COURT FILE NUMBER	2501-00574	Clerk's stamp
COURT	COURT OF KING'S BENCH OF ALBERTA	
JUDICIAL CENTRE	CALGARY	
	IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, C. C-36, AS AMENDED	
	AND IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF WESTPHALIA DEV. CORP.	
APPLICANT	WESTPHALIA DEV. CORP.	
DOCUMENT	**BRIEF OF LAW** **(MEETING ORDER)**	
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	Norton Rose Fulbright Canada LLP 400 3rd Avenue SW, Suite 3700 Calgary, Alberta T2P 4H2 CANADA Howard A. Gorman, K.C. / Meghan L. Parker howard.gorman@nortonrosefulbright.com meghan.parker@nortonrosefulbright.com Tel: +1 403.267.8222 Fax: +1 403.264.5973 Lawyers for the Applicant, Westphalia Dev. Corp. File no.: 1001326363	

I. INTRODUCTION

1 This Bench Brief is submitted on behalf of the applicant, Westphalia Dev. Corp. (**WDC**, or the **Applicant**) in support of a Meeting Order, which among other things, permits the Applicant to file the Plan, authorizes the establishment of one class of voting creditors, and authorizes the Applicant to call, hold, and conduct the Meeting.

2 The Order will support the Applicant's continued efforts to restructure for the benefit of its creditors and other stakeholders pursuant to these proceedings under the *Companies' Creditors Arrangement Act* (the **CCAA**).[1]

3 The Applicants have submitted the Third Affidavit of Bryce Tingle, K.C. (the **Third Affidavit**) in support of this Application. Capitalized terms not otherwise defined take their meaning from the Third Affidavit. The Monitor has prepared its Second Report of the Monitor (**Monitor's Report**).

4 This Bench Brief is intended to outline for the Court the legislation and jurisprudence pertinent to the relief being sought at a hearing scheduled for March 4, 2025.

II. LAW AND ARGUMENT

a. The Meeting Order

5 The Applicant proposes to call, hold and conduct a meeting of one class of creditors, being the Affected Creditors and Convenience Class Creditors.[2] The Claims Process has only identified two Affected Creditors, being WGIL and WAM, and two Convenience Class Creditors, being those with Claims up to an including $30,000. The Applicant has no secured creditors.[3]

6 For the reasons that follow, the Applicant submits that the form of Meeting Order should be granted so that the Plan may be put to a vote by Voting Creditors at the Meeting.

i. The Plan

7 The Plan, dated February 24, 2025, is attached as Exhibit "B" to the Third Affidavit, and in duplicate as Schedule "A" to the form of Meeting Order. The Applicant intends to seek approval of the Plan in a Sanction Order Hearing, which is scheduled for March 28, 2025.[4]

8 It is contemplated in the Meeting Order that the Plan will be voted on by Voting Creditors during a meeting convened on March 25, 2025.[5]

9 The Meeting Order contains a provision seeking an exemption of the requirements of *Multilateral Instrument 61-101 "Protection of Minority Security Holders in Special Transactions"* (**MI 61-101**).[6] As a reporting issuer in each of the provinces and territories

---

[1] *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended.
[2] Third Affidavit, para 8.
[3] Second Report, para 26.
[4] Third Affidavit, para 9(d).
[5] Third Affidavit, para 12.
[6] See paras 16-19 of the Third Affidavit. A copy of *Multilateral Instrument 61-101 "Protection of Minority Security Holders in Special Transactions"* may be found online: https://www.asc.ca/-/media/ASC-Documents-part-1/Regulatory-Instruments/2018/10/5331765-MI-61-101.ashx.

of Canada, the Applicant is subject to applicable securities laws of such provinces and territories, and would be subject to the provisions of MI 61-101 due to the fact that certain aspects of the plan would amount to a "related party transaction" with WGIL.

10 However, pursuant to sections 5.5(f) and 5.7(d) of MI-61-101, there is an exception of the ordinary shareholder approval requirements where a court orders that the transaction be effected pursuant to bankruptcy and insolvency statutes. In these circumstances, where the Plan is being conducted pursuant to the provisions of the CCAA, and no Equity Claims are entitled to vote, it is appropriate for the Court to grant an exception of the requirements of MI 61-101.

ii. Calling the Meeting

11 The Court has discretionary authority to order a meeting of unsecured and secured creditors of a debtor company pursuant to sections 4 and 5 of the CCAA:

> **Compromise with unsecured creditors**
>
> 4 Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.
>
> **Compromise with secured creditors**
>
> 5 Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

12 Sections 6(1) and 22.1 of the CCAA further provide that shareholders of a debtor company cannot vote on a plan of compromise and arrangement unless the court orders otherwise. Courts have provided colour to this: equity holders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full, and as such, cannot participate in any plan of compromise and arrangement of the company.[7]

13 In this case, the Applicant is seeking to hold a meeting of Voting Creditors, which are comprised of Affected Creditors and Convenience Class Creditors, both unsecured. Existing Shareholders of the Applicant have been given notice of the within Application and the Applicant's scheduled Meeting Order and Sanction Order Hearing.[8] In accordance

---

[7] See *Canadian Airlines Corp., Re,* 2000 ABQB 442, at para 143; *Stelco Inc., Re,* [2006] O.J. No. 276, at paras 15-17; *Delta 9 Cannabis Inc (Re)*, 2024 ABKB 657, at para 88.

[8] Third Affidavit at para 9(d), at Exhibit "B".

with Section 22.1 of the CCAA and the exemptions available under MI 61-101, Existing Shareholders will not vote, and are not entitled to vote, at the Meeting.

14 The courts set out a relatively low standard to be met in determining whether a meeting order should be granted, and in the majority of cases, it is a procedural step in the process that is not intended to be used to argue whether the proposed plan is fair and reasonable.[9]

15 The test as to whether a creditor meeting should be ordered is whether it is in the best interests of the debtor and its stakeholders to do so. It is typically only in circumstances where a plan is doomed to fail, such as where a creditor with a blocking position refuses to support the plan, or where the plan is incapable of meeting the criteria of a sanction order, that a court will refuse to order a meeting of creditors.[10] In *Re ScoZinc Ltd.*, the Nova Scotia Supreme Court explained:

> In my opinion it should not be up to the Court to second guess the probability of success of a proposed plan of arrangement. Businessmen are free to make their own views known before and ultimately at the creditors' meeting. It seems to me that the Court should only decline to give preliminary approval and refuse to order a meeting if it was of the view that there was no hope that the plan would be approved by the creditors or, if it was approved by the creditors, it would not, for some other reason, be approved by the Court.[11]

16 The Alberta Court of Appeal has followed the same approach. In *Royal Bank v. Fracmaster*,[12] Fruman J.A. stated that the decision to order a meeting of creditors is discretionary and "[i]n exercising its discretion, the court must consider whether the proposed plan of arrangement has a reasonable chance of success… or instead, is doomed to failure".[13]

17 In *Nova Metal Products Inc. v. Comiskey (Trustee Of)*,[14] Doherty J.A. of the Ontario Court of Appeal (dissenting in the result) explained that, while the feasibility of a plan is relevant, the courts should nonetheless not impose a heavy burden on the company in ordering a meeting of creditors:

> I agree that the feasibility of the plan is a relevant and significant factor to be considered in determining whether to order a meeting of creditors: S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," at pp. 594-595. I would not, however, impose a heavy burden on the debtor company to establish the likelihood of ultimate success from the outset. As the Act will often be the last refuge for failing companies, it is to be expected that many of the proposed plans of reorganization will involve variables and contingencies which will make the plan's ultimate acceptability to the creditors and the Court very uncertain at the time the initial application is made.[15]

---

[9] *Delta 9*, paras 12-13.
[10] *Delta 9*, paras 12 and 15.
[11] *Re ScoZinc Ltd,* 2009 NSSC 163, at para 7.
[12] *Royal Bank v Fracmaster,* 1999 ABCA 178; see also *Target Canada Co, Re*, 2016 ONSC 316, at paras 66-70.
[13] *Royal Bank, ibid*, at para 13 (citations removed).
[14] *Nova Metal Products Inc v Comiskey (Trustee Of),* 1 CBR (3d) 101, 1 OR (3d) 289.
[15] *Ibid* at para 90.

18 The Applicant submits that it has met its obligations under the CCAA and the common law, and that this is an appropriate case for the Court to grant a meeting order. The Monitor has opined that the Plan presents a better recovery to its stakeholders than the alternative.[16]

III. CONCLUSION AND RELIEF SOUGHT

19 The Applicant seeks a Meeting Order substantially in the form attached to its Application.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 3rd day of March, 2025.

NORTON ROSE FULBRIGHT CANADA LLP

Per: ______________________________

Howard A. Gorman, K.C.
Meghan L. Parker
Solicitors for the Applicant

[16] Second Report, paras 53-60

TABLE OF AUTHORITIES

A. *Companies' Creditors Arrangement Act*, RSC 1985, c C-36

B. *Canadian Airlines Corp., Re,* 2000 ABQB 442

C. *Stelco Inc., Re,* [2006] O.J. No. 276

D. *Delta 9 Cannabis Inc (Re)*, 2024 ABKB 657

E. *ScoZinc Ltd,* 2009 NSSC 163

F. *Royal Bank v Fracmaster,* 1999 ABCA 178

G. *Target Canada Co, Re*, 2016 ONSC 316

H. *Nova Metal Products Inc v Comiskey (Trustee Of),* 1 CBR (3d) 101, 1 OR (3d) 289

TAB C

Stelco Inc. (Re)

Ontario Judgments

Ontario Superior Court of Justice

Commercial List

J.M. Farley J.

Heard: January 17-18 and 20, 2006.

Judgment: January 20, 2006.

Court File No. 04-CL-5306

[2006] O.J. No. 276 | 14 B.L.R. (4th) 260 | 17 C.B.R. (5th) 78 | 145 A.C.W.S. (3d) 194 | 2006 CarswellOnt 406 | 2006 CanLII 1773

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF a proposed plan of compromise or arrangement with respect to Stelco Inc. and the other applicants listed in Schedule "A" APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

(41 paras.)

Case Summary

Creditors and debtors law — Legislation — Debtors' relief — Companies Creditors Arrangement Act — Motion by equity shareholders to extend the powers of a monitor dismissed — Proposed plan of arrangement under Companies' Creditors Arrangement Act was approved.

Insolvency law — Receivers, managers and monitors — Property — Sale of — Motion by equity shareholders to extend the powers of a monitor dismissed — Proposed plan of arrangement under Companies' Creditors Arrangement Act was approved.

Motion by certain shareholders of a company to extend the powers of a monitor to conduct a sale of the company's business as a going concern -- In the alternative, the shareholders sought suspension of a proposed plan of arrangement under the Companies' Creditors Arrangement Act -- The shareholders also requested that approval of the plan be adjourned for 60 days to have the monitor conduct an independent sale process -- HELD: Motion dismissed -- All statutory requirements and previous court orders had been complied with -- The plan was fair, reasonable and equitable in relation to the affected creditors -- The existing shareholders could not lay claim to there being any existing equity value -- The plan was implementable, therefore it was sanctioned and approved.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, s. 191

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

Counsel

Michael Barrack, James D. Gage and Geoff R. Hall, for the Applicants

Robert Thornton and Kyla Mahar, for the Monitor

Peter Jervis, George Glezos and Karen Kiang, for the Equity Holders

John Varley, for the Salaried Employees

David Jacobs, for USW Locals 8782 and 5328

Aubrey Kauffman, for Tricap Management Ltd.

Kevin Zych and Rick Orzy, for the 8% and 10.4% Stelco Bondholders

Lawrence Thacker, for the Directors of Stelco

Sharon White, for USW Local 1005

Ken Rosenberg, for USW International

Kevin McElcheran, for GE

Gale Rubenstein and Fred Myers, for the Superintendent of Financial Services

Derrick Tay, for Mittal

David R. Byers and Sean Dunphy, for CIT Business Credit as DIP and ABL Lender

V. Gauthier, for BABC Global Finance

L. Edwards, for EDS Canada Inc.

Peter Jacobsen, for Globe & Mail

Paul Macdonald and Andy Kent, for Sunrise and Appalloosa

Murray Gold and Andrew Hatnay, for the Salaried Retirees

Flaviano Stanc, Self-Represented

ENDORSEMENT

(Motion by the Applicants for a Sanction Order

and Cross-Motion of Certain Equity Holders)

J.M. FARLEY J. (endorsement)

1 The Applicants (collectively "Stelco") moved for:

(a) a declaration that Stelco has complied with the provisions of the Companies' Creditors Arrangement Act ("CCAA") and the orders of this court made in this CCAA proceeding;

(b) a declaration that the Stelco plan of arrangement pursuant to the CCAA and the reorganization of Stelco Inc. ("S") under the Canada Business Corporations Act ("CBCA") (collectively the "Plan") as voted on by the affected creditors of Stelco is fair and reasonable;

(c) an order sanctioning and approving the Plan; and

(d) an order extending the Stay Period and Stay Date in the Initial Order until March 31, 2006.

