Court File No. CV14-10781-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CLINE MINING CORPORATION, NEW ELK COAL COMPANY LLC AND NORTH CENTRAL ENERGY COMPANY

Applicants

BOOK OF AUTHORITIES OF THE APPLICANTS
(Plan Amendment Motion Returnable June 1, 2015)

GOODMANS LLP
Barristers & Solicitors
333 Bay Street, Suite 3400
Toronto, Canada M5H 2S7

Robert J. Chadwick LSUC#: 35165K
Email: rchadwick@goodmans.ca

Logan Willis LSUC#: 53894K
Email: lwillis@goodmans.ca

Bradley Wiffen LSUC#: 64279L
Email: bwiffen@goodmans.ca

Tel: (416) 979-2211
Fax: (416) 979-1234

Lawyers for the Applicants

INDEX

INDEX

1	*Elan Corporation et al. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101 (Ont. C.A.)
2	*Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List])
3	*Re Cinram International Inc.*, 2012 ONSC 3767 (Commercial List)
4	*Algoma Steel Corp. v. Royal Bank of Canada* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.)
5	*Ontario v. Canadian Airlines Corporation,* 2001 ABQB 983
6	*Re Ball Machinery Sales Ltd.* (2002), 37 C.B.R. (4th) 39 (Ont. Sup. Ct. [Commercial List])

1

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

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

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.

Table of Authorities

Cases considered:

Per Finlayson J.A. (Krever J.A. concurring)

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.) — *applied*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 166, 31 B.C.L.R. (2d) 35 (S.C.), aff'd (16 September 1988), Doc. No. Vancouver CA009772, Taggart, Lambert and Locke JJ.A. (B.C. C.A.) — *considered*

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

NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.) — *considered*

Sovereign Life Assurance Co. v. Dodd, [1892] 2 Q.B. 573, [1891-4] All E.R. 246 (C.A.) — *applied*

Wellington Building Corp., Re, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626, [1934] O.W.N. 562 (S.C.) — *applied*

Per Doherty J.A. (dissenting in part)

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.) — *considered*

Avery Construction Co., Re, 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont. S.C.) — *referred to*

Hongkong Bank of Canada v. Chef Ready Foods Ltd., [1991] 2 W.W.R. 136, 51 B.C.L.R. (2d) 84 (C.A.) — *considered*

Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce (1989), 102 A.R. 161 (Q.B.) — *referred to*

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.) — *referred to*

Metals & Alloys Co., Re (16 February 1990), Houlden J.A. (Ont. C.A.) [unreported] — *considered*

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.) — *referred to*

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

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 47 B.C.L.R. (2d) 193 (S.C.) — *referred to*

Reference re Residential Tenancies Act (Ontario), [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 158 — *referred to*

Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C.S.C.) — *considered*

United Maritime Fishermen Co-op., Re (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.), rev'd (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 (C.A.) — *considered*

Statutes considered:

Bank Act, R.S.C. 1985, c. B-1 —

s. 178, as am. R.S.C. 1985 (3d Supp.), c. 25, s. 26

Companies' Creditors Arrangement Act, S.C. 1932-33, c. 36 —

s. 3, en. as s. 2A, S.C. 1952-53, c. 3, s. 2

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

s. 3

s. 4

s. 5

s. 6

s. 6(a)

s. 11

s. 14(2)

Courts of Justice Act, 1984, S.O. 1984, c. 11 —

s. 144(1)

Interpretation Act, R.S.C. 1985, c. I-21 —

s. 12

Municipal Act, R.S.O. 1980, c. 302 —

s. 369

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.

2

1993 CarswellOnt 183
Ontario Court of Justice (General Division — Commercial List)

Lehndorff General Partner Ltd., Re

1993 CarswellOnt 183, [1993] O.J. No. 14, 17 C.B.R. (3d) 24, 37 A.C.W.S. (3d) 847, 9 B.L.R. (2d) 275

Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36; Re Courts of Justice Act, R.S.O. 1990, c. C-43; Re plan of compromise in respect of LEHNDORFF GENERAL PARTNER LTD. (in its own capacity and in its capacity as general partner of LEHNDORFF UNITED PROPERTIES (CANADA), LEHNDORFF PROPERTIES (CANADA) and LEHNDORFF PROPERTIES (CANADA) II) and in respect of certain of their nominees LEHNDORFF UNITED PROPERTIES (CANADA) LTD., LEHNDORFF CANADIAN HOLDINGS LTD., LEHNDORFF CANADIAN HOLDINGS II LTD., BAYTEMP PROPERTIES LIMITED and 102 BLOOR STREET WEST LIMITED and in respect of THG LEHNDORFF VERMÖGENSVERWALTUNG GmbH (in its capacity as limited partner of LEHNDORFF UNITED PROPERTIES (CANADA))

Farley J.

Heard: December 24, 1992
Judgment: January 6, 1993
Docket: Doc. B366/92

Counsel: *Alfred Apps, Robert Harrison* and *Melissa J. Kennedy* , for applicants.
L. Crozier , for Royal Bank of Canada.
R.C. Heintzman , for Bank of Montreal.
J. Hodgson, Susan Lundy and *James Hilton* , for Canada Trustco Mortgage Corporation.
Jay Schwartz , for Citibank Canada.
Stephen Golick , for Peat Marwick Thorne * Inc., proposed monitor.
John Teolis , for Fuji Bank Canada.
Robert Thorton , for certain of the advisory boards.

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Effect of arrangement — Stay of proceedings

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Stay of proceedings — Stay being granted even where it would affect non-applicants that were not companies within meaning of Act — Business operations of applicants and non-applicants being so intertwined as to make stay appropriate.

The applicant companies were involved in property development and management and sought the protection of the *Companies' Creditors Arrangement Act* ("CCAA") in order that they could present a plan of compromise. They also sought a stay of all proceedings against the individual company applicants either in their own capacities or because of their interest in a larger group of companies. Each of the applicant companies was insolvent and had outstanding debentures issued under trust deeds. They proposed a plan of compromise among themselves and the holders of the debentures as well as those others of their secured and unsecured creditors deemed appropriate in the circumstances.

A question arose as to whether the court had the power to grant a stay of proceedings against non-applicants that were not companies and, therefore, not within the express provisions of the CCAA.

Held:

The application was allowed.

It was appropriate, given the significant financial intertwining of the applicant companies, that a consolidated plan be approved. Further, each of the applicant companies had a realistic possibility of being able to continue operating even though each was currently unable to meet all of its expenses. This was precisely the sort of situation in which all of the creditors would likely benefit from the application of the CCAA and in which it was appropriate to grant an order staying proceedings.

The inherent power of the court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Clearly, the court had the jurisdiction to grant a stay in respect of any of the applicants that were companies fitting the criteria in the CCAA.

However, the stay requested also involved limited partnerships where (1) the applicant companies acted on behalf of the limited partnerships, or (2) the stay would be effective against any proceedings taken by any party against the property assets and undertakings of the limited partnerships in which they held a direct interest. The business operations of the applicant companies were so intertwined with the limited partnerships that it would be impossible for a stay to be granted to the applicant companies that would affect their business without affecting the undivided interest of the limited partnerships in the business. As a result, it was just and reasonable to supplement s. 11 and grant the stay.

While the provisions of the CCAA allow for a cramdown of a creditor's claim, as well as the interest of any other person, anyone wishing to start or continue proceedings against the applicant companies could use the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain the stay. In such a motion, the onus would be on the applicant companies to show that it was appropriate in the circumstances to continue the stay.

Table of Authorities

Cases considered:

Amirault Fish Co., Re, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) — *referred to*

Associated Investors of Canada Ltd., Re, 67 C.B.R. (N.S.) 237 , Alta. L.R. (2d) 259, [1988] 2 W.W.R. 211, 38 B.L.R. 148, *(*sub nom. *Re First Investors Corp.)* 46 D.L.R. (4th) 669 (Q.B.) , reversed (1988), 71 C.B.R. 71, 60 Alta. L.R. (2d) 242, 89 A.R. 344 (C.A.) — *referred to*

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) — *referred to*

Canada Systems Group (EST) v. Allen-Dale Mutual Insurance Co. (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) [affirmed (1983), 41 O.R. (2d) 135, 33 C.P.C. 210, 145 D.L.R. (3d) 266 (C.A.)] — *referred to*

Empire-Universal Films Ltd. v. Rank, [1947] O.R. 775 [H.C.] — *referred to*

Feifer v. Frame Manufacturing Corp., Re, 28 C.B.R. 124, [1947] Que. K.B. 348 (C.A.) — *referred to*

Fine's Flowers Ltd. v. Fine's Flowers (Creditors of) (1992), 10 C.B.R. (3d) 87, 4 B.L.R. (2d) 293, 87 D.L.R. (4th) 391, 7 O.R. (3d) 193 (Gen. Div.) — *referred to*

Gaz Métropolitain v. Wynden Canada Inc. (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) [affirmed (1982), 45 C.B.R. (N.S.) 11 (Que. C.A.)] — *referred to*

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.) — *referred to*

Inducon Development Corp. Re (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) — *referred to*

International Donut Corp. v. 050863 N.B. Ltd. (1992), 127 N.B.R. (2d) 290, 319 A.P.R. 290 (Q.B.) — *considered*

Keppoch Development Ltd., Re (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) — *referred to*

Langley's Ltd., Re, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) — *referred to*

McCordic v. Bosanquet (1974), 5 O.R. (2d) 53 (H.C.) — *referred to*

Meridian Developments Inc. v. Toronto Dominion Bank, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Q.B.) — *referred to*

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. 1 (Q.B.) — *referred to*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) — *referred to*

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, *(*sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282, 1 O.R. (3d) 289 (C.A.) — *referred to*

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.) , affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 B.C.L.R. (2d) xxxiii (note), 135 N.R. 317 (note) — *referred to*

Reference re Companies' Creditors Arrangement Act (Canada), [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75 — *referred to*

Seven Mile Dam Contractors v. R. (1979), 13 B.C.L.R. 137, 104 D.L.R. (3d) 274 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) — *referred to*

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) — *referred to*

Slavik, Re (1992), 12 C.B.R. (3d) 157 (B.C. S.C.) — *considered*

Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) — *referred to*

Ultracare Management Inc. v. Zevenberger (Trustee of) (1990), 3 C.B.R. (3d) 151, *(*sub nom. *Ultracare Management Inc. v. Gammon)* 1 O.R. (3d) 321 (Gen. Div.) — *referred to*

United Maritime Fishermen Co-operative, Re (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.) , reversed (1988), 69 C.B.R. (N.S.) 161, 88 N.B.R. (2d) 253, 224 A.P.R. 253, *(*sub nom. *Cdn. Co-op. Leasing Services v. United Maritime Fishermen Co-op.)* 51 D.L.R. (4th) 618 (C.A.) — *referred to*

Statutes considered:

Bankruptcy Act, R.S.C. 1985, c. B-3 —

s. 85

s. 142

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

s. 2

s. 3

s. 4

s. 5

s. 6

s. 7

s. 8

s. 11

Courts of Justice Act, R.S.O. 1990, c. C.43.

Judicature Act, The, R.S.O. 1937, c. 100.

Limited Partnerships Act, R.S.O. 1990, c. L.16 —

s. 2(2)

s. 3(1)

s. 8

s. 9

s. 11

s. 12(1)

s. 13

s. 15(2)

s. 24

Partnership Act, R.S.A. 1980, c.P-2 — Pt. 2

s. 75

Rules considered:

Ontario, Rules of Civil Procedure —

r. 8.01

r. 8.02

Application under Companies' Creditors Arrangement Act to file consolidated plan of compromise and for stay of proceedings.

***Farley J.*:**

1 These are my written reasons relating to the relief granted the applicants on December 24, 1992 pursuant to their application under the *Companies' Creditors Arrangement Act* , R.S.C. 1985, c. C-36 ("CCAA") and the *Courts of Justice Act* , R.S.O. 1990, c. C.43 ("CJA"). The relief sought was as follows:

> (a) short service of the notice of application;
>
> (b) a declaration that the applicants were companies to which the CCAA applies;
>
> (c) authorization for the applicants to file a consolidated plan of compromise;
>
> (d) authorization for the applicants to call meetings of their secured and unsecured creditors to approve the consolidated plan of compromise;
>
> (e) a stay of all proceedings taken or that might be taken either in respect of the applicants in their own capacity or on account of their interest in Lehndorff United Properties (Canada) ("LUPC"), Lehndorff Properties (Canada) ("LPC") and Lehndorff Properties (Canada) II ("LPC II") and collectively (the "Limited Partnerships") whether as limited partner, as general partner or as registered titleholder to certain of their assets as bare trustee and nominee; and
>
> (f) certain other ancillary relief.

2 The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issues under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermögensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee

on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the *Limited Partnership Act* , R.S.O. 1990, c. L.16 ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the *Partnership Act* , R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of intercorporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

3 This process has now evolved to a point where management has developed a consolidated restructuring plan which plan addresses the following issues:

(a) The compromise of existing conventional, term and operating indebtedness, both secured and unsecured.

(b) The restructuring of existing project financing commitments.

(c) New financing, by way of equity or subordinated debt.

(d) Elimination or reduction of certain overhead.

(e) Viability of existing businesses of entities in the Lehndorff Group.

(f) Restructuring of income flows from the limited partnerships.

(g) Disposition of further real property assets aside from those disposed of earlier in the process.

(h) Consolidation of entities in the Group; and

(i) Rationalization of the existing debt and security structure in the continuing entities in the Group.

Formal meetings of the beneficial limited partners of the Limited Partnerships are scheduled for January 20 and 21, 1993 in Germany and an information circular has been prepared and at the time of hearing was being translated into German. This application was brought on for hearing at this time for two general reasons: (a) it had now ripened to the stage of proceeding with what had been distilled out of the strategic and consultative meetings; and (b) there were creditors other than senior secured lenders who were in a position to enforce their rights against assets of some of the applicants (and Limited Partnerships) which if such enforcement did take place would result in an undermining of the overall plan. Notice of this hearing was given to various creditors: Barclays Bank of Canada, Barclays Bank PLC, Bank of Montreal, Citibank Canada, Canada Trustco Mortgage Corporation, Royal Trust Corporation of Canada, Royal Bank of Canada, the Bank of Tokyo Canada, Funtauna Investments Limited, Canadian Imperial Bank of Commerce, Fuji Bank Canada and First City Trust Company. In this respect the applicants have recognized that although the initial application under the CCAA may be made on an ex parte basis (s. 11 of the CCAA; *Re Langley's Ltd.*, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) ; *Re Keppoch Development Ltd.* (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) . The court will be concerned when major creditors have not been alerted even in the most minimal fashion (*Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) at p. 310). The application was either supported or not opposed.

4 "Instant" debentures are now well recognized and respected by the courts: see *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44 (N.B. Q.B.) , at pp. 55-56, varied on reconsideration (1988), 68 C.B.R. (N.S.) 170 (N.B. Q.B.) , reversed on different grounds (1988), 69 C.B.R. (N.S.) 161 (N.B. C.A.) , at pp. 165-166; *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) at pp. 250-251; *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (sub nom. *Ultracare Management Inc. v. Gammon*) (1990), 1 O.R. (3d) 321 (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

5 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent

companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659 at p. 661, 16 C.B.R. 1, [1934] 4 D.L.R. 75 ; *Meridian Developments Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215 (Alta. Q.B.) at pp. 219-220; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361 (Q.B.) , at pp. 12-13 (C.B.R.); *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.) , at pp. 310-311, affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.) , leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.) .; *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra, at p. 307 (O.R.); *Fine's Flowers v. Fine's Flowers (Creditors of)* (1992), 7 O.R. (3d) 193 (Gen. Div.) , at p. 199 and "Reorganizations Under The Companies' Creditors Arrangement Act", Stanley E. Edwards (1947) 25 Can. Bar Rev. 587 at p. 592.

6 The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. see *Nova Metal Products Inc. v. Comiskey (Trustee of)* , supra at pp. 297 and 316; *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252 and *Ultracare Management Inc. v. Zevenberger (Trustee of)* , supra, at p. 328 and p. 330. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed: see *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at p. 220 (W.W.R.). The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 108-110; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (C.A.) , at pp. 315-318 (C.B.R.) and *Re Stephanie's Fashions Ltd.* , supra, at pp. 251-252.

7 One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the *Bankruptcy Act* , R.S.C. 1985, c.

B-3, before the amendments effective November 30, 1992 to transform it into the *Bankruptcy and Insolvency Act* ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an application under the BIA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 318 and *Re Associated Investors of Canada Ltd.* (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) at pp. 245, reversed on other grounds at (1988), 71 C.B.R. (N.S.) 71 (Alta. C.A.) . It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See *Re Associated Investors of Canada Ltd.* , supra, at p. 318; *Re Amirault Fish Co.*, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) at pp. 187-188 (C.B.R.).

8 It strikes me that each of the applicants in this case has a realistic possibility of being able to continue operating, although each is currently unable to meet all of its expenses albeit on a reduced scale. This is precisely the sort of circumstance in which all of the creditors are likely to benefit from the application of the CCAA and in which it is appropriate to grant an order staying proceedings so as to allow the applicant to finalize preparation of and file a plan of compromise and arrangement.

9 Let me now review the aspect of the stay of proceedings. Section 11 of the CCAA provides as follows:

> 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.

10 The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affected the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* , supra, at pp. 12-17 (C.B.R.) and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 296-298 (B.C. S.C.) and pp. 312-314 (B.C. C.A.) and *Meridian Developments Inc. v. Toronto Dominion Bank* , supra, at pp. 219 ff. Further the court has the power to order a stay that is effective in respect of the rights arising in favour of secured creditors under all forms of commercial security: see *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* , supra, at p. 320 where Gibbs J.A. for the court stated:

> The trend which emerges from this sampling will be given effect here by holding that where the word "security" occurs in the C.C.A.A., it includes s. 178 security and, where the word creditor occurs, it includes a bank holding s. 178 security. To the extent that there may be conflict between the two statutes, therefore, the broad scope of the C.C.A.A. prevails.

11 The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see *Gaz Métropolitain v. Wynden Canada Inc.* (1982), 44 C.B.R. (N.S.) 285 (C.S. Que.) at pp. 290-291 and *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 311-312 (B.C. C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (C.A. Que.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

> 8. This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

The power to grant a stay may also extend to prevent persons from exercising any right of set off in respect of the amounts owed by such a person to the debtor company, irrespective of whether

the debtor company has commenced any action in respect of which the defense of set off might be formally asserted: see *Quintette Coal Ltd. v. Nippon Steel Corp.* , supra, at pp. 312-314 (B.C.C.A.).

12 It was submitted by the applicants that the power to grant a stay of proceedings may also extend to a stay of proceedings against non-applicants who are not companies and accordingly do not come within the express provisions of the CCAA. In support thereof they cited a CCAA order which was granted staying proceedings against individuals who guaranteed the obligations of a debtor-applicant which was a qualifying company under the terms of the CCAA: see *Re Slavik* , unreported, [1992] B.C.J. No. 341 [now reported at 12 C.B.R. (3d) 157 (B.C. S.C.)]. However in the *Slavik* situation the individual guarantors were officers and shareholders of two companies which had sought and obtained CCAA protection. Vickers J. in that case indicated that the facts of that case included the following unexplained and unamplified fact [at p. 159]:

> 5. The order provided further that all creditors of Norvik Timber Inc. be enjoined from making demand for payment upon that firm or upon any guarantor of an obligation of the firm until further order of the court.

The CCAA reorganization plan involved an assignment of the claims of the creditors to "Newco" in exchange for cash and shares. However the basis of the stay order originally granted was not set forth in this decision.

13 It appears to me that Dickson J. in *International Donut Corp. v. 050863 N.D. Ltd.* , unreported, [1992] N.B.J. No. 339 (N.B. Q.B.) [now reported at 127 N.B.R. (2d) 290, 319 A.P.R. 290] was focusing only on the stay arrangements of the CCAA when concerning a limited partnership situation he indicated [at p. 295 N.B.R.]:

> In August 1991 the limited partnership, through its general partner the plaintiff, applied to the Court under the *Companies' Creditors Arrangement Act* , R.S.C., c. C-36 for an order delaying the assertion of claims by creditors until an opportunity could be gained to work out with the numerous and sizable creditors a compromise of their claims. An order was obtained but it in due course expired without success having been achieved in arranging with creditors a compromise. *That effort may have been wasted, because it seems questionable that the federal Act could have any application to a limited partnership in circumstances such as these* . (Emphasis added.)

