commodities market means a derivatives agreement in respect of which the underlying trade is of a type that is the subject of recurrent dealings (i.e. repeatedly transacted) in the over-the-counter commodities markets: Robert Anderson and Kelly Bourassa. *What Are Eligible Financial Contracts*? Blakes Bulletin on Restructuring & Insolvency, May 2008

166 BP argues that this description is directed at agreements, the subject matter of which, as opposed to the agreement itself, is recurrently dealt with on a commodities market. Clearly, natural gas would qualify as such a commodity.

167 BP argues that the "recurrent dealings" required under Regulation 2(a)(ii) are evident not only from the Transaction Confirmations themselves, which are continually restated and amended as between the parties, but the fact that the underlying commodity itself is the subject of recurrent dealings and re-trading, both as between the parties and in the derivatives market more generally. BP would argue that dealings between Bellatrix and BP in respect of the Contract take place in the over-the-counter market.

168 Bellatrix argues that subparagraph 2(a)(ii) seeks to address dealings in agreements that would effect dispositions and acquisitions of interests in the agreement, rather than interests in the subject matter of the agreement, in this case, natural gas.

169 The difficult words here are "is the subject matter of".

170 Though not without some doubt, I believe that BP is correct in its assertion that derivatives agreements can be EFCs if the underlying commodity is the subject of recurrent dealings.

171 First, if the legislator had intended to require interests in the derivatives agreement itself to be disposed of or acquired on some type of market it could have said so. It did not. Were that the intention (ii) could have said: involves dispositions or acquisitions of interest thereunder on a recurrent basis in.... (the various markets).

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172 Secondly, the difference in wording in Regulation 2(a)(i) and (ii) is somewhat informative. Arguably, (ii) was required to distinguish trades, if any, in the underlying reference item (in this case, natural gas) from trades in the agreement itself, as contemplated in (i).

173 If (ii) was not intended to refer to the underlying commodity or reference item, it would probably not have been necessary to have it there. The wording in (i) would probably have encompassed the landscape. Or, the wording in (i) could have been tweaked slightly to have so encompassed that landscape and (ii) rendered redundant.

174 Though not advanced by counsel before me, there is a counter argument. I assume that underlying reference items, like climatic variables or real property indices, do not themselves trade on any market. How then can they be included within the ambit of Regulation 2(a)(ii) unless that regulation is referring to transactions in the agreement itself?

175 Perhaps the answer is that where the underlying reference item may not trade, such agreements will not be EFCs unless the agreements themselves trade on one or more of the markets described in (i) or interests therein are disposed of and acquired on one or more of the markets described in (ii). Absent that, they are not EFCs.

176 Here, I conclude that the Transaction Confirmations evidence recurrent dealings in the Contract and the underlying commodity (natural gas) is the subject of recurrent dealings on commodities markets.

177 I think the Contract is contemplated by Regulation 2(a)(ii) for another reason, though I acknowledge that reason it is somewhat speculative. Bellatrix argues that the Contract is separate and distinct from its hedging agreements. But I believe that Bellatrix acknowledges in the Press Release that the two go hand in hand as part of its risk management efforts.

178 Ignoring the Press Release, Bellatrix acknowledged in argument before me that the Contact seeks price diversification. The Ulmer Affidavit and Questioning confirm that acknowledgment.

179 It seems logical to me to conclude that the position Bellatrix takes in its hedging contracts will to some extent reflect its expectations of what price will ultimately prevail under the Contract upon delivery of natural gas.

180 Bellatrix would argue that its hedging contracts are derivatives. If those derivative agreements are the subject of frequent transactions on derivatives markets and if it is proper, as I believe it is, to view the Contract and Bellatrix's hedging contracts as part of Bellatrix's overall risk management strategy, then the Contract may themselves be said to, at least indirectly, be "the subject of recurrent dealings in the derivatives markets".

181 I like this conclusion for another reason. As noted in *Blue Range*, a forward commodity contract is not excluded from EFC status just because it is settled by delivery. Settlement by cash or delivery can qualify.

182 The scheme of Regulation 2(a) seems consistent with that underlying premise. Regulation 2(a)(i) seems to contemplate trades that involve a cash settlement in respect of interests in an agreement disposed of or acquired as a consequence of a trade. Regulation 2(a)(ii) extends to dealings on a commodities market that could include settlement by physical delivery.

183 Bellatrix argues strenuously against my analysis of the application of the Regulation to these facts. As noted above, Bellatrix urges me to dissociate my conclusions from the provisions of the Contract wherein the parties specifically acknowledge that the Contract is an EFC. I accept the assertion that a careful analysis of the purpose and scheme of the *CCAA*, the wording of the Regulation and the cases that have considered those or, in the case of the decisions in *Blue Range* and *Calpine*, predecessor provisions, are much more important to the determination of EFC status than what BP and Bellatrix have chosen to call their agreement.

184 After all, parties should be restrained in their attempts to contract in or out of legislation that seeks to implement public policy objectives.

185 As noted above, the Ontario Court of Appeal stated in *Androscoggin Energy LLC*: (as read)

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> Mere pro forma insertion of such terms into a contract will not result in its automatic characterization as an EFC. Regards must be head to the contract as a whole to determine its character.

186 I have noted above that I believe the Court was referring to provisions such as set-off, or netting, and not a characterization of an agreement with reference to a specific statute that imposes consequences of that characterization.

187 However, I believe there is a price to be paid for stepping back from what the parties have said in an agreement and performing the more nuanced analysis which I agree must be performed. That price, I believe, is that increased reliance must be placed on a strict application of the wording of the Regulation as it applies to the Contract.

188 Since the Court, in Bellatrix's view, cannot place much emphasis on the description the parties elect to apply to the Contract, the Court must look elsewhere.

189 And while I acknowledge the wisdom of the Ontario Court of Appeal in reminding us to look beyond mere expressions of the parties' intentions, as expressed in a contract, especially when construing an exception to the remedial object and purpose of *CCAA* legislation, I cannot help but wonder what third party interests may be affected by ignoring what the parties have expressed as their intention.

190 Further, in completely ignoring an expression of intention in a contract negotiated on an arm's length basis and no doubt at some cost to the parties, is the Court effectively rewriting their agreement? If so, to what extent is that a permissible outcome from a *CCAA* court?

191 Lastly, would Bellatrix have been so quick to have me ignore this expression of the parties' intention if the Contract had expressly stated that it was not an EFC?

192 I appreciate that a fundamental objective of the *CCAA* process is to preserve status quo while opportunities for an equitable restructuring may be pursued. I appreciate that the ability to terminate unfavourable contracts is one tool in the status quo toolbox.

193 Consequently, I agree that the exception for EFCs must be construed narrowly. But as was pointed out in*Blue Range*, the ability of a non-insolvent counter party to terminate agreements and net out its position is also considered to be important from a policy perspective. EFC status allows that to happen.

194 BP does not seek that result on these facts. I must assume that, like Bellatrix, BP engages in capital management, cash flow planning and risk management. Are BP, and the other entities whose agreements with BP form part of an integrated risk management undertaking to be left uncertain about their ability to offer various products priced to reflect their assessment of outcomes?

195 How does an entire industry assess likely outcomes when expressions of intention in a contract and explicit definitions in a statute are required to give way to an assessment of fairness which may depend to some extent on the perspective of a particular judge on a particular day?

196 If BP, and many others like it, are not permitted to compel enforcement of an agreement, the elements of which no doubt form a part of their overall risk management, capital planning and cash flow strategies, how do they effectively manage risk?

197 It is easy to say that risk has looked favourably on BP in this situation and the Court need not concern itself with BP's pleas to uphold the contract because it can certainly replace the natural gas Bellatrix agreed to sell it. It did not draw the short straw under the Contract.

198 But why should the Court not conclude that BP is party to other agreements, the efficacy of which in BP's own risk management program depend to some extent on upholding the integrity of the Contract?

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199 The EFC exception represents a policy decision. I believe that the art in applying that exception to the Contract requires the Court to take at least take some account of the reasonable expectations of BP and Bellatrix at the time the parties entered into the Contract.

200 Bellatrix and, I assume, BP, entered into other arrangements to manage financial risk. Did they enter into those agreements on the assumption that, in an insolvency, the Contract would be disclaimed, notwithstanding that the Contract was agreed by the parties to be an EFC?

201 Perhaps they did, but Bellatrix's Press Release suggests that agreements, like the Contract, are part of a larger risk management strategy. Bellatrix has offered no evidence to suggest that its risk management strategy, and the agreements entered into in support of it, contemplated an exit from its obligations under the Contract in the event of insolvency.

202 The netting out and set-off provisions of the Contract are a strong indication to me that management of financial risk is a key component and objective of the Contract. What message does a *CCAA* Court send when it allows agreements which form part of that risk management objective to be disclaimed?

203 I note that section 34(8) of the CCAA expressly provides that netting or setting off are permitted in respect of a terminated EFC. I note further that section 34(9) provides that no order may be made under this Act if the order would have the effect of staying or restraining the actions permitted under subsection (8).

204 Presumably, the prohibition on a Court interfering with the solvent counter-party's right to terminate would extend to any attempt to use the power in section 11 to do so. That seems to me to be a fairly strong indication that compliance with the requirements for EFC status is to be taken seriously, at least as that status confers certain rights under section 34(8). If that is correct, a Court might be hesitant to manipulate notions of fairness to interfere with what might otherwise be a clear result.

205 Clearly, Parliament intended to protect derivatives markets from some of the uncertainties inherent in insolvency and *CCAA* restructuring.

Summary

206 To summarize, *Blue Range* reminds us that physically settled forward commodity contracts are not excluded as EFCs. Bellatrix argues that the Contract was an agreement for the physical delivery of natural gas and should not be considered a financial agreement.

207 It makes no sense to me to argue that physical delivery of natural gas under the Contract should disentitle it to EFC status when physical delivery under a forward commodity contract would not.

208 It makes no sense to me to argue that a fixed price is required for derivative status, when the definition of derivatives agreement does not allude to a fixed price, or for that matter, any price.

209 I agree that an exception to a statutory provision must be interpreted in light of the underlying rationale of the statute. It must not be used to undermine the broad purpose of the legislation.

210 *Blue Range* concluded that the solvent counter-party to a forward commodity contract should be permitted to terminate the agreement and set off, all to manage its financial risk. Here, the solvent counter-party, BP, wants to preserve the Contract.

211 Is there a conflict? Should the policy analysis in *Blue Range*, which underscores the importance of the solvent counter-party being able to manage financial risk through termination and set-off, not apply to a situation where the solvent counter-party does not wish to terminate and set-off?

212 While that reversal of interest might affect the analysis under section 32(4) of the CCAA, were the Contract not found to fall within the definition of EFC, I do not think it matters for purposes of the characterization as an EFC.

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213 In my view, all of the arrangements which fall within the definition of EFC in the Regulations share a common theme. That theme is management of financial risk inherent in business transactions.

214 Why should that theme operate in one direction? Why should BP be denied the right to assert EFC status just because it stands to make money by buying gas from Bellatrix at less than it can sell that gas or the right to acquire that gas? Does Bellatrix's status under *CCAA* proceedings suggest that EFC status should be unidirectional?

215 Is BP to be punished for placing a good bet as part of its risk management efforts and Bellatrix be rewarded for placing a bad one? Does that mean that effective risk management strategies should only be supported for some parties to agreements and not others?

216 I think not. I think the unique characteristics of the parties to an agreement become relevant under section 32(4), if EFC status has not already been engineered. I see nothing in the definition of an EFC which would direct me to consider the size of a party to an agreement, its management team, the number of employees it has or any other characteristics in determining if it was a party to an EFC or an agreement which did not qualify as an EFC.

217 While Parliament wanted companies under *CCAA* protection to benefit from statutory protection while exploring the possibility of a successful restructuring, 1 do not think Parliament intended a wholesale abrogation of the principle of contractual enforcement.

218 The provisions of the *CCAA* that apply to an EFC require us to consider an apparent dichotomy. A solvent counter-party can terminate a contract and set-off in the name of managing financial risk while an insolvent counterparty may not.

219 Surely, as is the case here, the magnitude of financial risk to an insolvent party is likely to be greater than that to which the solvent counter-party is exposed. Why should Bellatrix have to face sacrifice at the altar of BP's financial risk management deity?

220 Perhaps that apparent contradiction may be resolved by noting that the more vulnerable party, in this case Bellatrix, already enjoys a significant measure of protection from adverse financial developments during the *CCAA* process. Perhaps Parliament intended to ensure that solvent counter-parties to risk management contracts were not adversely affected by the misfortunes of their insolvent counter-parties. In that way, allowing a solvent counterparty, such as BP, to either terminate or affirm, was conceived as a measure to ensure that the damage incurred by the insolvent counter-party did not become collateral damage to the solvent counter-party.

221 In the result, I conclude that the Contract qualifies as an EFC.

Application granted.

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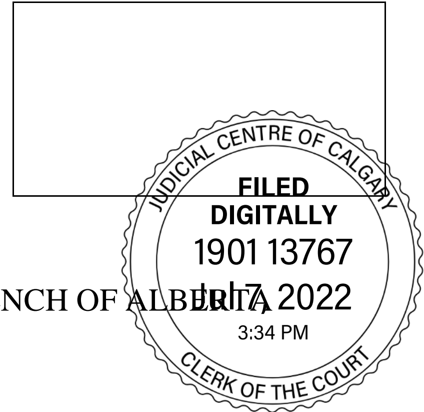
CERTIFIED by the Court Clerk as a true copy of the document digitally filed on Jul 7, 2022

Clerk's Stamp:



COURT FILE NUMBER	1901-13767
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 A PLAN OF COMPROMISE OR ARRANGEMENT OF BELLATRIX EXPLORATION LTD.
APPLICANT	BELLATRIX EXPLORATION LTD.
DOCUMENT	APPROVAL AND VESTING ORDER
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**Goodmans LLP** Bay Adelaide Centre 333 Bay Street, Suite 3400 Toronto, ON M5H 2S7 Attn: Robert J. Chadwick / Caroline Descours Tel: 416.597.4285 / 416.597.6275 Fax: 416.979.1234 Email: rchadwick@goodmans.ca / cdescours@goodmans.ca

DATE ON WHICH ORDER WAS PRONOUNCED:	July 7, 2022
NAME OF JUSTICE WHO MADE THIS ORDER:	The Honourable Justice Romaine
LOCATION WHERE ORDER WAS PRONOUNCED:	Calgary, Alberta

UPON THE APPLICATION by Bellatrix Exploration Ltd. ("**Bellatrix**") under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") for an order (this "**Order**"), *inter alia*, approving the transactions (the "**Transaction**") contemplated by the agreement dated as of June 22, 2022 (the "**Spartan Transaction Agreement**") among Bellatrix, 2350810 Alberta Ltd. ("**Newco**") and Spartan Delta Corp. (the "**Purchaser**"), a copy of which is attached as Exhibit "B" to the Abel Affidavit (as defined below), including the reorganization transactions contemplated in Schedule "B" therein (the "**Reorganization**");

AND UPON HAVING READ the Application, the Affidavit of Shane K. Abel sworn June 24, 2022 (the "**Abel Affidavit**"), the Affidavit of Service of Andrew Harmes sworn June 27, 2022, and the fifteenth report of PricewaterhouseCoopers Inc. in its capacity as Court-appointed monitor of Bellatrix (the "**Monitor**") dated June 28, 2022, each filed; **AND UPON HEARING** the submissions of counsel for Bellatrix, the Monitor and such other parties present;

IT IS HEREBY ORDERED AND DECLARED THAT:

SERVICE

1. Service of notice of this Application for this Order and supporting materials is hereby declared to be good and sufficient, no other person is required to have been served with notice of this Application and time for service of this Application is abridged to that actually given.

CAPITALIZED TERMS

2. Capitalized terms used but not otherwise defined in this Order shall have the meaning given to such terms in the Spartan Transaction Agreement.

APPROVAL OF THE TRANSACTION

3. The Spartan Transaction Agreement and the Transaction (including the Reorganization) are hereby approved, and the execution of the Spartan Transaction Agreement by Bellatrix is hereby authorized and approved, with such amendments to the Spartan Transaction Agreement as Bellatrix, Newco and the Purchaser may agree to with the consent of the Monitor. The performance by Bellatrix of its obligations under the Spartan Transaction Agreement is hereby authorized and approved. Bellatrix is hereby authorized to take such

additional steps and execute such additional documents as may be necessary or desirable for the completion of the Transaction, including, without limitation, the Reorganization.

REORGANIZATION

4. Bellatrix and Newco are authorized to undertake and complete the Reorganization contemplated in Schedule "B" to the Spartan Transaction Agreement and, without limiting the generality of the foregoing, subject to the terms of the Spartan Transaction Agreement, upon the delivery of a Monitor's certificate substantially in the form attached as Schedule "A" hereto (the "**Spartan Transaction Certificate**") to Bellatrix and the Purchaser, the following shall be deemed to occur in accordance with the timing, sequence, terms and conditions set forth in the Spartan Transaction Agreement:

   (a) Bellatrix shall issue the Purchased Shares to the Purchaser in consideration for the Purchase Price;

   (b) any and all outstanding shares of Bellatrix other than the Purchased Shares, and any all options, warrants, and other rights and entitlements to shares of Bellatrix existing prior to the Closing Date shall be deemed cancelled and extinguished without any consideration or any other Claim against Bellatrix or Newco therefor; and

   (c) any directors of Bellatrix immediately prior to the Closing Time shall be deemed to resign, and the new directors named in the Spartan Transaction Agreement shall be deemed to be appointed as directors of Bellatrix.

5. The Purchased Shares shall be issued by Bellatrix to the Purchaser free and clear of and from any and all Claims or Encumbrances.

6. Bellatrix and Newco, in completing the transactions contemplated in the Reorganization, are authorized:

   (a) to execute and deliver any documents and assurances governing or giving effect to the Reorganization as Bellatrix and/or Newco, in their discretion, may deem to be reasonably necessary or advisable to conclude the Reorganization, including the

execution of all such ancillary documents as may be contemplated in the Spartan Transaction Agreement or necessary or desirable for the completion and implementation of the Reorganization, and all such ancillary documents are hereby ratified, approved and confirmed; and

(b) to take such steps as are, in the opinion of Bellatrix and/or Newco, necessary or incidental to the implementation of the Reorganization.

7. Bellatrix and Newco are hereby permitted to execute and file articles of amendment, amalgamation, continuance or reorganization or such other documents or instruments as may be required to permit or enable and effect the Reorganization, including, without limitation, the issuance of the Purchased Shares and the appointment and resignation of directors of Bellatrix, and such articles, documents or other instruments shall be deemed to be duly authorized, valid and effective notwithstanding any requirement under federal or provincial law to obtain director or shareholder approval with respect to such actions or to deliver any statutory declarations that may otherwise be required under corporate law to effect the Reorganization.

8. This Order shall constitute the only authorization required by Bellatrix or Newco to proceed with the Transaction, including, without limitation, the Reorganization and, except as specifically provided in the Spartan Transaction Agreement, no director or shareholder approval shall be required and no authorization, approval or other action by or notice to or filing with any governmental authority or regulatory body exercising jurisdiction in respect of Bellatrix is required for the due execution, delivery and performance by Bellatrix and by Newco of the Spartan Transaction Agreement and the completion of the Transaction, including, without limitation, the Reorganization contemplated thereby. Without limiting the generality of the foregoing, Bellatrix shall not be required to comply with the requirements of Multilateral Instrument 61-101 - *Protection of Minority Security Holders in Special Transactions*, National Policy 11-207 – *Failure-to-File Cease Trade Orders* or the CTO in connection with implementing the Reorganization and any subsequent dissolution of Bellatrix (a "**Dissolution**") or amalgamation with the Purchaser (a "**Purchaser Amalgamation**"); however, for greater certainty, the CTO shall remain in

effect after the Reorganization is fully implemented (other than with respect to a Dissolution or Purchaser Amalgamation).

9. The Director appointed pursuant to Section 260 of the CBCA shall accept and receive any articles of amendment, amalgamation, continuance or reorganization or such other documents or instruments as may be required to permit or enable and effect the Reorganization contemplated in the Spartan Transaction Agreement, filed by either Bellatrix or Newco, as the case may be.