2 This relief was unopposed by any of the stakeholders except for various existing shareholders of S (who may also be employees or retirees of Stelco). In particular there was organized objection to the Plan, especially as in essence the Plan would eliminate the existing shareholders, by a group of shareholders (AGF Management Ltd., Stephen Stow, Pollitt & Co., Levi Giesbrecht, Joe Falco and Phil Dawson) who have styled themselves as "The Equity Holders" ("EH"). On December 23, 2005 the EH brought in essence a cross motion seeking the following relief:

(a) An order extending the powers of the Monitor, Ernst & Young, in order to conduct a sale of the entire Stelco enterprise as a going concern through a sale of the common shares or assets of Stelco on such terms and conditions as are considered fair;

(b) An order authorizing and directing the Monitor to implement and to take all steps necessary to complete and fulfil all requirements, terms, conditions and steps of such a sale;

(c) An order authorizing and directing the Monitor to conduct the sale process in accordance with a plan for the sale process approved by the court;

(d) An order directing the Monitor to retain such fully independent financial advisors and other advisors as necessary to conduct this sale process;

(e) An order confirming that the powers granted herein to the Monitor supersede any provision of any prior Order of this Court made in the within proceedings to the extent that such provision of any prior order is inconsistent with or contradictory to this order, or would otherwise limit or hinder the power and authority granted to the Monitor;

(f) An order directing Stelco and its directors, officers, counsel, agents, professional advisors and employees, and its Chief Restructuring Officer, to cooperate fully with the Monitor with regard to this sale process, and to provide the Monitor with such assistance as may be requested by the Monitor or its independent advisors;

(g) In the alternative, an order suspending the sanctioning of the Proposed Plan of Arrangement, approved by the creditors on December 9, 2005, for a period of two months from the date of such order, so that the Monitor may conduct the independent sale process that may result in a more profitable outcome for all stakeholders, including the Equity Holders;

(h) In the further alternative, an order lifting the Companies' Creditors Arrangement Act stay of proceedings in respect of Stelco without approving the Plan of Arrangement, as approved by the creditors on December 9, 2005, pursuant to such terms as are just and are directed by court; and

(i) Such further and other relief as counsel may advise and this Honourable Court may permit.

3 In its factum, the EH requested that the court adjourn approval of the Plan for 60 days and direct the Monitor to conduct an independent sale process for the shares of S. In the attendances on January 17 and 18, 2006, the EH then asked that approval of the Plan be adjourned for 30 days in order to see if there were expressions of interest for the shares of S forthcoming in the interim.

4 I indicated that I would defer my consideration of the adjournment request until after I had had submissions on the motions before me as set out above. I also indicated that while there did not appear to be any concern by anyone including the EH as to the first two elements concerning CCAA plan sanctioning as discussed in Re Algoma Steel Inc. *(2001), 30 C.B.R. (4th) 1* (Ont. S.C.J.) at p. 3:

In a sanction hearing under the Companies' Creditors Arrangement Act ("CCAA") the general principles to be applied in the exercise of the court's discretion are:

(a) There must be strict compliance with all statutory requirements and adherence to the previous orders of the court;

(b) All materials filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and

(c) The Plan must be fair and reasonable.

See Northland Properties Ltd., Re *(1988), 73 C.B.R. (N.S.) 175* (B.C. S.C.), affirmed Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada *(1989), 73 C.B.R. (N.S.) 195* (B.C. C.A.) at p. 201; Campeau Corp., Re *(1992), 10 C.B.R. (3d) 104* (Ont. Gen. Div.) at p. 109; Olympia & York Developments Ltd. v. Royal Trust Co. *(1993), 12 O.R. (3d) 500* (Ont. Gen. Div.) at p. 506; Sammi Atlas Inc., Re *(1998), 3 C.B.R. (4th) 171* (Ont. Gen. Div. [Commercial List]), at pp. 172-3; Canadian Airlines Corp., Re, *[2000] 10 W.W.R. 269* (Alta. Q.B.), leave to appeal dismissed, *[2000] 10 W.W.R. 314* (Alta. C.A. [In Chambers]).

it would not be sufficient to only deal in this hearing with the third test of whether the Plan was fair and reasonable (including the aspect of "fair, reasonable and equitable" as discussed in Sammi). Rather the court also had to be concerned as to whether the Plan was implementable. In other words, it would be futile and useless for the court to approve a plan which stood no reasonable prospect of being implemented. That concern of the court had been raised by my having been alerted by the Monitor in its 46th Report at paragraphs 8-9:

8. The Monitor has had discussions with the proposed ABL lenders, Tricap, the Province and Stelco regarding the status of the ABL Loan and the Bridge Loan. The Monitor has been advised that the parties are continuing to work at resolving issues that are outstanding as at the date of this Forty-Sixth Report. However, all of the parties remain optimistic that acceptable solutions to the outstanding issues will be found and implemented.

9. In the Monitor's view, the principal issues to be resolved include:

(a) the corporate structure of Stelco, which could involve the transfer of assets of some of the operations or divisions of the Applicants to new affiliates; and

(b) satisfying the ABL lenders and Tricap as to the priority of the new financing.

These issues need to be resolved primarily among the proposed ABL lenders, Tricap and Stelco and will also involve the Province insofar as they affect pension and related liabilities.

5 I was particularly disquieted by the lack of progress in dealing with these outstanding matters despite the passage of 39 days since the Plan was positively voted on December 9, 2005. I do appreciate that Christmas, Hanukkah and New Year's were celebrated in this interval and that there had been a certain "negotiation fatigue" leading up to the December 9th revisions to the Plan and that I have advocated that counsel, other professionals and litigation participants balance their lives and pay particular attention to family and health. However I find it unfortunate that there would appear to have been such a lengthy hiatus, especially when the workers at Stelco continued (as they have for the past two years while Stelco has been under CCAA protection) to produce steel in record amounts. I therefore demanded that evidence be produced forthwith to demonstrate to my satisfaction that progress was real and substantial so that I could be satisfied about implementability. As a side note I would observe that in the "normal" case, sanction orders are typically sought within two or three days of a positive creditor vote so that it is not unusual for documentation to be sorted out for a month before a plan is implemented with a closing.

6 The EH filed material to support its submission that the Plan is not fair, reasonable and equitable because it is alleged that there is currently sufficient value in Stelco to fully satisfy the claims of affected and unaffected creditors and to provide at least some value to current shareholders. The EH prefers to have a search for some entity to take out the current shareholders for "value". Fabrice Taylor, a chartered financial analyst with Pollit & Co. swore an affidavit on the eve of this hearing which was sent electronically to the service list on January 16, 2006 at approximately 7:30 p.m. In that affidavit, he states:

2. The Dofasco bidding war has highlighted a crucial fact about steel asset valuations, notably that strategic buyers place a much higher value on them than public market investors. Attached as Exhibit "1" is an article entitled "Restructuring of steel industry revives investors' interest", published in the Financial Times on December 14, 2005.
3. I, along with Murray Pollitt and a number of Stelco shareholders, have spent the past three months attempting to attract strategic buyers and/or equity investors in Stelco. These strategic buyers and equity investors are mostly international. Some had already considered buying Stelco or had made bids for the company but had stopped following the story some months ago. Others were not very familiar with Stelco.
4. Three factors hindered our efforts. First, Stelco is under CCAA protection, a complicated situation involving multiple players and interests (unions, politics, pensions) that is difficult to understand, particularly for foreigners. Second, there has not been enough time for these strategic buyers or equity investors to deepen their understanding or to perform due diligence. Finally, the Dofasco bid process, while providing emphatic evidence that steel assets are increasingly valuable, hinders certain strategic buyers and financial institutions interested in participating in Stelco because they are distracted and/or conflicted by the Dofasco sale. I have been advised by some of the participants in the Dofasco negotiations that they would be willing to carefully consider a Stelco transaction once the Dofasco sale has been resolved.
5. The Forty Fifth Report of the Monitor confirmed that Stelco had not received any offers in the last several months. The report does not answer the question of whether the company or its financial advisors have in fact attempted to attract any offers. I believe that Stelco would have received expressions of interest had the company made efforts to attract offers, or had the Dofasco sale been resolved earlier. I believe that the Monitor should be authorized, for a period of at least 60 days, to canvas interest in a sale of Stelco before the approval of the proposed plan of restructuring.

7 No satisfactory explanation was forthcoming as to why this affidavit, if it needed to be filed at all, was not served and filed by December 23, 2005, in accordance with the timetable which the EH and the other stakeholders agreed to. Certainly there is nothing in the affidavit which is such late breaking news that this deadline could not have been met, let alone that it was served mere hours before the hearing commenced on January 17, 2006. Aside from the fact that the financing arrangements forming the basis of the Plan contained "no shop" covenants which would make it inappropriate and a breach to try to attract other offers, the foregoing excerpts from the Taylor affidavit clearly illustrate that despite apparently diligent efforts by the EH, no one has shown any real or realistic interest in Stelco. Reading between the lines and without undue speculation, it would appear that the efforts of the EH were merely politely rebuffed.

8 Certainly Stelco is not Dofasco, nor is it truly a comparable (as opposed to a contrastor). Stelco has been a wobbly company for a long time. Further as I indicated in my October 3, 2005 endorsement, in the preceding 20 months under the CCAA protection, Stelco has become "shopped worn". The unusual elevation of steel prices in the past two years has helped Stelco avoid the looming liquidity crisis which it anticipated in its CCAA filing on January 29, 2004. However even this financial transfusion has not allowed it to become a healthy company or truly given it a burgeoning war chest to weather bad times the way that other steel companies (including some in Canada) have so benefited. The redness of the visage of Stelco is not a true indication of health and well being; rather it seems that it is rouge to mask a deep pallor.

9 I am satisfied on the evidence of Hap Stephen, the Chief Restructuring Officer of Stelco and of the Monitor that there has been compliance with all statutory requirements and adherence to previous orders of the court and further that nothing has been done or purported to be done that is not authorized by the CCAA.

10 The next question to be dealt with is whether the Plan is fair, reasonable and equitable. I was advised that creditors of the affected creditor classes representing approximately 90% in value of each class voted on the Plan. The Monitor reported at para. 19 of its 44th Report as to the results of the vote held December 9th as follows:

Class of Affected Creditors	Percentage in favour by Number	Percentage in favour by Dollar Value
Stelco	78.4%	87.7%
Stelwire	89.01%	83.47%
Stelpipe	94.38%	86.71%
CHT Steel	100%	100%
Welland Pipe	100%	100%

11 This favourable vote by the affected creditors is substantially in excess of the statutory two-thirds requirement. By itself that type of vote, particularly with such a large quorum present, would ordinarily be very convincing for a court not interfering with the informed decisions of business people. With that guideline, plus the aspect that a plan need not be perfect, together with the lack of any affected creditor opposition to the Plan being sanctioned and the fact that the Plan including its ingredients and nature and amount of compromise compensation to be given to affected creditors having been exhaustively negotiated in hard bargaining by the larger creditor groups who are recognized as generally being sophisticated and experienced in this area, and the consideration of the elements in the next paragraph, it would seem to me that the Plan is fair, reasonable and equitable vis-à-vis the affected creditors and I so find. See Sammi, at p. 173; Re T. Eaton Co. *(1999), 15 C.B.R. (4th) 311* (Ont. S.C.J.) at p. 313; Re Olympia & York Developments Ltd. *(1993), 12 O.R. (3d) 500* (Gen. Div) at p. 510.

12 I also think it helpful to examine the situation pursuant to the analysis which Paperny J. did in Re Canadian Airlines Corp. *(2000), 20 C.B.R. (4th) 1* (Alta. Q.B.), leave to appeal refused *(2000), 20 C.B.R. (4th) 46* (Alta C.A. [In Chambers]). That proceeding also involved an application pursuant to the corporate legislation, the Business Corporations Act (Alberta), concerning the shares and shareholders of Canadian Airlines. In that case, Paperny J. found the following factors to be relevant:

(a) the composition of the vote: claims must have been properly classified, with no secret arrangements to give an advantage to a creditor or creditors; approval of the plan by the requisite majority of creditors is most important (in the case before me of Stelco: the challenge to classification was dismissed; there was no suggestion of secret arrangements; and, as discussed above, the quorum and size of the positive vote were very high);

(b) anticipated receipts in liquidation or bankruptcy: it is helpful if the Monitor or other disinterested person has prepared a liquidation analysis (in Stelco, the Monitor determined that on liquidation, affected creditor recovery would likely range from 13 to 28 cents on the dollar; it should also be observed that Stelco has engaged in extensive testing of the market as to possible capital raising or sale with the aid of established firms and professionals of great experience and had come up dry.);

(c) alternatives to the proposed plan: it is significant if other options have been explored and rejected as unworkable (in Stelco; see comment in (b));

(d) oppression of the rights of certain creditors (in Stelco, this was not a live issue as nothing of this sort was alleged);

(e) unfairness to shareholders (in Stelco, this will be dealt with later in my reasons; however allow me to observe that the interests of shareholders becomes engaged if they are not so far underwater that there is a reasonable prospect in the foreseeable future that the fortunes of a company would otherwise likely be turned around so that they would not continue to be submerged); and

(f) the public interest: the retention of jobs for employees and the support of the plan by the company's unions is important (in Stelco, the Plan does not call for reductions in employment; there is provision for continuation of the capital expenditure program and its funding; an important enterprise for the municipal and provincial levels of government would be preserved with continuing benefits for those communities; an important customer and supplier would continue in the industry and maintain competition; the USW International Union and its locals (except for local 1005) supported the Plan and indeed were instrumental in bringing Tricap Management Limited to the table (local 1005's position was that it did not wish to engage in the CCAA process in any meaningful way as it was content to rely upon its existing collective agreement which now still has several months to go before expiring).