14 I am not persuaded that the words of s. 11 which are quite specific as relating as to a *company* can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in *Campeau v. Olympia & York Developments Ltd.* unreported, [1992] O.J. No. 1946 [now reported at 14 C.B.R. (3d) 303 (Ont. Gen. Div.)] at pp. 4-7 [at pp. 308-310 C.B.R.].

The Power to Stay

The court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co.* (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) , and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act* , R.S.O. 1990, c. C.43, which provides as follows:

> 106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.

Recently, Mr. Justice O'Connell has observed that this discre tionary power is "highly dependent on the facts of each particular case": *Arab Monetary Fund v. Hashim* (unreported) [(June 25, 1992), Doc. 24127/88 (Ont. Gen. Div.)], [1992] O.J. No. 1330.

Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the court is specifically granted the power to stay in a particular context, by virtue of statute or under the *Rules of Civil Procedure* . The authority to prevent multiplicity of proceedings in the same court, under r. 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the C.C.A.A., is an example of the former. Section 11 of the C.C.A.A. provides as follows.

The Power to Stay in the Context of C.C.A.A. Proceedings

By its formal title the C.C.A.A. is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.

In this respect it has been observed that the C.C.A.A. is "to be used as a practical and effective way of restructuring corporate indebtedness.": see the case comment following the report of *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.) , and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A.) at p. 113 [B.C.L.R.].

Gibbs J.A. continued with this comment:

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the

> courts have concluded that under s. 11 there is *a discretionary power to restrain judicial or extra-judicial conduct* against the debtor company *the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period* .
>
> (emphasis added)
>
> I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of negotiating the compromise or arrangement. [In this respect, see also *Sairex GmbH v. Prudential Steel Ltd.* (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.) at p. 77.]
>
> I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance* , supra (a "Mississauga Derailment" case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

It is quite clear from *Empire-Universal Films Limited v. Rank*, [1947] O.R. 775 (H.C.) that McRuer C.J.H.C. considered that *The Judicature Act* [R.S.O. 1937, c. 100] then [and now the CJA] merely confirmed a statutory right that previously had been considered inherent in the jurisdiction of the court with respect to its authority to grant a stay of proceedings. See also *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 (H.C.) and *Canada Systems Group (EST) Ltd. v. Allen-Dale Mutual Insurance Co.* (1982), 29 C.P.C. 60 (H.C.) at pp. 65-66.

15 Montgomery J. in *Canada Systems* , supra, at pp. 65-66 indicated:

> Goodman J. (as he then was) in *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in *Edmeades v. Thames Board Mills Ltd.*, [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in *Edmeades* was approved by Lord Justice Davies in *Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis)*, [1972] 1 All E.R. 430, *(*sub nom. *Lane v. Willis; Lane v. Beach)* [1972] 1 W.L.R. 326 (C.A.) .
>
> . . . . .

> In *Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122 , appeal allowed by consent without costs *(*sub nom. *Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.)* 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.) , Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:
>
> > The principles which must govern in these matters are clearly stated in the case of *Empire Universal Films Ltd. et al. v. Rank et al.*, [1947] O.R. 775 at p. 779, as follows [quoting *St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al.*, [1936] 1 K.B. 382 at p. 398]:
> >
> > > (1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.

16 Thus it appears to me that the inherent power of this court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Is it appropriate to do so in the circumstances? Clearly there is jurisdiction under s. 11 of the CCAA to grant a stay in respect of any of the applicants which are all companies which fit the criteria of the CCAA. However the stay requested also involved the limited partnerships to some degree either (i) with respect to the applicants acting on behalf of the Limited Partnerships or (ii) the stays being effective vis-à-vis any proceedings taken by any party against the property assets and undertaking of the Limited Partnerships in respect of which they hold a direct interest (collectively the "Property") as set out in the terms of the stay provisions of the order paragraphs 4 through 18 inclusive attached as an appendix to these reasons. [Appendix omitted.] I believe that an analysis of the operations of a limited partnership in this context would be beneficial to an understanding of how there is a close inter-relationship to the applicants involved in this CCAA proceedings and how the Limited Partnerships and their Property are an integral part of the operations previously conducted and the proposed restructuring.

17 A limited partnership is a creation of statute, consisting of one or more general partners and one or more limited partners. The limited partnership is an investment vehicle for passive investment by limited partners. It in essence combines the flow through concept of tax depreciation or credits available to "ordinary" partners under general partnership law with limited liability available to shareholders under corporate law. See Ontario LPA sections 2(2) and 3(1) and Lyle R.

Hepburn, *Limited Partnerships* , (Toronto: De Boo, 1991), at p. 1-2 and p. 1-12. I would note here that the limited partnership provisions of the Alberta PA are roughly equivalent to those found in the Ontario LPA with the interesting side aspect that the Alberta legislation in s. 75 does allow for judgment against a limited partner to be charged against the limited partner's interest in the limited partnership. A general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership. In particular a general partner is fully liable to each creditor of the business of the limited partnership. The general partner has sole control over the property and business of the limited partnership: see Ontario LPA ss. 8 and 13. Limited partners have no liability to the creditors of the limited partnership's business; the limited partners' financial exposure is limited to their contribution. The limited partners do not have any "independent" ownership rights in the property of the limited partnership. The entitlement of the limited partners is limited to their contribution plus any profits thereon, after satisfaction of claims of the creditors. See Ontario LPA sections 9, 11, 12(1), 13, 15(2) and 24. The process of debtor and creditor relationships associated with the limited partnership's business are between the general partner and the creditors of the business. In the event of the creditors collecting on debt and enforcing security, the creditors can only look to the assets of the limited partnership together with the assets of the general partner including the general partner's interest in the limited partnership. This relationship is recognized under the *Bankruptcy Act* (now the BIA) sections 85 and 142.

18 A general partner is responsible to defend proceedings against the limited partnership in the firm name, so in procedural law and in practical effect, a proceeding against a limited partnership is a proceeding against the general partner. See Ontario *Rules of Civil Procedure* , O. Reg. 560/84, Rules 8.01 and 8.02.

19 It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See *Lindley on Partnership* , 15th ed. (London: Sweet & Maxwell, 1984), at pp. 33-35; *Seven Mile Dam Contractors v. R.* (1979), 13 B.C.L.R. 137 (S.C.) , affirmed (1980), 25 B.C.L.R. 183 (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad A. Milne, (1985) 23 Alta. L. Rev. 345, at pp. 350-351. Milne in that article made the following observations:

> The preponderance of case law therefore supports the contention that a limited partnership is not a separate legal entity. It appears, nevertheless, that the distinction made in *Re Thorne* between partnerships and trade unions could not be applied to limited partnerships which, like trade unions, must rely on statute for their validity. The mere fact that limited partnerships owe their existence to the statutory provision is probably not sufficient to endow the limited partnership with the attribute of legal personality as suggested in *Ruzicks* unless it appeared that the Legislature clearly intended that the limited partnership should have a separate legal existence. A review of the various provincial statutes does not reveal any procedural advantages, rights or powers that are fundamentally different from those advantages enjoyed by ordinary partnerships. The legislation does not contain any provision resembling section

> 15 of the *Canada Business Corporation Act* [S.C. 1974-75, c. 33, as am.] which expressly states that a corporation has the capacity, both in and outside of Canada, of a natural person. It is therefore difficult to imagine that the Legislature intended to create a new category of legal entity.

20 It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, "The Control Test of Investor Liability in Limited Partnerships" (1983) 21 Alta. L. Rev. 303; E. Apps, "Limited Partnerships and the 'Control' Prohibition: Assessing the Liability of Limited Partners" (1991) 70 Can. Bar Rev. 611; R. Flannigan, "Limited Partner Liability: A Response" (1992) 71 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner — the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: *Control Test* , (1992), supra, at pp. 524-525. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-à-vis any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

21 It seems to me that using the inherent jurisdiction of this court to supplement the statutory stay provisions of s. 11 of the CCAA would be appropriate in the circumstances; it would be just and reasonable to do so. The business operations of the applicants are so intertwined with the limited partnerships that it would be impossible for relief as to a stay to be granted to the applicants which would affect their business without at the same time extending that stay to the undivided interests of the limited partners in such. It also appears that the applicants are well on their way to presenting a reorganization plan for consideration and a vote; this is scheduled to happen within the month so there would not appear to be any significant time inconvenience to any person interested in pursuing proceedings. While it is true that the provisions of the CCAA allow for a cramdown of

a creditor's claim (as well as an interest of any other person), those who wish to be able to initiate or continue proceedings against the applicants may utilize the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain that particular stay. It seems to me that in such a comeback motion the onus would be upon the applicants to show that in the circumstances it was appropriate to continue the stay.

22 The order is therefore granted as to the relief requested including the proposed stay provisions.

Application allowed.

Footnotes

* As amended by the court.

3

2012 ONSC 3767
Ontario Superior Court of Justice [Commercial List]

Cinram International Inc., Re

2012 CarswellOnt 8413, 2012 ONSC 3767, 217 A.C.W.S. (3d) 11, 91 C.B.R. (5th) 46

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

And In the Matter of a Plan of Compromise or Arrangement of
Cinram International Inc., Cinram International Income Fund,
CII Trust and The Companies Listed in Schedule "A" (Applicants)

Morawetz J.

Heard: June 25, 2012
Judgment: June 26, 2012
Docket: CV-12-9767-00CL

Counsel: Robert J. Chadwick, Melaney Wagner, Caroline Descours for Applicants
Steven Golick for Warner Electra-Atlantic Corp.
Steven Weisz for Pre-Petition First Lien Agent, Pre-Petition Second Lien Agent and DIP Agent
Tracy Sandler for Twentieth Century Fox Film Corporation
David Byers for Proposed Monitor, FTI Consulting Inc.

Subject: Insolvency

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Miscellaneous

C group of companies was replicator and distributor of CDs and DVDs with operational footprint across North America and Europe — C group experienced significant declines in revenue and EBITDA, and had insufficient funds to meet their immediate cash requirements as result of liquidity challenges — C group sought protection of Companies' Creditors Arrangement Act — C group brought application seeking initial order under Act, and relief including stay of proceedings against third party non-applicant; authorization to make pre-filing payments; and approval of certain Court-ordered charges over their assets relating to their DIP Financing, administrative costs, indemnification of their trustees, directors and

officers, Key Employee Retention Plan, and consent consideration — Application granted — Applicants met all qualifications established for relief under Act — Charges referenced in initial order were approved — Relief requested in initial order was extensive and went beyond what court usually considers on initial hearing; however, in circumstances, requested relief was appropriate — Applicants spent considerable time reviewing their alternatives and did so in consultative manner with their senior secured lenders — Senior secured lenders supported application, notwithstanding that it was clear that they would suffer significant shortfall on their positions.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Procedure — Miscellaneous

C group of companies was replicator and distributor of CDs and DVDs with operational footprint across North America and Europe — C group experienced significant declines in revenue and EBITDA, and had insufficient funds to meet their immediate cash requirements as result of liquidity challenges — C group brought application seeking initial order under Companies' Creditors Arrangement Act and other relief, including authorization for C International to act as foreign representative in within proceedings to seek recognition order under Chapter 15 of U.S. Bankruptcy Code on basis that Ontario, Canada was Centre of Main Interest (COMI) of applicants — Application granted on other grounds — It is function of receiving court, in this case, U.S. Bankruptcy Court for District of Delaware, to make determination on location of COMI and to determine whether present proceeding is foreign main proceeding for purposes of Chapter 15.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Initial application — Grant of stay — Miscellaneous

Stay against third party non-applicant — C group of companies was replicator and distributor of CDs and DVDs with operational footprint across North America and Europe — C group experienced significant declines in revenue and EBITDA, and had insufficient funds to meet their immediate cash requirements as result of liquidity challenges — C group sought protection of Companies' Creditors Arrangement Act — C LP was not applicant in proceedings; however, C LP formed part of C group's income trust structure with C Fund, ultimate parent of C group — C group brought application seeking initial order under Act, including stay of proceedings against C LP — Application granted — Applicants met all qualifications established for relief under Act — Charges referenced in initial order were approved — Relief requested in initial order was extensive and went beyond what court usually considers on initial hearing; however, in circumstances, requested relief was appropriate.

Table of Authorities

Cases considered by *Morawetz J.*:

Brainhunter Inc., Re (2009), 2009 CarswellOnt 7627 (Ont. S.C.J. [Commercial List]) — referred to

Cadillac Fairview Inc., Re (1995), 1995 CarswellOnt 36, 30 C.B.R. (3d) 29 (Ont. Gen. Div. [Commercial List]) — referred to

Canwest Global Communications Corp., Re (2009), 2009 CarswellOnt 6184, 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) — considered

Canwest Publishing Inc./Publications Canwest Inc., Re (2010), 63 C.B.R. (5th) 115, 2010 CarswellOnt 212, 2010 ONSC 222 (Ont. S.C.J. [Commercial List]) — considered

Fraser Papers Inc., Re (2009), 2009 CarswellOnt 3658, 56 C.B.R. (5th) 194 (Ont. S.C.J. [Commercial List]) — referred to

Global Light Telecommunications Inc., Re (2004), 2004 BCSC 745, 2004 CarswellBC 1249, 2 C.B.R. (5th) 210, 33 B.C.L.R. (4th) 155 (B.C. S.C.) — referred to

Grant Forest Products Inc., Re (2009), 2009 CarswellOnt 4699, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) — considered

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 1990 CarswellBC 394, 4 C.B.R. (3d) 311, *(*sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136 (B.C. C.A.) — referred to

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1990 CarswellOnt 139, 1 C.B.R. (3d) 101, *(*sub nom. *Elan Corp. v. Comiskey)* 1 O.R. (3d) 289, *(*sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282 (Ont. C.A.) — referred to

Priszm Income Fund, Re (2011), 2011 ONSC 2061, 2011 CarswellOnt 2258, 75 C.B.R. (5th) 213 (Ont. S.C.J.) — referred to

Sierra Club of Canada v. Canada (Minister of Finance) (2002), 287 N.R. 203, *(*sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 18 C.P.R. (4th) 1, 44 C.E.L.R. (N.S.) 161, *(*sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 20 C.P.C. (5th) 1, 40 Admin. L.R. (3d) 1, 2002 SCC 41, 2002 CarswellNat 822, 2002 CarswellNat 823, *(*sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 93 C.R.R. (2d) 219, [2002] 2 S.C.R. 522 (S.C.C.) — considered

Sino-Forest Corp., Re (2012), 2012 CarswellOnt 4117, 2012 ONSC 2063 (Ont. S.C.J. [Commercial List]) — considered

Stelco Inc., Re (2004), 48 C.B.R. (4th) 299, 2004 CarswellOnt 1211 (Ont. S.C.J. [Commercial List]) — referred to

Stelco Inc., Re (2004), 2004 CarswellOnt 2936 (Ont. C.A.) — referred to

Stelco Inc., Re (2004), 338 N.R. 196 (note), 2004 CarswellOnt 5200, 2004 CarswellOnt 5201 (S.C.C.) — referred to

Sulphur Corp. of Canada Ltd., Re (2002), 2002 CarswellAlta 896, 2002 ABQB 682, [2002] 10 W.W.R. 491, 5 Alta. L.R. (4th) 251, 319 A.R. 152, 35 C.B.R. (4th) 304 (Alta. Q.B.) — referred to

T. Eaton Co., Re (1997), 1997 CarswellOnt 1914, 46 C.B.R. (3d) 293 (Ont. Gen. Div.) — referred to

Timminco Ltd., Re (2012), 2012 CarswellOnt 1466, 2012 ONSC 948, 95 C.C.P.B. 222, 86 C.B.R. (5th) 171 (Ont. S.C.J. [Commercial List]) — referred to

Timminco Ltd., Re (2012), 2012 ONSC 106, 2012 CarswellOnt 1059, 89 C.B.R. (5th) 127 (Ont. S.C.J. [Commercial List]) — considered

Timminco Ltd., Re (2012), 2012 ONSC 506, 95 C.C.P.B. 48, 2012 CarswellOnt 1263, 85 C.B.R. (5th) 169 (Ont. S.C.J. [Commercial List]) — considered

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236, 79 B.C.L.R. (2d) 257, 1993 CarswellBC 530 (B.C. S.C.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 2 "insolvent person" — considered

Bankruptcy Code, 11 U.S.C. 1982
Chapter 15 — referred to

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

s. 2(1) "company" — considered

s. 2(1) "debtor company" — considered

s. 3(1) — considered

s. 3(2) — considered

s. 11 — considered

s. 11.2 [en. 1997, c. 12, s. 124] — considered

s. 11.2(1) [en. 1997, c. 12, s. 124] — considered

s. 11.2(2) [en. 1997, c. 12, s. 124] — considered

s. 11.2(4) [en. 1997, c. 12, s. 124] — considered

s. 11.4 [en. 1997, c. 12, s. 124] — considered

s. 11.51 [en. 2005, c. 47, s. 128] — considered

s. 11.52 [en. 2005, c. 47, s. 128] — considered

APPLICATION by group of debtor companies for initial order and other relief under *Companies' Creditors Arrangement Act*.

***Morawetz J.*:**

1 Cinram International Inc. ("CII"), Cinram International Income Fund ("Cinram Fund"), CII Trust and the Companies listed in Schedule "A" (collectively, the "Applicants") brought this application seeking an initial order (the "Initial Order") pursuant to the *Companies' Creditors Arrangement Act* ("CCAA"). The Applicants also request that the court exercise its jurisdiction to extend a stay of proceedings and other benefits under the Initial Order to Cinram International Limited Partnership ("Cinram LP", collectively with the Applicants, the "CCAA Parties").

2 Cinram Fund, together with its direct and indirect subsidiaries (collectively, "Cinram" or the "Cinram Group") is a replicator and distributor of CDs and DVDs. Cinram has a diversified operational footprint across North America and Europe that enables it to meet the replication and logistics demands of its customers.

3 The evidentiary record establishes that Cinram has experienced significant declines in revenue and EBITDA, which, according to Cinram, are a result of the economic downturn in Cinram's primary markets of North America and Europe, which impacted consumers' discretionary spending and adversely affected the entire industry.

4 Cinram advises that over the past several years it has continued to evaluate its strategic alternatives and rationalize its operating footprint in order to attempt to balance its ongoing operations and financial challenges with its existing debt levels. However, despite cost reductions and recapitalized initiatives and the implementation of a variety of restructuring alternatives, the Cinram Group has experienced a number of challenges that has led to it seeking protection under the CCAA.

5 Counsel to Cinram outlined the principal objectives of these CCAA proceedings as:

> (i) to ensure the ongoing operations of the Cinram Group;
>
> (ii) to ensure the CCAA Parties have the necessary availability of working capital funds to maximize the ongoing business of the Cinram Group for the benefit of its stakeholders; and
>
> (iii) to complete the sale and transfer of substantially all of the Cinram Group's business as a going concern (the "Proposed Transaction").

6 Cinram contemplates that these CCAA proceedings will be the primary court supervised restructuring of the CCAA Parties. Cinram has operations in the United States and certain of the Applicants are incorporated under the laws of the United States. Cinram, however, takes the position that Canada is the nerve centre of the Cinram Group.

7 The Applicants also seek authorization for Cinram International ULC ("Cinram ULC") to act as "foreign representative" in the within proceedings to seek a recognition order under Chapter 15

of the United States Bankruptcy Code ("Chapter 15"). Cinram advises that the proceedings under Chapter 15 are intended to ensure that the CCAA Parties are protected from creditor actions in the United States and to assist with the global implementation of the Proposed Transaction to be undertaken pursuant to these CCAA proceedings.

8 Counsel to the Applicants submits that the CCAA Parties are part of a consolidated business in Canada, the United States and Europe that is headquartered in Canada and operationally and functionally integrated in many significant respects. Cinram is one of the world's largest providers of pre-recorded multi-media products and related logistics services. It has facilities in North America and Europe, and it:

> (i) manufactures DVDs, blue ray disks and CDs, and provides distribution services for motion picture studios, music labels, video game publishers, computer software companies, telecommunication companies and retailers around the world;
>
> (ii) provides various digital media services through One K Studios, LLC; and
>
> (iii) provides retail inventory control and forecasting services through Cinram Retail Services LLC (collectively, the "Cinram Business").

9 Cinram contemplates that the Proposed Transaction could allow it to restore itself as a market leader in the industry. Cinram takes the position that it requires CCAA protection to provide stability to its operations and to complete the Proposed Transaction.