VESTING OF ASSETS AND LIABILITIES

10. Subject to the terms of the Spartan Transaction Agreement, upon the delivery of the Spartan Transaction Certificate to Bellatrix and the Purchaser, the following shall be deemed to occur in accordance with the timing, sequence, terms and conditions set forth in the Spartan Transaction Agreement:

(a) all of Bellatrix's right, title and interest in and to the Excluded Assets (including, for certainty, the right to receive the Purchase Price (for certainty, including the Deposit and the Subscription Cash)) shall vest absolutely and exclusively in the name of Newco and all Claims and Encumbrances attached to the Excluded Assets shall continue to attach to the Excluded Assets with the same nature and priority as they had immediately prior to their transfer;

(b) all Excluded Liabilities shall be transferred to, assumed by and vest absolutely and exclusively in the name of Newco, and the Excluded Liabilities shall be novated and become obligations of Newco and not obligations of Bellatrix, and Bellatrix shall be forever released and discharged from such Excluded Liabilities, and all Encumbrances securing the Excluded Liabilities shall be forever released and discharged in respect of Bellatrix, provided that nothing in this Order shall be deemed to cancel any Encumbrances expressly permitted by the Spartan Transaction Agreement as against Bellatrix;

(c) the commencement or prosecution, whether directly, indirectly, derivatively or otherwise of any demands, claims, actions, counterclaims, suits, judgements, or

other remedy or recovery with respect to any indebtedness, liability, obligation or cause of action against Bellatrix in respect of the Excluded Liabilities shall be permanently enjoined;

(d) the nature of the Retained Liabilities retained by Bellatrix, including, without limitation, their amount and their secured or unsecured status, shall not be affected or altered as a result of the Spartan Transaction Agreement or the steps and actions taken in accordance with the terms thereof;

(e) the nature and priority of the Excluded Liabilities assumed by Newco, including, without limitation, their amount and their secured or unsecured status, shall not be affected or altered as a result of their transfer to and assumption by Newco; and

(f) any Person that, prior to the Closing Date, had a valid Claim against Bellatrix in respect of the Excluded Liabilities shall no longer have such Claim against Bellatrix, but will have an equivalent Claim against Newco (including, without limitation, in respect of the net proceeds of the Transaction received by Newco pursuant to the Spartan Transaction Agreement) in respect of the Excluded Liabilities from and after the Closing Date in its place and stead, and, nothing in this Order limits, lessens or extinguishes the Excluded Liabilities or the Claim of any person as against Newco.

11. Upon delivery of the Spartan Transaction Certificate to Bellatrix and the Purchaser, and upon filing of a certified copy of this Order, together with any applicable registration fees, all governmental authorities (collectively, "**Governmental Authorities**") are hereby authorized, requested and directed to accept delivery of such Spartan Transaction Certificate and certified copy of this Order as though they were originals and to register such transfers, interest authorizations, discharges and discharge statements of conveyance as may be required in order to give effect to the terms of this Order and the Spartan Transaction Agreement.

12. In order to effect the transfers and discharges described above, this Court directs each of the Governmental Authorities to take such steps as are necessary to give effect to the terms of this Order and the Spartan Transaction Agreement. Presentment of this Order and the

Spartan Transaction Certificate shall be the sole and sufficient authority for the Governmental Authorities to make and register transfers of title or interest and cancel and discharge registrations such that the Retained Assets of Bellatrix shall be free from all Encumbrances.

13. The Purchaser shall be authorized to take all steps as may be necessary to effect the discharge of the Encumbrances as against the Retained Assets of Bellatrix.

CCAA APPLICANTS

14. Upon the filing of the Spartan Transaction Certificate:

(a) Newco shall be deemed to be a company to which the CCAA applies;

(b) Newco shall be added as an applicant in these CCAA proceedings and any reference in any Order of this Court in respect of these CCAA proceedings to an "Applicant" shall refer to Newco, *mutatis mutandis*, and, for greater certainty, each of the Charges (as such term is defined in the Initial Order granted by this Court in these CCAA proceedings dated October 2, 2019 (the "**Initial Order**")) shall, subject to the Distribution and Transition Order granted by this Court in these CCAA proceedings dated May 25, 2021 (the "**May 2021 Order**"), constitute a charge on the assets, property and undertaking of Newco;

(c) Bellatrix shall be deemed to cease to be an applicant in these CCAA proceedings, and shall be deemed to be released from the purview of any Order of this Court granted in respect of these CCAA proceedings, save an except for this Order, the terms of which as they relate to Bellatrix shall continue to apply in all respects to Bellatrix;

(d) without limiting the generality of (c), each of the Charges shall cease to constitute a charge on the assets, property and undertakings of Bellatrix, and Bellatrix shall have no obligation or liability in relation to the Charges; and

(e) the title of these CCAA proceedings is hereby, and shall be deemed to be, amended as follows:

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 2350810 ALBERTA LTD.

and any document filed thereafter in these CCAA proceedings (other than the Spartan Transaction Certificate) shall be filed using such revised title of proceedings.

RELEASES

15. Effective upon the filing of the Spartan Transaction Certificate, (i) the present and former directors, officers, employees, legal counsel and advisors of Bellatrix and Newco (or either of them), and (ii) the Monitor and its legal counsel (the persons listed in (i) and (ii) being collectively, the "**Released Parties**") shall be deemed to be forever irrevocably released and discharged from any and all present and future claims (including, without limitations, claims for contribution or indemnity), liabilities, indebtedness, demands, actions, causes of action, counterclaims, suits, damages, judgments, executions, recoupments, debts, sums of money, expenses, accounts, liens, taxes, recoveries, and obligations of any nature or kind whatsoever (whether direct or indirect, known or unknown, absolute or contingent, accrued or unaccrued, liquidated or unliquidated, matured or unmatured or due or not yet due, in law or equity and whether based in statute or otherwise) based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place prior to the issuance of the Spartan Transaction Certificate in connection with the Transaction (including the Reorganization) or completed pursuant to the terms of this Order (collectively, the "**Released Claims**"), which Released Claims are hereby fully, finally, irrevocably and forever waived, discharged, released, cancelled and barred as against the Released Parties, provided that nothing in this paragraph 15 shall waive, discharge, release, cancel or bar any claim against the directors and officers of Bellatrix and/or Newco that is not permitted to be released pursuant to section 5.1(2) of the CCAA.

THE MONITOR

16. Without in any way limiting the Monitor's powers set out in the Initial Order, the May 2021 Order, any other Order of this Court in these CCAA proceedings, or under the CCAA or applicable law, the Monitor is hereby authorized to undertake and perform such activities and obligations as are contemplated to be undertaken or performed by the Monitor pursuant to this Order and the Spartan Transaction Agreement or any ancillary document related thereto, and shall incur no liability in connection therewith, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall affect, vary, derogate from, limit or otherwise amend any of the protections in favour of the Monitor at law or pursuant to the CCAA, the Initial Order or any other Order granted in these CCAA proceedings. For greater certainty, the terms of the May 2021 Order shall apply in respect of authorizing the Monitor to take such steps and actions on behalf of Bellatrix as necessary or desirable to complete the Transaction pursuant to this Order.

17. The Monitor is directed to file with the Court a copy of the Spartan Transaction Certificate forthwith after delivery thereof to Bellatrix and the Purchaser.

18. The Monitor may rely on written notice from Bellatrix and the Purchaser or their respective counsel regarding the satisfaction of the Purchase Price and the fulfillment of the conditions to closing under the Spartan Transaction Agreement and shall incur no liability with respect to the delivery of the Spartan Transaction Certificate.

19. The Monitor, in addition to its prescribed rights and obligations under the CCAA, is authorized, entitled and empowered to assign or cause to be assigned, at any time after the Closing Date, Newco into bankruptcy and the Monitor shall be entitled but not obligated to act as trustee in bankruptcy thereof.

MISCELLANEOUS

20. Notwithstanding:

    (a) the pendency of these proceedings and any declaration of insolvency made herein;

    (b) the pendency of any applications for a bankruptcy order now or hereafter issued pursuant to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3, as amended

(the "**BIA**"), in respect of Bellatrix or Newco, and any bankruptcy order issued pursuant to any such applications;

(c) any assignment in bankruptcy made in respect of Bellatrix or Newco; and

(d) the provisions of any federal or provincial statute,

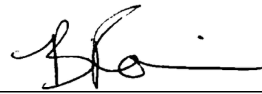
the execution of the Spartan Transaction Agreement, the implementation of the Reorganization (including the transfer of the Excluded Assets and the Excluded Liabilities to Newco and the issuance of the Purchased Shares to the Purchaser) and the implementation of the Transaction shall be binding on any trustee in bankruptcy that may be appointed in respect of Bellatrix or Newco, and shall not be void or voidable by creditors of Bellatrix, nor shall it constitute nor be deemed to be a transfer at undervalue, settlement, fraudulent preference, assignment, fraudulent conveyance, or other reviewable transaction under the BIA or any other applicable federal or provincial legislation, nor shall it constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

21. Bellatrix, Newco, the Monitor and the Purchaser shall each be at liberty to apply for further advice, assistance and direction as may be necessary or desirable in order to give full force and effect to the terms of this Order and to assist and aid the parties in closing the Transaction.

22. This Court hereby requests the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in any of its provinces or territories or in any foreign jurisdiction, to act in aid of and to be complimentary to this Court in carrying out the terms of this Order, to give effect to this Order and to assist Bellatrix, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such order and to provide such assistance to Bellatrix and to the Monitor, as an officer of the Court, as may be necessary or desirable to give effect to this Order, or to assist Bellatrix and the Monitor and their respective agents in carrying out the terms of this Order.

23. Service of this Order shall be deemed good and sufficient by: (a) serving this Order upon those interested parties attending or represented at the within Application, and (b) posting a copy of this Order on the Monitor's website at: http://www.pwc.com/ca/Bellatrix, and service of this Order on any other person is hereby dispensed with.

24. Service of this Order may be effected by fax, electronic mail, personal delivery or courier. Service is deemed to be effected the next business day following transmission or delivery of this Order.

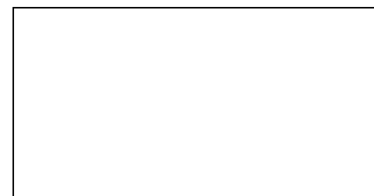


Justice of the Court of Queen's Bench of Alberta

SCHEDULE A

FORM OF MONITOR'S CERTIFICATE

Clerk's Stamp:



COURT FILE NUMBER	1901-13767
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 A PLAN OF COMPROMISE OR ARRANGEMENT OF BELLATRIX EXPLORATION LTD.
APPLICANT	BELLATRIX EXPLORATION LTD.
DOCUMENT	MONITOR'S CERTIFICATE
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**Goodmans LLP** Bay Adelaide Centre 333 Bay Street, Suite 3400 Toronto, ON M5H 2S7 Attn: Robert J. Chadwick / Caroline Descours Tel: 416.597.4285 / 416.597.6275 Fax: 416.979.1234 Email: rchadwick@goodmans.ca / cdescours@goodmans.ca

RECITALS

A. Pursuant to an Order of the Honourable Justice Jones of the Court of Queen's Bench of Alberta, Judicial District of Calgary (the "**Court**") dated October 2, 2019, PricewaterhouseCoopers Inc. was appointed as the monitor (the "**Monitor**") of Bellatrix Exploration Ltd. ("**Bellatrix**") in proceedings pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

B. Pursuant to an Order of the Court dated July 7, 2022, the Court, *inter alia*, approved the agreement dated as of June 22, 2022 (the "**Spartan Transaction Agreement**") among Bellatrix, 2350810 Alberta Ltd. ("**Newco**") and Spartan Delta Corp. (the "**Purchaser**") and the transactions contemplated thereby.

C. Unless otherwise indicated herein, capitalized terms have the meanings set out in the Spartan Transaction Agreement.

THE MONITOR CERTIFIES the following:

1. The Purchaser has satisfied the Purchase Price in accordance with the Spartan Transaction Agreement;

2. The conditions to Closing as set out in the Spartan Transaction Agreement have been satisfied or waived by Bellatrix and the Purchaser;

3. The Transaction has been completed to the satisfaction of the Monitor; and

4. This Certificate was delivered by the Monitor at ____________ **[a.m./p.m.]** on _________________, 2022.

PRICEWATERHOUSECOOPERS INC. in its capacity as Monitor of Bellatrix Exploration Ltd. and not in its personal capacity

Per: ____________________________________

Name:

Title:

3

SUMMARY: Loss carryforward under 111(5)—ITA-111(5), 80, 87—Advance income tax ruling—Whether subsec. 111(5) allows the losses of a loss company to be carried forward by an acquiror corporation if the acquisition is carried out in two stages (i.e., acquisition of the assets of the loss business, followed 15 months later by an acquisition of control of the loss company) if all of the requirements of subsec. 111(5) respecting the carrying on of the business are satisfied. ... Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CCRA. ... Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la

2002-0151343 -- Loss carryforward under 111(5)

Date: 2002

Reference: 111(5), 80, 87

SUMMARY: Loss carryforward under 111(5)—ITA-111(5), 80, 87—Advance income tax ruling—Whether subsec. 111(5) allows the losses of a loss company to be carried forward by an acquiror corporation if the acquisition is carried out in two stages (i.e., acquisition of the assets of the loss business, followed 15 months later by an acquisition of control of the loss company) if all of the requirements of subsec. 111(5) respecting the carrying on of the business are satisfied.

Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CCRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ADRC.

PRINCIPAL ISSUES: Does subsection 111(5) allow the losses of a loss company to be carried forward by an acquiror corporation if the acquisition is carried out in two stages—acquisition of the assets of the loss business followed 15 months later by an acquisition of control of the loss company—if all the requirements of subsection 111(5) respecting the carrying on of the business are satisfied?

POSITION: Yes.

REASONS: The technical requirements of subsection 111(5) are satisfied.

XXXXXXXXXX 2002-015134

XXXXXXXXXX, 2002

Dear XXXXXXXXXX:

Re: XXXXXXXXXX

XXXXXXXXXX

Advance Income Tax Ruling

We are writing in response to your letter of XXXXXXXXXX wherein you requested an advance income tax ruling on behalf of the above-referenced taxpayers. We also acknowledge receipt of your facsimiles and emails as well as the information provided in various telephone conversations.

Throughout this letter, certain individuals and corporations will be referred to as follows:

XXXXXXXXXX. Holdco

XXXXXXXXXX. Lossco

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XXXXXXXXXX. Subco

XXXXXXXXXX. Bco

XXXXXXXXXX. Opco

XXXXXXXXXX. Parentco

XXXXXXXXXX. USco

Lossco's tax affairs are administered by the XXXXXXXXXX Tax Services Office and its corporate tax returns have been filed at the XXXXXXXXXX Taxation Centre. Opco's tax affairs are administered by the XXXXXXXXXX Tax Services Office and its corporate tax returns have been filed at the XXXXXXXXXX Taxation Centre. Lossco and Opco are resident in Canada for the purposes of the Act.

To the best of your knowledge, and that of any of the taxpayers, none of the issues involved in this ruling request is:

(i) involved in an earlier return of any of the taxpayers or a related person;

(ii) being considered by a tax services office or taxation centre in connection with a previously filed tax return of any of the taxpayers or a related person;

(iii) under objection by any of the taxpayers or a related person;

(iv) before the courts; or

(v) the subject of a ruling previously issued by the Income Tax Rulings Directorate.

The taxpayers have represented that the proposed transactions will not affect their ability to pay any of their outstanding tax liabilities.

Unless otherwise indicated, all references to monetary amounts are in Canadian dollars.

DEFINITIONS

In this letter, unless otherwise expressly stated, the following terms have the meanings specified:

(a) “Act” means the *Income Tax Act* (Canada), R.S.C. 1985 (5th Supp.), c. 1, as amended to the date hereof, and unless otherwise stated, every reference herein to a part, section, subsection, paragraph or subparagraph is a reference to the relevant provision of the Act;

(b) “adjusted cost base” (“ACB”) has the meaning assigned by section 54;

(c) “arm's length” has the meaning assigned by section 251;

(d) “BCA” means the *Companies Act* (XXXXXXXXXX);

(e) “CBCA” means the Canada *Business Corporations Act* and, where applicable, its predecessor statutes;

(f) “cumulative eligible capital” (“CEC”) has the meaning assigned by subsection 14(5);

(g) “depreciable property” has the meaning assigned by subsection 13(21);

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(h) “disposition” has the meaning assigned by subsection 248(1);

(i) “eligible capital property” has the meaning assigned by section 54;

(j) “forgiven amount” has the meaning assigned by subsection 80(1) and 80.01(1);

(k) “net capital loss” has the meaning assigned by subsection 111(8);

(l) “non-capital loss” has the meaning assigned by subsection 111(8);

(m) “paid-up capital” (“PUC”) has the meaning assigned by subsection 89(1);

(n) “Paragraph” refers to a numbered paragraph in this letter;

(o) “parent” has the meaning assigned by subsection 88(1);

(p) “principal amount” has the meaning assigned by subsection 248(1);

(q) “related persons” has the meaning assigned by subsection 251(2);

(r) “subsidiary” has the meaning assigned by subsection 88(1);

(s) “taxable Canadian corporation” (“TCC”) has the meaning assigned by subsection 89(1);

(t) “terminal loss” means a deduction pursuant to subsection 20(16); and

(u) “undepreciated capital cost” (“UCC”) has the meaning assigned by subsection 13(21).

Our understanding of the facts, proposed transactions and purpose of the proposed transactions is as follows:

FACTS

1. Lossco is a taxable Canadian corporation incorporated under the CBCA. The shares of Lossco traded on the XXXXXXXXXX Stock Exchange until they were suspended from trading in XXXXXXXXXX. Holdco is the majority shareholder of Lossco, owning approximately XXXXXXXXXX% of its common shares. Lossco's taxation year-end is XXXXXXXXXX.

2. Lossco owns or has owned various subsidiary companies in Canada and in countries other than Canada including XXXXXXXXXX. Its Canadian subsidiaries include Subco, a wholly-owned subsidiary incorporated under the CBCA.

3. Prior to the transactions described below, Lossco carried on two separate businesses XXXXXXXXXX Lossco has treated the XXXXXXXXXX business and the XXXXXXXXXX business as separate divisions and businesses for financial accounting and income tax purposes.

4. In XXXXXXXXXX, Lossco and Subco obtained a protective order from the XXXXXXXXXX Superior Court of Justice under the *Companies' Creditors Arrangement Act* (the “CCAA”) in respect of creditors of their respective Canadian operations, and Lossco obtained a protective order under Section 304 of the *United States Bankruptcy Code* in respect of its U.S. assets.

5. Since receiving the protective orders, Lossco has been engaged in soliciting orders for the sale of its assets for the benefit of its creditors. In connection with this, Lossco sold the majority of the assets of the XXXXXXXXXX business to Opco on XXXXXXXXXX (the “Lossco/Opco Sale”).

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6. Opco is a taxable Canadian corporation and is a wholly-owned subsidiary of Parentco. Opco XXXXXXXXXX was incorporated in XXXXXXXXXX for the purposes of the Lossco/Opco Sale. Opco's taxation year-end is XXXXXXXXXX.

7. Parentco is a taxable corporation incorporated and headquartered in XXXXXXXXXX and is wholly-owned by an indirect wholly-owned subsidiary of USco. Parentco was acquired in XXXXXXXXXX as part of a worldwide acquisition when USco purchased an XXXXXXXXXX company. Parentco's only asset is its share of Opco.

8. USco is a taxable corporation that is headquartered in XXXXXXXXXX, U.S.A. and is a publicly traded company listed on the XXXXXXXXXX Stock Exchange.

9. Opco and Lossco deal at arm's length and are not related persons. Opco and any corporation related to it are not related to, and deal at arm's length with, the creditors of Lossco.

10. On XXXXXXXXXX, Lossco sold the XXXXXXXXXX business to an independent third party. Lossco realized a terminal loss in XXXXXXXXXX in respect of the undepreciated capital cost of depreciable property of prescribed classes of the XXXXXXXXXX business as a result of the sale of the XXXXXXXXXX business in XXXXXXXXXX.

11. Lossco has also recently disposed of its interests in some of its subsidiaries and realized capital losses as a consequence. Certain of these losses arose by virtue of Lossco's elections in respect of those subsidiaries pursuant to subsection 50(1). In addition, USco has agreed, subject to certain conditions being satisfied, to purchase the shares of Bco, a U.S. corporation wholly-owned by Subco. Other transactions involving Lossco and third parties are in the process of being concluded.

12. As a result of the various dispositions referred to above, Lossco currently owns:

(a) Certain redundant and surplus assets of the XXXXXXXXXX business (the “Residual Assets”);

(b) A warehouse in XXXXXXXXXX (the “Warehouse”) that operated as a plant of the XXXXXXXXXX business prior to its closure in XXXXXXXXXX and is now being leased to Opco in connection with the XXXXXXXXXX business;

(c) Shares, loans and intercompany balances with affiliates and subsidiaries; and

(d) Cash.

13. Unlike the XXXXXXXXXX business, Lossco has not realized a terminal loss in respect of the UCC of depreciable property of prescribed classes or a terminal allowance in respect of the cumulative eligible capital of eligible capital property of the XXXXXXXXXX business (the “XXXXXXXXXX business UCC/CEC”) since Lossco continues to own the Residual Assets that constitute depreciable property and eligible capital property included in the XXXXXXXXXX business UCC/CEC. This ruling request relates primarily to the losses that Lossco will realize in respect of the XXXXXXXXXX business UCC/CEC.

14. The following table indicates the amounts of Lossco's losses by year and of the XXXXXXXXXX business UCC/CEC by class, as set out in the tax return filed by Lossco in respect of its year ended XXXXXXXXXX:

Item

Year of Origin/Class

Amount ($ 000's)

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Non-capital losses

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

Total

XXXXXXXXXX

Net capital losses

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

Total

XXXXXXXXXX

XXXXXXXXXX business UCC/CEC

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

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XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

Total

XXXXXXXXXX

15. The XXXXXXXXXX business has been carried on, without interruption, throughout a period commencing well before XXXXXXXXXX (by Lossco and, commencing on XXXXXXXXXX, by Opco) and continues to be carried on by Opco, without interruption. The XXXXXXXXXX business carried on by Lossco prior to the Lossco/Opco Sale and the XXXXXXXXXX business carried on by Opco on and after the Lossco/Opco Sale are one and the same XXXXXXXXXX business. This is evident from the table below which illustrates the similarity of the identity and continuity of plants, employees, customers, suppliers and equipment, (there being a distinction only in respect of the usage of name), between the XXXXXXXXXX business carried on by Lossco prior to the Lossco/Opco Sale and the XXXXXXXXXX business carried on by Opco on and after the Lossco/Opco Sale.