However that is not the end of that issue: what of the shareholders?

13 Is the Plan fair, reasonable and equitable for the existing shareholders of S? They will be wiped out under the Plan and their shares eliminated. New equity will be created in which the existing shareholders will not participate. They have not been allowed to vote on the Plan.

14 It is well established that a reorganization pursuant to s. 191 of the CBCA may be made in conjunction with a sanction order under the CCAA and that such a reorganization may result in the cancellation of existing shares of the reorganized corporation based on those shares/equity having no present value (in the sense of both value "now" and the likelihood of same having value in the reasonably foreseeable future, absent the reorganization including new debt and equity injections and permitted indulgences or other considerations and adjustments). See Re Beatrice Foods Inc. *(1996), 43 C.B.R. (4th) 10* (Ont. Gen. Div.) at para. 10-15; Re Laidlaw Inc. *(2003), 39 C.B.R. (4th) 239* (Ont. S.J.C.); Algoma at para. 7; Cable Satisfaction International Inc. v. Richter & Associés Inc. *(2004), 48 C.B.R. (4th) 205* (Que. S.C.) at p. 217. The Dickenson Report, which articulated the basis for the reform of corporate law that resulted in the enactment of the CBCA, described the object of s. 191 as being:

> to enable the court to effect any necessary amendment to the articles of the corporation in order to achieve the objective of the reorganization without having to comply with all the formalities of the Draft Act, particularly shareholder approval of the proposed amendment (emphasis added): R.W.V. Dickenson, J.L. Howard, L. Getz, Proposals for a New Business Corporations Law for Canada, vol. 1 (Ottawa: Information Canada. 1971) at p. 124.

15 The fairness, reasonableness and equitable aspects of a plan must be assessed in the context of the hierarchy of interests recognized by insolvency legislation and jurisprudence. See Canadian Airlines at pp. 36-7 where Paperny J. stated:

> Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: Royal Oak Mines Ltd.,

> supra, para. 4., Re Cadillac Fairview Inc., [1995] O.J. No. 707, (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), and T. Eaton Company, supra. To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.
>
> It is through the lens of insolvency legislation that the rights and interests of both shareholders and creditors must be considered. The reduction or elimination of rights of both groups is a function of the insolvency and not of oppressive conduct in the operation of the CCAA. The antithesis of oppression is fairness, the guiding test for judicial sanction. If a plan unfairly disregards or is unfairly prejudicial it will not be approved. However, the court retains the power to compromise or prejudice rights to effect a broader purpose, the restructuring of an insolvent company, provided that the plan does so in a fair manner."

16 The question then is does the equity presently existing in S have true value at the present time independent of the Plan and what the Plan brings to the table? If it does then the interests of the EH and the other existing shareholders must be considered appropriately in the Plan. This is fairly put in K.P. McElcheran, Commercial Insolvency in Canada (Toronto, Lexis Nexis Canada Inc.: 2005) at p. 290 as:

> If, at the time of the sanction hearing, the business and assets of the debtor have a value greater than the claims of the creditors, a plan of arrangement would not be fair and reasonable if it did not offer fair consideration to the shareholders.

17 However if the shareholders truly have no economic interest to protect (keeping in mind that insolvency and the depth of that insolvency may vary according to which particular test of insolvency is applied in respect of a CCAA proceeding: as to which, see Re Stelco Inc., [2004] O.J. No. 1257 (S.C.J. [Commercial List]), leave to appeal dismissed [2004] O.J. No. 1903 (C.A.), leave to appeal dismissed, 336, [2004] S.C.C.A. No. 336 (S.C.C.) No. 30447). In Cable Satisfaction, Chaput J. at p. 218 observed that when shareholders have no economic interest to protect, then they have no claim to a right under the proposed arrangement and the "[m]ore so when, as in the present case, the shareholders are not contributing to any of the funding required by the Plan." I do note in the case of the Stelco Plan and the events leading up to it, including the capital raising and sale processes, that despite talk of an equity financing by certain shareholders, including the EH, no concrete offer ever surfaced.

18 If the existing equity has no true value at present, then what is to be gained by putting off to tomorrow (the ever present and continuous problem in these proceedings of manana - which never comes) what should be done today. The EH speculate, with no concrete basis for foundation as demonstrably illustrated by the eve of hearing Taylor affidavit discussed above, that something good may happen. I am of the view that that approach was accurately described in court by one counsel as a desperation Hail Mary pass and the willingness of someone, without any of his own chips, in the poker game willing to bet the farm of someone else who does have an economic interest in Stelco.

19 I also think it fair to observe that in the determination of whether someone has an economic value, that analysis should be conducted on a reasonable and probable basis. In a somewhat different but applicable context, I observed in New Quebec Raglan Mines Ltd. v. Blok-Andersen, [1993] O.J. No. 727 at p. 3:

> The "highest price" is not the price which could be derived on the basis of the most optimistic and risky assumptions without any regard as to their likelihood of being realized. It also seems to me that prudence would involve a consideration that there be certain fall back positions. Even in betting on horses, the most savvy and luckiest punter will not continue to stake all his winnings of the previous race on the next (and so on). If he does, he will go home wearing the barrel before the last race is run.

Alternatively there is a saying: "If wishes were horses, then beggars would ride."

20 Unless I were to now dismiss the motion for sanctioning and approving the Plan because I found that it was not implementable and/or that it was not fair, reasonable and equitable to the existing shareholders (based upon the proviso that I did determine that the existing shareholders did have a valid present material equity of value), then I see no reason not to dismiss the motion of the EH concerning its request for an adjournment and its request for a further sale (or other related disposition) process. Allow me to observe that no matter how well intentioned the motion of the EH in that regard, I find that that request to be lacking in any valid substance. Rather, the evidence presented was in essence a chimera. I think it fair to observe that, with all the capital raising and sales processes to date which Stelco has undertaken in conjunction with its experienced and well placed professional advisers together with its Chief Restructuring Officer and the Monitor, the bushes have been exhaustively and well beaten as to any real possible interest. Despite three months of what one must presume to be diligent efforts, the EH have come up with nothing concrete. I do not find that the three factors mentioned by Taylor in his late-blooming affidavit of January 16th to be remotely close to convincing. The first two, if taken at face value, would lead one to the conclusion that no one has the time, interest or ability to take an interest in Stelco in any meaningful timeframe. The third presumes that the losing bidder for Dofasco, be it Arcelor or ThyssenKrupp, will almost automatically want Stelco - and at a price and upon terms which would result in present equity being attributed value. I must say in fairness that this is wishful thinking as neither of these warring bidders pursued any interest in Stelco during the previous processes. It is neither clear nor obvious why mere municipal proximity of Dofasco to Stelco's Hilton Works in Hamilton would now ignite any interest in Stelco.

21 I also think it fair to observe that not proceeding with the sanction hearing now and indeed starting a brand new search for someone who will think Stelco so worthwhile that it will offer such a large amount (with or without onerous conditions) is akin to someone coming into court when a receiver is seeking court approval on a sale - and that someone being allowed to know the price and conditions - and then being able to make an offer for a price somewhat higher. (I reiterate that here we do not even have an offer or a price.) I do not see that such a procedure would be consistent with the principles laid out in Royal Bank v. Soundair Corp. *(1991), 7 C.B.R. (3d) 1* (Ont. C.A.). Given that the affected creditors have rather resoundingly voted in favour of the Plan, all in accordance with the provisions of the CCAA and the Court orders affecting the sanction, I would be of the view that if the existing equity has no value, then the EH's request in this respect would, if granted, be of significant detriment to the integrity of the insolvency system and regime. I would find that inappropriate to attempt to justify proceeding along that line.

22 Allow me to return to the pivotal point concerning the question of whether the Plan is fair, reasonable and equitable, vis-à-vis the existing equity. The EH retained Navigant Consulting which relied upon the views of Metal Bulletin Research ("MBR") which, inter alia, predicted a selling spot price of hot roll steel at $525 U.S. per ton. Navigant's conclusion in its December 8, 2005 report was that the value of residual shareholder equity was between $1.1 to $1.3 billion or a per share value of between $10.76 and $12.71. However, when Stelco pointed out certain deficiencies in this analysis, Navigant took some of these into account and reduced its assessment of value to between $745 million to $945 million for residual shareholder value on per share value of $7.29 to $9.24, using a discounted cash flow ("DCF") approach. Navigant tested the DCF approach against the EBITDA approach. It is interesting to note that on the EBITDA analysis approach Navigant only comes up to a conclusion that the equity is valued at $8 million to $83 million or $0.09 to $0.81 per share. If the Court were to accept that as an accurate valuation, or something at least of positive value even if not in that neighbourhood, then I would have to take into account existing shareholder interests in determining whether the Plan was fair, reasonable and equitable - and not only vis-à-vis the affected creditors but also vis-à-vis the interests of the existing shareholders given that at least some of their equity would be above water. I understand the pain and disappointment of the existing shareholders, particularly those who have worked hard and long with perhaps their life savings tied up in S shares, but regretfully for them I am not able to come to a conclusion that the existing equity has a true positive value.

23 The fight in the Stelco CCAA proceedings has been long and hard. No holds have been barred as major affected creditors have scrapped to maximize their recovery. There were direct protracted negotiations between a number of major affected creditors and the new equity sponsors under the Plan, all of whom had access to the confidential information of Stelco pursuant to Non Disclosure Agreements. These negotiations established a value of $5.50 per share for the new common shares of a restructured Stelco. That translates into an enterprise value (not an equity value since debt/liabilities must be taken into consideration) of $816.6 million for Stelco, or a recovery of approximately 65% for affected creditors. The parties engaged in these negotiations are sophisticated experienced enterprises. There would be no particular reason to believe that in the competition involved here that realistic values were ignored. Further, the affected creditors generally were rather resoundingly of the view by their vote that an anticipated 65% recovery was as good as they could reasonably expect.

24 The 45th Report of the Monitor had a chart of calculations to determine the level of recovery of affected creditors at various assumed enterprise values up to and including the top end of Navigant's range of enterprise value (as contrasted with residual equity value). At the high end of Navigant's range of revised enterprise value, $1.6 billion, the Monitor calculated that affected creditors would still not receive full recovery of their claims.

25 The EH cited the sale of the EDS Canada claim to Tricap as being at a premium as evidence in support of Navigant's conclusion. However, the fact was that this claim was purchased not at a premium, but rather at a discount. That would be confirmation of the opposite of which the EH has been contending.

26 Despite a very comprehensive capital raising and asset sale process, with the market alerted and well canvassed, and with the ability to conduct due diligence, no interested party came forwarded to conclude a deal. Even since the December 9, 2005 vote when the terms of the Plan were available, no interested party has come forward with any expression of interest which would attribute value to the existing shareholders.

27 Stelco's experts, UBS and BMO Nesbitt Burns, both have given opinions that there is no value to the existing equity. Their expert opinions were not challenged by cross-examination. Both these advisors are large sophisticated institutions; both have extensive experience in the steel industry.

28 UBS calculated the enterprise value of Stelco as being in the range of $550 million to $750 million; BMO Nesbitt Burns at $650 million to $850 million. On that basis the unsecured creditors would receive less than full recovery of their claims, which would lead to the conclusion that there is no value for the existing shareholders. The Monitor commissioned an independent estimate of the enterprise value from its affiliate, Ernst & Young Orenda Corporate Finance Inc.'s Valuation Group. That opinion came in at $635 million to $785 million.

29 I would note that Farley Cohen, the principal author of the Navigant report, does not have experience in dealing with integrated steel companies. I find it unusual that he would have customized his approach in calculating equity value by not deducting the Asset Based Lenders loan. Brad Fraser of BMO Nesbitt Burns stated that such customization was contrary to the practice at his firms both present and past and that the Navigant's approach was internally inconsistent with respect thereto as to 2005 to 2009 cash flows as contrasted with terminal value. The Navigant report appears to have forecasted a high selling price for steel combined with low costs for imports such as coal and scrap, which would be contrary to historical complementary movements between steel prices and these inputs.

30 Navigant relies on an average price of $525 US per ton as provided by MBR. This is a single source as to this forecast. While a single analyst may come up with a forecast which is shown by the passage of time to be dead on accurate, it would seem to me to be more realistic and prudent to rely on the consensus approach of considering the views of a greater number of "representative" analysts, especially when prices appear volatile for the foreseeable future. That consensus approach allows for consideration of the way that each analyst looks at the market and the factors and weights to be given. The UBS opinion reviewed the pricing forecast of eight analysts and BMO Nesbitt Burns' ten analysts. Interestingly, MBR's choice of a price at the top of the band would seem at odds as the statements on the MBR website foreseeing downward pressure on steel prices in 2006 because of falling prices in China; although this inconsistency was pointed out, there was no response forthcoming.

31 Navigant estimated Stelco's financial performance for the last quarter of 2005 and made a significant upward adjustment. However, the actual experience would appear to indicate that such an adjustment would overstate Stelco's results by $124 million.