10 The Proposed Transaction has the support of the lenders forming the steering committee with respect to Cinram's First Lien Credit Facilities (the "Steering Committee"), the members of which have been subject to confidentiality agreements and represent 40% of the loans under Cinram's First Lien Credit Facilities (the "Initial Consenting Lenders"). Cinram also anticipates further support of the Proposed Transaction from additional lenders under its credit facilities following the public announcement of the Proposed Transaction.

11 Cinram Fund is the direct or indirect parent and sole shareholder of all of the subsidiaries in Cinram's corporate structure. A simplified corporate structure of the Cinram Group showing all of the CCAA Parties, including the designation of the CCAA Parties' business segments and certain non-filing entities, is set out in the Pre-Filing Report of FTI Consulting Inc. (the "Monitor") at paragraph 13. A copy is attached as Schedule "B".

12 Cinram Fund, CII, Cinram International General Partner Inc. ("Cinram GP"), CII Trust, Cinram ULC and 1362806 Ontario Limited are the Canadian entities in the Cinram Group that are Applicants in these proceedings (collectively, the "Canadian Applicants"). Cinram Fund and CII Trust are both open-ended limited purpose trusts, established under the laws of Ontario, and each of the remaining Canadian Applicants is incorporated pursuant to Federal or Provincial legislation.

13 Cinram (US) Holdings Inc. ("CUSH"), Cinram Inc., IHC Corporation ("IHC"), Cinram Manufacturing, LLC ("Cinram Manufacturing"), Cinram Distribution, LLC ("Cinram Distribution"), Cinram Wireless, LLC ("Cinram Wireless"), Cinram Retail Services, LLC ("Cinram Retail") and One K Studios, LLC ("One K") are the U.S. entities in the Cinram Group that are Applicants in these proceedings (collectively, the "U.S. Applicants"). Each of the U.S. Applicants is incorporated under the laws of Delaware, with the exception of One K, which is incorporated under the laws of California. On May 25, 2012, each of the U.S. Applicants opened a new Canadian-based bank account with J.P. Morgan.

14 Cinram LP is not an Applicant in these proceedings. However, the Applicants seek to have a stay of proceedings and other relief under the CCAA extended to Cinram LP as it forms part of Cinram's income trust structure with Cinram Fund, the ultimate parent of the Cinram Group.

15 Cinram's European entities are not part of these proceedings and it is not intended that any insolvency proceedings will be commenced with respect to Cinram's European entities, except for Cinram Optical Discs SAC, which has commenced insolvency proceedings in France.

16 The Cinram Group's principal source of long-term debt is the senior secured credit facilities provided under credit agreements known as the "First-Lien Credit Agreement" and the "Second-Lien Credit Agreement" (together with the First-Lien Credit Agreement, the "Credit Agreements").

17 All of the CCAA Parties, with the exception of Cinram Fund, Cinram GP, CII Trust and Cinram LP (collectively, the "Fund Entities"), are borrowers and/or guarantors under the Credit Agreements. The obligations under the Credit Agreements are secured by substantially all of the assets of the Applicants and certain of their European subsidiaries.

18 As at March 31, 2012, there was approximately $233 million outstanding under the First-Lien Term Loan Facility; $19 million outstanding under the First-Lien Revolving Credit Facilities; approximately $12 million of letter of credit exposure under the First-Lien Credit Agreement; and approximately $12 million outstanding under the Second-Lien Credit Agreement.

19 Cinram advises that in light of the financial circumstances of the Cinram Group, it is not possible to obtain additional financing that could be used to repay the amounts owing under the Credit Agreements.

20 Mr. John Bell, Chief Financial Officer of CII, stated in his affidavit that in connection with certain defaults under the Credit Agreements, a series of waivers was extended from December 2011 to June 30, 2012 and that upon expiry of the waivers, the lenders have the ability to demand immediate repayment of the outstanding amounts under the Credit Agreements and the borrowers and the other Applicants that are guarantors under the Credit Agreements would be unable to meet

their debt obligations. Mr. Bell further stated that there is no reasonable expectation that Cinram would be able to service its debt load in the short to medium term given forecasted net revenues and EBITDA for the remainder of fiscal 2012, fiscal 2013, and fiscal 2014. The cash flow forecast attached to his affidavit indicates that, without additional funding, the Applicants will exhaust their available cash resources and will thus be unable to meet their obligations as they become due.

21 The Applicants request a stay of proceedings. They take the position that in light of their financial circumstances, there could be a vast and significant erosion of value to the detriment of all stakeholders. In particular, the Applicants are concerned about the following risks, which, because of the integration of the Cinram business, also apply to the Applicants' subsidiaries, including Cinram LP:

> (a) the lenders demanding payment in full for money owing under the Credit Agreements;
>
> (b) potential termination of contracts by key suppliers; and
>
> (c) potential termination of contracts by customers.

22 As indicated in the cash flow forecast, the Applicants do not have sufficient funds available to meet their immediate cash requirements as a result of their current liquidity challenges. Mr. Bell states in his affidavit that the Applicants require access to Debtor-In-Possession ("DIP") Financing in the amount of $15 millions to continue operations while they implement their restructuring, including the Proposed Transaction. Cinram has negotiated a DIP Credit Agreement with the lenders forming the Steering Committee (the "DIP Lenders") through J.P. Morgan Chase Bank, NA as Administrative Agent (the "DIP Agent") whereby the DIP Lenders agree to provide the DIP Financing in the form of a term loan in the amount of $15 million.

23 The Applicants also indicate that during the course of the CCAA proceedings, the CCAA Parties intend to generally make payments to ensure their ongoing business operations for the benefit of their stakeholders, including obligations incurred prior to, on, or after the commencement of these proceedings relating to:

> (a) the active employment of employees in the ordinary course;
>
> (b) suppliers and service providers the CCAA Parties and the Monitor have determined to be critical to the continued operation of the Cinram business;
>
> (c) certain customer programs in place pursuant to existing contracts or arrangements with customers; and
>
> (d) inter-company payments among the CCAA Parties in respect of, among other things, shared services.

24 Mr. Bell states that the ability to make these payments relating to critical suppliers and customer programs is subject to a consultation and approval process agreed to among the Monitor, the DIP Agent and the CCAA Parties.

25 The Applicants also request an Administration Charge for the benefit of the Monitor and Moelis and Company, LLC ("Moelis"), an investment bank engaged to assist Cinram in a comprehensive and thorough review of its strategic alternatives.

26 In addition, the directors (and in the case of Cinram Fund and CII Trust, the Trustees, referred to collectively with the directors as the "Directors/Trustees") requested a Director's Charge to provide certainty with respect to potential personal liability if they continue in their current capacities. Mr. Bell states that in order to complete a successful restructuring, including the Proposed Transaction, the Applicants require the active and committed involvement of their Directors/Trustees and officers. Further, Cinram's insurers have advised that if Cinram was to file for CCAA protection, and the insurers agreed to renew the existing D&O policies, there would be a significant increase in the premium for that insurance.

27 Cinram has also developed a key employee retention program (the "KERP") with the principal purpose of providing an incentive for eligible employees, including eligible officers, to remain with the Cinram Group despite its financial difficulties. The KERP has been reviewed and approved by the Board of Trustees of the Cinram Fund. The KERP includes retention payments (the "KERP Retention Payments") to certain existing employees, including certain officers employed at Canadian and U.S. Entities, who are critical to the preservation of Cinram's enterprise value.

28 Cinram also advises that on June 22, 2012, Cinram Fund, the borrowers under the Credit Agreements, and the Initial Consenting Lenders entered into a support agreement pursuant to which the Initial Consenting Lenders agreed to support the Proposed Transaction to be pursued through these CCAA proceedings (the "Support Agreement").

29 Pursuant to the Support Agreement, lenders under the First-Lien Credit Agreement who execute the Support Agreement or Consent Agreement prior to July 10, 2012 (the "Consent Date") are entitled to receive consent consideration (the "Early Consent Consideration") equal to 4% of the principal amount of loans under the First-Lien Credit Agreement held by such consenting lenders as of the Consent Date, payable in cash from the net sale proceeds of the Proposed Transaction upon distribution of such proceeds in the CCAA proceedings.

30 Mr. Bell states that it is contemplated that the CCAA proceedings will be the primary court-supervised restructuring of the CCAA Parties. He states that the CCAA Parties are part of a consolidated business in Canada, the United States and Europe that is headquartered in Canada and operationally and functionally integrated in many significant respects. Mr. Bell further states that

although Cinram has operations in the United States, and certain of the Applicants are incorporated under the laws of the United States, it is Ontario that is Cinram's home jurisdiction and the nerve centre of the CCAA Parties' management, business and operations.

31 The CCAA Parties have advised that they will be seeking a recognition order under Chapter 15 to ensure that they are protected from creditor actions in the United States and to assist with the global implementation of the Proposed Transaction. Thus, the Applicants seek authorization in the Proposed Initial Order for:

> Cinram ULC to seek recognition of these proceedings as "foreign main proceedings" and to seek such additional relief required in connection with the prosecution of any sale transaction, including the Proposed Transaction, as well as authorization for the Monitor, as a court-appointed officer, to assist the CCAA Parties with any matters relating to any of the CCAA Parties' subsidiaries and any foreign proceedings commenced in relation thereto.

32 Mr. Bell further states that the Monitor will be actively involved in assisting Cinram ULC as the foreign representative of the Applicants in the Chapter 15 proceedings and will assist in keeping this court informed of developments in the Chapter 15 proceedings.

33 The facts relating to the CCAA Parties, the Cinram business, and the requested relief are fully set out in Mr. Bell's affidavit.

34 Counsel to the Applicants filed a comprehensive factum in support of the requested relief in the Initial Order. Part III of the factum sets out the issues and the law.

35 The relief requested in the form of the Initial Order is extensive. It goes beyond what this court usually considers on an initial hearing. However, in the circumstances of this case, I have been persuaded that the requested relief is appropriate.

36 In making this determination, I have taken into account that the Applicants have spent a considerable period of time reviewing their alternatives and have done so in a consultative manner with their senior secured lenders. The senior secured lenders support this application, notwithstanding that it is clear that they will suffer a significant shortfall on their positions. It is also noted that the Early Consent Consideration will be available to lenders under the First-Lien Credit Agreement who execute the Support Agreement prior to July 10, 2012. Thus, all of these lenders will have the opportunity to participate in this arrangement.

37 As previously indicated, the Applicants' factum is comprehensive. The submissions on the law are extensive and cover all of the outstanding issues. It provides a fulsome review of the jurisprudence in the area, which for purposes of this application, I accept. For this reason, paragraphs 41-96 of the factum are attached as Schedule "C" for reference purposes.

38 The Applicants have also requested that the confidential supplement — which contains the KERP summary listing the individual KERP Payments and certain DIP Schedules — be sealed. I am satisfied that the KERP summary contains individually identifiable information and compensation information, including sensitive salary information, about the individuals who are covered by the KERP and that the DIP schedules contain sensitive competitive information of the CCAA Parties which should also be treated as being confidential. Having considered the principals of *Sierra Club of Canada v. Canada (Minister of Finance)*, [2002] 2 S.C.R. 522 (S.C.C.), I accept the Applicants' submission on this issue and grant the requested sealing order in respect of the confidential supplement.

39 Finally, the Applicants have advised that they intend to proceed with a Chapter 15 application on June 26, 2012 before the United States Bankruptcy Court in the District of Delaware. I am given to understand that Cinram ULC, as proposed foreign representative, will be seeking recognition of the CCAA proceedings as "foreign main proceedings" on the basis that Ontario, Canada is the Centre of Main Interest or "COMI" of the CCAA Applicants.

40 In his affidavit at paragraph 195, Mr. Bell states that the CCAA Parties are part of a consolidated business that is headquartered in Canada and operationally and functionally integrated in many significant respects and that, as a result of the following factors, the Applicants submit the COMI of the CCAA Parties is Ontario, Canada:

> (a) the Cinram Group is managed on a consolidated basis out of the corporate headquarters in Toronto, Ontario, where corporate-level decision-making and corporate administrative functions are centralized;
>
> (b) key contracts, including, among others, major customer service agreements, are negotiated at the corporate level and created in Canada;
>
> (c) the Chief Executive Officer and Chief Financial Officer of CII, who are also directors, trustees and/or officers of other entities in the Cinram Group, are based in Canada;
>
> (d) meetings of the board of trustees and board of directors typically take place in Canada;
>
> (e) pricing decisions for entities in the Cinram Group are ultimately made by the Chief Executive Officer and Chief Financial Officer in Toronto, Ontario;
>
> (f) cash management functions for Cinram's North American entities, including the administration of Cinram's accounts receivable and accounts payable, are managed from Cinram's head office in Toronto, Ontario;

(g) although certain bookkeeping, invoicing and accounting functions are performed locally, corporate accounting, treasury, financial reporting, financial planning, tax planning and compliance, insurance procurement services and internal audits are managed at a consolidated level in Toronto, Ontario;

(h) information technology, marketing, and real estate services are provided by CII at the head office in Toronto, Ontario;

(i) with the exception of routine maintenance expenditures, all capital expenditure decisions affecting the Cinram Group are managed in Toronto, Ontario;

(j) new business development initiatives are centralized and managed from Toronto, Ontario; and

(k) research and development functions for the Cinram Group are corporate-level activities centralized at Toronto, Ontario, including the Cinram Group's corporate-level research and development budget and strategy.

41 Counsel submits that the CCAA Parties are highly dependent upon the critical business functions performed on their behalf from Cinram's head office in Toronto and would not be able to function independently without significant disruptions to their operations.

42 The above comments with respect to the COMI are provided for informational purposes only. This court clearly recognizes that it is the function of the receiving court — in this case, the United States Bankruptcy Court for the District of Delaware — to make the determination on the location of the COMI and to determine whether this CCAA proceeding is a "foreign main proceeding" for the purposes of Chapter 15.

43 In the result, I am satisfied that the Applicants meet all of the qualifications established for relief under the CCAA and I have signed the Initial Order in the form submitted, which includes approvals of the Charges referenced in the Initial Order.

Schedule "A"

Additional Applicants

Cinram International General Partner Inc.

Cinram International ULC

1362806 Ontario Limited

Cinram (U.S.) Holdings Inc.

Cinram, Inc.

IHC Corporation

Cinram Manufacturing LLC

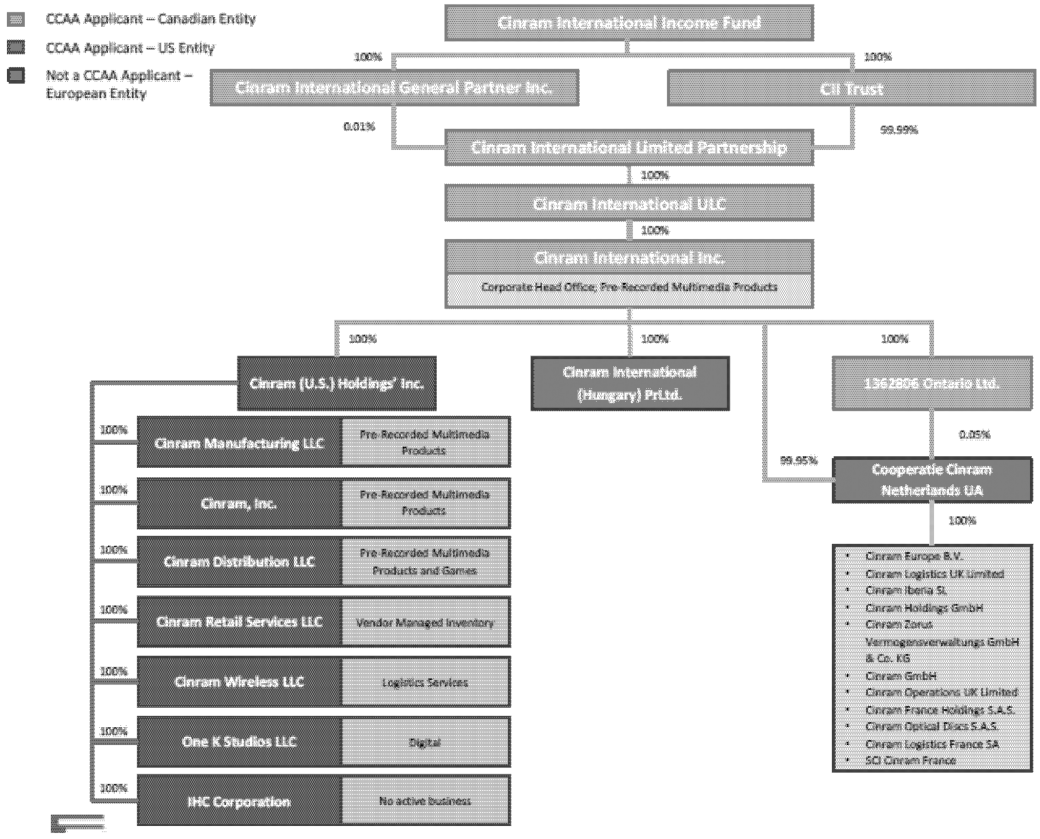
Cinram Distribution LLC

Cinram Wireless LLC

Cinram Retail Services, LLC

One K Studios, LLC

Schedule "B"



Graphic 1

Schedule "C"

A. The Applicants Are "Debtor Companies" to Which the CCAA Applies

41. The CCAA applies in respect of a "debtor company" (including a foreign company having assets or doing business in Canada) or "affiliated debtor companies" where the total of claims against such company or companies exceeds $5 million.

> CCAA, Section 3(1).

42. The Applicants are eligible for protection under the CCAA because each is a "debtor company" and the total of the claims against the Applicants exceeds $5 million.

(1) The Applicants are Debtor Companies

43. The terms "company" and "debtor company" are defined in Section 2 of the CCAA as follows:

> "company" means any company, corporation or legal person incorporated by or under an Act of Parliament or of the legislature of a province and any incorporated company having assets or doing business in Canada, wherever incorporated, and any income trust, but does not include banks, authorized foreign banks within the meaning of section 2 of the *Bank Act*, railway or telegraph companies, insurance companies and companies to which the *Trust and Loan Companies Act* applies.
>
> "debtor company" means any company that:
>
> (a) is bankrupt or insolvent;
>
> (b) has committed an act of bankruptcy within the meaning of the *Bankruptcy and Insolvency Act* or is deemed insolvent within the meaning of the *Winding-Up and Restructuring Act*, whether or not proceedings in respect of the company have been taken under either of those Acts;
>
> (c) has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy and Insolvency Act*; or
>
> (d) is in the course of being wound up under the *Winding-Up and Restructuring Act* because the company is insolvent.
>
> CCAA, Section 2 ("company" and "debtor company").

44. The Applicants are debtor companies within the meaning of these definitions.

(2) The Applicants are "companies"

45. The Applicants are "companies" because:

a. with respect to the Canadian Applicants, each is incorporated pursuant to federal or provincial legislation or, in the case of Cinram Fund and CII Trust, is an income trust; and

b. with respect to the U.S. Applicants, each is an incorporated company with certain funds in bank accounts in Canada opened in May 2012 and therefore each is a company having assets or doing business in Canada.

Bell Affidavit at paras. 4, 80, 84, 86, 91, 94, 98, 102, 105, 108, 111, 114, 117, 120, 123, 212; Application Record, Tab 2.

46. The test for "having assets or doing business in Canada" is disjunctive, such that either "having assets" in Canada or "doing business in Canada" is sufficient to qualify an incorporated company as a "company" within the meaning of the CCAA.

47. Having only nominal assets in Canada, such as funds on deposit in a Canadian bank account, brings a foreign corporation within the definition of "company". In order to meet the threshold statutory requirements of the CCAA, an applicant need only be in technical compliance with the plain words of the CCAA.

Canwest Global Communications Corp., Re (2009), 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) at para. 30 [*Canwest Global*]; Book of Authorities of the Applicants ("*Book of Authorities*"), Tab 1.

Global Light Telecommunications Inc., Re (2004), 2 C.B.R. (5th) 210 (B.C. S.C.) at para. 17 [*Global Light*]; Book of Authorities, Tab 2.

48. The Courts do not engage in a quantitative or qualitative analysis of the assets or the circumstances in which the assets were created. Accordingly, the use of "instant" transactions immediately preceding a CCAA application, such as the creation of "instant debts" or "instant assets" for the purposes of bringing an entity within the scope of the CCAA, has received judicial approval as a legitimate device to bring a debtor within technical requirements of the CCAA.