Characteristic of Business

Lossco, pre-XXXXXXXXXX

Opco, post-XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

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XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

XXXXXXXXXX

16. On XXXXXXXXXX, Lossco became a bankrupt for the purposes of the Act by reason of making a voluntary assignment in bankruptcy pursuant to the *Bankruptcy and Insolvency Act* (the “BIA”) in respect of which XXXXXXXXXX. has been appointed trustee-in-bankruptcy. At the time of making the voluntary assignment, Lossco was indebted to its secured and unsecured creditors (the “Lossco Creditors”) for approximately $XXXXXXXXXX (the “Lossco Indebtedness”). Pursuant to paragraph 128(1)(d), Lossco is deemed to have a taxation year ending on XXXXXXXXXX and a new taxation year commencing on XXXXXXXXXX.

PROPOSED TRANSACTIONS

17. During the administration of the bankruptcy of Lossco, the trustee-in-bankruptcy will endeavour to sell the Warehouse (included in Class 1 in the table in Paragraph 14 above) and the debt and/or shares of the remaining affiliates and subsidiaries of Lossco to independent third parties. Those properties that remain unsold will be disposed of by Lossco, prior to implementing the proposal referred to in Paragraph 18 below, to an entity that will liquidate such properties for the account of the Lossco Creditors. It is anticipated that such sales and/or dispositions will result in Lossco realizing a Class 1 terminal loss in respect of the Warehouse and capital losses in respect of such debt and/or shares. Thus, at the time of such proposal, the assets of Lossco will consist of cash and the Residual Assets.

18. A proposal will be made by the trustee-in-bankruptcy on behalf of Lossco under the BIA (the “Lossco Proposal”) providing for settlement of monetary claims of claimants against Lossco (the “Claims Settlement”), a reorganization of the share capital of Lossco (the “Capital Reorganization”) and certain other corporate steps necessary to effect the transactions contemplated hereunder. In order for the Lossco Proposal to be effective, it must be approved by the creditors of Lossco in accordance with the provisions of the BIA, and by the XXXXXXXXXX Superior Court of Justice.

19. Under the Claims Settlement component of the Lossco Proposal, the Lossco Indebtedness to the Lossco Creditors will be settled for approximately $XXXXXXXXXX in cash and a $XXXXXXXXXX principal amount promissory note (the “Recovery Note”). The Recovery Note will be held by the trustee-in-bankruptcy or other entity (the “Custodian”) as nominee for and on behalf of the Lossco Creditors. It will be paid over XXXXXXXXXX years in accordance with a formula (to be monitored by a third party) dependent on utilization of the tax attributes of Lossco in respect of the XXXXXXXXXX business by the company formed on the amalgamation of Lossco and Opco (“Amalco”) described below. It is anticipated that approximately $XXXXXXXXXX of the Lossco Indebtedness will be forgiven on the issuance of the Recovery Note. At the end of the XXXXXXXXXX-year term of the Recovery Note, the Recovery Note will be extinguished.

20. The following table illustrates the expected application of section 80 to the anticipated forgiveness of approximately $XXXXXXXXXX of the Lossco Indebtedness, having regard to the existing losses and XXXXXXXXXX business UCC/CEC of Lossco, as set out in the tax return filed by Lossco in respect of its taxation year ended XXXXXXXXXX and summarized in the table in Paragraph 14 above. It is recognized that adjustments will be required due to losses incurred after XXXXXXXXXX.

($ 000's)

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Approximate forgiveness

Applied to:

Non-capital losses

Capital losses

XXXXXXXXXX Business UCC/CEC

Balance

$ XXXXXXXXXX

(XXXXXXXXXX)

(XXXXXXXXXX)

(XXXXXXXXXX)

Nil

21. Under the Capital Reorganization component of the Lossco Proposal, all of the issued and outstanding voting common shares and preferred shares of Lossco will be converted into preferred shares (the “Lossco Preferred Shares”), and a new class of authorized voting common shares will be created. The Lossco Preferred Shares will have a nominal aggregate redemption amount and will be non-voting prior to the commencement of XXXXXXXXXX (except in matters as required by law) and voting commencing on XXXXXXXXXX. No shares that are voting at the time of the Capital Reorganization will be issued with the result that the issued share capital of Lossco immediately following the Capital Reorganization will be limited to the Lossco Preferred Shares.

22. Lossco's bankruptcy will be annulled pursuant to the BIA and, as a result, an absolute order of discharge from bankruptcy will not be granted in respect of Lossco.

23. Subsequent to the Capital Reorganization, the following transactions will occur in sequence on XXXXXXXXXX as part of the Lossco Proposal:

(i) Parentco, the parent corporation of Opco, will subscribe for 1 non-voting Lossco Preferred Share; and

(ii) Lossco will redeem all of the Lossco Preferred Shares with the exception of the single Lossco Preferred Share held by Parentco, which will result in Parentco becoming the sole holder of the Lossco Preferred Shares and the sole shareholder of Lossco.

24. On or after XXXXXXXXXX, and subsequent to the Lossco Proposal, described in Paragraphs 18 to 23 above, Lossco will have been continued under the BCA as a company limited by shares, and Lossco will be amalgamated with Opco pursuant to the BCA to form Amalco, XXXXXXXXXX (the “Amalgamation”). Upon the Amalgamation, the Lossco Preferred Shares and the issued and outstanding share capital of Opco will become issued voting common shares of Amalco. Since Parentco will be the sole shareholder of both Lossco and Opco prior to the amalgamation, Parentco will be the sole shareholder of Amalco upon the conversion of the respective shares of Lossco and Opco into shares of Amalco. Lossco will not make an election under subsection 256(9) in its tax return for its taxation year ending immediately before the acquisition of control of Lossco by Parentco and the certificate of amalgamation of Amalco will not specify an effective time of the Amalgamation.

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25. The losses of Lossco for purposes of the Act for its taxation year ending immediately before the acquisition of control of Lossco by Parentco will be approximately as shown in the table below. It is recognized that adjustments will be required due to losses incurred after XXXXXXXXXX.

($ 000's)

Remaining XXXXXXXXXX business UCC/CEC

Estimated fair market value

Total loss available after application of subsections 111(5.1)/(5.2)

$ XXXXXXXXXX

XXXXXXXXXX

$ XXXXXXXXXX

26. Lossco will not claim any deduction under paragraphs 20(1)(a) or (b), or subsection 20(16) in its taxation year ending immediately before the acquisition of control of Lossco by Parentco.

27. Amalco will carry on the XXXXXXXXXX business formerly carried on sequentially by Lossco and Opco, for profit or with a reasonable expectation of profit.

28. The Recovery Note will become an obligation of Amalco by reason of the Amalgamation. The former Lossco Creditors will receive, as beneficial holders of the Recovery Note, any payments made by Amalco pursuant to the terms of the Recovery Note.

PURPOSE OF THE PROPOSED TRANSACTIONS

29. The purpose of the proposed transactions is to maximize the recovery to the Lossco Creditors through potential recovery pursuant to the Recovery Note. This would be accomplished by an amalgamation of Lossco and Opco, thereby enabling Amalco to utilize the tax attributes of Lossco in respect of future income from the XXXXXXXXXX business. The proposed transactions would put Opco and Lossco in the same position as if Parentco had purchased all of the issued shares of Lossco, which, in the circumstances of the CCAA process, was not practicable at the time of the Lossco/Opco Sale.

RULINGS GIVEN

Provided that the preceding statements constitute a complete and accurate disclosure of all of the relevant facts, proposed transactions and purposes of the proposed transactions, and provided that the proposed transactions are completed in the manner described above, our rulings are as follows:

A. The Residual Assets and the Warehouse have not begun to be used by Lossco for “some other purpose” within the meaning of paragraph 13(7)(a) and, as a consequence, are not deemed to be disposed of by Lossco in accordance with such paragraph.

B. Notwithstanding Lossco's becoming a bankrupt, paragraph 128(1)(g) will not apply to Lossco or Amalco provided the bankruptcy of Lossco is annulled pursuant to the Lossco Proposal.

C. The provisions of paragraph 80(2)(h) will apply to the Recovery Note such that the principal amount of the Recovery Note upon issuance will be deemed to be paid by Lossco in satisfaction of the principal amount of the

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Lossco Indebtedness in respect of which the Recovery Note is issued by Lossco. The amount by which the Lossco Indebtedness exceeds the principal amount of the Recovery Note upon issuance will become the forgiven amount in respect of the Lossco Indebtedness for purposes of the application of the debt forgiveness rules in section 80.

When the Recovery Note is extinguished at the end of XXXXXXXXXX years following its issuance, the debt forgiveness rules in section 80 will also apply to the amount, if any, by which the principal amount of the Recovery Note exceeds the sum of all amounts paid out to the creditors under the terms of the Recovery Note during the XXXXXXXXXX-year period.

D. The provisions of section 80 will apply to the Recovery Note only at the time the Recovery Note is extinguished pursuant to its terms in XXXXXXXXXX years.

E. For purposes of subsections 111(4), (5), (5.1), (5.2) and 249(4), Parentco will be considered to have acquired control of Lossco at the commencement of XXXXXXXXXX.

F. The provisions of subsection 87(2.1) will apply to deem Amalco to be the same corporation as, and a continuation of, Lossco and Opco, for the purposes and subject to the restrictions set out in subsection 87(2.1).

G. If the amalgamation of Lossco and Opco occurs on XXXXXXXXXX, and provided that no election pursuant to subsection 256(9) is made with respect to the acquisition of control of Lossco by Parentco and no effective time is specified in the certificate of amalgamation obtained in respect of the Amalgamation, all as described in Paragraph 24 above, Lossco will have only one deemed taxation year end as a result of the acquisition of control of Lossco by Parentco and the Amalgamation.

If the amalgamation is not concluded on XXXXXXXXXX, Lossco will have one deemed taxation year end as a result of the acquisition of control of Lossco by Parentco and a second deemed taxation year end as a result of the Amalgamation.

H. Immediately before the acquisition of control of Lossco by Parentco, the amount by which:

> (a) the UCC of depreciable property of a prescribed class of the XXXXXXXXXX business exceeds the fair market value of all the property of that class will be required, by reason of subsection 111(5.1) and paragraph 20(1)(a), to be deducted in computing the income of Lossco for its taxation year ending at such time; and
>
> (b) the CEC of eligible capital property of the XXXXXXXXXX business exceeds 3/4 of the fair market value of the eligible capital property of that business will be required, by reason of subsection 111(5.2) and paragraph 20(1)(b), to be deducted in computing the income of Lossco for its taxation year ending at such time.

I. Provided that Lossco's XXXXXXXXXX business, described in Paragraphs 3 and 15 above, is carried on by Amalco for profit or with a reasonable expectation of profit throughout a particular taxation year ending after the acquisition of control of Lossco by Parentco, as described in Paragraph 23 above, and the amalgamation of Lossco with Opco, as described in Paragraph 24 above, and subject to the time limitations set out in paragraph 111(1)(a), the restrictions set out in subsection 111(3), and any other requirements of the Act regarding deductibility of non-capital losses, the non-capital loss of Lossco resulting from the deductions pursuant to subsections 111(5.1) and (5.2), described in Ruling H above, will be a non-capital loss of Amalco by reason of subsection 87(2.1) and may be deducted by Amalco under paragraph 111(5)(a) in computing its taxable income for that taxation year to the extent of the income earned by Amalco for that particular year from carrying on the XXXXXXXXXX business.

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J. Subsection 245(2) will not be applied to the proposed transactions, in and by themselves, to re-determine the tax consequences confirmed in the rulings given.

The above rulings are given subject to the limitations and qualifications set out in Information Circular 70-6R5 dated May 17, 2002 and are binding on the Canada Customs and Revenue Agency provided that the proposed transactions are completed by XXXXXXXXXX.

The above rulings are based on the law as it presently reads and do not take into account any proposed amendments to the Act which, if enacted, could have an effect on the rulings provided herein.

COMMENTS

1. Nothing in this ruling should be construed as implying that the Canada Customs and Revenue Agency has agreed to or reviewed:

(a) the determination of the fair market value or ACB of any particular asset, the paid-up capital in respect of any shares referred to herein, or the UCC, CEC, non-capital losses or net capital losses of any corporation; or

(b) any tax consequences relating to the facts and proposed transactions described herein other than those specifically described in the rulings given above.

Yours truly,

for Director

Reorganizations and Resources Division

Income Tax Rulings Directorate

Policy and Legislation Branch

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4

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

Court File No: CV-15-10869-00CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF PLASCO ENERGY GROUP INC., PLASCO TRAIL ROAD INC. AND PLASCO OTTAWA INC.

Applicants

July 17-15

July 17/15

R.J. Chadwick & Brad. Wiffen for the applicants
A. Taylor for the Monitor
S. Weisz for North Shore Power Group Inc. } the secured creditors
S. Van Allen for Canadian Water Projects }
J. Meha for the City of Ottawa
L. Brost for the Ministry of Research & Innovation
M. Wilsack for the Employees Committee

The applicants seek an extension of the stay under s. 11.02(2) of the Companies' Creditors Arrangement Act. The applicants are acting in good faith to finalize an inter-connected series of settlements with various creditors and a sale agreement, together with a companion reorganization necessary to implement the settlements. Additional time is required to formalize and close these arrangements although the material details are sufficiently agreed in principle that the applicants say a further extension below can be granted. In addition, time will be required to develop a plan for the remaining assets and to wind down the activities of the Business. The forecast cash flow indicates that the applicant will have sufficient

PTO

ONTARIO
SUPERIOR COURT OF JUSTICE-
COMMERCIAL LIST

Proceeding commenced at Toronto

MOTION RECORD
(Motion Returnable July 17, 2015)

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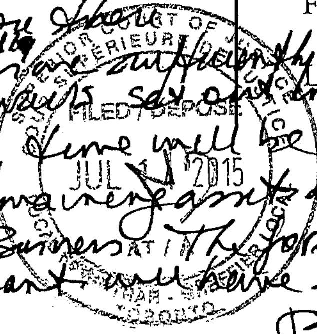

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financing during the ~~fo~~ extension period. There is also no evidence that any creditor will suffer material prejudice if the stay were extended. In this regard, the substantial majority of the creditors support the extension.

Accordingly the order extending the stay until September 25/15 shall issue. A hearing is scheduled for ~~S~~ July 24/15 (2hrs.) if required to address matters pertaining to the form of ~~the~~ an order giving effect to the approvals ~~and~~ to be addressed below in a further endorsement of today.

Wilton-Siegel J.

July 17/15

R.J. Chadwick and R. Weffen for the applicants
A. Taylor for the Monitor
S. Weisz for North Shore Power Group Inc., secured creditor
S. Von Allen for Canadian Water Projects, secured creditor
J. Mehta for the City of Ottawa
L. Brost for the Ministry of Research and Innovation of Ontario
M. Wiback for the Employees Committee

The applicants seek approval of (1) a sale transaction with Maynards Industries Ltd. ("Maynards) of certain equipment (the "Equipment"); and (2) settlement agreements among (i) the applicants, Plasco Energy ~~Group Inc.~~ L.P. Holdings S.L.U., North Shore Power Group Inc. ("NSPG") and Canadian Water Projects ("CWP"), referred to as the "Global Settlement", and (ii) among Plasco Energy Group Inc. ("Plasco"), Plasco Trail Road Inc. ("PTR") and the Ministry of Research and Innovation of the Province of Ontario ("MRI"), referred to as the "MRI Settlement". These agreements collectively form a package intended to sell the principal assets of the applicants and ensure the demolition of the applicants' demonstration facility with a view to advancing significantly the winding up and liquidation process of the applicants.

With respect to the Maynards sale agreement, the record establishes that the requirements of s. 36 of the Companies' Creditors Arrangement Act (the "CCAA") as well as the test set out in Royal Bank v Soundair Corp. have been satisfied. In particular, the transaction is the result of an extensive sales process which failed to

produce any bids for the applicants' business as an entirety and represents the best of the remaining share and liquidation bids. The applicants also consulted with the secured creditors, who support the transaction, as well as the other creditors and stakeholders likely to be affected by the transaction. In this regard, there is no evidence of any unfairness in the sales process. Accordingly, this transaction is approved.

With respect to the settlement agreements, the CCAA gives the Court the authority to approve such agreements under section 11 provided always that the approval furthers the purposes of the CCAA which, in this case, entails an orderly wind-up of the applicants' business and a maximization of recoveries for its creditors and other stakeholders. The test for approval requires demonstration that: (1) the settlement is fair and reasonable; (2) the settlement will be beneficial to the debtor and its stakeholders generally; and (3) that the settlement is consistent with the purpose and spirit of the CCAA. I am satisfied that each of the proposed settlements meets this test for the following reasons.

With respect to the Global Settlement, the agreement ~~transfers~~ effectively transfers the current tax losses and the applicants' intellectual property on a basis which recognizes value for such assets after the failure of the sales process to identify a better offer for the applicants' business as an entirety. In doing so, it also recognizes the security in the intellectual property that currently exists in favour of

NSPG and CWP. The settlement advances the CCAA proceedings insofar as it provides for disposition of the assets leased by these parties to the applicants and thereby for the decommissioning of the demonstration facility in a cost effective way through the Maynards transaction. As such, the Global Settlement satisfies the requirements of fairness and reasonableness and is consistent with the purpose of the CCAA. While it appears the shareholders will have no economic interest in the applicants, the settlement is also supported by creditors having approximately 95% of all known unsecured obligations of the applicants, upon which, in addition to the facts above, the Court can rely as evidence that the settlement is beneficial to the applicants and its stakeholders generally.

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 ~~the applicants~~ 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. The reorganization requires an amendment to the articles of Plasco to consolidate its shares and eliminate fractional shares arising on such consolidation. The Court has authority to approve such actions under section 11 of the CCAA which will constitute an order for the purposes of section 191(1) of the Canada Business Corporations Act, which governs Plasco.

Based on the foregoing, but subject to the qualification below, the Global Settlement and the reorganization contemplated therein to complement the Global Settlement are hereby approved.

With respect to the MRI Settlement, the MRI claims in respect of the GE engines will be released in return for payment of an amount approximately equal to the value allocated to the GE engines by Maynards, which is also at arm's length to the applicants. The MRI Settlement resolves a significant claim against the applicants and allows the Maynards transaction to proceed. On this basis, the MRI Settlement is fair and reasonable and furthers the purpose of the CCAA. It is also beneficial to applicants and the stakeholders for the same reasons.

Based on the foregoing, ~~and~~ but subject to the qualification below, the MRI Settlement is hereby approved.

I note that the City of Ottawa, which appeared today, has not consented to any of the

Maynards transaction, the Global Settlement or the MRI Settlement, pending its review of these transactions and has reserved its rights to object thereto at a hearing scheduled for July 24, 2015. The approvals herein are also subject to approval of an order or orders giving effect to such approvals after finalization of the transactions and the determination of any outstanding issues which are to be addressed at such hearing.

W. Hon-Siegel J.

5

Selected Income Tax Considerations in Court-Approved Debt Restructurings and Liquidations

Marie-Andrée Beaudry and Dean Kraus

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Abstract

In this paper, the authors first provide an overview and comparison of the main federal insolvency regimes—the Companies' Creditors Arrangement Act and the Bankruptcy and Insolvency Act. Following a brief overview of the debt-forgiveness regime under the Income Tax Act and the basic tax-planning themes to be considered in the context of a restructuring or liquidation of an insolvent corporation, the paper then considers two case studies (a restructuring scenario and a liquidation scenario) to illustrate certain tax-planning considerations that are commonly encountered. The paper then considers the deductibility of interest and the relevance of the recent decision of the Ontario Court of Appeal in *Re Nortel Networks*; the deductibility of professional fees incurred by a taxpayer in connection with a restructuring or liquidation; the tax treatment of damages for breach of contracts in the insolvency context; and the treatment of Crown claims in the insolvency context, including the right of setoff and the relevance of the recent Quebec Court of Appeal case *Girard, Re* on whether taxation authorities are permitted to issue assessments.

Keywords Insolvency; bankruptcy; debt forgiveness; restructuring; liquidation; tax planning.

Introduction

Tax professionals advising companies in regard to restructuring or liquidation proceedings undertaken pursuant to the Companies' Creditors Arrangement Act[1] (CCAA) or the Bankruptcy and Insolvency Act[2] (BIA) encounter a number of recurring tax considerations, from the planning required to navigate the debt-forgiveness rules to the issues that arise in evaluating the priority of government

tax claims. In this paper, we provide an overview of certain taxation issues commonly faced by insolvent companies under the CCAA or the BIA. We add to the literature on the general subject of the taxation of insolvency[3] by focusing on case studies in the CCAA context specifically. We also highlight planning strategies that may be considered to limit the impact of the debt-forgiveness rules and maximize the use of a debtor company's tax attributes.