32 Navigant's DCF approach involved a calculation of Stelco's enterprise value by adding the present value of a stream of cash flow from the present to 2009 and the present value of the terminal value determined as at 2009 so that the terminal value represents the majority (60% approximately) of enterprise value as calculated by Navigant. MBR chose a 53-year average steel price despite significant changes over that time in the industry. However, coal and scrap costs were determined as at 2009. This produced the anomalous result that steel prices are rising while costs are falling. This would imply great structural difficulties (economically and functionally) in the steel industry generally and a lack of competition. A terminal value EBITDA margin for Stelco would then be implied at approximately 26% or some 11% higher than the EBITDA margin actually achieved by Stelco in the first quarter of 2005, the most profitable quarter in the history of Stelco.

33 Interestingly, since Navigant's approach in fact would decrease calculated value, UBS and BMO Nesbitt Burns used a weighted average cost of capital ("WACC") for Stelco in the range of 10% to 14%; Navigant used 24%. A higher WACC will result, all other things being equal, in a lower enterprise value. Navigant considered that there should be a 10% to 15% company-specific premium because of the risks associated with Stelco vis-à-vis the higher steel prices forecast by MBR. This would appear to imply that there was recognition that either MBR was aggressive in its forecasting or that price volatility would caution one to use consensus forecasting. Colin Osborne, a senior executive of Stelco, with considerable experience in the steel industry provided direct evidence on the substantial differences between each of Stelco, AK Steel, U.S. Steel and Algoma. Mr. Cohen acknowledged in cross-examination that these differences made Dofasco a more valuable company than Stelco. As set out at para. 74 of the Stelco Factum:

> 74. The specific difference identified by Mr. Osborne which made Dofasco unique include but are not limited to:
>
> (a) non-union, flexible work environment (vs. Stelco, Algoma, AK Steel and U.S. Steel);
>
> (b) legacy costs which are very low due to non-conventional profit sharing, which limits liability (vs. Stelco, AK Steel, Algoma and U.S. Steel);
>
> (c) high historical cap-ex spend per ton (vs. Stelco, Algoma and U.S. Steel);
>
> (d) a flexible steelmaking stream in terms of a hybrid EAF and blast furnace BOF stream in Hamilton and a mini-mill operation in the U.S. (vs. Stelco, Algoma, U.S. Steel and AK Steel which are all blast furnace based steel makers);
>
> (e) a value added product mix focused on coated products and tubing (vs. Stelco and Algoma which focus on hot roll); and
>
> (f) a strong raw material position with excess iron ore and self-sufficiency in coke (Algoma, Stelco and AK Steel all have dependence to various degrees on either iron ore or coke or both).

Dofasco and Stelco are not in my view fungible. There are incredible differences between these two enterprises, to the disadvantage of Stelco.

34 The reply affidavit of Mr. Fraser of BMO Nesbitt Burns calculated the effect of all of the acknowledged corrections to the initial Navigant report and other adjustments. The result of this exercise was a conclusion by him that there was no value available for existing shareholders. This, along with all the other affidavits provided on the Stelco side, was not cross-examined on.

35 While not referred to in the Factum of EH, there were a number of quite serious allegations raised in material filed by the EH against management of Stelco concerning bias and manipulation. Mr. Osborne responded to each of these allegations; he was not cross-examined. I find it unfortunate that such allegations appear to have been made on an unsubstantiated shotgun approach.

36 The position of the EH is that certain of the features of the Plan should be assumed as transportable directly and without change into a scenario where some insolvency rescuer emerges on the scene as the equivalent of a

White Knight, one it would seem which has been awakened from slumber. I am of the view that presumes too much. For example, I take it that the Province would not automatically accept this potential newcomer without question; nor would it likely relish the resumption of weeks of hard bargaining. I would think it unwise, impudent and high stakes poker (with other peoples' money) to speculate as did Taylor in para. 41 of his December 23, 2005 affidavit:

> 41. Were Stelco to emerge from CCAA protection and were the province to carry out its threat to revoke Stelco's entitlement to the benefit of section 5.1 the end result would likely be a liquidation of the company. The Province would be responsible for a substantial portion of Stelco's pension promise. It would clearly not be in the Province's self-interest to force Stelco into liquidation. It was, in other words, an obvious bluff. Yet the notion of calling this bluff does not appear to have crossed management's mind.

This should be contrasted with the views of the Monitor in its 44th Report at para. 61:

> 61. It should also be noted that the Pension Plan Funding Arrangements and the $150 million New Province Note embodied in the Approved Plan were agreed to by the Province only in the context of the terms of the Approved Plan and, in particular, the capital structure, liquidity and other elements contemplated therein. The Province has advised that its proposed financing and the Pension Plan Funding Arrangements should not be assumed to be available if any of the elements of the Approved Plan are changed.

37 The end result is that given the above analysis, I have no hesitation in concluding that it would be preferable to rely upon the analysis of UBS, BMO Nesbitt Burns and Ernst & Young Orenda, both as to their direct views as to the enterprise value of existing Stelco and as to their criticism of the Navigant and MBR reports concerning Stelco. Therefore, I conclude that the existing shareholders cannot lay claim to there being any existing equity value. Given that conclusion, it would be inappropriate to justify cutting in these existing shareholders for any piece of the emergent restructured Stelco. If that were to happen, especially given the relative values and the depth of submersion of existing equity, then it would be unfair, unreasonable and inequitable for the affected creditors.

38 That then leaves the remaining question: Does it appear likely that the Plan will be implementable? I have been advised on Wednesday, January 18th that I would receive executed term sheets (which would address the issues raised by the Monitor discussed above) by 5 p.m., Friday, January 20th.

39 The motion and adjournment request of the EH is dismissed.

40 There was a request to extend the stay to March 31, 2006. I am of the view that it would be sufficient and desirable to extend the stay (subject, of course, to further extension) to March 3, 2006.

41 I have received the term sheets together with the Monitor's 48th Report by the 5 p.m. January 20th deadline and find them satisfactory as demonstrating to my analysis and satisfaction that the Plan is implementable as discussed above, subject to a comeback provision if anyone wishes to dispute the implementability issue (the onus remaining on Stelco). My decision today re: implementability should in no way be taken as deciding any corporate reorganization issue or anything of that or related nature. I therefore sanction and approve the Plan.

J.M. FARLEY J.

TAB H

1990 CarswellOnt 139
Ontario Court of Appeal

Nova Metal Products Inc. v. Comiskey (Trustee of)

1990 CarswellOnt 139, 1 C.B.R. (3d) 101, 1 O.R. (3d) 289, 23 A.C.W.S. (3d) 1192, 41 O.A.C. 282

ELAN CORPORATION et al. v. COMISKEY (TRUSTEE OF) et al.

Finlayson, Krever and Doherty JJ.A.

Heard: October 30 and 31, 1990
Judgment: November 2, 1990
Docket: Doc. Nos. CA 684/90 and CA 685/90

Counsel: *F.J.C. Newbould*, Q.C., and *G.B. Morawetz*, for appellant The Bank of Nova Scotia.
John Little, for respondents Elan Corporation and Nova Metal Products Inc.
Michael B. Rotsztain, for RoyNat Inc.
Kim Twohig and *Mel Olanow*, for Ontario Development Corp.
K.P. McElcheran, for monitor Ernst & Young.

Subject: Corporate and Commercial; Insolvency

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act

Corporations — Arrangements and compromises — Court having discretion when ordering creditors' meeting under s. 5 of Companies' Creditors Arrangement Act to consider equities between debtor company and secured creditors and to consider possible success of plan of arrangement — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.

Corporations — Arrangements and compromises — Opposing commercial and legal interests requiring secured creditors to be in separate classes — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Corporations — Arrangements and compromises — Where receiver-manager having been appointed, corporation not entitled to issue debentures and trust deeds or to bring application for relief under Companies' Creditors Arrangement Act — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 3.

The applicants were two related companies. The bank was the lender to the companies and was owed over $2,300,000. R Inc. was also a secured creditor of the companies, and was owed approximately $12 million. By agreement, the bank had a first registered charge on the companies' accounts receivable and inventory and a second registered charge on land, buildings and equipment, while R Inc. had a second registered charge on the accounts receivable and inventory and a first registered charge on the land, buildings and equipment. The security agreements with the bank prohibited the companies from encumbering their assets without the bank's consent. The bank also had s. 178 *Bank Act* security. The Ontario Development Corporation ("ODC") guaranteed part of the companies' debt to R. Inc. and held as security a debenture from one of the companies ranking third to the bank and R Inc. Two municipalities had first priority liens on the companies' lands for unpaid municipal taxes.

The bank demanded payment of its outstanding loans and on August 27, 1990, appointed a receiver-manager pursuant to the security agreements. When the companies refused to allow the receiver-manager access to the premises, the Court made an interim order authorizing the receiver-manager access to monitor the companies' business, and permitting the companies to remain in possession and carry on business in the ordinary course. The bank was restrained from selling the assets and from notifying account debtors to collect receivables, but could apply accounts receivable that were collected by the companies to the bank loans. On August 29, 1990, the companies each issued debentures to a friend and to the wife of the companies' principal, pursuant to trust deeds. The debentures conveyed personal property to a trustee as security. No consent was obtained from either the bank or the receiver-manager. It was conceded that the debentures were issued for the sole purpose of qualifying each company as a "debtor company" within the meaning of s. 3 of the *Companies' Creditors Arrangement Act*, ("CCAA").

The companies applied under s. 5 of the CCAA for an order directing the meeting of secured creditors to vote on a plan of arrangement. The plan of arrangement filed provided that the companies would carry on business for 3 months, the secured creditors would be paid and could take no action on their security for 3 months, and the accounts receivable assigned to the bank could be utilized by the companies for their day-to-day operations. No compromise was proposed. At the hearing of the application, orders were granted which set dates for presenting the plan to the secured creditors and for holding the meeting of the secured creditors. The companies were permitted, for 3 months, to spend the accounts receivable collected in accordance with cash flow projections. Proceedings by the bank, acting on its security or paying down the loan from the accounts receivable were stayed. An order was granted that created two classes of creditors for purposes of voting at the meeting of secured creditors. The classes were: (a) the bank, R Inc., ODC and the municipalities; and (b) the principal's wife and friend, who had acquired the debentures to enable the companies to apply under the CCAA. The bank appealed.

Held:

The appeal was allowed, Doherty J.A. dissenting in part; the application was dismissed.

Per Finlayson J.A. (Krever J.A. concurring): — Since the CCAA was intended to provide a structured environment for the negotiation of compromises between the debtor company and its creditors for the benefit of both, which could have significant benefits for the company, its shareholders and employees, debtor corporations were entitled to a broad and liberal interpretation of the jurisdiction of the Court under the CCAA. However, it did not follow that in exercising its discretion to order a meeting of creditors under s. 5 of the CCAA, a Court should not consider the equities as they related to the debtor company and to its secured creditors. Any discretion exercised by the Judge in this instance was not reflected in his reasons. Therefore, the appellate Court could examine the uncontested chronology of these proceedings and exercise its own discretion.

The significant date was August 27, 1990. The effect of the appointment of the receiver-manager was to disentitle the companies to issue the debentures and bring the application under the CCAA. Neither company had the power to create further indebtedness, and thus to interfere with the ability of the receiver-manager to manage the two companies. The interim order granting the receiver-manager access to the premises restricted its powers, but did not divest the receiver-manager of all its managerial powers. The issue of the debentures to the friend and wife was outside the companies' jurisdiction to carry on business in the ordinary course. Rather, the residual power to take such initiatives to gain relief under the CCAA rested with the receiver-manager. The issuance and registration of the trust deeds required a court order.

The probability of the meeting of secured creditors achieving some measure of success was another relevant consideration. Had there been a proper classification of creditors, the meeting would not have been productive. It was improper to create one class of creditors comprised of all secured creditors except the debenture creditors. There was no true community of interest among the former. The bank should have been classified in its own class. The companies had clearly intended to avoid having the bank designated as a separate class, because the companies knew that no plan of arrangement would succeed without the approval of the bank. The bank and R Inc. had opposing interests. It was in the commercial interest of the bank to collect and retain the accounts receivable while it was in R Inc.'s commercial interest to preserve the cash flow of the businesses and sell the businesses as going concerns. To have placed the bank and R Inc. in the same class would have enabled R Inc. to vote with the ODC to defeat the bank's prior claim.

There was no reason why the bank's legal interest in the receivables should be overriden by R Inc. as the second security holder in the receivables.

For the foregoing reasons, the application under the CCAA should be dismissed.

Per Doherty J.A. (dissenting in part): — The debentures and "instant" trust deeds sufficed to bring the companies within the requirements of s. 3 of the CCAA even if, in issuing those debentures, the companies breached a prior agreement with the bank. Section 3 merely required that at the time of an application by the debtor company, an outstanding debenture or bond be issued under a trust deed. However, where a bond or debenture did not

reflect a transaction which actually occurred and did not create a real debt owed by the company, such bond or debenture would not suffice for the purposes of s. 3. The statute should only be used for the purpose of attempting a legitimate reorganization. Where the application was brought for an improper purpose or the company acted in bad faith, the Court had means available to it, entirely apart from s. 3 of the CCAA, to prevent misuse of the Act. The contravention of the security agreement in creating the debentures without the bank's consent did not affect the status of the debentures for the purposes of s. 3, but could play a role in the Court's determination of what additional orders should be made under the statute.
The interim order regarding the receiver-manager effectively rendered the receiver-manager a monitor with rights of access but no further authority. Therefore, in light of the terms of the interim order, the existence of the receiver-manager installed by the bank did not preclude the application under s. 3 of the CCAA.
The Judge properly exercised his discretion in directing that a meeting of creditors should be held pursuant to s. 5 of the CCAA. Even though the chances of a successful reorganization were not good, the benefits flowing from the s. 5 order exceeded the risk inherent in the order. However, the bank and R Inc., as the two principal creditors, should not have been placed in the same class of secured creditors for the purposes of ss. 5 and 6 of the statute. Their interests were not only different, but opposed. The classification scheme created by the Judge effectively denied the bank any control over any plan of reorganization.