Global Light Telecommunications Inc., Re, supra at para. 17; Book of Authorities, Tab 2.

Cadillac Fairview Inc., Re (1995), 30 C.B.R. (3d) 29 (Ont. Gen. Div. [Commercial List]) at paras. 5-6; Book of Authorities, Tab 3.

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 O.R. (3d) 289 (Ont. C.A.) at paras. 74, 83; Book of Authorities, Tab 4.

(3) The Applicants are insolvent

49. The Applicants are "debtor companies" as defined in the CCAA because they are companies (as set out above) and they are insolvent.

50. The insolvency of the debtor is assessed as of the time of filing the CCAA application. The CCAA does not define insolvency. Accordingly, in interpreting the meaning of "insolvent", courts have taken guidance from the definition of "insolvent person" in Section 2(1) of the *Bankruptcy and Insolvency Act* (the "BIA"), which defines an "insolvent person" as a person (i) who is not bankrupt; and (ii) who resides, carries on business or has property in Canada; (iii) whose liabilities to creditors provable as claims under the BIA amount to one thousand dollars; and (iv) who is "insolvent" under one of the following tests:

> a. is for any reason unable to meet his obligations as they generally become due;
>
> b. has ceased paying his current obligations in the ordinary course of business as they generally become due; or
>
> c. the aggregate of his property is not, at a fair valuation, sufficient, or if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all his obligations, due and accruing due.
>
> BIA, Section 2 ("insolvent person").
>
> *Stelco Inc., Re* (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J. [Commercial List]); leave to appeal to C.A. refused [2004] O.J. No. 1903 (Ont. C.A.); leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 336 (S.C.C.), at para.4 [*Stelco*]; Book of Authorities, Tab 5.

51. These tests for insolvency are disjunctive. A company satisfying any one of these tests is considered insolvent for the purposes of the CCAA.

> *Stelco Inc., Re, supra* at paras. 26 and 28; Book of Authorities, Tab 5.

52. A company is also insolvent for the purposes of the CCAA if, at the time of filing, there is a reasonably foreseeable expectation that there is a looming liquidity condition or crisis that would result in the company being unable to pay its debts as they generally become due if a stay of proceedings and ancillary protection are not granted by the court.

> *Stelco Inc., Re, supra* at para. 40; Book of Authorities, Tab 5.

53. The Applicants meet both the traditional test for insolvency under the BIA and the expanded test for insolvency based on a looming liquidity condition as a result of the following:

a. The Applicants are unable to comply with certain financial covenants under the Credit Agreements and have entered into a series of waivers with their lenders from December 2011 to June 30, 2012.

b. Were the Lenders to accelerate the amounts owing under the Credit Agreements, the Borrowers and the other Applicants that are Guarantors under the Credit Agreements would be unable to meet their debt obligations. Cinram Fund would be the ultimate parent of an insolvent business.

d. The Applicants have been unable to repay or refinance the amounts owing under the Credit Agreements or find an out-of-court transaction for the sale of the Cinram Business with proceeds that equal or exceed the amounts owing under the Credit Agreements.

e. Reduced revenues and EBITDA and increased borrowing costs have significantly impaired Cinram's ability to service its debt obligations. There is no reasonable expectation that Cinram will be able to service its debt load in the short to medium term given forecasted net revenues and EBITDA for the remainder of fiscal 2012 and for fiscal 2013 and 2014.

f. The decline in revenues and EBITDA generated by the Cinram Business has caused the value of the Cinram Business to decline. As a result, the aggregate value of the Property, taken at fair value, is not sufficient to allow for payment of all of the Applicants' obligations due and accruing due.

g. The Cash Flow Forecast indicates that without additional funding the Applicants will exhaust their available cash resources and will thus be unable to meet their obligations as they become due.

Bell Affidavit, paras. 23, 179-181, 183, 197-199; Application Record, Tab 2.

(4) The Applicants are affiliated companies with claims outstanding in excess of $5 million

54. The Applicants are affiliated debtor companies with total claims exceeding 5 million dollars. Therefore, the CCAA applies to the Applicants in accordance with Section 3(1).

55. Affiliated companies are defined in Section 3(2) of the CCAA as follows:

a. companies are affiliated companies if one of them is the subsidiary of the other or both are subsidiaries of the same company or each is controlled by the same person; and

b. two companies are affiliated with the same company at the same time are deemed to be affiliated with each other.

CCAA, Section 3(2).

56. CII, CII Trust and all of the entities listed in Schedule "A" hereto are indirect, wholly owned subsidiaries of Cinram Fund; thus, the Applicants are "affiliated companies" for the purpose of the CCAA.

Bell Affidavit, paras. 3, 71; Application Record, Tab 2.

57. All of the CCAA Parties (except for the Fund Entities) are each a Borrower and/or Guarantor under the Credit Agreements. As at March 31, 2012 there was approximately $252 million of aggregate principal amount outstanding under the First Lien Credit Agreement (plus approximately $12 million in letter of credit exposure) and approximately $12 million of aggregate principal amount outstanding under the Second Lien Credit Agreement. The total claims against the Applicants far exceed $5 million.

Bell Affidavit, paras. 75; Application Record, Tab 2.

B. The Relief is Available under The CCAA and Consistent with the Purpose and Policy of the CCAA

(1) The CCAA is Flexible, Remedial Legislation

58. The CCAA is remedial legislation, intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy. In particular during periods of financial hardship, debtors turn to the Court so that the Court may apply the CCAA in a flexible manner in order to accomplish the statute's goals. The Court should give the CCAA a broad and liberal interpretation so as to encourage and facilitate successful restructurings whenever possible.

Nova Metal Products Inc. v. Comiskey (Trustee of), supra at paras. 22 and 56-60; Book of Authorities, Tab 4. *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]) at para. 5; Book of Authorities, Tab 6.

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311 (B.C. C.A.), at pp. 4 and 7; Book of Authorities, Tab 7.

59. On numerous occasions, courts have held that Section 11 of the CCAA provides the courts with a broad and liberal power, which is at their disposal in order to achieve the overall objective of the CCAA. Accordingly, an interpretation of the CCAA that facilitates restructurings accords with its purpose.

Sulphur Corp. of Canada Ltd., Re (2002), 35 C.B.R. (4th) 304 (Alta. Q.B.) ("*Sulphur*") at para. 26; Book of Authorities, Tab 8.

60. Given the nature and purpose of the CCAA, this Honourable Court has the authority and jurisdiction to depart from the Model Order as is reasonable and necessary in order to achieve a successful restructuring.

(2) The Stay of Proceedings Against Non-Applicants is Appropriate

61. The relief sought in this application includes a stay of proceedings in favour of Cinram LP and the Applicants' direct and indirect subsidiaries that are also party to an agreement with an Applicant (whether as surety, guarantor or otherwise) (each, a "Subsidiary Counterparty"), including any contract or credit agreement. It is just and reasonable to grant the requested stay of proceedings because:

> a. the Cinram Business is integrated among the Applicants, Cinram LP and the Subsidiary Counterparties;
>
> b. if any proceedings were commenced against Cinram LP, or if any of the third parties to such agreements were to commence proceedings or exercise rights and remedies against the Subsidiary Counterparties, this would have a detrimental effect on the Applicants' ability to restructure and implement the Proposed Transaction and would lead to an erosion of value of the Cinram Business; and
>
> c. a stay of proceedings that extends to Cinram LP and the Subsidiary Counterparties is necessary in order to maintain stability with respect to the Cinram Business and maintain value for the benefit of the Applicants' stakeholders.
>
> Bell Affidavit, paras. 185-186; Application Record, Tab 2.

62. The purpose of the CCAA is to preserve the *status quo* to enable a plan of compromise to be prepared, filed and considered by the creditors:

> In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors.
>
> *Lehndorff General Partner Ltd., Re*, *supra* at para. 5; Book of Authorities, Tab 6. *Canwest Global Communications Corp., Re*, *supra* at para. 27; Book of Authorities, Tab 1.
>
> CCAA, Section 11.

63. The Court has broad inherent jurisdiction to impose stays of proceedings that supplement the statutory provisions of Section 11 of the CCAA, providing the Court with the power to grant a stay

of proceedings where it is just and reasonable to do so, including with respect to non-applicant parties.

Lehndorff General Partner Ltd., Re, supra at paras. 5 and 16; Book of Authorities, Tab 6.

T. Eaton Co., Re (1997), 46 C.B.R. (3d) 293 (Ont. Gen. Div.) at para. 6; Book of Authorities, Tab 9.

64. The Courts have found it just and reasonable to grant a stay of proceedings against third party non-applicants in a number of circumstances, including:

a. where it is important to the reorganization process;

b. where the business operations of the Applicants and the third party non-applicants are intertwined and the third parties are not subject to the jurisdiction of the CCAA, such as partnerships that do not qualify as "companies" within the meaning of the CCAA;

c. against non-applicant subsidiaries of a debtor company where such subsidiaries were guarantors under the note indentures issued by the debtor company; and

d. against non-applicant subsidiaries relating to any guarantee, contribution or indemnity obligation, liability or claim in respect of obligations and claims against the debtor companies.

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236 (B.C. S.C.) at para. 31; Book of Authorities, Tab 10. *Lehndorff General Partner Ltd., Re, supra* at para. 21; Book of Authorities, Tab 6.

Canwest Global Communications Corp., Re, supra at paras. 28 and 29; Book of Authorities, Tab 1.

Sino-Forest Corp., Re, 2012 ONSC 2063 (Ont. S.C.J. [Commercial List]) at paras. 5, 18, and 31; Book of Authorities, Tab 11.

Re MAAX Corp, Initial Order granted June 12, 2008, Montreal 500-11-033561-081, (Que. Sup. Ct. [Commercial Division]) at para. 7; Book of Authorities, Tab 12.

65. The Applicants submit the balance of convenience favours extending the relief in the proposed Initial Order to Cinram LP and the Subsidiary Counterparties. The business operations of the Applicants, Cinram LP and the Subsidiary Counterparties are intertwined and the stay of proceedings is necessary to maintain stability and value for the benefit of the Applicants' stakeholders, as well as allow an orderly, going-concern sale of the Cinram Business as an important component of its reorganization process.

(3) Entitlement to Make Pre-Filing Payments

66. To ensure the continued operation of the CCAA Parties' business and maximization of value in the interests of Cinram's stakeholders, the Applicants seek authorization (but not a requirement) for the CCAA Parties to make certain pre-filing payments, including: (a) payments to employees in respect of wages, benefits, and related amounts; (b) payments to suppliers and service providers critical to the ongoing operation of the business; (c) payments and the application of credits in connection with certain existing customer programs; and (d) intercompany payments among the Applicants related to intercompany loans and shared services. Payments will be made with the consent of the Monitor and, in certain circumstances, with the consent of the Agent.

67. There is ample authority supporting the Court's general jurisdiction to permit payment of pre-filing obligations to persons whose services are critical to the ongoing operations of the debtor companies. This jurisdiction of the Court is not ousted by Section 11.4 of the CCAA, which became effective as part of the 2009 amendments to the CCAA and codified the Court's practice of declaring a person to be a critical supplier and granting a charge on the debtor's property in favour of such critical supplier. As noted by Pepall J. in *Canwest Global Communications Corp., Re*, the recent amendments, including Section 11.4, do not detract from the inherently flexible nature of the CCAA or the Court's broad and inherent jurisdiction to make such orders that will facilitate the debtor's restructuring of its business as a going concern.

> *Canwest Global Communications Corp., Re supra*, at paras. 41 and 43; Book of Authorities, Tab 1.

68. There are many cases since the 2009 amendments where the Courts have authorized the applicants to pay certain pre-filing amounts where the applicants were not seeking a charge in respect of critical suppliers. In granting this authority, the Courts considered a number of factors, including:

> a. whether the goods and services were integral to the business of the applicants;
>
> b. the applicants' dependency on the uninterrupted supply of the goods or services;
>
> c. the fact that no payments would be made without the consent of the Monitor;
>
> d. the Monitor's support and willingness to work with the applicants to ensure that payments to suppliers in respect of pre-filing liabilities are minimized;
>
> e. whether the applicants had sufficient inventory of the goods on hand to meet their needs; and
>
> f. the effect on the debtors' ongoing operations and ability to restructure if they were unable to make pre-filing payments to their critical suppliers.

Canwest Global Communications Corp., Re supra, at para. 43; Book of Authorities, Tab 1.

Brainhunter Inc., Re, [2009] O.J. No. 5207 (Ont. S.C.J. [Commercial List]) at para. 21 [*Brainhunter*]; Book of Authorities, Tab 13.

Priszm Income Fund, Re (2011), 75 C.B.R. (5th) 213 (Ont. S.C.J.) at paras. 29-34; Book of Authorities, Tab 14.

69. The CCAA Parties rely on the efficient and expedited supply of products and services from their suppliers and service providers in order to ensure that their operations continue in an efficient manner so that they can satisfy customer requirements. The CCAA Parties operate in a highly competitive environment where the timely provision of their products and services is essential in order for the company to remain a successful player in the industry and to ensure the continuance of the Cinram Business. The CCAA Parties require flexibility to ensure adequate and timely supply of required products and to attempt to obtain and negotiate credit terms with its suppliers and service providers. In order to accomplish this, the CCAA Parties require the ability to pay certain pre-filing amounts and post-filing payables to those suppliers they consider essential to the Cinram Business, as approved by the Monitor. The Monitor, in determining whether to approve pre-filing payments as critical to the ongoing business operations, will consider various factors, including the above factors derived from the caselaw.

Bell Affidavit, paras. 226, 228, 230; Application Record, Tab 2.

70. In addition, the CCAA Parties' continued compliance with their existing customer programs, as described in the Bell Affidavit, including the payment of certain pre-filing amounts owing under certain customer programs and the application of certain credits granted to customers pre-filing to post-filing receivables, is essential in order for the CCAA Parties to maintain their customer relationships as part of the CCAA Parties' going concern business.

Bell Affidavit, paras. 234; Application Record, Tab 2.

71. Further, due to the operational integration of the businesses of the CCAA Parties, as described above, there is a significant volume of financial transactions between and among the Applicants, including, among others, charges by an Applicant providing shared services to another Applicant of intercompany accounts due from the recipients of those services, and charges by a Applicant that manufactures and furnishes products to another Applicant of inter-company accounts due from the receiving entity.

Bell Affidavit, paras. 225; Application Record, Tab 2.

72. Accordingly, the Applicants submit that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the CCAA Parties the authority to make the pre-filing payments described in the proposed Initial Order subject to the terms therein.

(4) The Charges Are Appropriate

73. The Applicants seek approval of certain Court-ordered charges over their assets relating to their DIP Financing (defined below), administrative costs, indemnification of their trustees, directors and officers, KERP and Support Agreement. The Lenders and the Administrative Agent under the Credit Agreements, the senior secured facilities that will be primed by the charges, have been provided with notice of the within Application. The proposed Initial Order does not purport to give the Court-ordered charges priority over any other validly perfected security interests.

(A) DIP Lenders' Charge

74. In the proposed Initial Order, the Applicants seek approval of the DIP Credit Agreement providing a debtor-in-possession term facility in the principal amount of $15 million (the "DIP Financing"), to be secured by a charge over all of the assets and property of the Applicants that are Borrowers and/or Guarantors under the Credit Agreements (the "Charged Property") ranking ahead of all other charges except the Administration Charge.

75. Section 11.2 of the CCAA expressly provides the Court the statutory jurisdiction to grant a debtor-in-possession ("DIP") financing charge:

> 11.2(1) *Interim financing* - On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.
>
> 11.2(2) *Priority* — secured creditors — The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> *Timminco Ltd., Re*, 211 A.C.W.S. (3d) 881 (Ont. S.C.J. [Commercial List]) [2012 CarswellOnt 1466] at para. 31; Book of Authorities, Tab 15. CCAA, Section 11.2(1) and (2).

76. Section 11.2 of the CCAA sets out the following factors to be considered by the Court in deciding whether to grant a DIP financing charge:

> 11.2(4) Factors to be considered — In deciding whether to make an order, the court is to consider, among other things,
>
> (a) the period during which the company is expected to be subject to proceedings under this Act;
>
> (b) how the company's business and financial affairs are to be managed during the proceedings;
>
> (c) whether the company's management has the confidence of its major creditors;
>
> (d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;
>
> (e) the nature and value of the company's property;
>
> (f) whether any creditor would be materially prejudiced as a result of the security or charge; and
>
> (g) the monitor's report referred to in paragraph 23(1)(*b*), if any.
>
> CCAA, Section 11.2(4).

77. The above list of factors is not exhaustive, and it may be appropriate for the Court to consider additional factors in determining whether to grant a DIP financing charge. For example, in circumstances where funds to be borrowed pursuant to a DIP facility were not expected to be immediately necessary, but applicants' cash flow statements projected the need for additional liquidity, the Court in granting the requested DIP charge considered the fact that the applicants' ability to borrows funds that would be secured by a charge would help retain the confidence of their trade creditors, employees and suppliers.

> *Canwest Publishing Inc./Publications Canwest Inc., Re* (2010), 63 C.B.R. (5th) 115 (Ont. S.C.J. [Commercial List]) at paras. 42-43 [*Canwest Publishing*]; Book of Authorities, Tab 16.

78. Courts in recent cross-border cases have exercised their broad power to grant charges to DIP lenders over the assets of foreign applicants. In many of these cases, the debtors have commenced recognition proceedings under Chapter 15.

> *Re Catalyst Paper Corporation*, Initial Order granted on January 31, 2012, Court File No. S-120712 (B.C.S.C.) [*Catalyst Paper*]; Book of Authorities, Tab 17.

Angiotech, *supra*, Initial Order granted on January 28, 2011, Court File No. S-110587; Book of Authorities, Tab 18

Fraser Papers Inc., *Re* [2009 CarswellOnt 3658 (Ont. S.C.J. [Commercial List])], Initial Order granted on June 18, 2009, Court File No. CV-09-8241-00CL; Book of Authorities, Tab 19.

79. As noted above, pursuant to Section 11.2(1) of the CCAA, a DIP financing charge may not secure an obligation that existed before the order was made. The requested DIP Lenders' Charge will not secure any pre-filing obligations.

80. The following factors support the granting of the DIP Lenders' Charge, many of which incorporate the considerations enumerated in Section 11.2(4) listed above:

a. the Cash Flow Forecast indicates the Applicants will need additional liquidity afforded by the DIP Financing in order to continue operations through the duration of these proposed CCAA Proceedings;

b. the Cinram Business is intended to continue to operate on a going concern basis during these CCAA Proceedings under the direction of the current management with the assistance of the Applicants' advisors and the Monitor;

c. the DIP Financing is expected to provide the Applicants with sufficient liquidity to implement the Proposed Transaction through these CCAA Proceedingsand implement certain operational restructuring initiatives, which will materially enhance the likelihood of a going concern outcome for the Cinram Business;

d. the nature and the value of the Applicants' assets as set out in their consolidated financial statements can support the requested DIP Lenders' Charge;

e. members of the Steering Committee under the First Lien Credit Agreement, who are senior secured creditors of the Applicants, have agreed to provide the DIP Financing;

f. the proposed DIP Lenders have indicated that they will not provide the DIP Financing if the DIP Lenders' Charge is not approved;

g. the DIP Lenders' Charge will not secure any pre-filing obligations;

h. the senior secured lenders under the Credit Agreements affected by the charge have been provided with notice of these CCAA Proceedings;and

i. the proposed Monitor is supportive of the DIP Facility, including the DIP Lenders' Charge.

Bell Affidavit, paras. 199-202, 205-208; Application Record, Tab 2.

(B) Administration Charge

81. The Applicants seek a charge over the Charged Property in the amount of CAD$3.5 million to secure the fees of the Monitor and its counsel, the Applicants' Canadian and U.S. counsel, the Applicants' Investment Banker, the Canadian and U.S. Counsel to the DIP Agent, the DIP Lenders, the Administrative Agent and the Lenders under the Credit Agreements, and the financial advisor to the DIP Lenders and the Lenders under the Credit Agreements (the "Administration Charge"). This charge is to rank in priority to all of the other charges set out in the proposed Initial Order.

82. Prior to the 2009 amendments, administration charges were granted pursuant to the inherent jurisdiction of the Court. Section 11.52 of the CCAA now expressly provides the court with the jurisdiction to grant an administration charge:

> 11.52(1) *Court may order security or charge to cover certain costs*
>
> On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of
>
> > (a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;
> >
> > (b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and
> >
> > (c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.
>
> 11.52(2) *Priority*
>
> The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> CCAA, Section 11.52(1) and (2).