To provide the appropriate legislative context, we begin with an overview and comparison of the main federal insolvency regimes: the CCAA and the BIA. We then commence our study of tax considerations arising with respect to debt restructurings and liquidations with a review of the debt-forgiveness rules under section 80 of the Income Tax Act[4] and the tax-planning strategies that may reduce the impact of those rules. To illustrate the application of the debt-forgiveness rules, we provide two case studies: a debtor company that is restructuring under the CCAA, and a debtor company that is liquidating under the CCAA. Next, we address the deductibility of certain amounts while a company is under CCAA proceedings. We consider the deductibility of interest and the relevance of the case *Re Nortel Networks Corporation et al.*,[5] recently affirmed by the Ontario Court of Appeal. We then turn to an evaluation of the appropriate tax treatment of professional fees paid for advice relating to CCAA restructuring and liquidation, and follow with a brief analysis of the deductibility of damages for breaches of contract by insolvent companies. Because Crown claims play a prominent role in an insolvency scheme of distribution, we also examine the most frequently recurring issues related to assessments and claims by the tax authorities. After briefly discussing the rights of setoff and compensation available to the taxation authorities, we review the priority of various tax claims under the CCAA. Finally, we examine the ability of the taxation authorities to issue assessments when a company is under insolvency proceedings, referencing the recent Quebec Court of Appeal decision in *Girard*.[6]

Overview of the CCAA and BIA Regimes

Bankruptcy and insolvency fall under federal jurisdiction in Canada,[7] with insolvency law mainly governed by two federal statutes: the BIA and CCAA. An additional federal statute, the Winding-up and Restructuring Act,[8] provides an insolvency regime for entities that are excluded from the application of the BIA and the CCAA, such as banks, loan companies, insurance companies, and trust companies.[9] The BIA is the only legislation under which a corporation can undertake or be placed in a formal bankruptcy, which generally results in the debtor's assets being vested in a trustee who oversees the sale of those assets and the distribution of proceeds to creditors. Restructurings, however, can be undertaken under either the CCAA or pursuant to the BIA's notice-of-intention process. Despite the existence of two separate legislative regimes, there has been a modern tendency toward harmonization of those areas of the CCAA and the BIA that overlap, as well as encouragement of restructuring rather than liquidation, with both trends specifically noted by the Supreme Court of Canada in *Century Services*.[10]

For large companies facing serious financial difficulties, the CCAA offers a very flexible insolvency regime. Compared with the more rigid, rule-bound nature of the BIA, the CCAA framework generally allows insolvent companies to pursue a wider range of options with stakeholders, with more generous amounts of court-sanctioned time to negotiate a plan of compromise and arrangement ("a plan"). The judicial discretion available to judges under the CCAA in considering a debtor company's rights and obligations is often particularly valuable for complex restructurings and liquidations, which can take significant time. From a tax perspective, the careful navigation of tax considerations for debtor companies filing under the CCAA or BIA can maximize an insolvent company's tax attributes, minimize future tax liabilities post-restructuring, and provide greater value to stakeholders.

Eligibility Under Each Statute

The BIA is available to debtors, whether natural or legal persons, with liabilities owing to creditors that amount to at least $1,000 and who reside, carry on a business, or have property in Canada.[11] To be eligible for protection from creditors under the BIA, the debtor must meet one of the following three prongs of the statutory test for an "insolvent person":

1) the debtor cannot meet its obligations as they become due;
2) the debtor has stopped paying its current obligations in the ordinary course of business as they generally become due; or
3) at a fair valuation, the aggregate of the debtor's property is not sufficient, or, if sold through a fairly conducted sale under legal process, would be insufficient to allow it to pay all of its obligations due and accruing due.[12]

The CCAA, on the other hand, is only available to corporate entities if the total collective liabilities of the company and its affiliated companies exceed $5 million.[13] A debtor must also be "insolvent" to restructure under the CCAA; unlike the BIA, however, the CCAA does not provide a statutory definition of insolvency. While the courts in CCAA proceedings refer to the BIA definition of insolvency, case law has also established a "contextual and purposive interpretation" to define insolvency and determined that beyond the BIA definition, a debtor may also be considered insolvent for CCAA purposes when it is facing an impending liquidity crisis.[14]

Restructuring or Liquidating Under the BIA

Under the BIA, in the context of a restructuring or liquidation, an insolvent debtor can simply file a notice of intention to make a proposal to creditors. This is essentially a short document containing prescribed information.[15] Filing the notice of intention invokes an automatic stay of proceedings, protecting the insolvent debtor from its creditors as well as from the Crown.[16] The debtor company

has 30 days after the date on which it files its notice of intention to file a proposal. This period may be extended in 45-day increments, but only up to a maximum of six months from the date that the debtor filed its notice of intention. An automatic stay of proceedings also occurs when the proposal is filed.[17] The debtor's goal is to present a proposal that will be accepted by the requisite statutory majorities of each class of affected creditors for approval. The BIA process also allows a debtor to modify, disclaim, or terminate agreements to which the insolvent debtor is a party, subject to certain exceptions and objections that the counterparty and the court may have.

The BIA outlines the specific procedure and manner for addressing the rights and obligations of the insolvent debtor, including how to deal with claims and the method for voting on the plan submitted to creditors.[18] An insolvent debtor generally continues to control and manage the business, but the court has discretion to appoint an interim receiver when this is required to protect the debtor's estate or the interests of creditors.[19] An interim receiver can be directed to, inter alia, exercise control over the debtor's business and take any necessary conservatory measures.

A formal bankruptcy is triggered under the BIA when the insolvent debtor files an assignment in bankruptcy with the official receiver, when the court grants a creditor's petition for a bankruptcy order against the insolvent debtor, or when a debtor in a notice-of-intention process fails to file a proposal within the prescribed delay, in which case the debtor is deemed to be bankrupt. The insolvent debtor's assets are automatically vested in the trustee, followed by the liquidation of the insolvent debtor's assets and distributions to creditors.

Restructuring or Liquidating Under the CCAA

Under the CCAA, an application by a debtor company must be presented to the court, which will then issue an initial order, typically including a stay of proceedings.[20] The initial order will also usually provide for the appointment of a monitor,[21] the conditional authority to disclaim or resile agreements,[22] the authorization to obtain interim financing,[23] and various priority charges for payment of the monitor and legal counsel, as well as directors' charges.[24] The initial order typically provides for a stay of proceedings that lasts for 30 days, and the debtor company can apply for an extension of the order within that 30-day period. CCAA orders also typically allow the debtor company to terminate any contract, which can be particularly useful for downsizing operations or renegotiating contracts concluded in the past at rates higher than current market rates.

A stay of proceedings under section 11.02 of the CCAA prevents creditors from enforcing their claims for payments by staying, until otherwise ordered, all suits, actions, or proceedings from being commenced or continued against the debtor company or its directors and officers. Stays under the CCAA, however, can be significantly broader than stays under the BIA. In certain cases, the court may exercise its discretion to include under the umbrella of the stay certain related entities that are not CCAA applicants per se (such as related partnerships).

There is no time limit for restructuring or liquidating under the CCAA, meaning that the duration of any subsequent order is at the discretion of the court, as are many of the debtor company's obligations toward its stakeholders during the restructuring or liquidation process. Interim orders will generally include court-approved restructuring steps, such as orders that deal with an investor solicitation and sale process and the adjudication of claims against a debtor company. The plan of arrangement must be approved of by a vote of the majority of creditors in *each* class. The voting creditors of each class must together represent at least two-thirds of the value of claims in their class.[25]

Once successfully negotiated and approved by the creditors, the plan is put before the court to be sanctioned. If it approves the plan, the court issues a final order that is binding on all creditors. Recent high-profile filings under the CCAA include US Steel Canada Inc., which is currently pursuing a combined sale and restructuring/recapitalization process, and Target Canada, which is currently liquidating all of Target's Canadian subsidiaries under the CCAA.

Key Differences Between the Two Insolvency Regimes

If a debtor company meets the eligibility requirements under both the BIA and the CCAA, it must decide which regime to follow. Generally, an insolvent company must decide between the simpler rules-based approach to restructuring under the BIA and the more flexible approach of the CCAA. The CCAA provides courts with greater latitude in determining the rights and obligations of the company and its creditors, but it is a more complex and costly process that requires considerable court supervision. The availability of additional time to negotiate with stakeholders under the CCAA is a key consideration for insolvent companies undertaking complex restructurings. Another notable difference between the two regimes is that CCAA orders are much more likely to provide for the possibility of debtor-in-possession (DIP) financing,[26] which, although now explicitly authorized by the BIA,[27] is less common in insolvencies proceeding under that statute.

Under either regime, a debtor company must obtain creditors' approval of the proposal or plan of arrangement in order to restructure or liquidate. The effect of refusal of the proposal by creditors or by the court differs significantly depending on the governing regime. Under the BIA, if a proposal is refused, the debtor company becomes automatically bankrupt as of the date of the filing of the notice of intention.[28] Under the CCAA, the proceedings are not automatically terminated, nor is there an automatic bankruptcy. At that point, it is up to creditors to apply for an order lifting the stay, usually to appoint a receiver.

The discretion available under the CCAA for negotiating a plan comes with significant financial costs due to the higher level of court supervision required as well as the associated fees for professional advisers. A restructuring under the BIA is generally a simpler and less expensive proceeding. Large companies may choose to file under the BIA if they are concerned about the costs of a CCAA process and are comfortable with the BIA's more rigid and fast-moving restructuring or liquidation process. Recently, there has been some debate as to whether

the CCAA is the appropriate legislative vehicle for companies that are essentially liquidating rather than restructuring. These companies may choose to file under the CCAA because of the flexibility that the regime provides to negotiate with stakeholders.[29] Generally, for debtor companies that are experiencing significant issues related to the need to terminate contracts, the restructuring of share capital, significant pension deficits, or the need for DIP financing, the CCAA is the more appropriate insolvency regime.

Overview of the Debt-Forgiveness Rules

During the restructuring process, an insolvent debtor company will usually negotiate to settle a significant number of its commercial obligations for less than the full amount owed. Similarly, when a company is being liquidated under the CCAA or the BIA, some or all of its debt obligation will normally be settled for less than the full amount owed. The settlement (or deemed settlement) of a commercial debt obligation for less than the full amount owed will have income tax consequences for the issuer in accordance with the debt-forgiveness rules in the ITA, which are located in sections 80 to 80.04 and the related provisions. The debt-forgiveness rules are intricate and highly technical, and an in-depth study of them is beyond the scope of this paper.[30] For the purpose of discussing the issues canvassed in this paper and the two case studies, however, a general overview is provided below.

The Settlement of a Commercial Obligation

Section 80 applies to ensure that the settlement or extinguishment of a "commercial obligation" or a portion thereof has tax consequences for the debtor. A commercial obligation includes a "commercial debt obligation" and a "distress preferred share" issued by the debtor.[31] In general terms, a commercial debt obligation is a debt obligation issued by the debtor on which interest is or, if chargeable, would be deductible in computing the debtor's income, taxable income, or taxable income earned in Canada. Subsection 248(26) provides that a debtor's liability to repay borrowed money, a debtor's liability to pay an amount (other than interest) as consideration for property or services, and, more broadly, a debtor's liability to pay an amount that is deductible in calculating the debtor's income will be considered to be an obligation issued by the debtor that has a principal amount equal to the amount of the liability. As a consequence, the concept of a debt obligation issued by the debtor will capture all money borrowed by the debtor and also many other liabilities of the debtor. Any interest payable by a debtor is deemed by paragraph 80(2)(b) to be a separate obligation issued by the debtor having a principal amount equal to the amount that is, in general terms, deductible in computing the debtor's income.

During a debt restructuring or liquidation, a debtor company will likely have a myriad of commercial obligations that may be subject to the debt-forgiveness rules—from contracts for services and property to extensive debts for borrowed

funds. Note that the debt-forgiveness rules are not a concern for a company that is formally bankrupt because the difference between the principal amount of the obligation and the amount settled is deemed by the ITA to be nil in those circumstances.[32]

The Forgiven Amount

Very generally, the "forgiven amount" is essentially equal to the lesser of the amount for which the obligation was issued and its principal amount owed, less the amount for which the debt was settled or deemed to be settled.[33] If the debt was issued in a foreign currency, any forgiven amount is to be determined in Canadian dollars by using the applicable exchange rate for that currency in relation to Canadian dollars at the time that the debt was issued.[34] If the original debtor and creditor exchange one debt for another, pursuant to paragraph 80(2)(h), the principal amount of the new debt is deemed to be a payment on account of the principal amount of the old debt, and a forgiven amount will only arise if the principal amount of the new debt is less than the old debt. Note that changes to certain terms of a debt, such as interest rates and payment schedules, should not lead to a forgiven amount in and of themselves, provided that the principal amount of the debt is not altered, even though such changes may reduce the market value of the debt. This can provide some leeway for restructuring companies to negotiate more favourable terms with creditors without triggering the application of the debt-forgiveness rules.[35]

Subject to certain exceptions, including with respect to distress preferred shares, if a corporation issues shares as consideration for the settlement of a debt issued by the corporation, generally the amount paid to settle the debt is deemed to be equal to the fair market value (FMV) of the shares at the time they were issued, pursuant to paragraph 80(2)(g), plus any increase in the value of any other shares held by the creditor that occurred as a result of the settlement, pursuant to paragraph 80(2)(g.1). Accordingly, where this deemed settlement amount is less than the lesser of the principal and the issuance amount of the settled debt, the difference will be the forgiven amount.

The Tax Consequences of the Forgiven Amount

A debtor will be required to first apply the forgiven amount to reduce certain of its tax attributes. The order in which the debtor company's tax attributes are reduced is specified in the ITA,[36] and begins with mandatory applications to certain attributes that are ostensibly viewed as most valuable to the debtor, as follows:

1) the forgiven amount is first applied to reduce the debtor's non-capital loss carryforwards (NOLs) from prior years pursuant to subsection 80(3); and
2) any remaining forgiven amount is next applied to reduce the debtor's net capital loss carryforwards (NCLs) from prior years pursuant to subsection 80(4).

The debtor is then able to designate, on an elective basis, the application of any remaining forgiven amount to reduce any or all of the following tax depreciable and amortizable pool balances:

1) the capital cost and undepreciated capital cost (UCC) of the debtor's depreciable property (under subsection 80(5)),
2) the cumulative eligible capital (CEC) of the debtor (in accordance with subsection 80(7)), and
3) certain resource pool balances of the debtor (under subsection 80(8)).

While the application of the forgiven amount to the depreciable and amortizable pools described above is discretionary, the debtor must designate as much as possible to these pools before it can elect to apply any remaining forgiven amount to the adjusted cost base (ACB) of capital properties or to current-year capital losses, as discussed below.

Provided that the debtor has designated the maximum amount in respect of any remaining forgiven amount balance to be applied to its depreciable or amortizable pools, any remaining forgiven amount balance may be applied by the debtor to reduce the ACB of certain capital properties of the debtor. For these purposes there are effectively three categories of capital properties, and the debtor must make the maximum designation with respect to any preceding category of capital property before it may designate any amount in respect of a subsequent category of property. In hierarchical order, the three categories of capital property may be generally described as follows:

1) capital properties of the debtor, except for shares and debts of corporations of which the debtor is a specified shareholder and interests in partnerships related to the debtor (under subsection 80(9));
2) capital properties that are shares and debts of corporations that are not related to the debtor, but of which the debtor is a specified shareholder (under subsection 80(10)); and
3) shares and debt of corporations, and interests in partnerships, that are related to the debtor (under subsection 80(11)).

If the debtor has designated the maximum amount with respect to both its depreciable and amortizable pools, and also with respect to the ACB of the first category of capital property described above, then any remaining forgiven amount must be applied to reduce current-year capital losses of the debtor (pursuant to subsection 80(12)) but effectively only to the extent that such current-year losses exceed current-year capital gains of the debtor.

By agreement, a debtor company may transfer (pursuant to section 80.04) any remaining unapplied amounts to an "eligible transferee" (generally, certain Canadian persons that are related to the debtor) to effectively reduce the eligible transferee's tax attributes. However, the debtor company must first apply the

forgiven amount to the maximum extent possible to reduce its own tax attributes other than to the ACB of property that is in the third category of capital property described above (that is, the ACB of shares and debts of related corporations and interests in related partnerships under subsection 80(11)).[37]

After the forgiven amount has been mandatorily applied to reduce the NOLs and NCLs of the debtor and, if applicable, electively applied to reduce the debtor's other tax attributes and those of an eligible transferee in the manner described above, the debtor is required to include 50 percent of the remaining forgiven amount in its income.[38] If the debtor is a partnership, the inclusion rate is 100 percent.[39]

It should be emphasized, however, that further considerations arise when a debtor seeks to make a designation of the forgiven amount in respect of the shares or debts of the related corporation or interests in related partnerships (the third category of capital property referenced above). In fact, such a designation would not reduce the amount included in the debtor's income under subsection 80(13) by the amount designated in respect of that third category of capital property if certain related parties of the debtor have "gross tax attributes" and an amount of "residual balance" exists.[40] An amount of residual balance generally exists if the gross tax attributes of related entities exceed the debtor's unapplied forgiven amount. This means that in certain circumstances, to avoid an income inclusion, a debtor may effectively be compelled to transfer a forgiven amount balance to an eligible transferee pursuant to an agreement under section 80.04, rather than applying that forgiven amount balance to shares or debts of related corporations or to interests in related partnerships.

From a planning perspective, it is important to note that the inclusion in income of any remaining forgiven amount in the year that the forgiveness arises may be offset by deductions, reserves, or business or property losses. Accordingly, the relief provided by such deductions arising in the year that a debt is forgiven makes the tax treatment of amounts such as contractual damages and professional fees relating to the CCAA process (discussed below) particularly pertinent.

A relieving provision in section 61.3, which provides for a deduction for insolvent corporations that are residents of Canada, effectively limits the income inclusion under subsection 80(13) to an amount equal to twice the FMV of the corporation's net assets at the end of the year. A reserve is also available under section 61.4 that allows the subsection 80(13) income inclusion to be spread out over five years, at a minimum rate of inclusion of 20 percent per year. This deduction mechanism is available to corporations that are resident in Canada and to non-resident corporations carrying on business in Canada through a fixed place of business. When a deduction is taken for insolvent corporations under section 61.3 and the debtor does not make the maximum designations under subsections 80(5) to (11), the minister has the authority under subsection 80(16) to make designations under those provisions so as to erode the debtor company's tax attributes. The minister has no such discretion when a reserve is taken under section 61.4.

Debt Forgiveness Tax-Planning Techniques

For both a restructuring and a liquidation under the CCAA or the BIA, as the debtor company settles or extinguishes many of its commercial obligations, the impact of the debt-forgiveness rules is a critical issue. In a restructuring, it is beneficial to minimize the reduction of tax attributes, since this will reduce the amount of future taxes of the debtor once it emerges from insolvency. In a liquidation, the goals are to minimize or eliminate taxes in connection with the liquidation in order to maximize the amount available for distribution to creditors and to consider the potential monetization of tax attributes where appropriate. A carefully designed proposal or plan of arrangement can prevent or minimize settlement (or deemed settlement) of debt and/or ensure that the debt-forgiveness rules apply in the most tax-advantageous way possible.

A common planning theme in a restructuring is to seek to maximize the tax attributes of the debtor following the restructuring by effectively converting NOLs into other tax attributes that will be available after debt settlement. In this respect, there is an inherent arbitrage potential in the application of the debt-forgiveness regime because any forgiven amount will mandatorily reduce NOLs on a dollar-for-dollar basis, while any remaining forgiven amount, after mandatory and elective applications of the forgiven amount to the tax attributes of the debtor, will only result in a one-half inclusion of the remaining forgiven amount in the debtor's income. Accordingly, if NOLs can effectively be converted into other tax attributes that are available to the debtor following emergence from the restructuring process, the debtor may conceivably end up in a better position. In other words, such a strategy can, in the right circumstances and subject to certain timing issues, effectively allow the debtor to use only 50 percent of its tax attributes to shelter a forgiven amount while simultaneously preserving the remaining 50 percent of the debtor's tax attributes to shelter future income. While this strategy is not always viable, it should be considered as part of the planning process.

There are a number of ways that NOLs can effectively be converted into other tax attributes. One method is to amend tax returns for taxation years ending prior to the taxation year in which the settlement of the debt occurs in order to reduce discretionary deductions (for example, capital cost allowance [CCA] or deductions in respect of CEC) and thereby reduce NOLs, with the result that the debtor could have increased deductible pools after emerging from the restructuring process.[41] Similarly, not claiming certain reserves (for example, under paragraph 20(1)(m)) in the year preceding settlement may also reduce NOLs and potentially provide a benefit to the debtor. Another planning avenue to consider in order to accelerate income and thereby reduce NOLs includes the debtor effecting an internal taxable transfer of assets in the year preceding settlement.

Aside from reducing NOLs in order to reduce the mandatory application of the forgiven amount to that tax attribute, the debtor will also need to carefully consider the most tax-efficient course of action in making, or not making, discretionary designations of any forgiven amount to other tax attributes. Careful

tax modelling will be required to ensure that no material cash taxes will arise in the year of the restructuring as a result of the income inclusion under subsection 80(13), taking into account the potential five-year inclusion under section 61.4 and any other deductions available to the debtor in the year that the forgiveness arises to absorb any such income inclusion. In this regard, careful consideration should be given to the nature and timing of deductible expenses arising in connection with the restructuring process, since these deductible expenses can effectively shelter twice the amount of any forgiven amount balance that is subject to the one-half income inclusion under subsection 80(13). In addition, any balance of these deductible expenses will provide a significant benefit to the debtor in terms of sheltering future income following the debtor's emergence from the restructuring process.