APPEAL from order of Hoolihan J. dated September 11, 1990, allowing application under *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36.

***FINLAYSON J.A. (KREVER J.A.* concurring) (orally):**

1 This is an appeal by the Bank of Nova Scotia (the "bank") from orders made by Mr. Justice Hoolihan [(11 September 1990), Doc. Nos. Toronto RE 1993/90 and RE 1994/90 (Ont. Gen. Div.)] as hereinafter described. The Bank of Nova Scotia was the lender to two related companies, namely, Elan Corporation ("Elan") and Nova Metal Products Inc. ("Nova"), which commenced proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), for the purposes of having a plan of arrangement put to a meeting of secured creditors of those companies.

2 The orders appealed from are:

(i) An order of September 11, 1990, which directed a meeting of the secured creditors of Elan and Nova to consider the plan of arrangement filed, or other suitable plan. The order further provided that for 3 days until September 14, 1990, the bank be prevented from acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova, and that Elan and Nova could spend the accounts receivable assigned to the bank that would be received.

(ii) An order dated September 14, 1990, extending the terms of the order of September 11, 1990, to remain in effect until the plan of arrangement was presented to the Court no later than October 24, 1990. This order continued the stay against the bank and the power of Elan and Nova to spend the accounts receivable assigned to the bank. Further orders dated September 27, 1990, and October 18, 1990, have extended the stay, and the power of Elan and Nova to spend the accounts receivable that have been assigned to the bank. The date of the meetings of creditors has been extended to November 9, 1990. The application to sanction the plan of arrangement must be heard by November 14, 1990.

(iii) An order dated October 18, 1990, directing that there be two classes of secured creditors for the purposes of voting at the meeting of secured creditors. The first class is to be comprised of the bank, RoyNat Inc. ("RoyNat"), the Ontario Development Corporation ("O.D.C."), the city of Chatham and the village of Glencoe. The second class is to be comprised of persons related to Elan and Nova that acquired debentures to enable the companies to apply under the CCAA.

3 There is very little dispute about the facts in this matter, but the chronology of events is important and I am setting it out in some detail.

4 The bank has been the banker to Elan and Nova. At the time of the application in August 1990, it was owed approximately $1,900,000. With interest and costs, including receivers' fees, it is now owed in excess of $2,300,000. It has a first registered charge on the accounts receivable and inventory of Elan and Nova, and a second registered charge on the land, buildings and equipment. It also has security under s. 178 of the *Bank Act*, R.S.C. 1985, c. B-1, as am. R.S.C. 1985 (3rd Supp.), c. 25, s. 26. The terms of credit between the bank and Elan as set out in a commitment agreement provide that Elan and Nova may not encumber their assets without the consent of the bank.

5 RoyNat is also a secured creditor of Elan and Nova, and it is owed approximately $12 million. It holds a second registered charge on the accounts receivable and inventory of Elan and Nova, and a first registered charge on the land, buildings and equipment. The bank and RoyNat entered into a priority agreement to define with certainty the priority which each holds over the assets of Elan and Nova.

6 The O.D.C. guaranteed payment of $500,000 to RoyNat for that amount lent by RoyNat to Elan. The O.D.C. holds debenture security from Elan and secure the guarantee which it gave to RoyNat. That security ranks third to the bank and RoyNat. The O.D.C. has not been called upon by RoyNat to pay under its guarantee. O.D.C. has not lent any money directly to Elan or Nova.

7 Elan owes approximately $77,000 to the City of Chatham for unpaid municipal taxes. Nova owes approximately $18,000 to the Village of Glencoe for unpaid municipal taxes. Both municipalities have a lien on the real property of the respective companies in priority to every claim except the Crown under s. 369 of the *Municipal Act*, R.S.O. 1980, c. 302.

8 On May 8, 1990, the bank demanded payment of all outstanding loans owing by Elan and Nova to be made by June 1, 1990. Extensions of time were granted and negotiations directed to the settlement of the debt took place thereafter. On August 27, 1990, the bank appointed Coopers & Lybrand Limited as receiver and manager of the assets of Elan and Nova, and as agent under the bank's security to realize upon the security. Elan and Nova refused to allow the receiver and manager to have access to their premises, on the basis that insufficient notice had been provided by the bank before demanding payment.

9 Later on August 27, 1990, the bank brought a motion in an action against Elan and Nova (Court File No. 54033/90) for an order granting possession of the premises of Elan and Nova to Coopers & Lybrand. On the evening of August 27, 1990, at approximately 9 p.m., Mr. Justice Saunders made an order adjourning the motion on certain conditions. The order authorized Coopers & Lybrand access to the premises to monitor Elan's business, and permitted Elan to remain in possession and carry on its business in the ordinary course. The bank was restrained in the order, until the motion could be heard, from selling inventory, land, equipment or buildings or from notifying account debtors to collect receivables, but was not restrained from applying accounts receivable that were collected against outstanding bank loans.

10 On Wednesday, August 29, 1990, Elan and Nova each issued a debenture for $10,000 to a friend of the principals of the companies, Joseph Comiskey, through his brother Michael Comiskey as trustee, pursuant to a trust deed executed the same day. The terms were not commercial and it does not appear that repayment was expected. It is conceded by counsel for Elan that the sole purpose of issuing the debentures was to qualify as a "debtor company" within the meaning of s. 3 of the CCAA. Section 3 reads as follows:

3. This Act does not apply in respect of a debtor company unless

(a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and

(b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

11 The debentures conveyed the personal property of Elan and Nova as security to Michael Comiskey as trustee. No consent was obtained from the bank as required by the loan agreements, nor was any consent obtained from the receiver. Cheques for $10,000 each, representing the loans secured in the debentures, were given to Elan and Nova on Wednesday, August 29, 1990, but not deposited until 6 days later on September 4, 1990, after an interim order had been made by Mr. Justice Farley in favour of Elan and Nova staying the bank from taking proceedings.

12 On August 30, 1990 Elan and Nova applied under s. 5 of the CCAA for an order directing a meeting of secured creditors to vote on a plan of arrangement. Section 5 provides:

5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

13 The application was heard by Farley J. on Friday, August 31, 1990, at 8 a.m. Farley J. dismissed the application on the grounds that the CCAA required that there be more than one debenture issued by each company. Later on the same say, August 31, 1990, Elan and Nova each issued two debentures for $500 to the wife of the principal of Elan through her sister as trustee. The debentures provided for payment of interest to commence on August 31, 1992. Cheques for $500 were delivered that day to the companies but not deposited in the bank account until September 4, 1990. These debentures conveyed the personal property in the assets of Elan and Nova to the trustee as security. Once again it is conceded that the debentures were issued for the sole purpose of meeting the requirements of s. 3 of the CCAA. No consent was obtained from the bank as required by the loan terms, nor was any consent obtained from the receiver.

14 On August 31, 1990, following the creation of the trust deeds and the issuance of the debentures, Elan and Nova commenced new applications under the CCAA which were heard late in the day by Farley J. He adjourned the applications to September 10, 1990, on certain terms, including a stay preventing the bank from acting on its security and allowing Elan to spend up to $321,000 from accounts receivable collected by it.

15 The plan of arrangement filed with the application provided that Elan and Nova would carry on business for 3 months, that secured creditors would not be paid and could take no action on their security for 3 months, and that the accounts receivable of Elan and Nova assigned to the bank could be utilized by Elan and Nova for purposes of its day-to-day operations. No compromise of any sort was proposed.

16 On September 11, 1990, Hoolihan J. ordered that a meeting of the secured creditors of Elan and Nova be held no later than October 22, 1990, to consider the plan of arrangement that had been filed, or other suitable plan. He ordered that the plan of arrangement be presented to the secured creditors no later than September 27, 1990. He made further orders effective for 3 days until September 14, 1990, including orders:

(i) that the companies could spend the accounts receivable assigned to the bank that would be collected in accordance with a cash flow forecast filed with the Court providing for $1,387,000 to be spent by September 30, 1990; and

(ii) a stay of proceedings against the bank acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova.

17 On September 14, 1990, Hoolihan J. extended the terms of his order of September 11, 1990, to remain in effect until the plan of arrangement was presented to the Court no later than October 24, 1990 for final approval. This order continued the power of Elan and Nova to spend up to $1,387,000 of the accounts receivable assigned to the bank in accordance with the projected cash flow to September 30, 1990, and to spend a further amount to October 24, 1990, in accordance with a cash flow to be approved by Hoolihan J. prior to October 1, 1990. Further orders dated September 27 and October 18 have extended the power to spend the accounts receivable to November 14, 1990.

18 On September 14, 1990, the bank requested Hoolihan J. to restrict his order so that Elan and Nova could use the accounts receivable assigned to the bank only so long as they continued to operate within the borrowing guidelines contained in the terms of the loan agreements with the bank. These guidelines require a certain ratio to exist between bank loans and the book value of the accounts receivable and inventory assigned to the bank, and are designed in normal circumstances to ensure that there is sufficient value in the security assigned to the bank. Hoolihan J. refused to make the order.

19 On October 18, 1990, Hoolihan J. ordered that the composition of the classes of secured creditors for the purposes of voting at the meeting of secured creditors shall be as follows:

(a) The bank, RoyNat, O.D.C., the City of Chatham and the Village of Glencoe shall comprise one class.

(b) The parties related to the principal of Elan that acquired their debentures to enable the companies to apply under the CCAA shall comprise a second class.

20 On October 18, 1990, at the request of counsel for Elan and Nova, Hoolihan J. further ordered that the date for the meeting of creditors of Elan and Nova be extended to November 9, 1990, in order to allow a new plan of arrangement to be sent to all creditors, including unsecured creditors of those companies. Elan and Nova now plan to offer a plan of compromise or arrangement to the unsecured creditors of Elan and Nova as well as to the secured creditors.

21 There are five issues in this appeal.

(1) Are the debentures issued by Elan and Nova for the purpose of permitting the companies to qualify as applicants under the CCAA debentures within the meaning of s. 3 of the CCAA?

(2) Did the issue of the debentures contravene the provisions of the loan agreements between Elan and Nova and the bank? If so, what are the consequences for CCAA purposes?

(3) Did Elan and Nova have the power to issue the debentures and make application under the CCAA after the bank had appointed a receiver and after the order of Saunders J.?

(4) Did Hoolihan J. have the power under s. 11 of the CCAA to make the interim orders that he made with respect to the accounts receivable?

(5) Was Hoolihan J. correct in ordering that the bank vote on the proposed plan of arrangement in a class with RoyNat and the other secured creditors?

22 It is well established that the CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies, Elan

and Nova, are entitled to a broad and liberal interpretation of the jurisdiction of the Court under the CCAA. Having said that, it does not follow that in exercising its discretion to order a meeting of creditors under s. 5 of the CCAA that the Court should not consider the equities in this case as they relate to these companies and to one of its principal secured creditors, the bank.

23 The issues before Hoolihan J. and this Court were argued on a technical basis. Hoolihan J. did not give effect to the argument that the debentures described above were a "sham" and could not be used for the purposes of asserting jurisdiction. Unfortunately, he did not address any of the other arguments presented to him on the threshold issue of the availability of the CCAA. He appears to have acted on the premise that if the CCAA can be made available, it should be utilized.

24 If Hoolihan J. did exercise any discretion overall, it is not reflected in his reasons. I believe, therefore, that we are in a position to look at the uncontested chronology of these proceedings and exercise our own discretion. To me, the significant date is August 27, 1990 when the bank appointed Coopers & Lybrand Limited as receiver and manager of the undertaking, property and assets mortgaged and charged under the demand debenture and of the collateral under the general security agreement, both dated June 20, 1979. On the same date, it appointed the same company as receiver and manager for Nova under a general security agreement dated December 5, 1988. The effect of this appointment is to divest the companies and their boards of directors of their power to deal with the property comprised in the appointment: Raymond Walton, *Kerr on the Law and Practice as to Receivers*, 16th ed. (London: Sweet & Maxwell, 1983), p. 292. Neither Elan nor Nova had the power to create further indebtedness, and thus to interfere with the ability of the receiver to manage the two companies: *Alberta Treasury Branches v. Hat Development Ltd.* (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd (1989), 65 Alta. L.R. (2d) 374 (C.A.).

25 Counsel for the debtor companies submitted that the management powers of the receiver were stripped from the receiver by Saunders J. in his interim order, when he allowed the receiver access to the companies' properties but would not permit it to realize on the security of the bank until further order. He pointed out that the order also provided that the companies were entitled to remain in possession and "to carry on business in the ordinary course" until further order.