82. Administration charges were granted pursuant to Section 11.52 in, among other cases, *Timminco Ltd., Re, Canwest Global Communications Corp., Re* and *Canwest Publishing Inc./ Publications Canwest Inc., Re.*

Canwest Global Communications Corp., Re, *supra*; Book of Authorities, Tab 1.

Canwest Publishing, *supra*; Book of Authorities, Tab 16.

Timminco Ltd., Re, 2012 ONSC 106 (Ont. S.C.J. [Commercial List]) [*Timminco*]; Book of Authorities, Tab 20.

84. In *Canwest Publishing*, the Court noted Section 11.52 does not contain any specific criteria for a court to consider in granting an administration charge and provided a list of non-exhaustive factors to consider in making such an assessment. These factors were also considered by the Court in *Timminco*. The list of factors to consider in approving an administration charge include:

a. the size and complexity of the business being restructured;

b. the proposed role of the beneficiaries of the charge;

c. whether there is unwarranted duplication of roles;

d. whether the quantum of the proposed charge appears to be fair and reasonable;

e. the position of the secured creditors likely to be affected by the charge; and

f. the position of the Monitor.

Canwest Publishing supra, at para. 54; Book of Authorities, Tab 16.

Timminco, *supra*, at paras. 26-29; Book of Authorities, Tab 20.

85. The Applicants submit that the Administration Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the Administration Charge, given:

a. the proposed restructuring of the Cinram Business is large and complex, spanning several jurisdictions across North America and Europe, and will require the extensive involvement of professional advisors;

b. the professionals that are to be beneficiaries of the Administration Charge have each played a critical role in the CCAA Parties' restructuring efforts to date and will continue to be pivotal to the CCAA Parties' ability to pursue a successful restructuring going forward, including the Investment Banker's involvement in the completion of the Proposed Transaction;

c. there is no unwarranted duplication of roles;

d. the senior secured creditors affected by the charge have been provided with notice of these CCAA Proceedings; and

e. the Monitor is in support of the proposed Administration Charge.

Bell Affidavit, paras. 188, 190; Application Record, Tab 2.

(C) Directors' Charge

86. The Applicants seek a Directors' Charge in an amount of CAD$13 over the Charged Property to secure their respective indemnification obligations for liabilities imposed on the Applicants' trustees, directors and officers (the "Directors and Officers"). The Directors' Charge is to be subordinate to the Administration Charge and the DIP Lenders' Charge but in priority to the KERP Charge and the Consent Consideration Charge.

87. Section 11.51 of the CCAA affords the Court the jurisdiction to grant a charge relating to directors' and officers' indemnification on a priority basis:

11.51(1) *Security or charge relating to director's indemnification*

On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.

11.51(2) *Priority*

The court may order that the security or charge rank in priority over the claim of any secured creditors of the company

11.51(3) *Restriction* — indemnification insurance

The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

11.51(4) *Negligence, misconduct or fault*

The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

CCAA, Section 11.51.

88. The Court has granted director and officer charges pursuant to Section 11.51 in a number of cases. In *Canwest Global Communications Corp., Re*, the Court outlined the test for granting such a charge:

> I have already addressed the issue of notice to affected secured creditors. I must also be satisfied with the amount and that the charge is for obligations and liabilities the directors and officers may incur after the commencement of proceedings. It is not to extend to coverage of wilful misconduct or gross negligence and no order should be granted if adequate insurance at a reasonable cost could be obtained.

Canwest Global Communications Corp., Re, *supra* at paras 46-48; Book of Authorities, Tab 1.

Canwest Publishing, *supra* at paras. 56-57; Book of Authorities, Tab 16.

Timminco, *supra* at paras. 30-36; Book of Authorities, Tab 20.

89. The Applicants submit that the D&O Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the D&O Charge in the amount of CAD$13 million, given:

a. the Directors and Officers of the Applicants may be subject to potential liabilities in connection with these CCAA proceedings with respect to which the Directors and Officers have expressed their desire for certainty with respect to potential personal liability if they continue in their current capacities;

b. renewal of coverage to protect the Directors and Officers is at a significantly increased cost due to the imminent commencement of these CCAA proceedings;

c. the Directors' Charge would cover obligations and liabilities that the Directors and Officers, as applicable, may incur after the commencement of these CCAA Proceedings and is not intended to cover wilful misconduct or gross negligence;

d. the Applicants require the continued support and involvement of their Directors and Officers who have been instrumental in the restructuring efforts of the CCAA Parties to date;

e. the senior secured creditors affected by the charge have been provided with notice of these CCAA proceedings; and

f. the Monitor is in support of the proposed Directors' Charge.

Bell Affidavit, paras. 249, 250, 254-257; Application Record, Tab 2.

(D) KERP Charge

90. The Applicants seek a KERP Charge in an amount of CAD$3 million over the Charged Property to secure the KERP Retention Payments, KERP Transaction Payments and Aurora KERP Payments payable to certain key employees of the CCAA Parties crucial for the CCAA Parties' successful restructuring.

91. The CCAA is silent with respect to the granting of KERP charges. Approval of a KERP and a KERP charge are matters within the discretion of the Court. The Court in *Grant Forest Products Inc., Re* [2009 CarswellOnt 4699 (Ont. S.C.J. [Commercial List])] considered a number of factors in determining whether to grant a KERP and a KERP charge, including:

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

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

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

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

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

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

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

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

Grant Forest Products Inc., Re, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) at para. 8-24 [*Grant Forest*]; Book of Authorities, Tab 21.

Canwest Publishing Inc./Publications Canwest Inc., Re supra, at paras 59; Book of Authorities, Tab 16.

Canwest Global Communications Corp., Re supra, at para. 49; Book of Authorities, Tab 1.

Timminco Ltd., Re (2012), 95 C.C.P.B. 48 (Ont. S.C.J. [Commercial List]) at paras. 72-75; Book of Authorities, Tab 22.

92. The purpose of a KERP arrangement is to retain key personnel for the duration of the debtor's restructuring process and it is logical for compensation under a KERP arrangement to be deferred until after the restructuring process has been completed, with "staged bonuses" being acceptable. KERP arrangements that do not defer retention payments to completion of the restructuring may also be just and fair in the circumstances.

Grant Forest Products Inc., Re, *supra* at para. 22-23; Book of Authorities, Tab 21.

93. The Applicants submit that the KERP Charge is warranted and necessary, and that it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the KERP Charge in the amount of CAD$3 million, given:

a. the KERP was developed by Cinram with the principal purpose of providing an incentive to the Eligible Employees, the Eligible Officers, and the Aurora Employees to remain with the Cinram Group while the company pursued its restructuring efforts;

b. the Eligible Employees and the Eligible Officers are essential for a restructuring of the Cinram Group and the preservation of Cinram's value during the restructuring process;

c. the Aurora Employees are essential for an orderly transition of Cinram Distribution's business operations from the Aurora facility to its Nashville facility;

d. it would be detrimental to the restructuring process if Cinram were required to find replacements for the Eligible Employees, the Eligible Officers and/or the Aurora Employees during this critical period;

e. the KERP, including the KERP Retention Payments, the KERP Transaction Payments and the Aurora KERP Payments payable thereunder, not only provides appropriate incentives for the Eligible Employees, the Eligible Officers and the Aurora Employees to remain in their current positions, but also ensures that they are properly compensated for their assistance in Cinram's restructuring process;

f. the senior secured creditors affected by the charge have been provided with notice of these CCAA proceedings; and

g. the KERP has been reviewed and approved by the board of trustees of Cinram Fund and is supported by the Monitor.

Bell Affidavit, paras. 236-239, 245-247; Application Record, Tab 2.

(E) Consent Consideration Charge

94. The Applicants request the Consent Consideration Charge over the Charged Property to secure the Early Consent Consideration. The Consent Consideration Charge is to be subordinate in priority to the Administration Charge, the DIP Lenders' Charge, the Directors' Charge and the KERP Charge.

95. The Courts have permitted the opportunity to receive consideration for early consent to a restructuring transaction in the context of CCAA proceedings payable upon implementation of such restructuring transaction. In *Sino-Forest Corp., Re,* the Court ordered that any noteholder wishing to become a consenting noteholder under the support agreement and entitled to early consent consideration was required to execute a joinder agreement to the support agreement prior to the applicable consent deadline. Similarly, in these proceedings, lenders under the First Lien Credit Agreement who execute the Support Agreement (or a joinder thereto) and thereby agree to support the Proposed Transaction on or before July 10, 2012, are entitled to Early Consent Consideration earned on consummation of the Proposed Transaction to be paid from the net sale proceeds.

Sino-Forest Corp., Re, *supra*, Initial Order granted on March 30, 2012, Court File No. CV-12-9667-00CL at para. 15; Book of Authorities, Tab 23. Bell Affidavit, para. 176; Application Record, Tab 2.

96. The Applicants submit it is appropriate in the present circumstances for this Honourable Court to exercise its jurisdiction and grant the Consent Consideration Charge, given:

a. the Proposed Transaction will enable the Cinram Business to continue as a going concern and return to a market leader in the industry;

b. Consenting Lenders are only entitled to the Early Consent Consideration if the Proposed Transaction is consummated; and

c. the Early Consent Consideration is to be paid from the net sale proceeds upon distribution of same in these proceedings.

Bell Affidavit, para. 176; Application Record, Tab 2.

Application granted.

2012 ONSC 3767, 2012 CarswellOnt 8413, 217 A.C.W.S. (3d) 11, 91 C.B.R. (5th) 46

End of Document

4

1992 CarswellOnt 163
Ontario Court of Appeal

Algoma Steel Corp. v. Royal Bank

1992 CarswellOnt 163, [1992] O.J. No. 889, 11 C.B.R. (3d) 11, 34 A.C.W.S. (3d) 1109, 3 W.D.C.P. (2d) 397, 55 O.A.C. 303, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98

ALGOMA STEEL CORPORATION, LIMITED v. ROYAL BANK OF CANADA, MONTREAL TRUST COMPANY (Trustee of certain debentures issued by Algoma Steel Corporation, Limited under a certain trust indenture) and ROYAL BANK OF CANADA, CANADIAN IMPERIAL BANK OF COMMERCE, HONGKONG BANK OF CANADA, and TORONTO DOMINION BANK (in their capacity as holders of certain of the debentures issued pursuant to said trust indenture)

Krever, McKinlay and Labrosse JJ.A.

Heard: April 21-23, 1992
Judgment: April 30, 1992
Docket: Doc. CA C11707

Counsel: *D.J.T. Mungovan* and *Debbie A. Campbell*, for Kelsey-Hayes Canada Limited and Kelsey-Hayes Company.
M.E. Royce and *M.E. Barrack*, for Algoma Steel Corporation, Limited.
W.L.N. Somerville, Q.C., and *B.H. Bresner*, for Royal Insurance Company of Canada.
R.N. Robertson, Q.C., and *W.A. Apps*, for Dofasco Inc.

Subject: Corporate and Commercial; Insolvency

Table of Authorities

Statutes considered:

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

s. 11(c)

s. 12(2)(a)(iii)

Insurance Act, R.S.O. 1990, c. I.8 —

s. 132

s. 132(1)

Motion for leave to appeal and an appeal under the *Companies' Creditors Arrangement Act*.

Per curiam:

1 This is a motion for leave to appeal and, if leave is granted, an appeal, under the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "C.C.A.A."), from the order of Farley J. dismissing a motion for the valuation of the claim of Kelsey-Hayes Canada Limited ("Kelsey-Hayes") and for leave to bring proceedings against The Algoma Steel Corporation Limited ("Algoma"), the subject of a plan of arrangement under the C.C.A.A.

2 Kelsey-Hayes is involved in product-liability litigation in Missouri as a result of serious personal injuries suffered by a child when a wheel broke away from a Dodge truck and struck him. The wheel was manufactured by Kelsey-Hayes, against whom a Missouri jury awarded a verdict in excess of $4 million U.S. That verdict was set aside by the trial judge on the basis that Chrysler Corporation, the truck's manufacturer, had been improperly dismissed from the action at an earlier stage. The setting aside of the verdict was appealed to the Missouri Court of Appeals, but judgment on the appeal has been reserved. Kelsey-Hayes, the defendant in the Missouri litigation, alleges that the steel used for the manufacture of the errant wheel was a defective product of Algoma and seeks to claim contribution or indemnity from Algoma in order to be able to pursue, under s. 132 of the *Insurance Act*, R.S.O. 1990, c. I.8, the proceeds of a product-liability insurance policy by which Algoma is insured by the Royal Insurance Company of Canada ("Royal"). It also seeks relief under the plan of arrangement in respect of the amount of any liability Algoma may have to it in excess of the policy limits.

3 In the C.C.A.A. proceedings, an order was made by Montgomery J. in the terms of s. 11(*c*) of the C.C.A.A. that no action or other proceeding may be proceeded with or commenced against Algoma except with the leave of the court. It is common ground that Kelsey-Hayes, by reason of its claim against Algoma, is a known designated unsecured creditor of Algoma, as defined in the plan of arrangement. The plan of arrangement, which has been voted on by all classes of affected creditors, and sanctioned, subject to the outcome of this appeal, by an order of Farley J. dated April 26, 1992, provides that upon payment by Algoma to a trustee of a certain sum in payment of the claims of the specified unsecured creditors, "all Claims of Specified Unsecured Creditors will be released, discharged and cancelled."

4 After Kelsey-Hayes notified Algoma of the litigation in Missouri, of its allegation of defective steel against Algoma, and of its claim in the amount of the Missouri verdict, Algoma responded by valuing the claim at the sum of $1. Kelsey-Hayes thereupon applied to the court, under the provisions of s. 12(2)(*a*)(iii) of the C.C.A.A., for the determination of the amount of its claim. Before the application was heard, Kelsey-Hayes enlarged the relief sought to include that described above and Royal was brought into the proceedings. Mr. Justice Farley held that he had no authority to permit Kelsey-Hayes to proceed against Algoma and went on to confirm the valuation of the claim at $1. The essential issue in this appeal is whether, under the C.C.A.A., the fact that the plan of arrangement now exists prevents the court from permitting Algoma from being proceeded against by Kelsey-Hayes even to the limited extent of the insurance proceeds.

5 We are of the view that, however weak the evidence available on the application may have been with respect to the origin of the steel used in the manufacture of the wheel, and thus the case against Algoma, it cannot be said that the case is without any foundation or is frivolous. The fact that s. 12(2)(iii) provides that the amount of a creditor's claim, if not admitted by the company, "shall be determined by the court on summary application by the company or by the creditor," does not compel the court to determine the valuation summarily. The provision simply authorizes the proceedings to be brought summarily, that is, by way of originating notice of motion or application rather than by the lengthier, and more complicated, procedure of an action. In an appropriate case, therefore, there is no reason why the determination cannot be made after a trial either of an issue or an action, in the course of which production and discovery would be available. In the absence of such a trial, it cannot be said, in our view, that the valuation of the claim of Kelsey-Hayes against Algoma in the sum of $1 is correct.

6 The more difficult question is whether the court has jurisdiction to authorize proceedings now that the plan of arrangement is in place. It is submitted that it does not, because of the need for commercial certainty and because to do so would be to amend the plan of arrangement (which extinguishes the claims of all designated unsecured creditors, of which Kelsey-Hayes is certainly one). The plan of arrangement is a matter of contract, it is argued, and the court's jurisdiction is limited to sanctioning or refusing to sanction the arrangement arrived at contractually. There is much merit in this argument, but, in our view, it is not a complete answer.

7 Kelsey-Hayes does not deny that if the language of the plan of arrangement quoted above, extinguishing the claims of designated unsecured creditors, is unambiguous, as we believe it is, to grant the relief which it seeks would require an amendment by the court of the plan of arrangement. We accept the submission that, generally speaking, the plan of arrangement is consensual and the result of agreement and that if it is fair and reasonable (an issue for the court to decide) it is not to be interfered with by the court unless (a) the Act authorizes the court to affect the plan and (b) there are compelling reasons

justifying the court's action. Generally speaking again, the court ought not to interfere where to do so would prejudice the interests of the company or the creditors. But where no prejudice would result and the needs of justice are to be met, the court may act if the C.C.A.A., properly interpreted, authorizes intervention. In this connection, it may be relevant that, although it is hardly conclusive, Algoma's management information circular to creditors, shareholders and employees, which accompanied the proposed plan of arrangement, advised those persons, under the heading "Court Approval of the Plan" as follows:

> The authority of the Court is very broad under both the CCAA and the OBCA — Algoma has been advised by counsel that the Court will consider, among other things, the fairness and reasonableness of the Plan. The Court may approve the Plan as proposed *or as amended in any manner that the Court may direct* and subject to compliance with such terms and conditions, if any, as the Court thinks fit.

[Emphasis added.] We agree that the circular's statement that the court may direct an amendment of the plan does not, as a matter of law, make it so. The C.C.A.A. must be the authority for the jurisdiction and the critical issue is whether there is any provision in the Act that fairly gives rise to a power in the court to amend. In our view, there is such a provision and that provision, s. 11(*c*), depending on the language of the plan itself, may by necessary inference, in an appropriate case, enable the court to make an order, the technical effect of which is that the plan is amended. The relevant portion of the section reads as follows:

> 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,
>
> . . . . .
>
> (*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.

[Emphasis added.]

8 As we have already pointed out, an order in the terms of this provision was made early in the proceedings by Montgomery J. The effect of the enactment and the order is to empower the court to grant leave to take proceedings against Algoma in appropriate circumstances. It was submitted that this power, having regard to the commercial realities reflected by the C.C.A.A., is one that may be exercised only before the creditors have voted to accept the plan of arrangement. No authority could be cited to support such a circumscription of the court's jurisdiction, unqualifiedly conferred by the statute. Nor, as a matter of principle, is there any reason to suggest that the scheme created by the C.C.A.A. contemplates a role for the court as a mere rubber stamp or one that is simply administrative rather than judicial. On the other hand, we have no doubt that, given the primacy accorded by the Act to agreement among the affected actors, the jurisdiction of the court is to be exercised sparingly and in exceptional circumstances only, if the result of the exercise is to amend the plan, even in merely a technical way. In this case, for example, it would be an unacceptable exercise of jurisdiction if the effect of granting leave to Kelsey-Hayes to proceed against Algoma would be to render vulnerable to possible execution any assets other than insurance proceeds, if any, that may be available under the policy by which Royal insured Algoma against product liability. If the leave granted could be so limited, and that is the difficulty that must be addressed, the plan of arrangement which, in its terms, extinguishes the claims of designated unsecured creditors, would undergo amendment in an insignificant and technical way only, as far as the other creditors are concerned.

9 The concern of prejudice must now be considered and the question asked whether any interests would be affected detrimentally if Kelsey-Hayes were permitted to claim against Algoma to the extent only of recourse to the insurance proceeds. If to give leave had the effect of giving potential access to assets over and above the policy limits, there would indeed be prejudice to several interests and, moreover, the plan of arrangement would be significantly amended. On the premise that only the insurance proceeds were to be made potentially available to satisfy any judgment that Kelsey-Hayes may be awarded in its claim over against Algoma, it cannot be said that any interest is affected adversely except possibly that of Royal and that of Dofasco Inc. ("Dofasco"). It is to that issue that we now turn.

10 The potential liability of Royal to Kelsey-Hayes as insurer of Algoma arises out of the provisions of s.132(1) of the *Insurance Act*, which read as follows:

> Where a person incurs a liability for injury or damage to the person or property of another, and is insured against such liability, and fails to satisfy a judgment awarding damages against the person in respect of the person's liability, and an execution against the person in respect thereof is returned unsatisfied, the person entitled to the damages may recover by action against the insurer the amount of the judgment up to the face value of the policy, but subject to the same equities as the insurer would have if the judgment had been satisfied.

Royal is potentially answerable to Kelsey-Hayes, a third party with respect to Algoma's policy of insurance only by virtue of this statutory provision but, in any third party claim against it, its liability is "subject to the same equities as the insurer would have if the judgment had been satisfied." Prejudice, in a legal sense, as far as Royal is concerned is non-existent.