Another common tax-planning technique that may be beneficial in certain cases is to trigger any embedded capital losses on the shares of related subsidiaries held by the debtor in the year preceding the year of debt settlement so that those embedded capital losses will become NCLs and any forgiven amount will be mandatorily applied to those NCLs (after NOLs are fully reduced). Because of the issues that arise with respect to designating an unapplied forgiven amount to be applied to reduce the ACB of the shares of related subsidiaries (discussed above), the realization of embedded losses in those shares can effectively allow the debtor to apply a forgiven amount to the embedded loss in those shares without having to first make mandatory designations to reduce other valuable tax attributes or enter into a section 80.04 agreement with the subsidiary. Such an agreement would expose the tax attributes of the related subsidiary to the application of the debt-forgiveness rules. Several possible avenues to realize such an embedded loss may be considered, depending on the circumstances, including (1) triggering an acquisition of control of the debtor and the resulting writedown of the debtor's capital property, including the shares of underlying subsidiaries; (2) effecting a taxable windup of the subsidiary; or (3) electing under subsection 50(1).

There are a myriad of other planning avenues that should also be considered, depending on the specific circumstances. These planning techniques potentially include (1) a so-called tuck-under transaction to eliminate underwater debt owed between corporations in the same corporate group in certain circumstances,[42] (2) a change in the terms of current debt to reflect more favourable terms or the issuance of a new debt in satisfaction of old debt to avoid the application of the debt-forgiveness rules, and (3) the repayment of debt through the issuance of distress preferred shares.

Restructuring and Liquidation Case Studies

The two case studies below illustrate the application of the debt-forgiveness rules and some of the potential tax planning avenues that may be available in certain situations involving a restructuring or liquidation under the CCAA.

Case Study 1: Debt-Forgiveness Rules Applied to a Restructuring Under the CCAA

The first case study involves a restructuring under the CCAA, as depicted in figure 1.[43] Pubco, a widely held Canadian public corporation whose shares are traded on the Toronto Stock Exchange (TSX), is a large retailer with stores across Canada. Pubco has one Canadian operating subsidiary (Subco) and one US subsidiary (USco). After a failed experiment expanding into the United States, the operations of USco have been wound down, its assets have been sold to pay creditors of USco, and USco is now dormant. Pubco is in financial difficulty, has filed under the CCAA, and will be undertaking a restructuring process that will take place over a 12- to 18-month period.

The objective is for Pubco to emerge from restructuring under the CCAA as a viable and profitable company with its shares traded on the TSX. All of Pubco's debts and contracts are to be restructured or cancelled. In this regard, Pubco has $500 of unsecured debentures outstanding as well as $300 of secured indebtedness owing to a third-party lender. Subco also has $300 of unsecured third-party debentures outstanding. Pubco has a significant number of lease contracts that it will seek to terminate or alter as part of the restructuring process. In addition, Subco has significant intercompany receivables owing to it from Pubco.

In terms of tax attributes, Pubco has NOLs of $400, depreciable property with an FMV of $500, and a UCC of $100 (that is, embedded recapture of $400, assuming that capital cost is greater than $500). Subco has NOLs of $240 and depreciable property with a UCC of $100. The Subco shares have an ACB of $200 and no value. The USco shares also have an ACB of $200 and no value.

Under the restructuring plan, secured third-party lenders will be paid in full with cash and Pubco shares, as shown in figure 2. Current shareholders of Pubco will not receive any consideration in respect of the relinquishment of their Pubco common shares, and all unsecured creditors will receive newly issued common shares of Pubco, representing approximately 20 percent of the value of their claims. Absent planning, no acquisition of control of Pubco will arise as a result of the restructuring because the debt is widely held.

Determination of the Forgiven Amount

The settlement of Pubco and Subco's obligations in exchange for Pubco shares will trigger the application of the debt-forgiveness rules. The determination of the forgiven amount in respect of the settled indebtedness should be based on the FMV of Pubco shares, as discussed below.

Paragraph 80(2)(g) provides that when a corporation issues a share to a person as consideration for the settlement of a debt issued by the corporation and payable to the person, the amount paid in satisfaction of the debt is deemed to be equal to the FMV of the share at the time it was issued. In the case study, this provision applies to Pubco shares issued in settlement of the indebtedness of

Figure 1 Restructuring Under the CCAA—Before Restructuring

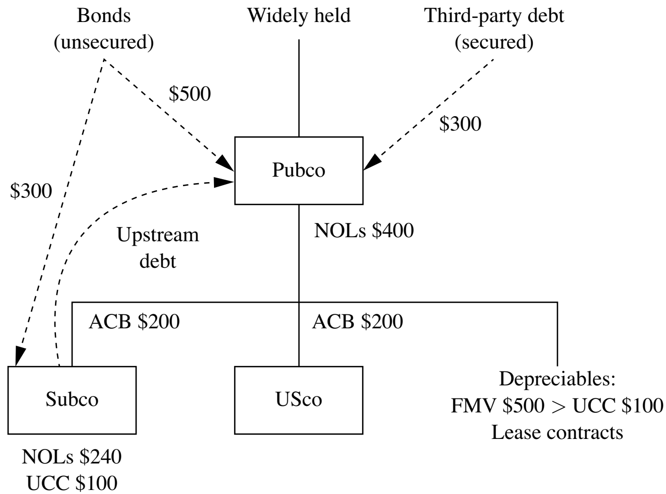
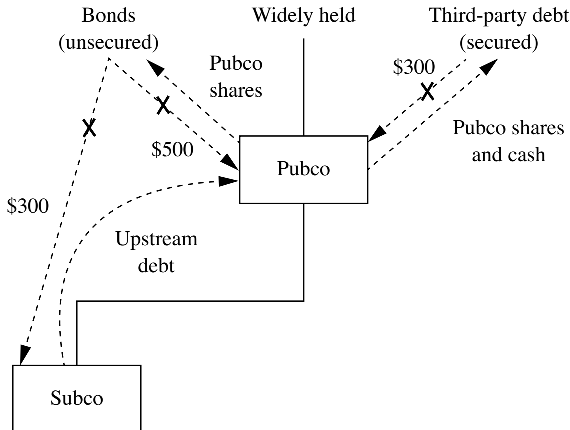


Figure 2 Restructuring Under the CCAA—Restructuring Plan



Pubco, but does not technically apply to any Pubco shares issued in settlement of indebtedness of Subco.[44] However, because the Pubco shares delivered to Subco's creditors constitute a payment in kind by Subco to those creditors, the FMV of any shares issued by Pubco in settlement of Subco's indebtedness should, on the basis of general principles, also be used to determine the amount paid in satisfaction of Subco's indebtedness.

However, a number of questions arise with respect to a determination of the FMV of Pubco shares. A threshold question is whether the effect of the restructuring should be taken into account in assessing the value of the shares delivered

in settlement of the indebtedness. In spinoff transactions where shares are distributed to the public, the practice is to use the trading value of the shares after their distribution to determine the tax consequences of the distribution. Similarly, after the restructuring, the use of the trading price of the Pubco shares, once the public trading of such shares commences, should be equally acceptable.

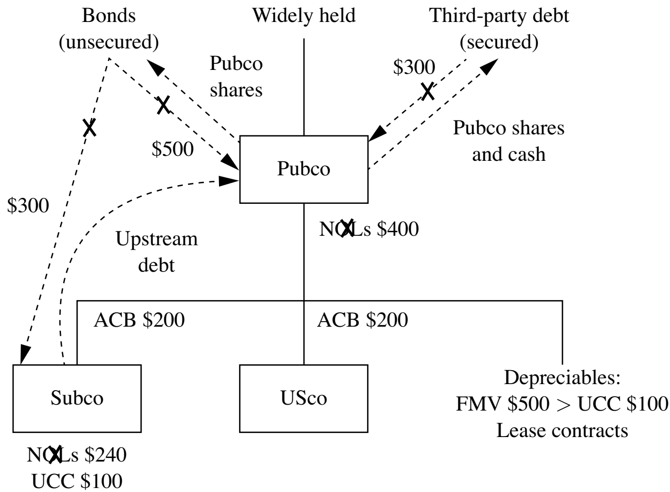
Because the value of the issued shares post-restructuring is the relevant touchstone for measuring the amount paid as part of the debt settlement, a further question that arises is whether the trading price of the Pubco shares on the day that they start trading should be considered the best indication of that value. It is common in public company restructurings to use an average trading price on the first day that the relevant shares trade (or a similar formulation) as an indication of value. However, it is conceivable that in unusual circumstances the trading price may not necessarily be an accurate indicator of value, especially if the shares are traded in small volume, or are subject to other restrictions.

The Supreme Court has ratified the principle that the market price is not always a good indicator of the FMV of publicly traded shares. In *Untermeyer*, the court held that the market price is the best test of the FMV of publicly traded shares as long as the price is not "spasmodic or ephemeral."[45] In *Bendix Automotive*,[46] the Federal Court of Appeal held that generally the FMV of publicly traded shares is the amount at which a willing, informed owner of shares who is not acting under pressure would sell the shares to a willing purchaser. *Bendix Automotive* concerned the valuation of shares paid in the form of dividends to a non-resident of Canada for the purpose of calculating withholding tax. The company argued that the shares should have a lower valuation than the stock market price because they were subject to a restriction on their sale. The court concluded that the FMV could be other than the traded price of the shares, and on the facts of the case was best reflected by looking at a subsequent transfer of such shares to an arm's-length party at a price lower than the trading price.

Tax Results Without Planning

Assume that no tax planning is undertaken in connection with the restructuring, as depicted in figure 3. Because the secured creditors are paid in full with cash and Pubco shares, no forgiven amount arises with respect to Pubco's secured indebtedness. As the value of the Pubco shares issued to the unsecured creditors of Pubco and Subco are assumed to have an FMV equal to 20 percent of the amount of the indebtedness, a forgiven amount of $400 arises for Pubco ($500 of indebtedness less the $100 FMV of Pubco shares issued in settlement) and a forgiven amount of $240 ($300 of indebtedness less the $60 FMV of Pubco shares issued in settlement) arises for Subco. There is a requirement that the $400 forgiven amount at the Pubco level be applied to eliminate Pubco's entire $400 NOL balance. Similarly, the $240 forgiven amount in respect of Subco results in a complete loss of Subco's $240 of NOL. Because the forgiven amounts for each of Pubco and Subco are mandatorily applied to the NOLs of each corporation,

Figure 3 Restructuring Under the CCAA—Without Planning



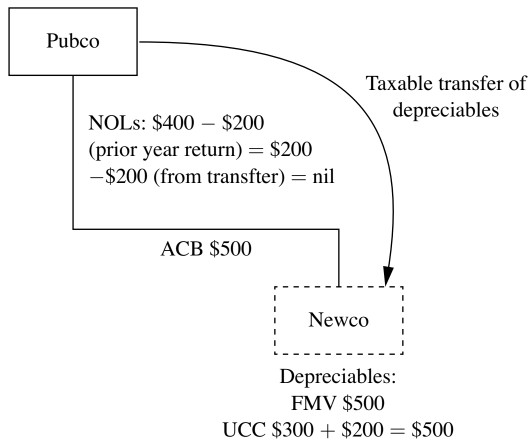
no permissive designations are possible and no income inclusion under subsection 80(13) will arise. As a result, the only valuable tax attributes of Pubco and Subco that will survive the restructuring are $100 of UCC in each corporation.

Actions To Preserve Tax Attributes

There are potential planning actions that can be taken to preserve the valuable tax attributes for the Pubco group so that they may be available to shelter income arising either in the year in which the debt forgiveness occurs pursuant to subsection 80(13) or in future years of the Pubco group. First, in accordance the Canada Revenue Agency's (CRA's) administrative practice, prior tax returns of Pubco and Subco that have been filed can be amended to reverse discretionary deductions claimed in those returns (including CCA and other deductible or amortizable pools, as well as reserves) and thereby reduce NOLs that would be affected by the debt-forgiveness rules.[47] The planning objective is to minimize the impact of any debt forgiveness on valuable NOLs, with the result that all or a portion the forgiven amount either will be applied to less valuable tax attributes or will ultimately result in only a 50 percent income inclusion in the year in which settlement occurs. In the case study, it is assumed that prior tax returns of Pubco can be amended to reverse $200 of discretionary CCA deductions, thereby reducing Pubco's NOLs from $400 to $200 and increasing Pubco's depreciable UCC balance from $100 to $300.

Second, as depicted in figure 4, in the year of Pubco ending immediately before the year in which the settlement of indebtedness occurs under the plan, and after obtaining court permission by interim order, Pubco can also transfer its depreciable property to a newly created subsidiary (Newco). This transfer can

Figure 4 Restructuring Under the CCAA—New Subsidiary



take place on a partially tax-deferred basis pursuant to subsection 85(1) with an elected amount sufficient to trigger the realization of $200 of the recapture embedded in Pubco's depreciable property. The remaining $200 of Pubco's NOLs can be applied to fully absorb the $200 of income realized by Pubco as a result of the taxable portion of the transfer. As a result of these two planning avenues, Pubco's NOLs are reduced from $400 to nil and Pubco's subsidiary, Newco, will own depreciable property with UCC of $500.[48] In other words, Pubco's NOLs have effectively been converted to UCC (in Newco), which does not have to be reduced by any forgiven amount unless a designation is made by Pubco on an elective basis.

In addition, it may make sense to wind up Subco for a variety of reasons, including to eliminate the intercompany receivable owing from Pubco to Subco. Specifically, Subco can be wound up into Pubco under subsection 88(1) before indebtedness is compromised under the plan, but in the same taxation year of Pubco in which such compromise occurs. Pubco can then make an election under subsection 80.01(4), with the result that the intercompany indebtedness will be deemed to be settled at its cost amount such that no debt forgiveness results from the extinguishment of the intercompany indebtedness.

The winding up of Subco into Pubco also results in Subco's $240 of NOLs flowing up to Pubco pursuant to subsection 88(1.1). However, these NOLs are only available to be utilized by Pubco beginning in respect of its next year that commences after the year in which the windup of Subco occurs. Importantly, these NOLs should not be considered NOLs of Pubco for the year of Pubco ending before compromise, and therefore they should not be reduced by any forgiven amount of Pubco that arises in the year of Pubco in which the debt settlement occurs. The winding up of Subco insulates Subco's NOLs from the application of any forgiven amount that arises at the Pubco level in these circumstances.

Subco's $100 UCC is available to Pubco in the year of the compromise to shelter income of Pubco in that year, including any income inclusion arising under subsection 80(13). However, the tradeoff is the loss of the $200 ACB in the Subco shares. This windup scenario is illustrated in figure 5.

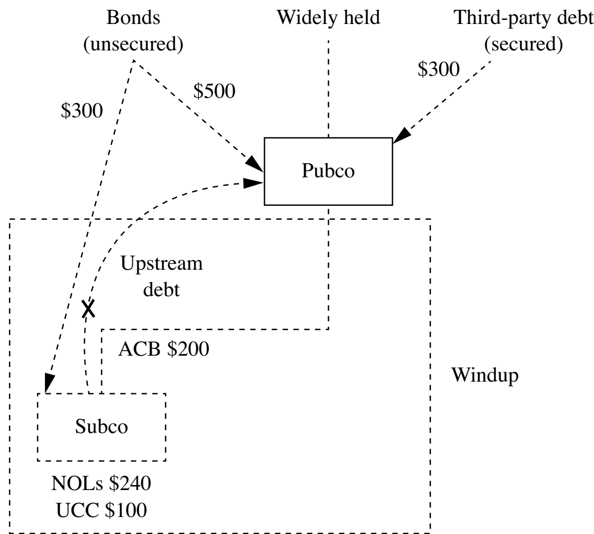
In addition, consider planning to realize any embedded capital losses of Pubco in the year of Pubco ending prior to the year in which the indebtedness of Pubco is compromised under the restructuring plan. Such a crystallization strategy will maximize the NCLs of Pubco and ensure that any forgiven amount can be applied to absorb the NCLs, instead of being applied against more valuable tax attributes. In the absence of such a crystallization, for example, any forgiven amount can be applied to reduce the $200 ACB of the USco shares held by Pubco pursuant to subsection 80(11) only if Pubco has made the maximum designations possible under subsections 80(5), (7), (8), (9), and (10). Moreover, to derive the full benefit of the subsection 80(11) designation in terms of reducing any ultimate income inclusion under subsection 80(13), Pubco may be compelled to first transfer a portion of any remaining forgiven amount to an eligible transferee (Newco). As mentioned above, because a "residual balance" exists with respect to Newco by virtue of the fact that Newco has material tax attributes of its own, Pubco is subject to an income inclusion. The prior crystallization of the embedded capital loss in the USco shares eliminates this concern.

A number of alternatives are possible in order to achieve a crystallization of the embedded capital loss in the USco shares. For example, as depicted in figure 6, USco can be wound up and dissolved (through an interim order) in the year ending before the year of the compromise, thereby realizing the accrued capital loss in the USco shares. Alternatively, given that USco is dormant, consideration could also be given to whether an election under subsection 50(1) could be made in order to realize the accrued loss in the year ending before the year in which the debt settlement occurs.

Tax Results of Actions To Preserve Tax Attributes

Assuming that all of the tax-planning possibilities discussed above are employed, the tax consequences to Pubco are considerably different than if no planning had occurred. As depicted in figure 7, the settlement of $800 of unsecured indebtedness at Pubco in consideration for Pubco shares having an FMV equal to $160 (that is, 20 percent of the amount of the indebtedness) results in a total forgiven amount of $640. Pubco has no NOLs, but it has an NCL of $200 attributable to the prior crystallization of the loss embedded in the USco shares that would be reduced to nil pursuant to subsection 80(4). Assuming Pubco decides not to make any designations to reduce other tax attributes, the remaining forgiven amount of $440 will result in a $220 (50 percent of $440) income inclusion to Pubco in the year of compromise. This $220 income inclusion can effectively be spread over five taxation years (at $44 per year) pursuant to the reserve mechanism in section 61.4.

Figure 5 Restructuring Under the CCAA—Windup of Subco



A comparison of the results where tax planning has not been used and when tax planning has been used is summarized in the accompanying table:

No planning		**Planning**	
Attributes		Attributes	
Pubco UCC	$100	Pubco UCC (from Subco)	$100
Subco UCC	$100	NOLs from Subco (available in following year)	$240
ACB of Subco shares	$200	UCC in Newco	$500
ACB of USco shares	$200		
Income inclusion		Income inclusion	
No income inclusion		$220 income inclusion ($44 each year over five years)	

Offsetting Subsection 80(13) Income Inclusion

As can be seen from the table, the Pubco group will preserve $640 of valuable tax attributes through the planning detailed above. However, Pubco will face a $220 income inclusion over the course of a five-year period and detailed tax modelling will be required to determine whether Pubco will have sufficient deductions to avoid cash taxes arising from that income inclusion. In addition to the $100 of UCC that Pubco has available to it in the year of compromise from the winding up of Subco, Pubco may also have significant other deductions available in the year of compromise that could help shelter the $44 income inclusion that arises in that year, including deductions in respect of CCAA restructuring fees and contractual damages, discussed below. Pubco will also have $240 of NOLs available to use in subsequent years as a result of the winding up of Subco,

Figure 6 Restructuring Under the CCAA—Crystallization Strategy

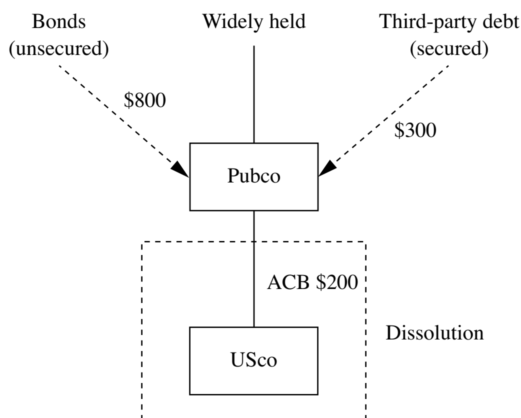
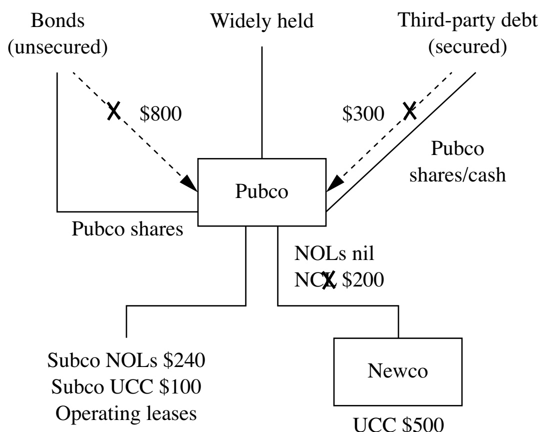


Figure 7 Restructuring Under the CCAA—Final Result

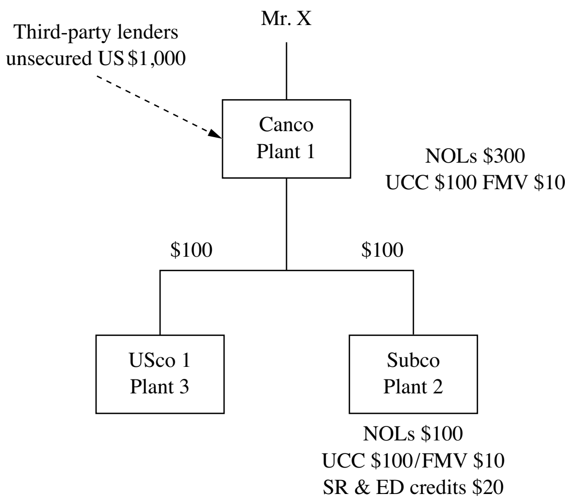


and it can potentially take steps to access the $500 of UCC in Newco. Accordingly, subject to detailed modelling, a $220 income inclusion spread over five years may be worthwhile in order to preserve $640 of valuable tax attributes that will be available to Pubco when it successfully emerges from the restructuring process.