26 I do not agree with counsel's submission covering the effect of the order. It certainly restricted what the receiver could do on an interim basis, but it imposed restrictions on the companies as well. The issue of these disputed debentures in support of an application for relief as insolvent companies under the CCAA does not comply with the order of Saunders J. This is not carrying on business in the ordinary course. The residual power to take all of these initiatives for relief under the CCAA remained with the receiver, and if trust deeds were to be issued, an order of the Court in Action 54033/90 was required permitting their issuance and registration.

27 There is another feature which, in my opinion, affects the exercise of discretion, and that is the probability of the meeting achieving some measure of success. Hoolihan J. considered the calling of the meeting at one hearing, as he was asked to do, and determined the respective classes of creditors at another. This latter classification is necessary because of the provisions of s. 6(a) of the CCAA, which reads as follows:

> 6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company.

28 If both matters had been considered at the same time, as in my view they should have been, and if what I regard as a proper classification of the creditors had taken place, I think it is obvious that the meeting would not be a productive one. It was improper, in my opinion, to create one class of creditors made up of all the secured creditors save the so-called "sham" creditors. There is no true community of interest among them, and the motivation of Elan and Nova in striving to create a single class is clearly designed to avoid the classification of the bank as a separate class.

29 It is apparent that the only secured creditors with a significant interest in the proceeding under the CCAA are the bank and RoyNat. The two municipalities have total claims for arrears of taxes of less than $100,000. They have first priority in the lands of the companies. They are in no jeopardy whatsoever. The O.D.C. has a potential liability in that it can be called upon by RoyNat under its guarantee to a maximum of $500,000, and this will trigger default under its debentures with the companies, but its interests lie with RoyNat.

30 As to RoyNat, it is the largest creditor with a debt of some $12 million. It will dominate any class it is in because, under s. 6 of the CCAA, the majority in a class must represent three-quarters in value of that class. It will always have a veto by reason of the size of its claim, but requires at least one creditor to vote for it to give it a majority in number (I am ignoring the municipalities). It needs the O.D.C.

31 I do not base my opinion solely on commercial self-interest, but also on the differences in legal interest. The bank has first priority on the receivables referred to as the "quick assets", and RoyNat ranks second in priority. RoyNat has first priority on the buildings and realty, the "fixed assets", and the bank has second priority.

32 It is in the commercial interests of the bank, with its smaller claim and more readily realizable assets, to collect and retain the accounts receivable. It is in the commercial interests of RoyNat to preserve the cash flow of the business and sell the enterprise as a going concern. It can only do that by overriding the prior claim of the bank to these receivables. If it can vote with the O.D.C. in the same class as the bank, it can achieve that goal and extinguish the prior claim of the bank to realize on the receivables. This it can do, despite having acknowledged its legal relationship to the bank in the priority agreement signed by the two. I can think of no reason why the legal interest of the bank as the holder of the first security on the receivables should be overridden by RoyNat as holder of the second security.

33 The classic statement on classes of creditors is that of Lord Esher M.R. in *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573, [1891-4] All E.R. 246 (C.A.), at pp. 579-580 [Q.B.]:

> The Act [*Joint Stock Companies Arrangement Act, 1870*] says that the persons to be summoned to the meeting (all of whom, be it said in passing, are creditors) are persons who can be divided into different classes — classes which the Act of Parliament recognises, though it does not define them. This, therefore, must be done: they must be divided into different classes. What is the reason for such a course? It is because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.

34 The *Sovereign Life* case was quoted with approval by Kingstone J. in *Re Wellington Building Corp.*, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626, [1934] O.W.N. 562 (S.C.), at p. 659 [O.R.]. He also quoted another English authority at p. 658:

> In *In re Alabama, New Orleans, Texas and Pacific Junction Ry. Co.*, [1891] 1 Ch. 213, a scheme and arrangement under the Joint Stock Companies Arrangement Act (1870), was submitted to the Court for approval. Lord Justice Bowen, at p. 243, says:

> Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation ... Its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.

35 Kingstone J. set aside a meeting where three classes of creditors were permitted to vote together. He said at p. 660:

> It is clear that Parliament intended to give the three-fourths majority of any class power to bind that class, but I do not think the Statute should be construed so as to permit holders of subsequent mortgages power to vote and thereby destroy the priority rights and security of a first mortgagee.

36 We have been referred to more modern cases, including two decisions of Trainor J. of the British Columbia Supreme Court, both entitled *Re Northland Properties Ltd.* One case is reported in (1988), 73 C.B.R. (N.S.) 166, 31 B.C.L.R. (2d) 35, and the other in the same volume at p. 175 [C.B.R.]. Trainor J. was upheld on appeal on both judgments. The first judgment of the British Columbia Court of Appeal is unreported (16 September, 1988) [Doc. No. Vancouver CA009772, Taggart, Lambert and Locke JJ.A.]. The judgment in the second appeal is reported at 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122.

37 In the first *Northland* case, Trainor J. held that the difference in the terms of parties to and priority of different bonds meant that they should be placed in separate classes. He relied upon *Re Wellington Building Corp.*, supra. In the second *Northland* case, he dealt with 15 mortgagees who were equal in priority but held different parcels of land as security. Trainor J. held that their relative security positions were the same, notwithstanding that the mortgages were for the most part secured by charges against separate properties. The nature of the debt was the same, the nature of the security was the same, the remedies for default were the same, and in all cases they were corporate loans by sophisticated lenders. In specifically accepting the reasoning of Trainor J., the Court of Appeal held that the concern of the various mortgagees as to the quality of their individual securities was "a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both" (p. 203).

38 In *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.), the Court stressed that a class should be made up of persons "'whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest'" (p. 8 [of C.B.R.]).

39 My assessment of these secured creditors is that the bank should be in its own class. This being so, it is obvious that no plan of arrangement can succeed without its approval. There is no useful purpose to be served in putting a plan of arrangement to a meeting of creditors if it is known in advance that it cannot succeed. This is another cogent reason for the Court declining to exercise its discretion in favour of the debtor companies.

40 For all the reasons given above, the application under the CCAA should have been dismissed. I do not think that I have to give definitive answers to the individual issues numbered (1) and (2). They can be addressed in a later case, where the answers could be dispositive of an application under the CCAA. The answer to (3) is that the combined effect of the receivership and the order of Saunders J. disentitled the companies to issue the debentures and bring the application under the CCAA. It is not necessary to answer issue (4), and the answer to (5) is no.

41 Accordingly, I would allow the appeal, set aside the three orders of Hoolihan J., and, in their place, issue an order dismissing the application under the CCAA. The bank should receive its costs of this appeal, the applications for leave to appeal, and the proceedings before Farley and Hoolihan JJ., to be paid by Elan, Nova and RoyNat.

42 Ernst & Young were appointed monitor in the order of Hoolihan J. dated September 14, 1990, to monitor the operations of Elan and Nova and give effect to and supervise the terms and conditions of the stay of proceedings in accordance with Appendix "C" appended to the order. The monitor should be entitled to be paid for all services performed to date, including whatever is necessary to complete its reports for past work, as called for in Appendix "C".

***DOHERTY J.A.* (dissenting in part):**

I Background

43 On November 2, 1990, this Court allowed the appeal brought by the Bank of Nova Scotia (the "bank") and vacated several orders made by Hoolihan J. Finlayson J.A. delivered oral reasons on behalf of the majority. At the same time, I delivered brief oral reasons dissenting in part from the conclusion reached by the majority and undertook to provide further written reasons. These are those reasons.

44 The events relevant to the disposition of this appeal are set out in some detail in the oral reasons of Finlayson J.A. I will not repeat that chronology, but will refer to certain additional background facts before turning to the legal issues.

45 Elan Corporation ("Elan") owns the shares of Nova Metal Products Inc. ("Nova Inc."). Both companies have been actively involved in the manufacture of automobile parts for a number of years. As of March 1990, the companies had total annual sales of about $30 million, and employed some 220 people in plants located in Chatham and Glencoe, Ontario. The operation of these companies no doubt plays a significant role in the economy of these two small communities.

46 In the 4 years prior to 1989, the companies had operated at a profit ranging from $287,000 (1987) to $1,500,000 (1986). In 1989, several factors, including large capital expenditures and a downturn in the market, combined to produce an operational loss of about $1,333,000. It is anticipated that the loss for the year ending June 30, 1990, will be about $2.3 million. As of August 1, 1990, the companies continued in full operation, and those in control anticipated that the financial picture would improve significantly later in 1990, when the companies would be busy filling several contracts which had been obtained earlier in 1990.

47 The bank has provided credit to the companies for several years. In January 1989, the bank extended an operating line of credit to the companies. The line of credit was by way of a demand loan that was secured in the manner described by Finlayson J.A. Beginning in May 1989, and from time to time after that, the companies were in default under the terms of the loan advanced by the bank. On each occasion, the bank and the companies managed to work out some agreement so that the bank continued as lender and the companies continued to operate their plants.

48 Late in 1989, the companies arranged for a $500,000 operating loan from RoyNat Inc. It was hoped that this loan, combined with the operating line of $2.5 million from the bank, would permit the company to weather its fiscal storm. In March 1990, the bank took the position that the companies were in breach of certain requirements under their loan agreements, and warned that if the difficulties were not rectified the bank would not continue as the company's lender. Mr. Patrick Johnson, the president of both companies, attempted to respond to these concerns in a detailed letter to the bank dated March 15, 1990. The response did not placate the bank. In May 1990, the bank called its loan and made a demand for immediate payment. Mr. Spencer, for the bank, wrote: "We consider your financial condition continues to be critical and we are not prepared to delay further making formal demand." He went on to indicate that, subject to further deterioration in the companies' fiscal position, the bank was prepared to delay acting on its security until June 1, 1990.

49 As of May 1990, Mr. Johnson, to the bank's knowledge, was actively seeking alternative funding to replace the bank. At the same time, he was trying to convince the union which represented the workers employed at both plants to assist in a co-operative effort to keep the plants operational during the hard times. The union had agreed to discuss amendment of the collective bargaining agreement to facilitate the continued operation of the companies.

50 The June 1, 1990 deadline set by the bank passed without incident. Mr. Johnson continued to search for new financing. A potential lender was introduced to Mr. Spencer of the bank on August 13, 1990, and it appeared that the bank, through Mr. Spencer, was favourably impressed with this potential lender. However, on August 27, 1990, the bank decided to take action to protect its position. Coopers & Lybrand was appointed by the bank as receiver-manager under the terms of the security agreements with the companies. The companies denied the receiver access to their plants. The bank then moved before the Honourable Mr. Justice E. Saunders for an order giving the receiver possession of the premises occupied by the companies. On August 27, 1990, after hearing argument from counsel for the bank and the companies, Mr. Justice Saunders refused to install the receivers and made the following interim order:

> 1. THIS COURT ORDERS that the receiver be allowed access to the property to monitor the operations of the defendants but shall not take steps to realize on the security of The Bank of Nova Scotia until further Order of the Court.
>
> 2. THIS COURT ORDERS that the defendants shall be entitled to remain in possession and to carry on business in the ordinary course until further Order of this Court.
>
> 3. THIS COURT ORDERS that until further order the Bank of Nova Scotia shall not take steps to notify account debtors of the defendants for the purpose of collecting outstanding accounts receivable. This Order does not restrict The Bank of Nova Scotia from dealing with accounts receivable of the defendants received by it.
>
> 4. THIS COURT ORDERS that the motion is otherwise adjourned to a date to be fixed.

51 The notice of motion placed before Saunders J. by the bank referred to "an intended action" by the bank. It does not appear that the bank took any further steps in connection with this "intended action."

52 Having resisted the bank's efforts to assume control of the affairs of the companies on August 27, 1990, and realizing that their operations could cease within a matter of days, the companies turned to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "Act"), in an effort to hold the bank at bay while attempting to reorganize their finances. Finlayson J.A. has described the companies' efforts to qualify under that Act, the two appearances before the Honourable Mr. Justice Farley on August 31, 1990, and the appearances before the Honourable Mr. Justice Hoolihan in September and October 1990, which resulted in the orders challenged on this appeal.

II The Issues

53 The dispute between the bank and the companies when this application came before Hoolihan J. was a straightforward one. The bank had determined that its best interests would be served by the immediate execution of the rights it had under its various agreements with the companies. The bank's best interest was not met by the continued operation of the companies as going concerns. The companies and their other two substantial secured creditors considered that their interests required that the companies continue to operate, at least for a period which would enable the companies to place a plan of reorganization before its creditors.

54 All parties were pursuing what they perceived to be their commercial interests. To the bank, these interests entailed the "death" of the companies as operating entities. To the companies, these interests required "life support"

for the companies through the provisions of the Act to permit a "last ditch" effort to save the companies and keep them in operation.

55 The issues raised on this appeal can be summarized as follows:

(i) Did Hoolihan J. err in holding that the companies were entitled to invoke the Act?

(ii) Did Hoolihan J. err in exercising his discretion in directing that a meeting of creditors should be held under the Act?

(iii) Did Hoolihan J. err in directing that the bank and RoyNat Inc. should be placed in the same class of creditors for the purposes of the Act?

(iv) Did Hoolihan J. err in the terms of the interim orders he made pending the meeting of creditors and the submission to the court of a plan of reorganization?