11 The question of prejudice to Dofasco is more difficult. Its interest arises in this way. As part of the comprehensive restructuring scheme, of which the plan of arrangement is the central part, Algoma's assets are to be transferred to a new corporate entity, referred to in argument as New Algoma, in which Algoma's shareholders and creditors (whose claims are being compromised and otherwise discharged) are to receive shares. The funds to make this possible are to be supplied by Dofasco in the sum of $30 million. In return, Dofasco is to obtain Algoma's tax loss in the sum of $150 million. The result of these transactions as contemplated by the comprehensive scheme is that Algoma is to become devoid of assets and creditors, in short, that Algoma is to be made a "clean corporation," or a mere shell with a tax loss carryforward. Dofasco filed no material, and on the appeal filed no factum, showing any prejudice which it might suffer if leave to proceed is granted. Instead, in oral argument, it submitted that any such order would impair the integrity of the plan of arrangement and reduce the certainty that was necessary for the plan's success. In our view, no impairment will occur if an order is made subject to sufficient safeguards to limit any possible recovery to the insurance proceeds. We think a safeguard can be provided. The difficulty is in the language of s. 132 of the *Insurance Act*, which requires, as a condition precedent to a direct action against the insurer, that an execution against the insured be returned unsatisfied.

12 This very requirement makes the purpose of the section clear. It is to provide direct access to an insurer, by a person incurring the liability referred to in the section, in a situation where the insured is judgment proof, thus circumventing the normal operation of insurance contracts, which is solely to indemnify the insured against loss. To interpret the section in such a way as to apply only in the narrow situation where the insured is judgment proof (and therefore almost certainly insolvent), but not in situations where either the insured or its creditors have taken proceedings pursuant to federal insolvency statutes, would be to frustrate its objectives in a large percentage of situations where it would otherwise apply.

13 If the plaintiff in this case were successful in the Missouri action against Kelsey-Hayes and Kelsey-Hayes were successful in a permitted claim over for indemnity or contribution from Algoma, there could be no question that, notionally, the condition precedent of an unsatisfied judgment would be met because, prior to the plan, Algoma was insolvent and the commencement of proceedings under the C.C.A.A. rendered it judgment proof. To secure the certainty of the integrity of the plan, which Dofasco argues it needs in order to discharge its role in the scheme, we make clear our intention that only any insurance proceeds that may become available to Algoma are to be the subject of any recovery against Algoma that Kelsey-Hayes may prove that it is entitled to. That is to be accomplished by providing in our order that neither the assets of Algoma (other than the insurance proceeds) nor the assets of any other corporation which may become responsible in any way for any liabilities of Algoma by virtue of the operation of the plan of arrangement or the more comprehensive scheme of restructuring, or any condition precedent thereto, shall be available to satisfy any judgment obtained as a result of any proceedings by Kelsey-Hayes against Algoma.

14 The justice of permitting an amendment to the plan as inconsequential as the one we permit in these exceptional circumstances is illustrated by the hypothetical case put in argument. Suppose a visitor had become quadriplegic as a result of an injury on the premises of Algoma under circumstances in which Algoma as occupier might be liable and suppose Algoma's potential liability was insured against by an appropriate insurance policy. To restrict the injured person, a known designated unsecured creditor under the terms of the plan of arrangement, to his or her compromised claim valued, without a trial, in a summary proceeding, would, in our view, be unacceptable. The actual situation before the court is analogous.

15 For these reasons, we grant leave to appeal, allow the appeal, set aside the order of Farley J. dated April 9, 1992, and grant leave to Kelsey-Hayes to proceed as it may be advised in the terms set out above.

Leave to appeal granted; appeal allowed; leave to proceed granted.

End of Document

5

2001 ABQB 983
Alberta Court of Queen's Bench

Ontario v. Canadian Airlines Corp.

2001 CarswellAlta 1488, 2001 ABQB 983, [2001] A.J. No. 1457, [2002] 3 W.W.R. 373, [2002] A.W.L.D. 43, 110 A.C.W.S. (3d) 238, 29 C.B.R. (4th) 236, 306 A.R. 124, 96 Alta. L.R. (3d) 1, 98 Alta. L.R. (3d) 277

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

AND IN THE MATTER OF THE BUSINESS CORPORATIONS ACT (ALBERTA), S.A. 1981, c. B.-15, AS AMENDED, SECTION 185;

AND IN THE MATTER OF CANADIAN AIRLINES CORPORATION AND CANADIAN AIRLINES INTERNATIONAL LTD.;

HER MAJESTY THE QUEEN IN RIGHT OF THE PROVINCE OF ONTARIO (Applicant) and CANADIAN AIRLINES CORPORATION AND CANADIAN AIRLINES INTERNATIONAL LTD. (Respondents)

Romaine J.

Judgment: November 16, 2001
Docket: Calgary 0001-05071

Counsel: *Larry B. Robinson, Michael D. Aasen*, for Her Majesty the Queen in Right of the Province of Ontario
Chris Simard, for Canadian Airlines Corporation and Canadian Airlines International Ltd.
Sean Dunphy, for Air Canada

Subject: Corporate and Commercial; Insolvency; Provincial Tax

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Banking and banks --- Letters of credit

Company self-assessed its tax liabilities and made instalment payments under provincial statutes — Province assessed company for taxes owing — Company filed notices of objections and appeals were ongoing — Company provided province with letters of credit to

secure assessments under appeal — Until decisions were rendered in tax appeals, no amounts were payable and province was precluded from drawing on letters of credit — Company received protection under Companies' Creditors Arrangement Act — Company included province in list of "affected unsecured claims" — Province's claim was for greater amount than letters of credit — Company's plan of compromise and arrangement was approved — Province brought application for declaration that debt secured by letters of credit was not compromised by plan — Issue arose as to appropriate characterization of portion of province's claim under letters of credit — Claim was secured — Letters of credit were not simply payment devices — Letters of credit provided province with form of security subject to conditions — That insolvency was irrelevant to letter of credit was reflected in s. 11.2 of Act — Province's forbearance in accepting letters of credit in lieu of cash was not waiver of anything other than immediate right to be paid — No evidence that in accepting letters of credit, province agreed to have its claims treated as unsecured — That no immediate enforcement rights of province were being compromised by plan did not convert nature of province's interest to unsecured claim — No implied agreement between province and company that debt underlying secured claims could be compromised by intervening events other than tax appeals — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.2.

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Effect of arrangement — General

Company self-assessed its tax liabilities and made instalment payments under provincial statutes — Province assessed company for taxes owing — Company filed notices of objections and appeals were ongoing — Company provided province with letters of credit to secure assessments under appeal — Company received protection under Companies' Creditors Arrangement Act — Company included province in list of "affected unsecured claims" — Province's claim was for greater amount than letters of credit — Company's plan of compromise and arrangement was approved — Province brought application for declaration that debt secured by letters of credit was not compromised by plan — Application granted — Plan made no express reference to letters of credit — Company provided no evidence that compromise of entirety of province's claim was required for company's ongoing survival or formed integral part of whole plan — No evidence that interpreting plan in manner proposed by province would be prejudicial to company — No evidence of prejudice to company's creditors — No suggestion of damage to integrity of plan — Disregarding letters of credit in company's insolvent circumstances was inconsistent with rationale of particular security devices — Compromising entirety of province's claim was inconsistent with general concept of plan — Company's interpretation resulted in anomalous treatment of secured creditor under plan — No evidence that any other secured creditor was included in "affected unsecured creditors" list — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Table of Authorities

Cases considered by *Romaine J.*:

Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 11, 8 O.R. (3d) 449, 93 D.L.R. (4th) 98, 55 O.A.C. 303 (Ont. C.A.) — considered

Algoma Steel Corp. v. Royal Bank (1992), 94 D.L.R. (4th) vii, 10 O.R. (3d) xv, *(*sub nom. *Royal Insurance Co. of Canada v. Kelsey-Hayes Canada Ltd.)* 145 N.R. 391 (note), *(*sub nom. *Royal Insurance Co. of Canada v. Kelsey-Hayes Canada Ltd.)* 59 O.A.C. 326 (note) (S.C.C.) — referred to

Armbro Enterprises Inc., Re (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.) — distinguished

Canada Deposit Insurance Corp. v. Canadian Commercial Bank, *(*sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidation))* 232 A.R. 235, *(*sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidation))* 195 W.A.C. 235, *(*sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidator of))* 173 D.L.R. (4th) 309, *(*sub nom. *Barclays Bank of Canada v. Canadian Commercial Bank (Liquidator of))* 70 Alta. L.R. (3d) 69, [1999] 10 W.W.R. 704, 10 C.B.R. (4th) 70 (Alta. C.A.) — referred to

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

Canadian Airlines Corp., Re (2000), 2001 ABCA 9, 2000 CarswellAlta 1556, 277 A.R. 179, 242 W.A.C. 179, 88 Alta. L.R. (3d) 8, [2001] 4 W.W.R. 1, [2000] A.J. No. 1028 (Alta. C.A.) — referred to

Canadian Airlines Corp., Re, 2001 CarswellAlta 888, 2001 CarswellAlta 889, [2001] S.C.C.A. No. 60 (S.C.C.) — referred to

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 4 C.B.R. (3d) 311, *(*sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136 (B.C. C.A.) — considered

Horizon Village Corp., Canada, Re (1991), 8 C.B.R. (3d) 25, 82 Alta. L.R. (2d) 152, 122 A.R. 348 (Alta. Q.B.) — considered

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

Lindsay v. Transtec Canada Ltd. (1994), 28 C.B.R. (3d) 110, 5 C.C.P.B. 219, [1995] 2 W.W.R. 404, 99 B.C.L.R. (2d) 73 (B.C. S.C.) — considered

Lindsay v. Transtec Canada Ltd., 2 B.C.L.R. (3d) 304, [1995] 4 W.W.R. 364, 31 C.B.R. (3d) 157 (B.C. C.A.) — referred to

Meridian Development Inc. v. Toronto Dominion Bank, [1984] 5 W.W.R. 215, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Alta. Q.B.) — considered

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20, 72 C.R. (N.S.) 20 (Alta. Q.B.) — considered

NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (N.S. T.D.) — considered

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

Ontario v. Canadian Airlines Corp. (2000), *(*sub nom. *Canadian Airlines Corp., Re)* 276 A.R. 273 (Alta. Q.B.) — considered

366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd. (1996), 39 C.B.R. (3d) 134 (Alta. Q.B.) — considered

366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd. (1998), *(*sub nom. *366604 Alberta Ltd. (Bankrupt) v. Pensionfund Properties Ltd.)* 228 A.R. 59, *(*sub nom. *366604 Alberta Ltd. (Bankrupt) v. Pensionfund Properties Ltd.)* 188 W.A.C. 59, 7 C.B.R. (4th) 42 (Alta. C.A.) — referred to

885676 Ontario Ltd. (Trustee of) v. Frasmet Holdings Ltd. (1993), 17 C.B.R. (3d) 64, 12 O.R. (3d) 62, 99 D.L.R. (4th) 1, 30 R.P.R. (2d) 1 (Ont. Gen. Div. [Commercial List]) — considered

Statutes considered:

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

s. 6 — considered

s. 7 — considered

s. 11.2 [en. 1997, c. 12, s. 124] — considered

Corporations Tax Act, R.S.O. 1990, c. C.40
s. 81 [rep. & sub. 1994, c. 14, s. 39(1)] — considered

s. 103 — considered

Retail Sales Tax Act, R.S.O. 1990, c. R.31
ss. 18-20 — referred to

s. 18(9) [en. 1994, c. 13, s. 13] — referred to

s. 19(1) [rep. & sub. 1999, c. 9, s. 186] — referred to

s. 19(4) [am. 1994, c. 13, s. 14(2)] — referred to

s. 20(10) [am. 1994, c. 13, s. 15(3)] — referred to

s. 37(2) — considered

APPLICATION by province for declaraion that portion of debt secured by letters of credit was not compromised by company's plan of compromise and arrangement.

***Romaine J.*:**

INTRODUCTION

1 Her Majesty the Queen in Right of the Province of Ontario ("Ontario") seeks an order for the following relief:

> a. a declaration that the portion of the debt owed by Canadian Airlines International Ltd. ("Canadian") to Ontario as secured by three letters of credit is not compromised by the Amended and Restated Plan of Compromise and Arrangement (the "Plan") filed by Canadian Airlines Corporation and Canadian Airlines International Ltd. on May 25, 2000;
>
> b. in the alternative, a declaration that the Plan allows the tax liability secured by the letters of credit to be considered a secured claim and that Canadian is liable for the full amount thereof up to the face value of the letters of credit;
>
> c. in the further alternative, an order varying the Plan to permit the tax liability secured by the letters of credit to be considered a secured claim and directing that Canadian is liable for the full amount thereof up to the value of the letters of credit.

FACTS

2 The relationship between the parties and the background to this application were set out succinctly by Paperny J.(as she then was) in an earlier, related application as follows:

> Canadian Airlines International Ltd. ("Canadian") has followed a practice of self-assessing its tax liabilities and has made installment payments of tax under two Ontario statutes, the Retail Sales Tax Act and the Corporations Tax Act. Pursuant to an ongoing auditing process, Ontario has assessed Canadian for taxes owing under these two statutes. The assessments date back as far as 1981. Following the assessments, Canadian filed eight notices of objection and appeals are ongoing. Canadian has provided Ontario with three separate letters of credit to secure the assessments under appeal. The letters of credit have been renewed at least once.
>
> Ontario estimates the total assessments at approximately $2 million. This may be subject to adjustment due to ongoing audits and the failure of Canadian to have completed its 1999 and 2000 tax returns. Canadian has disputed these assessments from the outset and as stated in the affidavit of Nhan Le, Canadian's Director of Taxation, is of the view that its liability to Ontario for these taxes is contingent and negligible. In short, the tax liability of Canadian to Ontario has been in dispute for several years.
>
> Canadian received court protection under the Companies' Creditors Arrangement Act on March 24, 2000.
>
> Canadian included Ontario in its list of "Affected Unsecured Claims" and quantified Ontario's claim at zero. Contrary to paragraph 27 of the March 24, 2000 order, Ontario was not served with a copy.

Ontario did not receive a copy of the March 24, 2000 order until it received it as part of the voting package sent out in accordance with my April 7, 2000 order in these proceedings. The package was mailed on April 25, 2000, the last possible day under the terms of the April 7, 2000 order and arrived in the mail room of the Corporations Tax Branch of the Revenue Division of Ontario on May 2, 2000, three days before the Claims Bar Date set in that order. The Revenue Division has nine branches. According to the affidavit of Rosita Vinkovic, Senior Collections Officer for the Bankruptcy and Insolvency Unit in the Collections and Compliance Branch of the Ministry of Finance, the normal procedure is for insolvency related documents to be mailed directly to the Insolvency Unit, not to the Corporations Tax Branch. According to Ms. Vinkovic, a notice to this effect was published by the Minister of Finance in a 1997 newsletter of the Canadian Insolvency Practitioners' Association. . .

The voting package did not make its way to the Insolvency Unit until May 18, 2000. Despite extensive inquiries, Ms. Vinkovic has been unable to determine the reason for this delay. The collection officer in the Insolvency Unit that received the package on May 18, 2000 did not have an opportunity to review it in its entirety until May 23, 2000, the first business day after the long weekend (and the date that a second package was sent by the monitor to the Ministry of Finance public inquiry desk and directly routed to the Insolvency Unit).

As Senior Collections Officer, Ms. Vinkovic was assigned to handle the matter on May 25, 2000. She immediately noted the May 5, 2000 Claims Bar Date and a proof of claim along with copies of the letters of credit were faxed to the monitor that same day. The amount claimed was expressed as preliminary due to the ongoing audit, which was lengthy due to the extent of Canadian's operations and its failure to timely respond to requests for information and documents. The monitor initially advised Ms. Vinkovic that the claim would not be accepted as it was past the Claims Bar Date, but changed its position upon being advised of the related security.

On June 19, 2000, nearly one month later, Ontario received a letter from Canadian's counsel advising that its claim would not be accepted because it was submitted after the Claims Bar Date. Ms. Vinkovic was away on vacation from June 23, 2000 until July 10th. On her return on the 10th she read the June 19th letter and immediately sent a request for assistance to Joel Weintraub, Senior Legal Counsel in the Legal Services Branch. Mr. Weintraub contacted the Alberta firm that had handled a similar claim for the BC government and a request was sent to the Assistant Deputy Attorney General for Ontario to authorize the retention of outside counsel. Mr. Robinson advised that he was retained September 14, 2000 and immediately advised Canadian's counsel of his intention to bring [an application to extend time to file a proof of claim] but that it would take some time to prepare the necessary material and have it sworn. *Ontario v. Canadian Airlines Corp.* (2000), 276 A.R. 273 (Alta. Q.B.) paras.2 - 9;

3 Paperny J. heard the application to extend time to file a proof of claim and granted leave to Ontario to file its claim on November 7, 2000. She found that in the circumstances, Ontario's delay in filing its claim was due to inadvertence and not an attempt to circumvent the CCAA process or gain an advantage over other creditors. She also found that Canadian had contributed to the delay by its conduct: Canadian failed to serve Ontario with the March 24, 2000 order, it did not mail the voting package until the last possible day, it mailed it to the wrong office and waited until the last day of the sanction hearing, nearly one month after receiving Ontario's claim, to notify Ontario that its claim was rejected . She found no prejudice to Canadian or Air Canada, the funder of the Plan as they were specifically aware of the existence of Ontario's claim, and were, in fact, attempting to use the delay to avoid resolving the dispute with Ontario. Paperny J. found for these reasons it was not unfair to the funder of the Plan, Air Canada, to deal with Ontario's claim after the claims bar date.

4 The proof of claim faxed by Ontario to the monitor on May 25, 2000 divided Ontario's claim between an unsecured portion and a secured portion, and referred to a letter of credit. As it had been prepared in a hurry, the amount claimed was in error. Paperny J. allowed Ontario to file an amended claim and also allowed further amendments that may become necessary due to the late filing of Canadian's 1999 and 2000 tax returns. Ontario's amended claim is for $2,064,444.19. The three letters of credit lodged with Ontario total $1,248,324.84.

5 Canadian's position is that the effect of its Plan is that the debt due to Ontario, once quantified, is compromised in its entirety from $1.00 of proven claim to $0.14, as with all other Affected Unsecured Claims, and that the letters of credit only facilitate the payment of the reduced indebtedness. Ontario's position is that the only amount that is compromised by the Plan is the deficiency remaining after applying the amount of security represented by the letters of credit held by Ontario.

6 The Plan was approved at a meeting of affected creditors held on May 26, 2000, and was sanctioned by Paperny J. on June 27, 2000 after an extensive hearing that commenced on June 5, 2000. The last day of the hearing was June 19, 2000, the same day that Canadian advised Ontario that it was rejecting its claim as being out of time and not prepared in the proper form. Although there is no question that Canadian was aware of Ontario's claim and the provision of letters of credit, there is no reference to the letters of credit in the Plan or in the evidence that was put before the court in the sanction hearing.

ISSUES

7 The issues that arise in this application are as follows:

(1) What is the appropriate characterization of the letters of credit?

(2) What is the effect of the Plan on Ontario's claim and the letters of credit?

(3) If the Plan compromises the whole of Ontario's claim, should Ontario be granted relief from such compromise, in the form of an amendment to the Plan?

ANALYSIS

1. What is the appropriate characterization of the letters of credit?

8 The parties agreed that the letters of credit held by Ontario are not obligations that are compromised by the Plan: *Meridian Development Inc. v. Toronto Dominion Bank* (1984), 11 D.L.R. (4th) 576 (Alta. Q.B.); Section 11.2 of the *Companies Creditors Arrangement Act*, R.C.C. 1985 c.C-36, as amended. However, Canadian submitted that the Plan compromises the underlying debt, and the letters of credit operate only to facilitate the payment of Ontario's post-compromise debt and have no other effect on the nature of Ontario's claim. This interpretation of the nature of the letters of credit and the limitation of their effect is the expressed rationale for the inclusion of Ontario's claim in the "Affected Unsecured Claims" category and the lack of any reference to the letters of credit in the Plan that was put before the court for sanction.

9 Canadian submitted that such possession does not convert what it characterizes as an unsecured claim into some kind of secured claim. It argued that, since the letters of credit are not security interests in the assets of Canadian, but rather separate obligations between the relevant banks and Ontario, Ontario's claim is not secured.

10 I disagree with Canadian's characterization of the letters of credit and their effect on the nature of the relationship between Canadian and Ontario.