Case Study 2: Debt-Forgiveness Rules Applied to a Liquidation Under the CCAA

Assume that Canco, our liquidation CCAA case study, is a manufacturing company that is privately owned by Mr. X, as depicted in figure 8. Given its current insolvency and the general challenges facing the sector, Canco and its Canadian

Figure 8 Liquidating Under the CCAA—Before Liquidation



subsidiary (Subco) have filed under the CCAA. Canco's US subsidiary (USco 1) has filed under chapter 11 of the US Bankruptcy Code.[49] Canco owns plant 1, Subco owns plant 2, and USco 1 owns plant 3, which is located in the United States. Shortly after filing, the plants (including all assets) will be sold for cash and all contracts will be terminated. The proceeds will be used to pay claims and expenses once the claim process, which is expected to take 18 months, is terminated. Canco has US $1,000 of unsecured third-party debt, as well as pension claims, and CCAA and chapter 11 expenses. Once the CCAA process is completed, Canco will be dissolved.

Canco has NOLs of $300 and UCC of $100 (embedded loss of $90). Subco has NOLs of $100, UCC of $100 (embedded loss of $90), and scientific research and experimental development (SR & ED) credits of $20. The Subco shares have ACB of $100 and no value. The USco 1 shares have ACB of $100 and no value.

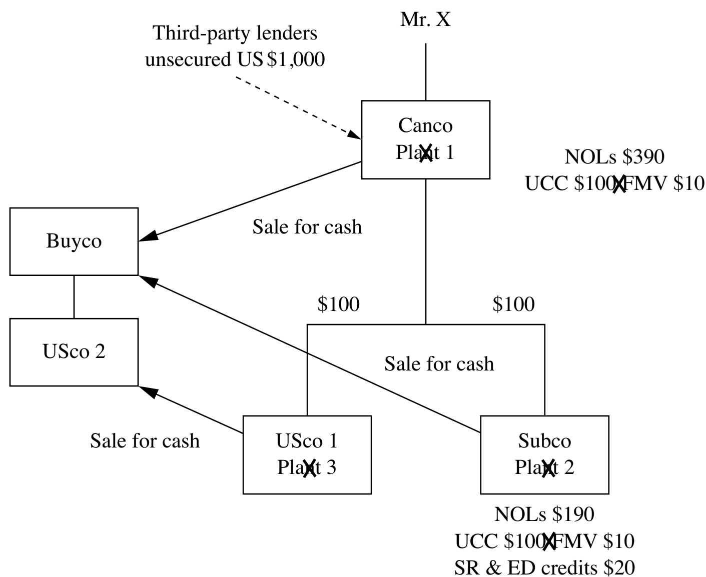
Canco's assets are sold in consideration for cash to Buyco and its wholly owned US subsidiary (USco 2), which are dealing at arm's length with Canco and are not related to Canco, as depicted in figure 9. Canco's NOLs are increased to $390 and Subco's NOLs to $190. The sale of USco 1's assets generates an exempt loss.

Determination of the Forgiven Amount

Sale proceeds are used pursuant to the Final Order in the following year to pay the unsecured third-party debt, pension claims, and CCAA and chapter 11 transaction expenses. We will assume that unsecured creditors (without priority charges) have a 5 percent recovery on their claims.

The forgiven amount with respect to the settlement of Canco's US$1,000 unsecured debt is to be determined in Canadian dollars by using the applicable

Figure 9 Liquidating Under the CCAA—Sale to Buyco



exchange rate for the US dollar in relation to the Canadian dollar at the time that the debt was issued by Canco. For the purposes of the case study, the applicable exchange rate when debt was issued by Canco is assumed to be US$1.00 = Cdn$1.48.

The debt-forgiveness rules apply to the unsecured US$1,000 debt as shown in the accompanying table:

Forgiven Amount	
Third-party debt	US $1,000
Repayment	US $50
Unpaid amount	US $950
Forgiven amount	Cdn $1,400

Paragraph 80(2)(k) exchange rate
US $1.00 = Cdn $1.48

With respect to the settlement of the pension claims, our view is that they are not commercial debt obligation issued by Canco and thus the unpaid pension claims are not subject to the debt-forgiveness rules. Although subsection 248(26) extends the concept of "issued debt" to amounts that are (1) owing as consideration for any property acquired by the debtor or services rendered to the debtor, or (2) deductible in computing the debtor's income, resulting from a pension obligation, it appears that claims are not consideration for property acquired or for service rendered; and even if they were, the unpaid pension claims and the

interest thereon are not deductible in computing the debtor's income because of the limitation imposed by section 147.2. Thus, the unpaid pension claims should not be considered commercial debt obligations issued by Canco and no forgiven amount should result from the compromise of these pension claims.

Tax Result Without Planning

Assume that no tax planning is undertaken in connection with the liquidation. Canco's NOLs are reduced from $390 to nil, leaving an unapplied forgiven amount of $1,010 ($1,400 − NOLs of $390), while Subco is left with $190 of NOLs and $20 of SR & ED credits. Canco has an income inclusion under subsection 80(13) of $505 (50 percent of $1,010) and a capital gain under subsection 39(2) of $24 on the repayment of US$50 on the US unsecured third-party debt (assuming the applicable exchange rate at the time of settlement is US$1.00 = Cdn$1.00). An insolvency deduction under section 61.3 should be available to offset the subsection 80(13) inclusion, but not to offset the capital gain.

Because the insolvency deduction is available to reduce the subsection 80(13) inclusion to nil, a designation under subsection 80(11) to apply a portion of the unapplied forgiven amount to reduce the ACB of Subco and USco is not helpful. It will simply reduce the subsection 80(13) inclusion by $100 ($200 × 50 percent), causing a corresponding reduction of $100 in the insolvency deduction. Under subsection 80(16), however, in these circumstances the minister may designate amounts under subsection 80(11) up to the amount that Canco would have been permitted to designate. Even if the minister makes such a designation, it does not compel Canco to transfer an equivalent amount of unapplied forgiven amount to Subco, an eligible transferee, because Canco is not in any case subject to an income inclusion under variable B of subsection 80(13). There is no inclusion because the "residual balance" is nil, given that there is no excess amount between $190 (the gross tax attribute of Subco) over Canco's unapplied forgiven amount of $810 ($1,010 − $200). However, such a designation by the minister reduces the ACB of the USco 1 and Subco shares and the accrued capital loss to nil.

A designation under section 80.04 is not helpful either. It will reduce the subsection 80(13) inclusion by $95 (Subco's gross tax attributes × 50 percent), causing a corresponding reduction of $95 in Canco's insolvency deduction.

The accompanying table outlines the income inclusion in Canco.

Subsection 80(13) ($1,010 × 50 percent)	$505
Section 61.3 insolvency deduction	($505)
	nil
Capital gain:	
Repayment	US$50
Historical rate (US$1.00 = Cdn$1.48)	$74
Current rate (US$1.00 = Cdn$1.00)	$50
Subsection 39(2) capital gain:	$24

Offsetting Subsection 39(2) Income Inclusion

As can be seen from the table, Canco will have no NOLs left but will be able to offset the subsection 80(13) inclusion with an insolvency deduction under section 61.3. Subco will have NOLs of $190 and SR & ED credits of $20. The ACB in the shares of Subco and USco 1 may be reduced to nil if the minister exercises her right to designate under subsection 80(16). However, Canco is faced with a $12 ($24 × 50%) income inclusion in the year of compromise as a result of the foreign exchange gain on the repayment of a portion of the third-party debt. Post-filing liabilities are generally not compromised, and cash proceeds from the sale should be maximized and used for the payment of claims, not for the payment of post-filing taxes. Accordingly, planning is important to avoid post-filing taxes and to ensure that there are sufficient deductions or attributes left to offset any post-filing income or taxes. Canco may also have deductions that could help shelter the capital gain, such as the payment of pension claims deductible under subsection 147.2(2).

Actions To Eliminate Post-Filing Taxes

Assuming that there are not enough deductions available to offset post-filing taxes, an election under subsection 50(1) in the year of compromise with respect to the USco 1 or Subco shares can be helpful, subject to the minister's right to designate under subsection 80(16) to reduce the ACB of shares to nil. Subsection 50(1) is not helpful in the prior year because the prior year's NCLs are absorbed by the forgiven amount. However, the dissolution of USco 1 (as depicted in figure 10) carried out in the year of, but prior to, compromise so as to trigger the accrued capital loss on USco 1 shares (subject to the stop-loss limitation under subsection 93(2)) helps to offset the capital gain. Because the dissolution of USco 1 occurs prior to compromise, the minister cannot use her right under subsection 80(16) to make a designation under subsection 80(11) to reduce ACB of USco 1 shares to nil. Furthermore, current-year NCLs must first be used to reduce current-year capital gains before they can be reduced by Canco's unapplied forgiven amount. The timing of the dissolution is thus key. If the dissolution of USco 1 occurs after the compromise, the minister may still exercise her right to designate in order to reduce the ACB of USco 1 shares to nil, which would prevent the triggering of the NCL on the shares of USco 1 on the dissolution.

Another possible action is for Subco to wind up into Canco in the year of compromise so as to use Subco's SR & ED credits to offset taxes (as depicted in figure 11). Subco's NOLs are only available in the following year due to subsection 88(1.1), and they are thus not available to offset Canco's capital gain. Alternatively, Subco and Canco can amalgamate prior to the compromise to allow Amalco to use the SR & ED credits to offset the post-filing taxes (this strategy may not work to reduce certain provincial taxes, depending on the rules that apply to the provincial SR & ED credits). However, Amalco's NOLs from Subco will be reduced by the forgiven amount.

Figure 10 Liquidating Under the CCAA—Dissolution of USco 1

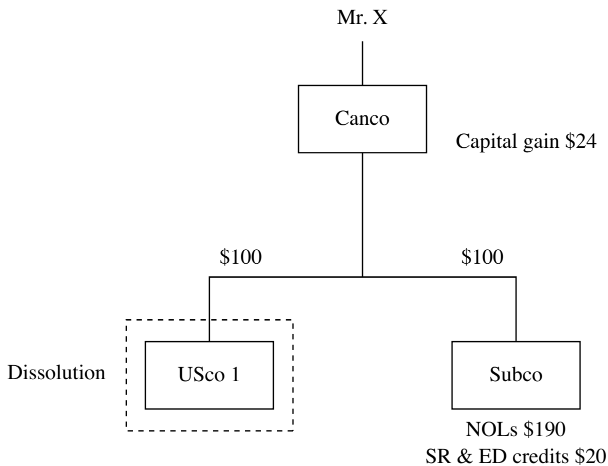
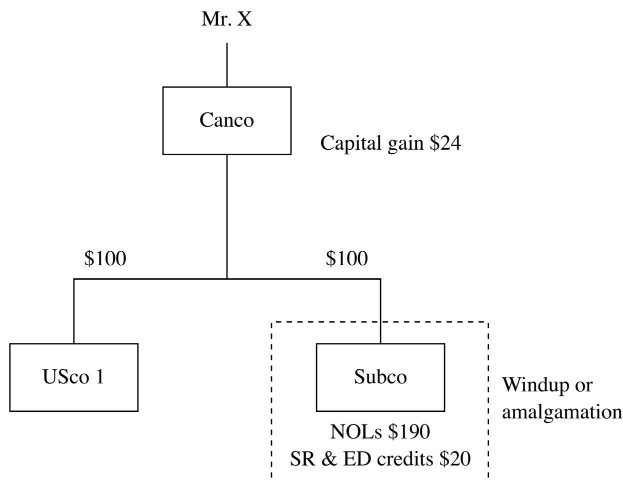


Figure 11 Liquidating Under the CCAA—Amalgamation of Subco into Canco

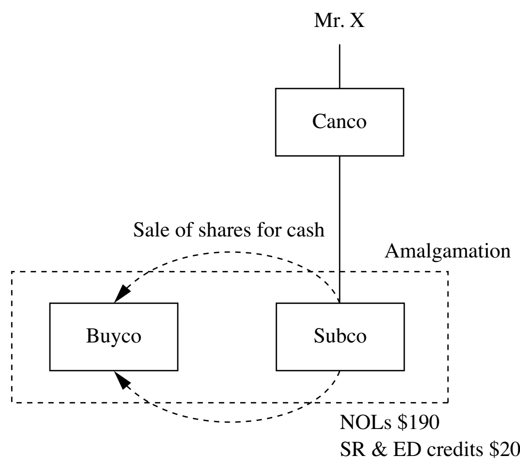


Loss Monetization: Sale of Subco Shares

Canco can attempt to monetize Subco's NOLs by selling the shares of Subco to Buyco after the compromise (as depicted in figure 12).

Provided that Buyco continued to carry on the business of Subco, once all of Subco's debts have been compromised or settled, Buyco (or the shareholder of Buyco) acquires the shares of Subco. Subco is amalgamated with Buyco to form Amalco. Subsection 87(2.1) should apply to deem Amalco to be the same corporation and a continuation of Buyco and Subco. Provided that Subco's business

Figure 12 Liquidating Under the CCAA—Amalgamation of Subco into Buyco



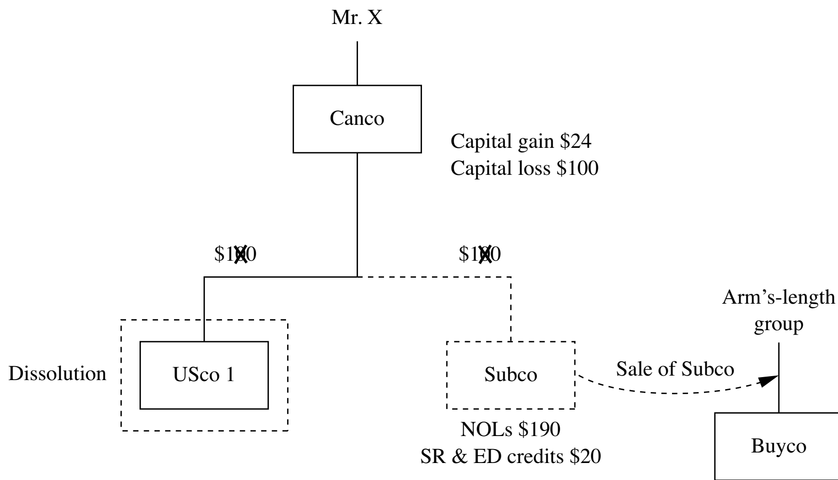
(plant 2) is carried on by Amalco for profit throughout the year after the acquisition of control of Subco, Subco's NOLs are available to Amalco to the extent provided under paragraph 111(5)(a) and allowed under the limitations set out in paragraph 111(1)(a) and subsection 111(3), although there may be other applicable requirements under the ITA. Therefore, Subco, Buyco, and Amalco must carry on Subco's business for profit without interruption.[50] On the sale of the Subco shares, Canco triggers the NCL on the Subco shares (subject to the stop-loss rules in subsection 112(3)). As mentioned above, if the minister exercises her right to designate to reduce the ACB of the Subco shares to nil pursuant to subsection 80(16), a capital gain could result for Canco. Presumably, Canco should have enough deductions or NCLs (as depicted in figure 13) to offset this gain. The proceeds from the sale would be used for the payment of claims.

Interest Accrual During CCAA Proceedings

A recurring issue in insolvency is whether the interest on a debt obligation of a debtor company continues to accrue after it files under the CCAA ("the post-filing interest"). For creditors, whether post-filing interest continues to accrue can greatly affect the size of their claims and, consequently, their pro rata entitlements to restructured debt settlements or the proceeds of sales on liquidation. Indeed, for creditors whose claims do not bear interest, such as pensioners and former employees, the continued accrual of interest after the filing of other claims can significantly diminish the pro rata value of their own claims.

For income tax purposes, the question of whether interest continues to accrue post-filing determines whether the debtor can deduct those interest amounts under paragraph 20(1)(c) in the computation of its income for the post-filing years. It also determines the extent to which the debt-forgiveness rules apply on

Figure 13 Liquidating Under the CCAA—Offsetting Capital Gains



any post-filing interest amounts that were payable but settled or extinguished in the course of a plan.[51] A deduction under paragraph 20(1)(c) is available only for amounts that are paid or payable in the year that the deduction is sought when there is a legal obligation to pay interest. If there is no obligation to pay interest, then there is no deduction under paragraph 20(1)(c) and the debt-forgiveness rules are not applicable.

Pre-Nortel Case Law on Post-Filing Interest

Before the recent decision in *Nortel*, case law on the accrual of post-filing interest under the CCAA supported the position that interest continued to accrue during the post-filing period and thus the debtor's legal obligation to pay interest should not be affected by CCAA proceedings.

In *Stelco*, certain creditors ("the note holders") argued that interest did not accrue post-filing on the claims of other creditors ("the debenture holders"), on the basis that the "interest-stops rule," which applies in Canadian bankruptcy and winding up proceedings, should also apply under the CCAA.[52] The rule provides that no interest is payable on a debt from the date of winding up or bankruptcy. Developed in the common law, the interest-stops rule has also been codified in the BIA,[53] which provides that only interest up to the date of bankruptcy is payable, unless there is a surplus after the payment of claims, at which point interest from the date of bankruptcy is payable on all claims at a set rate. While no such explicit interest-stopping statutory mechanism exists under the CCAA, the note holders argued that it should apply nonetheless.

The Ontario Superior Court of Justice rejected the note holders' argument, asserting that filing under the CCAA does not terminate or suspend an obligation

to pay interest. The court referred to the Supreme Court decision in *Canada 3000 Inc*. as an authority on the subject, in which Binnie J, writing for the court, stated the following:

> While a CCAA filing does not stop the accrual of interest, the unpaid charges remain an unsecured claim provable against the bankrupt airline. The claim does not accrue interest after the bankruptcy: ss. 121 and 122 of the *Bankruptcy and Insolvency Act*.[54]

The court noted that, in contrast to a bankruptcy, in a restructuring under the CCAA there might be justifications for including post-filing interest in the claims of some creditors in a plan.[55]

In upholding the trial judge's decision in *Stelco*, the Ontario Court of Appeal emphasized that the concept of "claim" under the CCAA related to setting a date and amounts for voting purposes, rather than setting the quantum of creditors' claims.[56] The court also noted that when CCAA restructurings are unsuccessful and convert to bankruptcy proceedings, creditors' claims under the BIA include interest up to the date of bankruptcy, thereby including interest beyond the date of the original filing under the CCAA.

Key to pre-*Nortel* case law regarding the accrual of post-filing interest is the distinction between the diverging purposes of restructuring under the CCAA versus filing for bankruptcy under the BIA. While the goal of the CCAA is to restructure the debtor's business, the trustee's goal in a bankruptcy is to liquidate the debtor's business assets and distribute the proceeds to satisfy all or a portion of provable claims. If no agreement is reached under the CCAA and the debtor's assets are ultimately liquidated under the BIA, creditors will have the right to the entire amount of interest until the moment at which the debtor becomes bankrupt. Indeed, when a debtor seeks to restructure under the BIA, the purpose of the proceedings is the same as under the CCAA and, accordingly, jurisprudence has recognized that unless a court orders otherwise, the interest-stops rule does not apply because the debtor is not a bankrupt for BIA purposes.[57]

Nortel: Extending the Interest-Stops Rule to CCAA Proceedings

Nortel,[58] which was recently affirmed by the Ontario Court of Appeal,[59] significantly altered the insolvency jurisprudential landscape by concluding that, under common law, interest stopped accruing post-filing for creditors of Nortel, a debtor liquidating under the CCAA (unless otherwise provided in a plan). The reasons given by both the trial judge and the appellate court were based on the importance of maintaining a coherent insolvency regime in Canada that provides for analogous treatment of the same claims under both the CCAA and the BIA,[60] as emphasized by the Supreme Court in *Century Services*[61] and *Indalex*.[62] The Ontario Court of Appeal explained that its decision was also grounded in fairness concerns, noting that it would defeat the purpose of a stay to maintain the status

quo while the company attempts to restructure under the CCAA if interest-bearing claims were allowed to continue to grow post-filing while other claims remained frozen.[63] The court also explained that without the interest-stops rule, the key restructuring objective of the CCAA could be undermined because certain creditors with no claim to post-filing interest would favour proceeding under the BIA as opposed to restructuring under the CCAA.

The Ontario Court of Appeal in *Nortel* distinguished *Stelco* on the basis that the latter involved not a claim for post-filing interest against the debtor itself, but rather an agreement between creditors. The court further deemed the comments by the courts in *Stelco* about there being no judicial authority in support of an interest-stops rule in the CCAA context to be obiter.[64] The court also concluded that Binnie J's comments in *Canada 3000 Inc.* should be construed narrowly within the strict factual and statutory context of that case, rather than as standing for a general proposition regarding an interest-stops rule under the CCAA.[65] The court called for coherence between the CCAA and the BIA in light of the subsequent Supreme Court decisions in *Century Services* and *Indalex*.