III The Purpose and Scheme of the Act

56 Before turning to these issues, it is necessary to understand the purpose of the Act, and the scheme established by the Act for achieving that purpose. The Act first appeared in the midst of the Great Depression (S.C. 1932-33, c. 36). The Act was intended to provide a means whereby insolvent companies could avoid bankruptcy and continue as ongoing concerns through a reorganization of their financial obligations. The reorganization contemplated required the cooperation of the debtor companies' creditors and shareholders: *Re Avery Construction Co.*, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont. S.C.); Stanley E. Edwards, "Reorganizations under the Companies' Creditors Arrangement Act" (1947) 25 Can. Bar Rev. 587, at pp. 592-593; David H. Goldman, "Reorganizations Under the Companies' Creditors Arrangement Act (Canada)" (1985) 55 C.B.R. (N.S.) 36, at pp. 37-39.

57 The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy- or creditor-initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

58 The purpose of the Act was artfully put by Gibbs J.A., speaking for the British Columbia Court of Appeal, in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, an unreported judgment released October 29, 1990 [Doc. No. Vancouver CA12944, Carrothers, Cumming and Gibbs JJ.A., now reported [1991] 2 W.W.R. 136, 51 B.C.L.R. (2d) 84], at pp. 11 and 6 [unreported, pp. 91 and 88 B.C.L.R.]. In referring to the purpose for which the Act was initially proclaimed, he said:

> Almost inevitably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A. ['the Act'], to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

59 In an earlier passage, His Lordship had said:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business.

60 Gibbs J.A. also observed (at p. 13) that the Act was designed to serve a "broad constituency of investors, creditors and employees." Because of that "broad constituency", the Court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest. That interest is generally, but not always, served by permitting

an attempt at reorganization: see S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," at p. 593.

61 The Act must be given a wide and liberal construction so as to enable it to effectively serve this remedial purpose: *Interpretation Act*, R.S.C. 1985, c. I-21, s. 12; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, supra, at p. 14 [unreported, p. 92 B.C.L.R.].

62 The Act is available to all insolvent companies, provided the requirements of s. 3 of the Act are met. That section provides:

> 3. This Act does not apply in respect of a debtor company unless
>
> (a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and
>
> (b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

63 A debtor company, or a creditor of that company, invokes the Act by way of summary application to the Court under s. 4 or s. 5 of the Act. For present purposes, s. 5 is the relevant section:

> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

64 Section 5 does not require that the Court direct a meeting of creditors to consider a proposed plan. The Court's power to do so is discretionary. There will no doubt be cases where no order will be made, even though the debtor company qualifies under s. 3 of the Act.

65 If the Court determines that a meeting should be called, the creditors must be placed into classes for the purpose of that meeting. The significance of this classification process is made apparent by s. 6 of the Act:

> 6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and
>
> (b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy Act* or is in the course of being wound up under the *Winding-up Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

66 If the plan of reorganization is approved by the creditors as required by s. 6, it must then be presented to the Court. Once again, the Court must exercise a discretion, and determine whether it will ap prove the plan of reorganization. In exercising that discretion, the Court is concerned not only with whether the appropriate majority has approved the plan at a meeting held in accordance with the Act and the order of the Court, but also with whether

the plan is a fair and reasonable one: *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 at 182-185 (S.C.), aff'd 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.).

67 If the Court chooses to exercise its discretion in favour of calling a meeting of creditors for the purpose of considering a plan of reorganization, the Act provides that the rights and remedies available to creditors, the debtor company, and others during the period between the making of the initial order and the consideration of the proposed plan may be suspended or otherwise controlled by the Court.

68 Section 11 gives a court wide powers to make any interim orders:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act*, whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (a) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (b) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (c) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

69 Viewed in its totality, the Act gives the Court control over the initial decision to put the reorganization plan before the creditors, the classification of creditors for the purpose of considering the plan, conduct affecting the debtor company pending consideration of that plan, and the ultimate acceptability of any plan agreed upon by the creditors. The Act envisions that the rights and remedies of individual creditors, the debtor company and others may be sacrificed, at least temporarily, in an effort to serve the greater good by arriving at some acceptable reorganization which allows the debtor company to continue in operation: *Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce* (1989), 102 A.R. 161 at p. 165 (Q.B.).

IV Did Hoolihan J. Err in Holding that the Debtor Companies were Entitled to Invoke the Act?

70 The appellant advances three arguments in support of its contention that Elan and Nova Inc. were not entitled to seek relief under the Act. It argues first that the debentures issued by the companies after August 27, 1990, were "shams" and did not fulfil the requirements of s. 3 of the Act. The appellant next contends that the issuing of the debentures by the companies contravened their agreements with the bank, in which they undertook not to further encumber the assets of the companies without the consent of the bank. Lastly, the appellant maintains that once the bank had appointed a receiver-manager over the affairs of the companies on August 27, 1990, the companies had no power to create further indebtedness by way of debentures or to bring an application on behalf of the companies under the Act.

(i) Section 3 and "Instant" Trust Deeds

71 The debentures issued in August 1990, after the bank had moved to install a receiver-manager, were issued solely and expressly for the purpose of meeting the requirements of s. 3 of the Act. Indeed, it took the companies two attempts to meet those requirements. The debentures had no commercial purpose. The transactions did, however, involve true loans in the sense that moneys were advanced and debt was created. Appropriate and valid trust deeds were also issued.

72 In my view, it is inappropriate to refer to these transactions as "shams." They are neither false nor counterfeit, but rather are exactly what they appear to be, transactions made to meet jurisdictional requirements of the Act

so as to permit an application for reorganization under the Act. Such transactions are apparently well known to the commercial Bar: B. O'Leary, "A Review of the Companies' Creditors Arrangement Act" (1987) 4 Nat. Insolvency Rev. 38, at p. 39; C. Ham, " 'Instant' Trust Deeds Under the C.C.A.A." (1988) 2 Commercial Insolvency Reporter 25; G.B. Morawetz, "Emerging Trends in the Use of the Companies' Creditors Arrangement Act" (1990) Proceedings, First Annual General Meeting and Conference of the Insolvency Institute of Canada.

73 Mr. Ham writes, at pp. 25 and 30:

> Consequently, some companies have recently sought to bring themselves within the ambit of the C.C.A.A. by creating 'in stant' trust deeds, i.e., trust deeds which are created solely for the purpose of enabling them to take advantage of the C.C.A.A.

74 Applications under the Act involving the use of "instant" trust deeds have been before the Courts on a number of occasions. In no case has any court held that a company cannot gain access to the Act by creating a debt which meets the requirements of s. 3 for the express purpose of qualifying under the Act. In most cases, the use of these "instant" trust deeds has been acknowledged without comment.

75 The decision of Chief Justice Richard in *Re United Maritime Fishermen Co-op.* (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.), varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.), at 55-56 [67 C.B.R.], speaks directly to the use of "instant" trust deeds. The Chief Justice refused to read any words into s. 3 of the Act which would limit the availability of the Act depending on the point at which, or the purpose for which, the debenture or bond and accompanying trust deed were created. He accepted [at p. 56 C.B.R.] the debtor company's argument that the Act:

> does not impose any time restraints on the creation of the conditions as set out in s. 3 of the Act, nor does it contain any prohibition against the creation of the conditions set out in s. 3 for the purpose of obtaining jurisdiction.

76 It should, however, be noted that in *Re United Maritime Fishermen Co-op.*, supra, the debt itself was not created for the purpose of qualifying under the Act. The bond and the trust deed, however, were created for that purpose. The case is therefore factually distinguishable from the case at Bar.

77 The Court of Appeal reversed the ruling of the Chief Justice ((1988), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, 88 N.B.R. (2d) 253, 224 A.P.R. 253) on the basis that the bonds required by s. 3 of the Act had not been issued when the application was made, so that on a precise reading of the words of s. 3 the company did not qualify. The Court did not go on to consider whether, had the bonds been properly issued, the company would have been entitled to invoke the Act. Hoyt J.A., for the majority, did, however, observe without comment that the trust deeds had been created specifically for the purpose of bringing an application under the Act.

78 The judgment of MacKinnon J. in *Re Stephanie's Fashions Ltd.*, unreported, Doc. No. Vancouver A893427, released January 24, 1990 (B.C. S.C.) [now reported 1 C.B.R. (3d) 248], is factually on all fours with the present case. In that case, as in this one, it was acknowledged that the sole purpose for creating the debt was to effect compliance with s. 3 of the Act. After considering the judgment of Chief Justice Richard in *Re United Maritime Fishermen Co-op.*, supra, MacKinnon J. held, at p. 251:

> The reason for creating the trust deed is not for the usual purposes of securing a debt but, when one reads it, on its face, it does that. I find that it is a genuine trust deed and not a fraud, and that the petitioners have complied with s. 3 of the statute.

79 *Re Metals & Alloys Co.* (16 February 1990) is a recent example of a case in this jurisdiction in which "instant" trust deeds were successfully used to bring a company within the Act. The company issued debentures for the purpose of permitting the company to qualify under the Act, so as to provide it with an opportunity to prepare

and submit a reorganization plan. The company then applied for an order, seeking, inter alia, a declaration that the debtor company was a corporation within the meaning of the Act. Houlden J.A., hearing the matter at first instance, granted the declaration request in an order dated February 16, 1990. No reasons were given. It does not appear that the company's qualifications were challenged before Houlden J.A.; however, the nature of the debentures issued and the purpose for their issue was fully disclosed in the material before him. The requirements of s. 3 of the Act are jurisdictional in nature, and the consent of the parties cannot vest a court with jurisdiction it does not have. One must conclude that Houlden J.A. was satisfied that "instant" trust deeds suffice for the purposes of s. 3 of the Act.

80 A similar conclusion is implicit in the reasons of the British Columbia Court of Appeal in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*. In that case, a debt of $50, with an accompanying debenture and trust deed, was created specifically to enable the company to make application under the Act. The Court noted that the debt was created solely for that purpose in an effort to forestall an attempt by the bank to liquidate the assets of the debtor company. The Court went on to deal with the merits, and to dismiss an appeal from an order granting a stay pending a reorganization meeting. The Court could not have reached the merits without first concluding that the $50 debt created by the company met the requirements of s. 3 of the Act.

81 The weight of authority is against the appellant. Counsel for the appellant attempts to counter that authority by reference to the remarks of the Minister of Justice when s. 3 was introduced as an amendment to the Act in the 1952-53 sittings of Parliament (House of Commons Debates, 1-2 Eliz. II (1952-53), vol. II, pp. 1268-1269). The interpretation of words found in a statute, by reference to speeches made in Parliament at the time legislation is introduced, has never found favour in our Courts: *Reference Re Residential Tenancies Act (Ontario)*, [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 138, at 721 [S.C.R.], 561 [D.L.R.]. Nor, with respect to Mr. Newbould's able argument, do I find the words of the Minister of Justice at the time the present s. 3 was introduced to be particularly illuminating. He indicated that the amendment to the Act left companies with complex financial structures free to resort to the Act, but that it excluded companies which had only unsecured mercantile creditors. The Minister does not comment on the intended effect of the amendment on the myriad situations between those two extremes. This case is one such situation. These debtor companies had complex secured debt structures, but those debts were not, prior to the issuing of the debentures in August 1990, in the form contemplated by s. 3 of the Act. Like Richard C.J.Q.B. in *Re United Maritime Fishermen Co-op.*, supra, at pp. 52-53, I am not persuaded that the comments of the Minister of Justice assist in interpreting s. 3 of the Act in this situation.

82 The words of s. 3 are straightforward. They require that the debtor company have, at the time an application is made, an outstanding debenture or bond issued under a trust deed. No more is needed. Attempts to qualify those words are not only contrary to the wide reading the Act deserves, but can raise intractable problems as to what qualifications or modifications should be read into the Act. Where there is a legitimate debt which fits the criteria set out in s. 3, I see no purpose in denying a debtor company resort to the Act because the debt and the accompanying documentation was created for the specific purpose of bringing the application. It must be remembered that qualification under s. 3 entitles the debtor company to nothing more than consideration under the Act. Qualification under s. 3 does not mean that relief under the Act will be granted. The circumstances surrounding the creation of the debt needed to meet the s. 3 requirement may well have a bearing on how a court exercises its discretion at various stages of the application, but they do not alone interdict resort to the Act.

83 In holding that "instant" trust deeds can satisfy the requirements of s. 3 of the Act, I should not be taken as concluding that debentures or bonds which are truly shams, in that they do not reflect a transaction which actually occurred and do not create a real debt owed by the company, will suffice. Clearly, they will not. I do not, however, equate the two. One is a tactical device used to gain the potential advantages of the Act. The other is a fraud.

84 Nor does my conclusion that "instant" trust deeds can bring a debtor company within the Act exclude considerations of the good faith of the debtor company in seeking the protection of the Act. A debtor company should not be allowed to use the Act for any purpose other than to attempt a legitimate reorganization. If the purpose of the application is to advantage one creditor over another, to defeat the legitimate interests of creditors,

to delay the inevitable failure of the debtor company, or for some other improper purpose, the Court has the means available to it, apart entirely from s. 3 of the Act, to prevent misuse of the Act. In cases where the debtor company acts in bad faith, the Court may refuse to order a meeting of creditors, it may deny interim protection, it may vary interim protection initially given when the bad faith is shown, or it may refuse to sanction any plan which emanates from the meeting of the creditors: see Lawrence J. Crozier, "Good Faith and the Companies' Creditors Arrangement Act" (1989) 15 Can. Bus. L.J. 89.