11 In suggesting that Ontario's claim is unsecured, Canadian appears to be including in the definition of "secured" the requirement that any security must be in the assets of Canadian. While that may be so in the context of the Plan drafted by Canadian, letters of credit are commonly used and recognized by the courts as a form of security: *885676 Ontario Ltd. (Trustee of) v. Frasmet Holdings Ltd.* (1993), 17 C.B.R. (3d) 64 (Ont. Gen. Div. [Commercial List]) at para. 35; *Meridian Development Inc.*, supra, at pp. 585 and 587; *Canada Deposit Insurance Corp. v. Canadian Commercial Bank* (1999), 232 A.R. 235 (Alta. C.A.). As pointed out by Blair, J. in *Frasmet*, supra, at para. 27:

> [t]here is a fundamental difference between a letter of credit, which is a very specialized form of security, and a guarantee, which is not a form of security at all (except in a loose, non-legal sense of the term).

12 Wachowich J. (as he then was) recognized the distinction between the use of letters of credit as security and as guarantees at p. 585 of *Meridian Development Inc.*:

> [*Aspen Planners Ltd. v. Commerce Masonry & Forming Ltd.* (1979), 100 D.L.R. (3d) 546 (Ont. H.C.)], as do the English cases cited by counsel, exemplifies the more traditional use of the letter to guarantee payment in commercial transactions where goods and services are bought and sold.
>
> Here, however, a more novel use has been made of the letter of credit as a security device...

13 Kevin McGuinness, in his text ***The Law of Guarantee*** (Scarborough: Carswell, 1996) emphasizes the difference between the payment and security functions of letters of credit at 815:

> In the case of a traditional letter of credit...[it] provides a payment facilitating mechanism...Thus the letter of credit is not intended as a security for payment...
>
> In contrast, a stand-by credit is not furnished as a means of making payment, but as a method of providing security against the possibility of default.

Although Canadian agreed that the letters of credit it posted are "standby" (or security) letters of credit, it attempts to characterize them as simply payment devices. I do not agree.

14 While counsel for Air Canada also submitted that a letter of credit is basically ~~a~~ guarantee, that is not how it was characterized in *Frasmet*, supra and *Meridian Development Inc.*, supra and properly so, since an irrevocable standby letter of credit such as those held by Ontario represents the equivalent of cash, the advance of which is subject to the satisfaction of certain conditions.

15 The legislation under which the tax is payable to Ontario and the letters of credit were posted confirm that the letters of credit were provided as security. The *Corporations Tax Act, R.S.O. 1990, c. C-40*, as amended by S.O. 1994, c. 14, s. 39(1) provides in s. 81 that:

> Every corporation shall pay, immediately on receipt of a notice of assessment or reassessment or of a statement of account in respect of a taxation year, any part of the tax, interest, penalties and any other amounts then unpaid in respect of the taxation year, whether or not an objection to or an appeal from an assessment in respect of the taxation year is outstanding.

16 Section 103 of that Act provides that the Minister may accept security in lieu of this immediate payment:

> The Minister may, if he or she considers it advisable, accept security for the payment of taxes by a corporation by way of a mortgage or other charge of any kind upon the property of the corporation or of any other person, or by way of a guarantee of the payment of the taxes by another person.

17 The *Retail Sales Tax Act*, R.S.O. 1990, c. R-31, as amended by S.O. 1994, c. 13, ss 13, 14(2), 15(3), S.O. 1999, C. 9, s. 186 contains similar provisions for the immediate payment of assessed tax notwithstanding an objection by the taxpayer in ss. 18-20. Section 37(2) provides that "[w]here the Minister considers it advisable to do so, the Minister may accept security for the payment of taxes in any form that the Minister considers satisfactory".

18 In short, although Ontario's claim may not have been characterized as "secured" by Canadian in the Plan, the letters of credit provide Ontario with a form of security, albeit subject to certain conditions.

19 The letters of credit require Ontario to provide either a drawing certificate stating that the amount being drawn is "due and payable in accordance with the provisions of the [Ontario Retail Sales] Act" and remains unpaid, or a written demand stating that the amount demanded is "payable and the taxpayer has failed to pay it." The parties agreed that until decisions have been rendered in the tax appeals, no amounts are payable, and Ontario is therefore precluded from drawing on the letters of credit until that time. Canadian submitted that the effect of this agreed-upon forbearance by Ontario is that the underlying debt is subject, not only to potential reduction by virtue of the tax appeals in Ontario, but also to reduction by compromise in the CCAA proceedings. To hold otherwise, Canadian suggested, flies in the face of the explicit wording of the letters of credit and is an attempt to improve Ontario's pre-CCAA entitlement.

20 A finding that the requirement to provide a written confirmation of the amount of debt owing prior to drawing on a letter of credit renders the underlying debt subject to compromise through CCAA proceedings would undermine the commercial purpose of such instruments and frustrate their objectives. It would render any security provided by a letter of credit meaningless in the very situation it has been obtained to alleviate. As stated by Blair J. in *Frasmet*, supra at para. 36:

> In the case at bar, the stated purpose of the letter of credit is to secure Standford's obligations under the lease. It can scarcely be gain-said that an event which is sure to impair a tenant's ability to honour its obligations under the lease is its bankruptcy. Why should Frasmet, which had obtained for itself a stand-by letter of credit as collateral security in connection with the lease transaction, be precluded from calling upon that security when the very kind of situation for which security is most likely necessary arises? In my view, in the circumstances of this case, it should not be so precluded.

21 In *Frasmet*, supra, while the tenant's bankruptcy terminated its continuing obligations to pay rent, Blair J. found that there were other obligations under the lease that arose upon default, including accelerated rent, damages arising out of the breach and the landlord's right to recoup capital expenditures on leasehold improvements made at the outset of the lease. Blair J. allowed the landlord to draw upon the letter of credit, stating at para. 40 that:

> [w]hile the bankruptcy of Stanford and the subsequent disclaimer of the lease by the Trustee may release the Tenant and its Trustee from those obligations, they cannot in my opinion, deprive the landlord from having resort to the security for which it bargained in order to protect itself in the case of the very kind of eventuality which has occurred.

22 Similarly, in *366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd.* (1996), 39 C.B.R. (3d) 134 (Alta. Q.B.), aff'd(1998), 7 C.B.R. (4th) 42 (Alta. C.A.), Smith J. found that the bankruptcy of a tenant did not affect the right of a landlord to call on a letter of credit issued as security for the repayment of a cash inducement. Smith J. found that the landlord was entitled to call on the letter of credit "irrespective of any dispute arising as to entitlement to the fund." (p.137). A letter of credit is "a form of security which may be called upon by the secured creditor when the event for which the security has been given occurs, without regard to the circumstances existing between the parties to the underlying transaction": *Frasmet*, para. 35.

23 That insolvency is irrelevant to a letter of credit is reflected in s. 11.2 of the CCAA:

> No order may be made under section 11 staying or restraining any action, suit or proceeding against a person, other than a debtor company in respect of which an application has been made under this Act, who is obligated under a letter of credit or guarantee in relation to the company.

24 Canadian submited that, as the provision of a letter of credit involves three separate contracts (*Meridian Development Inc.*, supra at 586), it is necessary that I determine the terms of the contract between Ontario and Canadian. Canadian suggested that, based on the specific wording of the letters of credit, I should find that one term of such contract is that Ontario could not call on the letters of credit as long as they were kept current and until the final amount of tax debt owing by Canadian to Ontario was determined. Canadian then submitted that I should take an additional step and find that Ontario's forbearance is subject, not only to the result of the tax appeals, but to reduction of the claims pursuant to compromise in these proceedings. The argument is that, since Ontario has by its forbearance waived its right to immediate payment of the tax assessed, it has somehow without more left itself open to reduction of its claim through the Plan.

25 The answer to this argument again lies with the nature of the letters of credit and the nature of Canadian's obligation to the taxing authorities. Had Ontario not accepted the letters of credit from Canadian, Canadian would have been obliged to pay the entire amount of tax assessed pending the outcome of its appeals of the assessments, resulting in no debt to be compromised. Forbearance by Ontario in recognition of the possibility that Canadian's appeals of the assessments may be successful is not the equivalent of acceptance of the risk of Canadian's intervening insolvency. As set out by Lazar Sarna in the text ***Letters of Credit : The Law and Current Practice*** at p. 5-25 (quoted in *366604 Alberta Ltd. (Trustee of) v. Pensionfund Properties Ltd.*, supra at para. 11 (Q.B.):

> . . .[O]ne of the fundamental commercial reasons for the use of the letter of credit mechanism is to secure anticipated payments in a manner which would not rely upon the will, status or financial faith of the applicant.

26 I cannot find that Ontario's forbearance in accepting the letters of credit in lieu of cash was a waiver of anything other than an immediate right to be paid. Its forbearance is to delay such right until after the appeals have been concluded, for the amount determined to be payable on appeal. There is no evidence of any greater forbearance, either in the letters of credit or otherwise before me, and certainly no evidence that, in accepting the letters of credit, Ontario agreed to have its claims treated as unsecured. The nature of the letters of credit dictates the opposite conclusion, as does Ontario's response to that characterization when it finally became aware of how it was being treated under the Plan.

27 Canadian also sought to draw a distinction between Ontario's claim and other secured claims by noting that this is not a case in which Canadian has committed an act of default under a security agreement such that Ontario would be in a position to enforce its security rights. Ontario must still wait for the outcome of the tax appeals before drawing on the letters of credit. However, the fact that no immediate enforcement rights of Ontario are being compromised by the Plan does not convert the nature of Ontario's interest from a secured claim to an unsecured claim.

28 Canadian submitted that Ontario is seeking relief from the terms of its own letters of credit, in that it is asking to change the terms of the bargain it struck with Canadian upon acceptance of the letters of credit. I reject that submission and find the converse; Ontario is asking that the bargain be honoured. Ontario did not ask for any amendment to the letters of credit, but for recognition of the secured nature of part of its claim. Ontario argued that once that question is settled, the letters of credit can be exercised in due course after the appeals have been concluded and any difficulty arising from the necessity of making representations in a draw-down certificate or written demand will be resolved.

29 For the reasons discussed, I find that a portion of Ontario's claim is indeed secured, and that there was no implied agreement between Ontario and Canadian that the debt underlying the secured portion of the claims could be compromised by intervening events other than the tax appeals.

30 Despite this, there is no reference to the letters of credit anywhere in the Plan, nor any suggestion that Ontario's claim may be anything other than entirely unsecured. It is clear that Canadian had full knowledge of the letters of credit, and of the position taken by Ontario in its May 25, 2000 form of claim, that it was secured for part of its claim.

31 The court sanctioning the Plan did not have knowledge of Ontario's position, or the form of security that distinguished Ontario's claim from other, apparently unsecured claims in the same

category. It is clear that the court proceeded on the assumption that Ontario's claim was completely unsecured, on the basis of an aggressive characterization of the letters of credit by Canadian. The question then becomes, what effect does the Plan have on Ontario's claim and the letters of credit? Specifically, it must be determined whether an interpretation of the Plan which disregards the security arrangements made between these parties should be adopted.

2. What is the effect of the Plan on Ontario's claim and the letters of credit?

32 After court approval of a CCAA plan, an application for directions may be made if a difficulty arises in its interpretation or application: *Re Horizon Village Corp., Canada* (1991), 8 C.B.R. (3d) 25 (Alta. Q.B.).

33 In that case, Wachowich J. (as he then was) was asked to interpret a court-sanctioned plan with respect to a federal tax rebate that had arisen in favour of the debtor company. The court-appointed manager sought a declaration that the rebate formed part of the estate of the debtor company. A secured creditor argued that it was entitled to the rebate because it held an assignment of the rebate as collateral security. Wachowich J. found in favour of the secured creditor.

34 He stated that as a starting point in such applications, the court must always keep in mind the purpose and effect of the CCAA: para. 5. He referred to the wide scope of the legislation in granting protection to debtor companies and enabling them to continue carrying on business. Commensurate with the court's protection of debtors under the CCAA, Wachowich J. noted, is the court's desire not to prejudice creditors: para. 7, quoting from *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.) at p. 6: "[the CCAA] was, in my view, never intended to disadvantage any group which, but for the Act, would have enjoyed rights and priorities vis-a-vis the debtor or the debtor's assets."

35 Wachowich J. found that the plan before him did not expressly refer to either the secured creditor's collateral security interest in the rebate, nor to the rebate itself. The rebate was not a source of funds contemplated by the plan. He considered, however, that the collateral security interest or the rebate might be impliedly included in the plan. He held that the court will be reluctant to imply terms which will alter the legal relationship between parties, but will do so if the purposes of the CCAA and any plan made under the CCAA will be defeated without such implied terms. He concluded that there were no implied inclusions in regard to the rebate, specifically rejecting that the rebate was impliedly caught by the plan's use of the words "proceeds of sale" or "funds generated".

36 The aim of minimizing prejudice to creditors embodied in the CCAA is a reflection of the cardinal principle of insolvency law: that relative entitlements created before insolvency are preserved: R. Goode, ***Principles of Corporate Insolvency Law***, 2nd ed. (London:Sweet & Maxwell, 1997) at 54. While the CCAA may qualify this principle, it does so only when it is

consistent with the purpose of facilitating debtor reorganization and ongoing survival, and in the spirit of what is fair and reasonable.

37 Paperny J. (as she then was) also discussed the purpose of the CCAA in *Re Canadian Airlines Corp.* (2000), 265 A.R. 201 (Alta. Q.B.), aff'd [2000] A.J. No. 1028 (Alta. C.A.), leave refused [2001] S.C.C.A. No. 60 (S.C.C.). At para. 95, she stated that the purpose of the CCAA is to facilitate the reorganization of debtor companies for the benefit of a broad range of constituents.

38 Paperny J. also noted at para. 95 that, in dealing with applications under the CCAA, the court has a wide discretion to ensure the objectives of the CCAA are met. At para. 94, she identified guidance for the exercise of this discretion in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) at p. 9 as follows:

> "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction - although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise an exercise in equity - and "reasonableness" is what lends objectivity to the process.

39 In addition to the purposes of the CCAA and the principles which guide the court's role in proceedings under that statute, the overall purpose and intention of the plan in question will also be considered by the court when faced with disputes in interpretation: *Lindsay v. Transtec Canada Ltd.* (1994), 28 C.B.R. (3d) 110 (B.C. S.C.), aff'd(1995), 31 C.B.R. (3d) 157 (B.C. C.A.)

40 With these guiding principles in mind, I now turn to the interpretation of the Plan.

41 As referenced above, Canadian submitted that the Plan must be interpreted as compromising the entirety of Ontario's claim, not just the portion remaining after the application of letters of credit. Its position is summarized in a letter sent by its counsel to Ontario's counsel, Exhibit "C" to the affidavit of Ontario's deponent, Susan Scarlett:

> ...We note that, in Canadian's...Plan, ..., approved by the Order of Madam Justice M.S. Paperny dated June 27, 2000, all Affected Unsecured Creditors (i.e. holders of Affected Unsecured Claims- art. 1.1) are to receive $0.14 for each $1.00 of Proven Unsecured Claim (arts. 1.1, 5.1(a)). "Affected Unsecured Claims" is defined in art. 1.1 as "all Claims listed in Part I of the Affected Unsecured Claims List or all Claims of any Person listed in Part II of the Affected Unsecured Claims List...". Your client is covered by each alternative branch in that definition. Listed at para. 2 of Part I of the Unsecured Claims List is "Claims in respect of any Tax Claims including, without limitation, those Claims listed on Part "II" to this Schedule "B". As well, Ontario is a person listed in Part II of the Affected Unsecured Claims List. The definition of "Tax Claim" (at art. 1.1 of the Plan) includes the following words:

> "Tax Claims" means any and all Claims for Taxes by any...provincial...authority, agency or government (including, without limitation, any and all Claims for Taxes by ...Her Majesty the Queen in right of any province or territory of Canada...) ... in respect of any taxation year or period ending on or before the Effective Date...
>
> Thus, the entirety of your client's claim is an Affected Unsecured Claim, and your client will receive in payment thereof, $0.14 per $1.00 of Proven Claim.

42 Ontario suggested that the Plan should be interpreted as including the secured portion of its claim in the "Noteholders Claims List" under the Plan, which is characterized as secured. It pointed out that the Plan defines the "Noteholders Claims List" as "the list of Affected Secured Note Claims attached hereto as Schedule "C", as amended or supplemented from time to time as provided in the Creditors' Meetings Order". From that language, Ontario submitted that it is clear that the list of Noteholders was not intended to be complete or final. It also suggested that the secured portion of Ontario's claim could be considered to be an "unknown" claim in accordance with the definition of "Claims" under the Plan, and that, therefore, the addition of its claim to the Noteholders Claims List would not offend the Plan as sanctioned.

43 I disagree with Canadian's suggestion that its interpretation is the only or most reasonable interpretation of the Plan. I also do not find the interpretation suggested by Ontario to be persuasive. I do agree, however, with Ontario's position as reflected in the first ground of relief sought in this application, as paraphrased at the outset of these reasons: the Plan only compromises the balance of Ontario's claim after the letters of credit are applied. In my view, the language of the Plan, the general concept of the Plan as a whole and the purpose and philosophy of the CCAA support this result.

44 Although the Plan is capable of the interpretation that Canadian suggested, I find that interpretation should not be adopted in view of the purpose of the CCAA and the whole of the Plan itself. Specifically:

> a. The Plan makes no express reference to the letters of credit. Implying that the treatment of Ontario's claim is entirely unsecured is not necessary to avoid defeating the purpose of the CCAA and the Plan. Canadian has not suggested nor provided any evidence that the compromise of the entirety of Ontario's claim is required for its ongoing survival, or formed an integral part of the whole of the Plan.
>
> b. Not only is there is no evidence or suggestion that interpreting the Plan in the manner Ontario proposed would be prejudicial to Canadian or Air Canada, there is no evidence of prejudice to Canadian's creditors, nor can there be any suggestion of damage to the integrity of the Plan.

c. While certainly the alteration of legal relationships between creditors and debtors is a necessary incident of CCAA plans, the court also endeavours to minimize to the extent possible prejudice to creditors: *Horizon Village Corp., Canada (Re)*, supra. Canadian's interpretation is inconsistent with this goal.

d. The premise of Canadian's position is that the Plan compromises only the underlying debt to Ontario and leaves intact the letters of credit, which are mere payment devices. This wholly disregards the reality of the security Canadian granted to Ontario pre-CCAA to avoid immediate payment of assessed tax, as well as the entire concept of the Plan, described below. This technical approach is to be discouraged in CCAA proceedings: *Lindsay v. Transtec Canada Ltd.*, supra at para. 26.

e. Disregarding the letters of credit in Canadian's insolvent circumstances is wholly inconsistent with the rationale of these particular security devices. Letters of credit are obtained to secure payments in a manner that does not rely on the financial position of the applicant. As recognized in s. 11.2 of the CCAA, letters of credit are designed to operate outside and not be subject to the compromises typically involved in insolvency.

f. Compromising the entirety of Ontario's claim, which in effect deprives Ontario of much of the value of its security, is inconsistent with the general concept of the Plan. This was to compromise the claims of certain of Canadian's unsecured creditors to the extent of 86 cents per dollar of proven claims (with no cap on total proven unsecured claims) and to compromise the claims of Affected Secured Noteholders to the extent of 3 cents per dollar of proven claims and allowing those secured creditors to receive the unsecured dividend on the deficiency.

g. Canadian's interpretation results in anomalous treatment of a secured creditor and tax claimant under the Plan. It treats a secured creditor as an unsecured creditor in compromising its entire claim at 14 cents on the dollar, while only the deficiency portion of the other secured creditors under the Plan (Affected Secured Noteholders) are treated in this fashion. Further, there is no evidence that any other secured creditor is included in the Affected Unsecured Creditors list, except for Ontario and the Affected Secured Noteholders (and then only to the extent of the deficiency). Similarly, there is no evidence that any other tax claimant was secured but deprived of that security by having the entirety of its claim compromised.

For these reasons and the reasons that follow, Canadian's interpretation is not fair and reasonable.

45 As noted, I am not persuaded by Ontario's suggested interpretation of the Plan. It would be a strained interpretation to include Ontario's secured claim with those of the Affected Secured Noteholders. It is not consistent with the overall concept of the Plan, as described above. It also appears that it is no longer possible to amend the Noteholders Claims List, since the power to do so expired on May 15, 2000.

46 However, the Plan can and should be interpreted as excluding secured claims from compromise as "Affected Unsecured Claims". Rather, the only secured claims compromised under the terms of the Plan are those of the Affected Secured Noteholders. These notes represented a principal debt to Canadian of US$ 175,000,000.00 with a provision that could increase the obligation to US $190,000,000.00. It is obvious why the compromise of those secured claims was integral to the success of the Plan and the ability of Canadian to carry on business.