Because the facts in *Nortel* specifically relate to a liquidation under the CCAA, the application of an interest-stops rule in this situation is arguably consistent with the Supreme Court's concern about harmonizing the federal insolvency regime. In *Nortel*, however, the trial judge decided that the interest-stops rule should apply indiscriminately to *all* CCAA proceedings, whether the ultimate objective is restructuring or liquidation.[66]

The Ontario Court of Appeal decision in *Nortel* focused on the rationale for ensuring analogous treatment under both statutes without distinguishing between liquidating and restructuring under the CCAA.

Interest Deductibility Under the CCAA for Tax Purposes

The CRA's position is that interest is not deductible while a debtor company is under CCAA proceedings, on the basis that the debtor has no legal obligation to pay interest as long as a stay is in effect, unless the court specifically orders otherwise.[67] Beginning on the day that the debtor company obtains protection from its creditors under the CCAA and throughout the stay period, the CRA interpretation is that the debtor company has no legal obligation to pay interest because payment cannot be enforced:

> Beyond that day, the obligation to pay such interest could not exist because its creditors, by virtue of the stay proceedings, could not enforce payment. Therefore, as there is no legal obligation to pay interest during the stay order period, in our view, the debtor, i.e., CanOpco, cannot deduct any interest expense during that period pursuant to paragraph 20(1)(c) of the Act.[68]

The CRA, therefore, does not distinguish between the inability of creditors to enforce their claims and the extinguishment of a legal obligation to pay interest. CCAA proceedings, however, do not terminate the obligations of the debtor.

For tax purposes, the Federal Court of Appeal has concluded that a legal obligation to pay arises as a result of the contractual relationship between the debtor and the creditor, regardless of when payment of the obligation is required or whether the payment will be made.[69] Creditors are only prevented under the CCAA stay from enforcing the debtor company's obligations. If a plan is not successful, the creditors can enforce payment and the debtor is required to pay all interest, including the interest that accrued following the initial order. Likewise, if a debtor has to declare bankruptcy, all interest accruing up to the date of the bankruptcy forms part of a provable claim within the meaning of the BIA, including interest accruing after the initial order under the CCAA.

Despite the CRA's position, unless the interest is subject to the interest-stops rule as concluded in *Nortel*, it seems that post-filing interest should be considered as being payable pursuant to a legal obligation to pay interest, whether or not creditors are temporarily prevented from enforcing their claims as a result of the stay. In our view, the fact that creditors are prevented from enforcing their claims does not affect the nature of a contractual obligation to pay interest, nor does it make that legal obligation a contingent liability subject to the limitation under paragraph 18(1)(e).[70] Regardless, the outcome in *Nortel* finally confirms that interest should no longer be deductible under paragraph 20(1)(c) unless otherwise provided for in the plan.

The Deductibility of Professional Fees

Another tax issue that arises for companies filing under the CCAA is the appropriate tax treatment of professional fees paid for legal and financial advice on restructuring or liquidating under the CCAA. The analysis of the deductibility of professional fees in calculating profit so as to determine income under subsection 9(1) begins with determining whether such expenses are consistent with "well accepted principles of business (or accounting) practice."[71] The key factor to assess is whether there is a strong enough factual connection between the amount claimed and the business.[72]

One must then consider whether such expenses are barred from deductibility on the basis of the general limitation under paragraph 18(1)(a), which requires that amounts deducted have been incurred for the purpose of gaining or producing income.[73] On the basis that the CCAA's purpose is to allow an insolvent company to restructure and emerge as a going concern, the CRA recently concluded that certain professional fees paid in relation to a CCAA restructuring were incurred for income-earning purposes.[74] The deductibility of professional fees for CCAA liquidations may face a hurdle in regard to the income-earning purpose requirement in paragraph 18(1)(a) and the requirements for the deductibility of certain financing expenses under paragraph 20(1)(e)[75] and eligible capital expenditures (ECEs) under paragraph 20(1)(b).[76] From the moment that liquidation becomes the chosen course of action for a debtor company, it can be difficult to claim that professional fees are incurred for the purposes of gaining business income, because

there is no longer an intention to continue to carry on a business. The courts have previously determined that certain windup expenses were not deductible by focusing on the true purpose for which the amounts were incurred and determining that the purpose was not income-earning.[77] The CRA has similarly concluded that legal expenses incurred to wind up a company are not laid out to earn income.[78] Depending on the moment and the purposes for which the professional fees were incurred during a CCAA liquidation, certain professional fees may not be deductible under either paragraph 20(1)(e) or (b). Professional fees should nonetheless be taken into account for the purposes of determining the capital gain, capital loss, or terminal loss, as the case may be, arising on the sale of the assets.

The Limitation on Capital Outlays Under Paragraph 18(1)(b)

The next step in analyzing the appropriate characterization of CCAA professional fees is to ascertain whether they are income expenses or capital outlays. Amounts paid on capital account will be subject to paragraph 18(1)(b), which restricts deductions for capital outlays unless they are specifically permitted under the ITA. In assessing the treatment of professional fees incurred in relation to a restructuring under the CCAA, the CRA stated that the courts have generally found that costs incurred for the creation or modification of a business entity or structure are capital in nature, and they have contrasted such capital outlays with current expenditures made in the course of the operations of a profit-making business.[79]

Professional fees incurred in relation to CCAA proceedings that are characterized as capital expenditures may nonetheless be deductible under subsection 20(1) which expressly permits certain capital deductions that might otherwise be prohibited by paragraphs 18(1)(a), (b), and (h).[80]

Financing Expenses Under Paragraph 20(1)(e)

Paragraph 20(1)(e) allows the amortization over a five-year period of certain expenses incurred in connection with financing. Specifically, this includes expenses incurred "in the course" of

1) the issuing or selling of shares, trust units, or interests in a partnership or syndicate;
2) the borrowing of money or incurring indebtedness used by the taxpayer for income-earning proposes; or
3) the rescheduling or restructuring of debt obligations incurred by the taxpayer for income-earning purposes.

There is an exception to the five-year amortization period under paragraph 20(1)(e) in subparagraph 20(1)(e)(v), which allows the full deduction of any remaining unamortized balance in the year if all of the debt obligations relating

to the financing expenses are settled or extinguished, except in the case of refinancing. This exception does not apply if the consideration received in settling or extinguishing the debt includes a share, unit, interest, or debt obligation of a person with whom the taxpayer does not deal at arm's length.

In the context of CCAA proceedings, the CRA stated that legal and consulting fees incurred in relation to a CCAA restructuring would be deductible if they otherwise satisfy the requirements for deductibility under paragraph 20(1)(e), regardless whether such expenses were incurred during a period when the corporation was under CCAA protection. The CRA further concluded that expenses relating to debts completely extinguished in a year may be eligible for deduction under subparagraph 20(1)(e)(v). Regarding the issuing or selling of shares in relation to a restructuring under the CCAA, the CRA concluded that it is arguable that expenses under subparagraph 20(1)(e)(i) should be available only in the context of financing where such a share issuance resulted in the raising of funds for the corporation.[81]

ECEs Under Paragraph 20(1)(b)

Alternatively, if some professional fees do not qualify for the deduction under paragraph 20(1)(e), they may be deductible under paragraph 20(1)(b) as ECEs[82] to the extent that they are capital amounts, are incurred in respect of a business for the purpose of gaining or producing income from that business, and are not specifically excluded from the definition in subsection 14(5). The CRA stated in *Interpretation Bulletin* IT-143R3[83] that it considers expenses incurred in connection with the reorganization of the affairs of a corporation to be ECEs. The CRA has articulated the same interpretation in the context of CCAA proceedings, concluding that an expense that is not deductible under paragraph 20(1)(e) or (e.1) may qualify as an ECE.[84] Where professional fees are not deductible under paragraph 20(1)(e), therefore, 75 percent of the expense may be considered as ECEs, added to the cumulative eligible capital of a business, and deducted by the taxpayer at the 7 percent rate under paragraph 20(1)(b).

The Deductibility of Amounts for Contractual Claims

A debtor company under CCAA proceedings may be faced with substantial claims for damages with respect to contracts that have been terminated or repudiated. This outcome raises a number of questions, including whether any liability for such damages is deductible by the debtor and, if so, when the deduction arises. A further question is whether the settlement of any such claims for less than the amount of the liability will itself give rise to a forgiven amount under the debt-forgiveness rules.

It must first be determined whether the amount of any such contractual damage claims can be considered to be incurred for the purpose of gaining or earning income, as required under paragraph 18(1)(a), and whether the amount cannot

be considered a contingent liability within the meaning of paragraph 18(1)(e) or a capital outlay for the purposes of paragraph 18(1)(b). A complete discussion of the principles embraced by the courts in interpreting these provisions is beyond the scope of this paper. However, some observations can be made.

Paragraphs 18(1)(a) and (e)

In *Wawang Forest Products*, the Federal Court of Appeal emphasized that the key to determining whether amounts have been "incurred" for the purposes of paragraph 18(1)(a) is whether a legal obligation to pay an amount has come into existence at the relevant time.[85] The CRA's position is that "[a]n allowable deduction in respect of damages can only be claimed by a taxpayer when paid, or where there is a legal or contractual liability to pay the damages, and the amount thereof has been quantified."[86]

In circumstances involving claims for liquidated damages specifically provided for in contractual agreements (such as leases), it will often be possible to achieve a high level of comfort that the amount of the claim is known with sufficient certainty to say that such damages have been incurred at the precise moment when a default occurs under those agreements. In other circumstances, it may not be immediately known whether the debtor is liable to pay an amount in respect of damages. Also, the precise quantum of any such liability may not be known with sufficient certainty until the claims have been adjudicated as part of the CCAA process. The facts of each case will need to be considered to determine whether a liability to pay an amount can be ascertained or is ascertainable with sufficient precision in order to say whether a liability has been incurred and when.

The court in *Wawang* also defined the question that must be asked in order to determine whether a liability is a contingent liability, the deductibility of which is prohibited by paragraph 18(1)(e):

> [T]he correct question to ask, in determining whether a legal obligation is contingent at a particular point in time, is whether the legal obligation has come into existence at that time, or whether no obligation will come into existence until the occurrence of an event that may not occur.[87]

The Supreme Court in *Canada v. McLarty* confirmed that the test for a contingent liability as articulated in *Wawang* is correct.[88] In our view, while a stay under the CCAA stays proceedings with respect to damage claims, such a stay does not, in and of itself, render any liability for such damages contingent for the purposes of paragraph 18(1)(e). The existence of a stay impedes the ability of a creditor to enforce contractual remedies, but it does not mean that a contractual liability has not come into existence.

With respect to the issue of whether liability for damages arising from the termination or repudiation of contracts would satisfy the requirement that those

damages are incurred for the purpose of gaining or producing income (as required by paragraph 18(1)(a)), each case will depend on the facts, including the nature of the contract and the circumstances that gave rise to the claim for damages. The CRA has stated that if the amounts payable under a contract would have been deductible had they been paid, then payments to terminate or cancel those contracts will generally also be deductible.[89] For example, the CRA considers amounts paid to cancel a lease to be deductible in computing income if the rent was deductible.[90]

In accordance with the Supreme Court decision in *65302 British Columbia Ltd.*, the taxpayer has an obligation to demonstrate only that the expense was motivated by business reasons, not that the taxpayer avoided incurring liability for damages.[91] The reprehensibility of the taxpayer's actions is also not a factor.[92] In *65302 British Columbia*, fines paid for producing eggs over a quota were determined to be deductible as current expenses. While that decision dealt with the deductibility of fines and penalties, which would no longer be deductible under section 67.6, in *McNeill v. The Queen*[93] the Federal Court of Appeal extended the same principles to any analysis concerning the tax treatment of damages. In that case, contractual damages awarded on the basis that the taxpayer violated a restrictive covenant when he sold his accounting business were determined to be deductible as current expenses on the basis that the damages had been incurred in order for the taxpayer to earn income from its business.

In general terms, the income-earning purpose test should be met if the termination or damage amounts emanate from contracts that are integral to the taxpayer's business and that business will continue. For example, consider damages associated with the breach or repudiation of store lease agreements, as in case study 1. Pubco entered into lease agreements as part of its operations from which it earns income. It is suggested that the risk of breach of lease agreements was an ordinary risk that was inherent in Pubco's business and was an integral part of Pubco's income-earning process. Because any damages emanate from contracts that are essential to Pubco's business, those damages should be considered to satisfy the income-earning purpose test.

Paragraph 18(1)(b)

Once it is determined that any liability for damages arising from the termination or repudiation of a contract was incurred for the purpose of gaining or producing income, it must then be determined whether the expense is incurred on income or capital account. If the liability is viewed as being on capital account, any deduction will be disallowed pursuant to paragraph 18(1)(b). The case law in this area is confusing and often contradictory; therefore, this will typically be the most difficult aspect of the deductibility analysis with respect to claims for contractual damages, and any such determination will be heavily dependent on the particular facts and circumstances. However, a few general comments may be made.

There is some support in the case law for the position that a payment to eliminate a recurring expense should be considered to be on income account. In a leading example, *Anglo-Persian Oil Co.*,[94] a payment to cancel a contract with an agent in order to eliminate substantial commission payments was held to be deductible from income. Similarly, in *Bomag (Canada) Ltd.*, the amount a taxpayer paid to terminate a sales agency agreement was determined to be deductible by the Federal Court of Appeal.[95] In *Automatic Toll Systems (Canada)*, a payment to terminate an onerous contract was held to be on income account on the basis that the funds were paid to end the contract, not to acquire a capital asset.[96]

On the other hand, an amount paid to terminate an onerous contract in *Atkins & Durbrow*[97] was determined to be capital in nature on the basis that it conferred a lasting advantage. A payment made by a corporation for release from a contract that gave a manufacturer exclusive rights to produce a beverage was held to be a capital expenditure on the basis that it was a non-recurring payment to re-acquire the exclusive licence, a capital asset.[98]

However, where damages for breach of contract or other amounts incurred to terminate a contract are determined to be capital outlays, they will often qualify as ECEs.

Debt-Forgiveness Consequences

In addition to the issue of deductibility of claims for contractual damages, consideration must also be given to whether the settlement of any such claims under a CCAA restructuring for less than the amount of the liability may result in the application of the debt-forgiveness rules. Generally, the settlement of contractual claims as part of the financial restructuring of a corporation under the CCAA will be on capital account and, accordingly, any debt forgiveness of such claims should not generally result in an inclusion in the corporation's income under section 9. Therefore, any such claims should not generally be considered an "excluded obligation" for the purposes of the debt-forgiveness rules. When the amount of any such liability is deductible by the taxpayer and is settled or extinguished for less than the amount of the liability, the question that arises is whether that liability is a commercial debt obligation for the purposes of the debt-forgiveness rules.[99]

A "commercial debt obligation" is defined in subsection 80(1) as a debt obligation issued by the debtor where interest was paid or payable by the debtor in respect of it pursuant to a legal obligation or, if interest had been paid or payable by the debtor in respect of it pursuant to a legal obligation, an amount in respect of the interest would have been deductible in computing the debtor's income. Subsection 248(26) provides, inter alia, that for the purpose of applying the provisions of the ITA relating to the treatment of the debtor in respect of the liability, any amount that a debtor becomes liable to pay that is otherwise deductible in computing the debtor's income will be considered to be an obligation issued by the debtor having a principal amount equal to the amount of the liability.

Accordingly, for the purpose of applying the debt-forgiveness rules, when damage claims are deductible in computing the debtor's income, as discussed above, any liability in respect of those claims would likely constitute obligations issued by the debtor having a principal amount equal to the amount of the liability, by virtue of subsection 248(26).

However, to conclude that any such obligation constitutes a commercial debt obligation, one must conclude that interest would be deductible if it were payable on the obligation. It may be difficult to conclude that any interest owing in respect of the claim for damages would be deductible under paragraph 20(1)(c), since it is difficult to say that any such liability for contractual claims qualifies either as "borrowed money" or has been incurred for the acquisition of a "property." Although an argument could be made, depending on the precise facts, that any such interest may be deductible under section 9, the Supreme Court decision in *Gifford* may make such an argument difficult.[100] In any event, if a taxpayer is seeking to deduct any claims for damages, the CRA will likely argue strenuously that if the deduction of those claims is allowed, their settlement should also be subject to the application of the debt-forgiveness rules. In the case where the damage claims are deductible in the year they are compromised under a CCAA restructuring, even if their settlement gives rise to a debt forgiveness the taxpayer may nevertheless be in an advantageous position because the forgiveness will result in only a 50 percent income inclusion under subsection 80(13).

Crown Claims in Insolvency

Crown claims against the debtor are a significant concern during insolvency proceedings. A key consideration in the taxation of insolvency will be the extent to which a stay prevents the tax authorities from taking certain actions against the tax debtor. Assessing the priority of the Crown for tax claims in relation to other creditors is an ever-evolving issue, with legislative amendments and case-law developments continuing at a steady pace over the last few decades. This section provides a brief overview of considerations relating to Crown claims in the insolvency context, as well as recent developments of note.

The Right of Setoff for Tax Debts

Section 224.1 of the ITA and section 318 of the Excise Tax Act[101] (ETA) provide the minister with the right to recover amounts owing by deducting from or setting off those debts using amounts owed to the tax debtor. The provision is expansive, covering not only debts under the ITA, but also debts under the act of any province with whom the federal government has entered into an agreement for the collection of taxes. Setoff rights under the ITA encompass a multitude of amounts that may be owed by government bodies to the tax debtor. For example, in *The Clarkson Company Limited v. The Queen*,[102] the Federal Court of Appeal found that setoff rights applied to allow the tax authority to reduce the taxpayer's

debts by using amounts owed to the taxpayer for its provision of air charter services to the federal government.

In the Quebec context, sections 31, 31.1, and 31.1.1 of the Tax Administration Act provide the provincial minister with rights of deduction and setoff under any fiscal law administered by Revenu Québec, including the ETA.[103] Debts owed by the taxpayer under any fiscal law can therefore be offset by any available Quebec sales tax (QST) rebates, goods and services tax (GST) credits, and income tax refunds, as well as amounts owed to the taxpayer by a wide array of public bodies.

Both the BIA and CCAA specifically provide that rights of setoff or compensation apply under each respective act unless a court order states otherwise,[104] and such rights have also been explicitly recognized by the courts.[105] In the insolvency context, the CRA will generally offset tax debts with refunds or credits when both relate to the pre-insolvency period.[106]

In *Re: Air Canada*, the Ontario Superior Court of Justice acknowledged the possibility of creditors setting off post-filing refunds against pre-filing claims in the context of CCAA proceedings; accordingly, it struck a sentence in its order that could be read as prohibiting such an action.[107] The right of setoff was similarly allowed during BIA proceedings in *Industries Davie inc*.[108] In *DIMS Construction inc*., a formal bankruptcy case, the Supreme Court interpreted narrowly the right of setoff under the BIA and concluded that mutual debts must come into existence before the bankruptcy.[109] The court stated that there is an implicit rule under the BIA whereby the setoff mechanism cannot be used to apply a post-bankruptcy payment to a pre-bankruptcy debt, because it would have the effect of granting to the creditor security that does not exist, to the prejudice of other creditors.[110]

While Revenu Québec followed the decision in *DIMS Construction* with regard to formal bankruptcies, until quite recently, it continued to apply the compensation mechanism to use post-insolvency refunds owed to the tax debtor to reduce pre-insolvency debts when the debtor was the subject of an approved proposal under the BIA.[111] The justification provided by the tax authorities for this distinction between a bankruptcy and a proposal was that the estate of the debtor company is not vested in the trustee for a proposal as it is for a formal bankruptcy. Debtors claiming harm from this continued practice filed a class action lawsuit against Revenu Québec.[112] Revenu Québec entered into a settlement agreement on June 19, 2014, accepting the principles of *DIMS Construction* that pre-filing debts should not be offset by post-filing refunds.

More recently, in its decision in *Métaux Kitco*,[113] the Quebec Superior Court saw no reason to differentiate between the context of a formal bankruptcy and that of an arrangement under the CCAA, extending the applicability of the *DIMS Construction* decision to the CCAA.[114] In obiter, the court also rejected the presumptions of exigibility and validity created under tax laws of tax claims as applicable in an insolvency context when the taxpayer filed an objection to a notice of assessment.[115]

The Priority of Claims for Tax Debts

The Crown used to have priority over many claims in insolvency proceedings, which led to various calls for legislative reforms that were ultimately enacted in the 1990s.[116] These reforms rendered the Crown an ordinary unsecured creditor for most claims in insolvency proceedings,[117] but certain carved-out exceptions remain. These exceptions are outlined below.

Tax debts for amounts certified in the Federal Court prior to the commencement of bankruptcy and CCAA proceedings rank as secured claims under the BIA and the CCAA, as do tax debts for which a memorial has been obtained and registered in a public registry system against real or personal property.[118] While the tax authorities are prevented from exercising their garnishment authority[119] while a stay of proceedings under sections 69(1) and 69.1(1) of the BIA or section 11.02 of the CCAA is in effect, if a "requirement to pay" notice was issued prior to BIA proceedings commencing, the courts determined in *Toronto-Dominion Bank v. Canada*[120] that the property belonged to the Crown and was no longer within the estate of the taxpayer.