(ii) Section 3 and the Prior Agreement with the Bank Limiting Creation of New Debt

85 The appellant also argues that the debentures did not meet the requirements of s. 3 of the Act because they were issued in contravention of a security agreement made between the companies and the bank. Assuming that the debentures were issued in contravention of that agreement, I do not understand how that contravention affects the status of the debentures for the purposes of s. 3 of the Act. The bank may well have an action against the debtor company for issuing the debentures, and it may have remedies against the holders of the debentures if they attempted to collect on their debt or enforce their security. Neither possibility, however, negates the existence of the debentures and the related trust deeds. Section 3 does not contemplate an inquiry into the effectiveness or enforceability of the s. 3 debentures, as against other creditors, as a condition precedent to qualification under the Act. Such inquiries may play a role in a judge's determination as to what orders, if any, should be made under the Act.

(iii) Section 3 and the Appointment of a Receiver-Manager

86 The third argument made by the bank relies on its installation of a receiver-manager in both companies prior to the issue of the debentures. I agree with Finlayson J.A. that the placement of a receiver, either by operation of the terms of an agreement or by court order, effectively removes those formerly in control of the company from that position, and vests that control in the receiver-manager: *Alberta Treasury Branches v. Hat Development Ltd.* (1988), 71 C.B.R. (N.S.) 264, 64 Alta. L.R. (2d) 17 (Q.B.), aff'd without deciding this point (1989), 65 Alta. L.R. (2d) 374 (C.A.). I cannot, however, agree with his interpretation of the order of Saunders J. I read that order as effectively turning the receiver into a monitor with rights of access, but with no authority beyond that. The operation of the business is specifically returned to the companies. The situation created by the order of Saunders J. can usefully be compared to that which existed when the application was made in *Hat Development Ltd.* Forsyth J., at p. 268 C.B.R., states:

> The receiver-manager in this case and indeed in almost all cases is charged by the court with the responsibility of managing the affairs of a corporation. It is true that it is appointed pursuant, in this case, to the existence of secured indebtedness and at the behest of a secured creditor to realize on its security and retire the indebtedness. Nonetheless, this receiver-manager was court-appointed and not by virtue of an instrument. As a court-appointed receiver it owed the obligation and the duty to the court to account from time to time and to come before the court for the purposes of having some of its decisions ratified or for receiving advice and direction. *It is empowered by the court to manage the affairs of the company and it is completely inconsistent with that function to suggest that some residual power lies in the hands of the directors of the company to create further indebtedness of the company and thus interfere, however slightly, with the receiver-manager's ability to manage*.

[Emphasis added.]

87 After the order of Saunders J., the receiver-manager in this case was not obligated to manage the companies. Indeed, it was forbidden from doing so. The creation of the "instant" trust deeds and the application under the Act did not interfere in any way with any power or authority the receiver-manager had after the order of Saunders J. was made.

88 I also find it somewhat artificial to suggest that the presence of a receiver-manager served to vitiate the orders of Hoolihan J. Unlike many applications under s. 5 of the Act, the proceedings before Hoolihan J. were not ex parte and he was fully aware of the existence of the receiver-manager, the order of Saunders J., and the arguments based on the presence of the receiver-manager. Clearly, Hoolihan J. considered it appropriate to proceed with a plan of reorganization despite the presence of the receiver-manager and the order of Saunders J. Indeed, in his initial order he provided that the order of Saunders J. "remains extant." Hoolihan J. did not, as I do not, see that order as an impediment to the application or the granting of relief under the Act. Had he considered that the receiver-manager was in control of the affairs of the company, he could have varied the order of Saunders J. to permit the applications under the Act to be made by the companies: *Hat Development Ltd.*, at pp. 268-269 C.B.R. It is clear to me that he would have done so had he felt it necessary. If the installation of the receiver-manager is to be viewed as a bar to an application under this Act, and if the orders of Hoolihan J. were otherwise appropriate, I would order that the order of Saunders J. should be varied to permit the creation of the debentures and the trust deeds and the bringing of this application by the companies. I take this power to exist by the combined effect of s. 14(2) of the Act and s. 144(1) of the *Courts of Justice Act*, 1984, S.O. 1984, c. 11.

89 In my opinion, the debentures and "instant" trust deeds created in August 1990 sufficed to bring the company within the requirements of s. 3 of the Act, even if in issuing those debentures the companies breached a prior agreement with the bank. I am also satisfied that, given the terms of the order of Saunders J., the existence of a receiver-manager installed by the bank did not preclude the application under s. 3 of the Act.

V Did Hoolihan J. Err in Exercising his Discretion in Favour of Directing that a Creditors' Meeting be Held to Consider the Proposed Plan of Reorganization?

90 As indicated earlier, the Act provides a number of points at which the Court must exercise its discretion. I am concerned with the initial exercise of discretion contemplated by s. 5 of the Act, by which the Court may order a meeting of creditors for purposes of considering a plan of reorganization. Hoolihan J. exercised that discretion in favour of the debtor companies. The factors relevant to the exercise of that discretion are as variable as the fact situations which may give rise to the application. Finlayson J.A. has concentrated on one such factor, the chance that the plan, if put before a properly constituted meeting of the creditors, could gain the required approval. I agree that the feasibility of the plan is a relevant and significant factor to be considered in determining whether to order a meeting of creditors: S.E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act," at pp. 594-595. I would not, however, impose a heavy burden on the debtor company to establish the likelihood of ultimate success from the outset. As the Act will often be the last refuge for failing companies, it is to be expected that many of the proposed plans of reorganization will involve variables and contingencies which will make the plan's ultimate acceptability to the creditors and the Court very uncertain at the time the initial application is made.

91 On the facts before Hoolihan J., there were several factors which supported the exercise of his discretion in favour of directing a meeting of the creditors. These included the apparent support of two of the three substantial secured creditors, the companies' continued operation, and the prospect (disputed by the bank) that the companies' fortunes would take a turn for the better in the near future, the companies' ongoing efforts — that eventually met with some success — to find alternate financing, and the number of people depending on the operation of the company for their livelihood. There were also a number of factors pointing in the other direction, the most significant of which was the likelihood that a plan of reorganization acceptable to the bank could not be developed.

92 I see the situation which presented itself to Hoolihan J. as capable of a relatively straightforward risk-benefit analysis. If the s. 5 order had been refused by Hoolihan J., it was virtually certain that the operation of the companies would have ceased immediately. There would have been immediate economic and social damage to those who worked at the plants, and those who depended on those who worked at the plants for their well-being. This kind of damage cannot be ignored, especially when it occurs in small communities like those in which these plants are located. A refusal to grant the application would also have put the investments of the various creditors,

with the exception of the bank, at substantial risk. Finally, there would have been obvious financial damage to the owner of the companies. Balanced against these costs inherent in refusing the order would be the benefit to the bank, which would then have been in a position to realize on its security in accordance with its agreements with the companies.

93 The granting of the s. 5 order was not without its costs. It has denied the bank the rights it had bargained for as part of its agreement to lend substantial amounts of money to the companies. Further, according to the bank, the order has put the bank at risk of having its loans become undersecured because of the diminishing value of the accounts receivable and inventory which it holds as security and because of the ever-increasing size of the companies' debt to the bank. These costs must be measured against the potential benefit to all concerned if a successful plan of reorganization could be developed and implemented.

94 As I see it, the key to this analysis rests in the measurement of the risk to the bank inherent in the granting of the s. 5 order. If there was a real risk that the loan made by the bank would become undersecured during the operative period of the s. 5 order, I would be inclined to hold that the bank should not have that risk forced on it by the Court. However, I am unable to see that the bank is in any real jeopardy. The value of the security held by the bank appears to be well in excess of the size of its loan on the initial application. In his affidavit, Mr. Gibbons of Coopers & Lybrand asserted that the companies had overstated their cash flow projections, that the value of the inventory could diminish if customers of the companies looked to alternate sources for their product, and that the value of the accounts receivable could decrease if customers began to claim set-offs against those receivables. On the record before me, these appear to be no more than speculative possibilities. The bank has had access to all of the companies' financial data on an ongoing basis since the order of Hoolihan J. was made almost 2 months ago. Nothing was placed before this Court to suggest that any of the possibilities described above had come to pass.

95 Even allowing for some overestimation by the companies of the value of the security held by the bank, it would appear that the bank holds security valued at approximately $4 million for a loan that was, as of the hearing of this appeal, about $2.3 million. The order of Hoolihan J. was to terminate no later than November 14, 1990. I am not satisfied that the bank ran any real risk of having the amount of the loan exceed the value of the security by that date. It is also worth noting that the order under appeal provided that any party could apply to terminate the order at any point prior to November 14. This provision provided further protection for the bank in the event that it wished to make the case that its loan was at risk because of the deteriorating value of its security.

96 Even though the chances of a successful reorganization were not good, I am satisfied that the benefits flowing from the making of the s. 5 order exceeded the risk inherent in that order. In my view, Hoolihan J. properly exercised his discretion in directing that a meeting of creditors should be held pursuant to s. 5 of the Act.

VI Did Hoolihan J. Err in Directing that the Bank and RoyNat Inc. Should be Placed in the Same Class for the Purposes of the Act?

97 I agree with Finlayson J.A. that the bank and RoyNat Inc., the two principal creditors, should not have been placed in the same class of secured creditors for the purposes of ss. 5 and 6 of the Act. Their interests are not only different, they are opposed. The classification scheme created by Hoolihan J. effectively denied the bank any control over any plan of reorganization.

98 To accord with the principles found in the cases cited by Finlayson J.A., the secured creditors should have been grouped as follows:

— Class 1 — The City of Chatham and the Village of Glencoe

— Class 2 — The Bank of Nova Scotia

— Class 3 — RoyNat Inc., Ontario Development Corporation, and those holding debentures issued by the company on August 29 and 31, 1990.

VII Did Hoolihan J. Err in Making the Interim Orders He Made?

99 Hoolihan J. made a number of orders designed to control the conduct of all of the parties, pending the creditors' meeting and the placing of a plan of reorganization before the Court. The first order was made on September 11, 1990, and was to expire on or before October 24, 1990. Subsequent orders varied the terms of the initial order somewhat, and extended its effective date until November 14, 1990.

100 These orders imposed the following conditions pending the meeting:

(a) all proceedings with respect to the debtor companies should be stayed, including any action by the bank to realize on its security;

(b) the bank could not reduce its loan by applying incoming receipts to those debts;

(c) the bank was to be the sole banker for the companies;

(d) the companies could carry on business in the normal course, subject to certain very specific restrictions;

(e) a licensed trustee was to be appointed to monitor the business operations of the companies and to report to the creditors on a regular basis; and

(f) any party could apply to terminate the interim orders, and the orders would be terminated automatically if the companies defaulted on any of the obligations imposed on them by the interim orders.

101 The orders placed significant restrictions on the bank for a 2-month period, but balanced those restrictions with provisions limiting the debtor companies' activities, and giving the bank ongoing access to up-to-date financial information concerning the companies. The bank was also at liberty to return to the Court to request any variation in the interim orders which changes in financial circumstances might merit.

102 These orders were made under the wide authority granted to the court by s. 11 of the Act. L.W. Houlden and C.H. Morawetz, in *Bankruptcy Law of Canada*, 3d ed. (Toronto: Carswell, 1989), at pp. 2-102 to 2-103, describe the purpose of the section:

> The legislation is intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and it creditors. This aim is facilitated by s. 11 of the Act, which enables the court to restrain further proceedings in any action, suit or proceeding against the company upon such terms as the court sees fit.

103 A similar sentiment appears in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*. Gibbs J.A., in discussing the scope of s. 11, said at p. 7 [unreported, pp. 88-89 B.C.L.R.]:

> When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success, there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

104 Similar views of the scope of the power to make interim orders covering the period when reorganization is being attempted are found in *Meridian Developments Inc. v. Toronto-Dominion Bank; Meridian Developments Inc. v. Nu-West Ltd.*, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 11 D.L.R. (4th) 576, 53 A.R. 39 (Q.B.) at 114-118 [C.B.R.]; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.) at 12-15 [C.B.R.]; *Quintette Coal Ltd. v. Nippon Steel Corp.*, an unreported judgment of Thackray J., released June 18, 1990 [since reported (1990), 47 B.C.L.R. (2d) 193 (S.C.)], at pp. 5-9 [pp. 196-198 B.C.L.R.]; and B. O'Leary, "A Review of the Companies' Creditors Arrangement Act," at p. 41.

105 The interim orders made by Hoolihan J. are all within the wide authority created by s. 11 of the Act. The orders were crafted to give the company the opportunity to continue in operation, pending its attempt to reorganize, while at the same time providing safeguards to the creditors, including the bank, during that same period. I find no error in the interim relief granted by Hoolihan J.

VIII Conclusion

106 In the result, I would allow the appeal in part, vacate the order of Hoolihan J. of October 18, 1990, insofar as it purports to settle the class of creditors for the purpose of the Act, and I would substitute an order establishing the three classes referred to in Part VI of these reasons. I would not disturb any of the other orders made by Hoolihan J.

Appeal allowed.

End of Document