47 While the Plan's definition of "Claim" is broad and refers to both unsecured and secured claims, the way the Plan was drafted requires that the term "Claim" be used in relation to both the secured (the "Affected Secured Note Claims") and the unsecured (the "Affected Unsecured Claims") claims. These two categories constitute the classification of compromised claims under the Plan (Section 5.1). It is true that "Tax Claims" are included within the definition of "Affected Unsecured Claims" and arguably the use of the word "Claims" in conjunction with "Tax" could incorporate a compromise of a secured claim. That result, however, amounts to including the whole of an apparently isolated secured claim, which is not an Affected Secured Note Claim, in a group of unsecured claims. There is no evidence before me to suggest that there are any other creditors in the Affected Unsecured Claims List that hold security, except for Ontario and creditors holding Senior Secured Notes, to the extent of any deficiency only. There is no other reference in the Plan that would suggest that the Affected Unsecured Creditors include secured claims.

48 The interpretation of the Plan to exclude compromise of secured claims except for those of Affected Secured Noteholders is consistent with the purposes of the CCAA, as well as the Plan itself. The letters of credit are not Canadian's property and there is no evidence or suggestion that their intended use by Ontario will operate to defeat any aspect of the Plan, nor to prejudice Canadian's ongoing operations. The purpose of the CCAA to facilitate reorganization and ongoing survival of debtor companies is honoured. Honouring Ontario's secured claim is consistent with the general concept of compromising only the claims of unsecured creditors and Affected Secured Noteholders in the Plan.

49 Interpretation of the Plan in this way does not result in an enhancement of Ontario's rights or special treatment under the Plan. It honours the clear security arrangements made prior to the CCAA proceedings and treats the deficiency in a manner identical to the unsecured claims of all affected creditors.

50 Canadian emphasized in its written submissions that it was not compromising a secured claim in its proposed treatment of Ontario under the Plan. Not only did Canadian reject Ontario as a secured creditor, it stressed that the only compromise was of the underlying debt to Ontario. In substance, however, what Canadian hopes to achieve from its suggested interpretation is the effective disregard of Ontario's security. If Canadian had intended to compromise a secured claim within the Affected Unsecured Claims category, this should have been expressed clearly within

the terms of the Plan, Ontario should have been expressly notified in a timely fashion, and the court should have been alerted to this anomalous treatment in the sanction hearing. Canadian did none of these things. It now relies on an interpretation of the language of the Plan to support its purported compromise of the whole of Ontario's claim without regard to its security. While I appreciate that CCAA proceedings necessarily change debtor-creditor relationships, this must be done clearly and fairly. Under the circumstances, the court cannot condone the change Canadian is seeking vis-a-vis Ontario's claim.

51 In summary, the evidence is clear that the letters of credit were granted by Canadian well prior to the March 24, 2000 stay order. Ontario's secured claim is not mentioned in the Plan, and the security would be effectively stripped of its value by the application of the Plan as proposed by Canadian, in a fashion that is aberrant to the treatment of any other creditor under the Plan and inconsistent with its general concept. This cannot be right and can be avoided by a reasonable interpretation of the Plan that is consistent with the general concepts of both the CCAA and the Plan.

52 This conclusion is strengthened by the role that Canadian played in the delay surrounding the submission of Ontario's claim, discussed further below.

3. Should Ontario be granted relief from the complete compromise of its claim under the Plan, in the form of an amendment to the Plan?

53 If I was unable to interpret the Plan in a manner which compromises only the unsecured portion of Ontario's claim, I would in any event have considered it appropriate to direct an amendment to the terms of the Plan to effect this result.

54 The Ontario Court of Appeal considered the question of whether the court has jurisdiction to amend a plan of arrangement in *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 11 (Ont. C.A.), leave refused (1992), 10 O.R. (3d) xv (S.C.C.)

55 In that case, the plan of arrangement had been voted upon by creditors and sanctioned by the court, subject to the outcome of the appeal. The court found that, generally speaking, a plan of arrangement is consensual and the result of agreement, and that a plan found to be fair and reasonable ought not be amended by the court unless jurisdiction is found in the CCAA and there are compelling reasons to do so. The court also found that, generally speaking, the court ought not interfere by amendment in situations where to do so would prejudice the interests of the company or the creditors. In the facts of the *Algoma* situation, the court found that an amendment would be insignificant and technical as far as other creditors were concerned, and allowed the plan to be amended.

56 Sections 6 and 7 of the CCAA deal with the authority of the court to sanction a plan of arrangement, and to alter or modify its terms. Section 7 provides that, when an amendment is

proposed at any time after meetings of creditors have been summoned, the court may adjourn those meetings or may direct that no adjournment of the meetings or convening of additional meetings is necessary if the court is of the opinion that the creditors or shareholders are not adversely affected by the amendment proposed. Section 7 also provides that any arrangement so altered or modified may be sanctioned under section 6. The Plan was in fact amended pursuant to the authority of Section 7 in this manner by Paperny, J. Section 6 and 7 offer no guidance on whether a court-sanctioned plan may be subsequently amended.

57 As mentioned, the CCAA confers broad discretion on the court and is to be afforded a large and liberal interpretation: *Re Canadian Airlines Corp.*, supra at para 95; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.). It is silent, however, on many procedural issues. Given the lack of legislative guidance, the courts have used the basic purpose of the CCAA as a guide to its application and the exercise of its discretion in disposing of applications under the Act: *Re Canadian Airlines Corp.*, supra at para. 95. The keynote concepts of fairness and reasonableness have been recognized as the driving force behind the CCAA and the court's interpretation and application of the Act: *Re Canadian Airlines Corp*. at para. 95, *Olympia & York Developments Ltd. v. Royal Trust Co.*, supra at p. 9.

58 I have already described that the purposes of the CCAA are honoured in the interpretation of the Plan that would compromise only the unsecured portion of Ontario's claim. Those purposes are equally honoured in an amendment to the Plan to achieve this result. Further, the concepts of fairness and reasonableness are also recognized in such an amendment, in contrast to the existing effect of the Plan if my interpretation were not possible.

59 It would not be fair to Ontario, given the pre-existing arrangements made with Canadian to secure the payment of tax and the process by which it found itself faced with Canadian's attempt to compromise the entirety of its claim (discussed further below), to allow Canadian to succeed in this regard. Moreover, it is not unfair to either Canadian or Air Canada to allow an amendment to effect the result that only the deficiency portion of Ontario's claim is compromised as an unsecured claim. Canadian and Air Canada were well aware of the letters of credit and that Ontario had submitted a form of claim that recognized this security. There is no evidence or assertion of unfairness to any other party.

60 It would similarly not be reasonable to deprive Ontario of its security, as I found would be the effective result if Canadian's interpretation of the Plan were to prevail. While Canadian argued that the security itself is not compromised, that argument does not recognize the reality that if the letters of credit are to be treated as the simple payment mechanisms that Canadian asserted they were, their value is essentially reduced, cent for cent, in a manner identical to unsecured claims under the Plan. Ultimately, the letters of credit would be deprived of their value by Ontario's treatment under the Plan. This is not a reasonable result in view of the whole of the Plan and the anomalous treatment Canadian would have the court inflict on Ontario's secured claim.

61 The CCAA authorizes the court to amend a plan in appropriate circumstances, where there are compelling reasons to do so. Although the Act does not expressly state that such amendment could take place after the Plan is sanctioned, as pointed out in *Algoma*, supra there is no reason to suggest that the CCAA "contemplates a role for the court as a mere rubber stamp or one that is simply administrative rather than judicial." (p.103). While the circumstances justifying an amendment after a sanction hearing ought to be truly exceptional, in recognition of the potential violence done to the laudable goal of commercial certainty, there is no reason why subsequent amendments should be conclusively foreclosed in every case, without examination of the particular circumstances.

62 Are there compelling circumstances in this case that would justify a subsequent amendment? Ontario submitted that there are, in that it would be unfair to compel Ontario to be bound by the unilateral characterization of its claim by Canadian.

63 The process established by the April 7, 2000 order setting out the claims procedure was unique, in that it allowed Canadian to list its creditors under categories reflecting its opinion of their status. A creditor that did not agree with Canadian's characterization of the nature or amount of its claim was required to file a Dispute Notice.

64 In Ontario's case, for the reasons set out in Paperny J.'s findings of fact, the claims bar date intervened. Ontario filed a Dispute Notice on the basis of a partially secured claim. Ontario did not become aware that Canadian was rejecting its claim as being out of time until the last day evidence was presented at the sanction hearing, and no evidence of Ontario's position was presented to the court at the hearing.

65 While Ontario must bear some responsibility for its systemic internal delays, and while it would have been prudent for Ontario to have been represented at the hearing or to have followed-up its Dispute Notice to ensure that Canadian was in agreement with its claim, it was not aware of the position Canadian would take with respect to the validity of its claim until after the time it would have had an opportunity to appear at the sanction hearing. I note that in Canadian's June 19, 2000 letter to Ontario, it did not suggest that it was also taking the position that the security would not be honoured as originally intended by the parties. This was only raised after Canadian failed to have Ontario's claim barred in the late claim application.

66 Ontario never had a realistic opportunity to present its position to the court before the Plan was sanctioned, and the court was completely unaware of any issue involving the nature of Ontario's claim. It must surely never be the case that a creditor in CCAA proceedings is deprived of the opportunity to present its submissions on the nature and amount of its claim by reasons of procedural irregularities that do not arise from a lack of diligence or good faith. The wide scope and protection offered by the CCAA should not be allowed to operate to disadvantage or prejudice creditors without a fair hearing of their concerns and submissions.

67 This is not a situation, as in *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.), where the creditor had several opportunities to make submissions to the court and to appeal its classification and failed to pursue these options. While it is true that Ontario was aware of its proposed classification under the Plan, and also aware of the sanction hearing at which classification was to be approved, it had taken action to place its position on classification before the monitor and Canadian by filing its Dispute Notice. At the least, it was entitled to assume that, if Canadian disagreed with its position, it would give Ontario notice prior to the conclusion of the sanction hearing. It was not Ontario that was "lying in the weeds" in this case, delaying in the hopes of gaining an advantage.

68 There is no prejudice to other creditors if the Plan is amended as sought by Ontario. As was the case in *Algoma*, supra, the letters of credit are not the property of Canadian and there is no evidence or suggestion that there will be any prejudice or impairment of operations as a result of drawing on the letters of credit. Both Canadian and Air Canada were aware of Ontario's claim, and cannot be said to be prejudiced except to the extent that they disagree with the characterization of the claim. Paperny, J. specifically found no prejudice in the late claim application and also found that Canadian and Air Canada were attempting to use the delay to avoid resolving the dispute with Ontario. As I have stated previously, this is not an attempt by Ontario to improve its pre-insolvency rights, but merely to enforce them.

69 Canadian submitted that Ontario's request for amendment of the Plan is a procedurally improper method of attacking the sanction order. The Canadian process was unusual in that the classification of creditors was approved in the sanction order, and not previously. Canadian submitted that Ontario should have appealed the sanction order as it was the order approving the classification, relying on *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.).

70 The rationale of that case is that, while the proper procedure for attacking a classification order is by way of appeal from that order and not a subsequent sanction order, because of the overall supervisory duty of the court to ensure fairness of a plan, the court can intervene in the subsequent appeal of the sanction order "if necessary to avert substantial injustice" (para.21). In *Re: Keddy Motor Inns*, supra, the court found the circumstances did not warrant intervention.

71 Shortly before the sanction order was issued, Ontario was advised by Canadian that its claim would not be accepted because it was submitted after the claims bar date. Ontario's next step was to pursue its application for extension of time to file a proof of claim. It was successful in that application, and filed its amended claim, continuing to assert secured status. The decision of Paperny J. allowing Ontario's application does not restrict Ontario to making its claim as an "Affected Unsecured Creditor". In fact, in the decision, Paperny J. refers several times to the letters of credit as "security" for the assessments under appeal. It is arguable that, had Ontario chosen to appeal the sanction order because of the classification of its claim, it would have faced the

objection that it lacked status as its claim was time-barred. The process followed by Ontario is not a collateral attack on the sanction order, but the logical outcome of the procedure followed to re-establish its claim.

72 Canadian also submitted that Ontario's classification as an "Affected Unsecured Creditor" is appropriate because it is in the same classification as other Tax Claimants, citing the principle of "commonality of interest" as enunciated by Forsyth, J. in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.). This is not, however, a case of a secured creditor attempting to be distinguished from other secured creditors, but of a secured creditor attempting to be characterized as secured. The distinction between a secured claim and an unsecured claim is surely sufficient to overcome the "commonality of interest" test.

73 Were it necessary, I would direct that the Plan be amended to provide that the portion of Ontario's claim that is secured by the letters of credit not be compromised.

CONCLUSION

74 In conclusion, I find that the Plan compromises only the unsecured portion of Ontario's claim. If I was unable to make that finding, I would have found compelling reasons in these very unusual circumstances for the court to take the extraordinary step of amending the Plan, even after its sanction. To do otherwise would be to allow Ontario to be prejudiced by a process that was flawed in its operation with respect to Ontario's claim. Canadian and Air Canada were aware both of Ontario's claim and its characterization of its security and there is no prejudice to either of them in the interpretation I have found, nor the amendment to effect it, if necessary. Canadian did not suggest nor is there any evidence of prejudice to the other creditors arising from this interpretation or amendment.

Application granted.

6

2002 CarswellOnt 2742
Ontario Superior Court of Justice

Ball Machinery Sales Ltd., Re

2002 CarswellOnt 2742, [2002] O.J. No. 3228, 116 A.C.W.S. (3d) 7, 37 C.B.R. (4th) 39

The Companies' Creditors Arrangement Act, R.S.C. 1985, c.C-36 and A Plan of Compromise or Arrangement of Ball Machinery Sales Ltd. and the other Applicants Listed on Schedule "A"

Pepall J.

Judgment: August 22, 2002
Docket: 01-CL-4154

Counsel: *Sean Lawler*, for Moving Parties, Ball Machinery Sales Ltd. et al
Craig Hill, for Aecon Construction Group Inc.
Harvey Chaiton, for Monitor, Deloitte & Touche Inc.
Alex Ilchenko, for Orix Financial Services

Subject: Corporate and Commercial; Insolvency

Related Abridgment Classifications

For all relevant Canadian Abridgment Classifications refer to highest level of case via History.

Headnote

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues

Plan of compromise for debtor group of companies was approved at meetings of debtor's secured and unsecured creditors — Plan provided that it could be amended after meetings, provided court determined that amendment would not be materially prejudicial to interests of creditors — Subsequent to meetings, release provision of plan was amended at request of creditor A Inc. — A Inc. wished to preserve its rights to pursue claim against certain officers and directors of debtor for breach of trust pursuant to Construction Lien Act — Amended release provision provided that general release of claims by creditors did not include claims based on allegations of wrongful or oppressive conduct or misrepresentation by directors, officers and/or employees to any creditor or claims relating to contractual rights of any creditor — Debtor brought motion for order approving plan — Motion granted — Debtor group of companies fell within definition of companies to which Companies'

Creditors Arrangement Act applied, notice was properly given, creditors were properly classified, meetings were properly constituted, voting was properly carried out and plan was overwhelmingly approved by requisite majorities — Plan was fair and reasonable — Amended wording of release was in accordance with s. 5.1(2) of Companies' Creditors Arrangement Act — Amended release was not materially prejudicial to interests of creditors — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 5.1(2) — Construction Lien Act, R.S.O. 1990, c. C.30.

Table of Authorities

Cases considered by *Pepall J.*:

Northland Properties Ltd., Re, 73 C.B.R. (N.S.) 175, 1988 CarswellBC 558 (B.C. S.C.) — referred to

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

Statutes considered:

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

s. 5.1 [en. 1997, c. 12, s. 122] — referred to

s. 5.1(2) [en. 1997, c. 12, s. 122] — referred to

Construction Lien Act, R.S.O. 1990, c. C.30
s. 13 — referred to

MOTION by debtor group of companies for order approving plan of compromise.

***Pepall J.*:**

1 The Applicants, the Ball Machinery group of Companies ("Ball Machinery") bring a motion for, amongst other things, an order approving and sanctioning the Plan of Compromise

or Arrangement of the Applicants which was approved and agreed to by the creditors of the Applicants at meetings held on July 24, 2002.

2 On May 24, 2001, an order was granted pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c.C-36 granting a stay of proceedings against Ball Machinery.

3 A Plan of Compromise was considered and voted upon by the secured and unsecured creditors at meetings held on July 24, 2002. Of all the creditors that voted in person or by proxy, only one unsecured creditor voted against the Plan.

4 The Respondent on the motion, Aecon Construction Group Inc. ("Aecon") is a creditor of Ball Machinery. Aecon opposes the release provision found in paragraph 9.08 of the Plan. While no factums were filed by any of the parties on this motion, my understanding is that Aecon wishes to preserve its rights to pursue a trust claim against certain officers and directors of Ball Machinery for breach of trust pursuant to s.13 of the *Construction Lien Act*, R.S.O. 1990, c.C.30. Aecon agrees that the Plan should be sanctioned but proposes that paragraph 9.08 be amended to conform with the provisions of s.5.1 of the CCAA. It did not propose any amendment at the meeting called to approve the Plan which it attended. It abstained on the vote.

5 In an attempt to accommodate Aecon, the Applicants have proposed a new form of release. They are able to make amendments to the Plan after the creditors' meetings pursuant to paragraph 9.06 of the Plan provided the Court determines that the amendment is of a nature that would not be materially prejudicial to the interests of the creditors. That proposed release is more circumspect than the actual release which was approved and removes certain third party releasees. It states:

> Each Creditor shall, effective as of the Plan Implementation Date, be deemed to forever release any and all suits, claims and causes of action that such Creditor may have had against the directors, officers and/or employees of Ball that arose before the commencement of the CCAA proceedings and that relate to the obligations of Ball where the directors, officers and/or employees are by law liable in their respective capacities as directors, officers and/or employees for the payment of such obligations. The claims hereby released do not include claims that:
>
> > (a) relate to contractual rights of any Creditor; or
> >
> > (b) are based on allegations of misrepresentations made by directors, officers and/or employees to any Creditor or of wrongful or oppressive conduct by directors, officers, and/or employees.
>
> Despite the foregoing, no guarantor shall be released from any liability pursuant to any guarantee and nothing in the Plan or resulting from this Plan shall release any guarantor from any such liability.

6 In considering whether to sanction a Plan under the CCAA, the court must review the Plan to see if it satisfies the following requirements:

a) there must be compliance with all statutory requirements;

b) all material 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.), at 182-3, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.)

7 I am satisfied that these requirements have been met in the amended Plan presented to me for approval which includes the new form of release. Ball Machinery falls within the definition of companies to which the CCAA applies, notice was properly given, creditors were properly classified, the meetings were properly constituted, the voting was properly carried out and the Plan was overwhelmingly approved by the requisite majorities. In light of the amended wording of the release which I note excludes wrongful conduct of directors, officers and employees, I am satisfied that the Plan is authorized by the CCAA and that the amended wording complies with s.5.1(2) and does not offend the Act. In addition, the Plan is fair and reasonable. I am also persuaded that the modified release is not materially prejudicial to the interests of the creditors. With this amendment, the Applicants meet the three part test for a sanction order.

8 Whether Aecon is ultimately successful in asserting its claim pursuant to s.13 of the *Construction Lien Act* and whether wrongful conduct is established are issues which will have to be addressed in the future. The draft order found at Tab 4 of the motion record is granted. In paragraph 18, the words commencing "including most" and ending "August 2, 2002" shall be deleted.

Motion granted.

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

AND IN THE MATTER OF A PLAN OF COMPROMISE AND ARRANGEMENT OF CLINE MINING CORPORATION, NEW ELK COAL COMPANY LLC AND NORTH CENTRAL ENERGY COMPANY

Applicants

Court File No.: CV14-10781-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF THE APPLICANTS
(Plan Amendment Motion
Returnable June 1, 2015)

GOODMANS LLP
Barristers & Solicitors
333 Bay Street, Suite 3400
Toronto, Canada M5H 2S7

Robert J. Chadwick LSUC#: 35165K
Email: rchadwick@goodmans.ca

Logan Willis LSUC #: 53894K
Email: lwillis@goodmans.ca

Bradley Wiffen LSUC #: 64279L
Email: bwiffen@goodmans.ca

Tel: (416) 979-2211
Fax: (416) 979-1234

Lawyers for the Applicants