Priority of Certain Tax Claims

The Crown's garnishment powers under subsection 224(1.2), the Canada Pension Plan,[121] the Employment Insurance Act,[122] and similar provisions under provincial law are maintained under the CCAA.[123] These are essentially debts for unremitted source deductions, non-resident withholding tax, and similar provincial amounts.[124] The Crown's garnishment power may nonetheless be subject to a stay order under section 11.09(1) of the CCAA, but pursuant to section 11.09(2) that order will cease to be in effect if the debtor company defaults on payments for amounts that become due after the CCAA order.

Unless the Crown agrees otherwise, the court may sanction a plan that provides for Crown claims relating to unremitted source deductions, non-resident withholding tax, and similar amounts under provincial legislation only if the plan provides for the payment of those amounts within six months of the court sanction of the plan.[125]

Deemed Trusts

Most deemed trusts under federal and provincial legislation for Crown claims are rendered inoperative by the CCAA.[126] The CCAA, however, provides for certain deemed trusts to continue to operate for amounts withheld or deducted under the ITA, the Employment Insurance Act, and the Canada Pension Plan, as well as for similar provincial amounts. These amounts are generally source deductions, non-resident withholding taxes, and other amounts withheld or deducted subject to a withholding obligation under the ITA.[127] The result is that a deemed trust is created over the debtor company's assets for an amount equivalent to the debt,

and these amounts are deemed to fall outside of the debtor company's estate in insolvency proceedings, in priority to any security interest other than a mortgage in real property.

For GST/HST and QST deemed trusts, however, case law has established that these amounts are not subject to any exception or carve-out once insolvency proceedings have been undertaken under the BIA or the CCAA.[128] In *Century Services*, the Supreme Court denied the Crown's claim that a GST/HST deemed trust survived the commencement of CCAA proceedings despite any explicit statement authorizing such an exception. The court emphasized that both the CCAA and the BIA contain express exceptions allowing deemed trusts for source deductions to continue to be operative after the commencement of proceedings, and both statutes clearly establish that the Crown ranks as an unsecured creditor for most claims. On that basis, the court concluded that had Parliament intended to ensure a statutory carve-out for GST/HST deemed trusts, it would have done so explicitly.

Assessments Against Insolvent Companies

The stay under the CCAA prohibits any proceedings against a debtor company in any action, suit, or proceeding from commencing or continuing during the period of the stay, unless authorized by the court.[129] The courts have determined that a notice of assessment or reassessment issued by the tax authorities constitutes an action or proceeding,[130] and that a valid stay under the CCAA prevents the government from issuing requirements to pay under the ETA and the ITA.[131]

In the recent decision in *Girard*,[132] the Quebec Court of Appeal concluded that a notice of assessment or reassessment constituted a proceeding and was therefore subject to the stay of proceedings under the BIA. The court determined that a notice of assessment or reassessment issued while the stay is in effect will not have the legal effect conferred on it under the ITA unless the tax authorities obtain the leave of the court under section 69.4 of the BIA. The attorney general of Canada's application for leave to appeal the decision to the Supreme Court was dismissed. While in *Girard* the stay of proceedings was issued under section 69.3 of the BIA, the language in that provision is quite similar to that of the stay provision in section 11.02 of the CCAA. On the basis of maintaining coherency between the insolvency regimes, as emphasized by the Supreme Court in *Century Services*, *Girard* likely also applies to stays under the CCAA.

Navigating the Taxation of a Debtor Company Under the CCAA

For large companies facing insolvency, the CCAA offers the opportunity to restructure in a flexible manner and (should restructuring not be possible) to liquidate with more leeway for negotiation. While the debt-forgiveness rules line the path to many debt settlements with creditors, tax-planning can maximize the preservation or use of a debtor company's tax attributes and significantly improve its

tax situation should the business emerge from insolvency as a going concern. As large companies face ongoing uncertain economic times, debtor companies will continue to need assistance with navigating taxation during CCAA proceedings and utilizing their tax positions to best support their goals for the CCAA process.

Notes

1 Companies' Creditors Arrangement Act, RSC 1985, c. C-36, as amended.

2 Bankruptcy and Insolvency Act, RSC 1985, c. B-3, as amended.

3 See, for example, Sharon Hamilton, Adrienne Oliver, and Jessica Lyn, "Government Collection of Tax in the Insolvency Context," in *Tax Dispute Resolution, Compliance, and Administration in Canada* (Toronto: Canadian Tax Foundation, 2013), 18:1-31; Steven Hurowitz, Ron Maiorano, and Carrie Smit, "Debt Restructuring: Domestic and Cross-Border Issues," in *Report of Proceedings of the Sixty-First Tax Conference*, 2009 Conference Report (Toronto: Canadian Tax Foundation, 2010), 14:1-44; Greg Boehmer, Kathleen Hanly, and Eric Xiao, "Insolvency: Selected Income Tax Issues Relating to Debt Restructuring and Liquidation," ibid., 7:1-40; Jennifer Hanna, "Acquiring Distressed Businesses," in *2009 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2009), 8:1-33; Christopher Stocco, Sean Wilson, and Brooke Ko, " 'Insolvency 101' and Related Income Tax Issues," in *2009 British Columbia Tax Conference* (Toronto: Canadian Tax Foundation, 2009), 8:1-35; Ronald N. Robertson and Edmond F.B. Lamek, "Tax Collection and Insolvency: An Update," in *Report of Proceedings of the Forty-Fifth Tax Conference*, 1993 Conference Report (Toronto: Canadian Tax Foundation, 1994), 8:1-23; and Bruce Warnock, "Selected Income Tax Aspects of Bankruptcy and Insolvency," in *1992 Prairie Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 1992), 7:1-51.

4 Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA"). Unless otherwise stated, statutory references in this paper are to the ITA.

5 *Re Nortel Networks Corporation et al.*, 2014 ONSC 4777; aff'd. 2015 ONCA 681. Motion to appeal to the Supreme Court of Canada filed on December 14, 2015.

6 *Girard (Syndic de)*, 2014 QCCA 1922, leave to appeal to the Supreme Court of Canada dismissed, 2015 CanLII 23008.

7 Section 91(21) of the Constitution Act, 1867, 30 & 31 Vict., c. 3 (UK), as amended.

8 Winding-Up and Restructuring Act, RSC 1985, c. W-11, as amended.

9 See the definition of "corporation" in CCAA section 2 and BIA section 2.

10 *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60, at paragraph 24.

11 See the definition of "insolvent person" in BIA section 2.

12 Ibid.

13 See CCAA section 3(1).

14 *Stelco Inc., Re*, 2004 CanLII 24933, at paragraphs 21-23 and 40 (ONSC); and *Redstone Investment Corporation (Re)*, 2014 ONSC 2004, at paragraphs 43-44. This reasoning was applied in Quebec in *Homburg Invest Inc. (Arrangement relatif à)*, 2011 QCCS 4989 (see judgment on the application for the issuance of an initial order).

15 BIA section 50.4.

16 BIA section 69. Note that if a secured creditor filed a notice under section 244 more than 10 days before (or if the insolvent debtor has waived the delay), it is not stayed.

17 BIA section 69.1.

18 BIA sections 51, 54, 121 et seq., 135, and 150.

19 BIA section 47.1.

20 Pursuant to CCAA section 11.02.

21 Pursuant to CCAA section 11.7.

22 Pursuant to CCAA section 32.

23 With the factors for consideration codified in CCAA section 11.2.

24 CCAA sections 11.51 and 11.52. For a model CCAA initial order, see Supreme Court of British Columbia, "Model Companies' Creditors Arrangement Act Initial Order," August 1, 2015.

25 CCAA section 6(1).

26 See CCAA section 11.2. Note that DIP financing is referred to as "interim financing" under the CCAA.

27 See BIA section 50.6. Again, note that DIP financing is referred to as "interim financing."

28 See BIA sections 57 and 61.

29 See, for example, Shannon Kari, "CCAA v. BIA—Legal Report: Insolvency," *Canadian Lawyer*, June 1, 2015.

30 For an in-depth study of the debt-forgiveness rules, see, for example, Thomas A. Bauer, "Restructuring Debt Obligations," in *Report of Proceedings of the Sixtieth Tax Conference*, 2008 Conference Report (Toronto: Canadian Tax Foundation, 2009), 37:1-30; Jim Cruickshank, "Understanding the Boundaries of Section 80: What Triggers Debt Forgiveness?" in *2009 Atlantic Provinces Tax Conference* (Toronto: Canadian Tax Foundation, 2009), 4B:1-33; Peter Dale, "Debt Forgiveness—Tough Times and Section 80 Often Go Hand in Hand," in *2009 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2009), 3:1-11; and Michael Vantil, "Corporate Debt Settlement and Forgiveness: The Technical Rules," in *2009 British Columbia Tax Conference*, supra note 3, 6:1-38.

31 We do not address in this paper the concept of distress preferred shares and the tax issues that arise in connection with such shares.

32 Definition of "forgiven amount," in subsection 80(1).

33 Ibid. for the detailed technical definition of "forgiven amount."

34 Paragraph 80(2)(k).

35 See Cruickshank, supra note 30, at 4B:8.

36 Paragraph 80(2)(c).

37 Section 80.04.

38 Subsection 80(13).

39 Ibid.

40 See variable B of subsection 80(13) and the concepts of "residual balance" and "gross tax attributes" described in subsections 80(14) and (14.1), respectively.

41 *Information Circular* 84-1, "Revision of Capital Cost Allowance Claims and Other Permissive Deductions," July 9, 1984.

42 See *Advance Tax Ruling* ATR-66 (Cancelled), "Non-Arm's Length Transfer of Debt Followed by a Winding-Up and a Sale of Shares," April 20, 1995; and CRA document no. 2004-0081691R3, 2004.

43 All amounts shown in the case studies and accompanying figures and tables are in Canadian dollars, unless otherwise indicated.

44 The legal mechanism would generally be that Subco issues its own shares to Pubco in consideration for an undertaking by Pubco to issue Pubco shares to Subco's creditors.

45 *Untermeyer Estate v. Attorney General for British Columbia*, [1929] SCR 84, at 91.

46 *Bendix Automotive of Canada Ltd. v. The Queen*, 78 DTC 6137 (FCA).

47 See IC 84-1, supra note 41, at paragraphs 1 and 10. Generally, the CRA administrative position is that an amendment of a return for a taxation year in which no tax was payable will normally be accepted, provided that such an amendment does not change the tax payable for any taxation year that is beyond the time period for a notice of objection to be filed, and the CRA has not issued a loss determination notice for the year pursuant to subsection 152(1.1) that is beyond the 90-day period for objection.

48 Both of the planning avenues discussed above are combined for the purpose of case study 1 in order to illustrate each idea in concept. It is acknowledged that, on the facts of the case study, a taxable transfer of depreciable property by Pubco in the taxation year ending prior to the year in which the restructuring occurred could have triggered a full $400 of recapture that would fully absorb Pubco's NOLs without needing to resort to an amendment of Pubco's prior tax returns to reduce CCA claims.

49 1 USC sections 1101-1174 (2010).

50 See CRA document no. 2005-0140981C6, October 7, 2005. See also CRA document no. 2002-0151343, 2002, which states that the general anti-avoidance rule (GAAR) is not applicable. This shows the same result as if Buyco shareholders bought Subco shares from Canco, owning plant 2 (but this is not possible under the CCAA process).

51 Paragraph 80(2)(b).

52 *Stelco Inc., Re*, 2006 CanLII 27117 (ONSC); aff'd. *Stelco Inc. (Re)*, 2007 ONCA 483.

53 BIA sections 121, 122, and 143.

54 *Canada 3000 Inc., Re*; *Inter-Canadian (1991) Inc. (Trustee of)*, 2006 SCC 24, at paragraph 96.

55 *Stelco Inc.*, supra note 52, at paragraph 59 (ONSC).

56 Ibid., at paragraphs 67-70.

57 See also *AMIC Mortgage Investment Corporation v. Abacus Cities Ltd.*, 1992 ABCA 57.

58 Supra note 5.

59 Ibid. A motion to appeal to the Supreme Court of Canada was filed on December 15, 2015.

60 *Nortel Networks Corporation*, supra note 5, at paragraphs 29-34 (ONSC); and *Nortel Networks Corporation*, ibid., at paragraphs 35-43 (ONCA).

61 Supra note 10.

62 *Sun Indalex Finance, LLC v. United Steelworkers*, 2013 SCC 6.

63 *Nortel Networks Corporation*, supra note 5, at paragraph 43 (ONCA).

64 Ibid., at paragraphs 88-91. For the relevant comments in *Stelco*, see *Stelco Inc.*, supra note 52, at paragraph 58 (ONSC) and *Stelco Inc.*, ibid., at paragraph 67 (ONCA).

65 *Nortel Networks Corporation*, supra note 5, at paragraphs 68-69 (ONCA).

66 *Nortel Networks Corporation*, ibid., at paragraph 35 (ONSC).

67 CRA document no. 2008-0304841I7, May 14, 2009; CRA document no. 2009-0314641I7, October 15, 2009.

68 CRA document no. 2008-0304841I7, May 14, 2009.

69 *Wawang Forest Products Ltd. v. The Queen*, 2001 FCA 80.

70 See also Greg Boehmer et al., supra note 3, at 7:32.

71 *65302 British Columbia Ltd. v. Canada*, [1999] 3 SCR 804, at paragraph 39.

72 *Canadian Imperial Bank of Commerce v. Canada*, 2013 FCA 122, at paragraph 79.

73 *International Colin Energy Corporation v. The Queen*, 2002 CanLII 47015, at paragraph 43 (TCC).

74 CRA document no. 2009-0328671I7, August 12, 2010.

75 An income-earning purpose test is incorporated into subparagraphs 20(1)(e)(ii), 20(1)(e)(ii.1), 20(1)(e)(ii.2), and 20(1)(e)(ii.2).

76 The income-earning purpose test is incorporated in paragraph 20(1)(b) via the definition of "eligible capital expenditure" in subsection 14(5).

77 *Bannerman v. Minister of National Revenue*, [1959] SCR 562; and *The Queen v. Jager Holdings (Calgary) Ltd. et al.*, [1983] CTC 225 (FCTD).

78 "Revenue Canada Round Table," in *Report of Proceedings of the Thirty-Third Tax Conference*, 1981 Conference Report (Toronto: Canadian Tax Foundation, 1982), 726-66, question 40, at 756.

79 See CRA document no. 2009-0328671I7, August 12, 2010, which cites in particular *Canada Starch Co. Ltd. v. MNR*, 68 DTC 5320 (Ex. Ct.) and *Rona Inc. v. The Queen*, 2003 DTC 979, at paragraphs 45 and 51 (TCC).

80 *International Colin Energy*, supra note 73, at paragraph 43.

81 See CRA document no. 2009-0328671I7, August 12, 2010.

82 *Interpretation Bulletin* IT-143R3 (Archived), "Meaning of Eligible Capital Expenditure," August 29, 2002, at paragraphs 13-14.

83 Ibid.

84 See CRA document no. 2009-0328671I7, August 12, 2010.

85 See *Wawang Forest Products*, supra note 69, at paragraph 9.

86 *Interpretation Bulletin* IT-467R2 (Archived), "Damages, Settlements and Similar Payments," November 13, 2002, at paragraph 10. See also *Income Tax Folio* S4-F2-C1, "Deductibility of Fines and Penalties."

87 Supra note 69, at paragraph 16.

88 *Canada v. McLarty*, 2008 SCC 26, at paragraph 18.

89 IT-467R2, supra note 86, at paragraph 16.

90 *Interpretation Bulletin* IT-359R2 (Archived), "Premiums and Other Amounts with Respect to Leases," December 20, 1983.

91 *65302 British Columbia Ltd.*, supra note 71.

92 See *Canadian Imperial Bank of Commerce*, supra note 72, and *McNeill v. The Queen*, 2000 DTC 6211 (FCA).

93 *McNeill*, supra note 92.

94 *Anglo-Persian Oil Co., Ltd. v. Dale (HM Inspector of Taxes)* (1931), 16 TC 253 (CA).

95 *Bomag (Canada) Ltd. v. The Queen*, [1984] CTC 378 (FCA).

96 *Automatic Toll Systems (Canada) Ltd. v. MNR*, 74 DTC 6060 (FCTD).

97 *Atkins & Durbrow v. MNR* (1965), 37 Tax ABC 321.

98 *James Vernor Company v. Minister of National Revenue*, 50 DTC 482 (TAB).

99 Consideration should also be given to whether any forgiveness may be viewed as being on income account, with the result that the liability would be an "excluded obligation." It is unlikely that any forgiveness of significant contractual claims, such as store leases, that occurs as part of a CCAA restructuring process—the purpose of which is to fundamentally alter the capital structure of the debtor—would be viewed as being on income account.

100 See *Gifford v. Canada*, 2004 SCC 15.

101 Excise Tax Act, RSC 1985, c. 15, as amended (herein referred to as "the ETA").

102 Sub nom. *Aero Trades (Western) Ltd. (Receiver of) v. Canada*, [1989] 1 CTC 142 (FCA).

103 Tax Administration Act, RSQ c. A-6.002, section 31; Agreement with Respect to the Administration by Quebec of Part IX of the Excise Tax Act (RSC 1985 c. E-15) relating to the Goods and Services Tax.

104 BIA section 97(3); CCAA section 21.

105 See, for example, *Engage Energy Canada, LP v. Blue Range Resource Corporation*, 2000 ABCA 200; *British Columbia v. Canadian Airlines Corp.*, 2001 ABQB 146; and *Air Canada (Re)*, 2003 CanLII 64234 (ONSC).

106 Canada Revenue Agency, *National Collections Manual* (Ottawa: CRA, January 2015).

107 *Air Canada (Re)*, supra note 105. See also *North American Tungsten Corporation Ltd. (Re)*, 2015 BCSC 1382.

108 *Industries Davie Inc. (Groupe MIL Inc.) (Proposition concordatoire de)*, [2000] RJQ 65 (QCCA).

109 *DIMS Construction inc. (Trustee of) v. Quebec (Attorney General)*, 2005 SCC 52. See also *Caisse populaire Desjardins de l'Est de Drummond v. Canada*, 2009 SCC 29.

110 *DIMS Construction*, supra note 109, at paragraphs 34-36; and Civil Code of Québec, CQLR c. C-1991, article 56.

111 Serge Bouchard, Lucie Saint-Pierre, and Carole Thériault, "Les sujets techniques de l'heure : Compensation d'un remboursement fiscal 'post' avec une dette fiscale 'pré' en matière de faillite et d'insolvabilité," Colloque 169 APFF—Symposium sur les taxes, May 2007, at 23-26.

112 *Brisebois c. Agence du revenu du Québec*, 2014 QCCS 83.

113 *Métaux Kitco inc. (Arrangement relatif à)*, 2016 QCCS 444.

114 *Métaux Kitco*, ibid., is currently under appeal.

115 Ibid., at paragraphs 120-22.

116 See Hamilton et al., supra note 3, at 18:20-21; and *Century Services*, supra note 10, at paragraphs 29-30.

117 CCAA section 38(1).

118 Pursuant to BIA sections 86(2) and 87 and CCAA sections 38(2) and 39. Sections 223 and 316 of the ETA outline the process for obtaining a certificate and a memorial for a tax debt. Regarding Quebec income and sales tax debts, see section 13 of the Tax Administration Act, supra note 102. See also Hamilton et al., supra note 3, at 18:23.

119 Section 224 of the ITA; section 317 of the ETA; and sections 15 and 15.2 of the Tax Administration Act, supra note 103.

120 *Toronto-Dominion Bank v. Canada*, 2012 SCC 1; aff'g. 2010 FCA 174.

121 Canada Pension Plan, RSC 1985, c. C-8, as amended.

122 Employment Insurance Act, SC 1996, c. 23, as amended.

123 CCAA section 38(3).

124 For the policy rationale regarding this exception, see Industry Canada, *Clause by Clause Briefing Book: 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* (Ottawa: Industry Canada, September 6, 2011) (www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/cl00821.html).

125 CCAA section 6(3).

126 CCAA section 37(1).

127 CCAA section 37(2); ITA subsections 227(4) and (4.1); Canada Pension Plan, supra note 121, section 23(3); and Employment Insurance Act, supra note 122, sections 86(2) and 86(2.1).

128 *Century Services*, supra note 10. See also *Canada v. Callidus Capital Corporation*, 2015 FC 977; leave to appeal to the FCA filed September 15, 2015.

129 CCAA section 11.02.

130 See *Slater Steel Inc., Re*, 2004 CanLII 7971 (QCCS); *Manago v. MNR*, 90 DTC 1889, at 1893 (TCC); and *Larocque et al. v. MNR*, 91 DTC 899, at 901 (TCC).

131 *In the Matter of United Used Auto & Truck Parts Ltd. et al.*, 2000 BCSC 30, at paragraphs 35-39.

132 *Girard*, supra note 6.

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

Court File No. CV-23-00707394-00CL

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TACORA RESOURCES INC.

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF CARGILL, INCORPORATED AND CARGILL INTERNATIONAL TRADING PTE LTD.
(Motion to Set Aside Disclaimer and Global Process Motion returnable June 26, 2024)

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