File No. CV-09-8396-00CL

COURT OF APPEAL FOR ONTARIO

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 CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A"

Applicants

BOOK OF AUTHORITIES OF THE AD HOC GROUP OF SHAREHOLDERS

June 18, 2010

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TO: THE SERVICE LIST

Court File No. CV-09-8396-00CL

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
CANWEST GLOBAL COMMUNICATIONS CORP.
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Applicants

CANWEST SERVICE LIST, JUNE 17, 2010

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TAB "1"

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended and in the Matter of a Proposed Plan of Compromise or Arrangement with respect to Stelco Inc., and other Applicants listed in Schedule "A" Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 as amended

[Indexed as: Stelco Inc. (Re)]

Court of Appeal for Ontario, Goudge, Feldman and Blair JJ.A.
March 31, 2005

Corporations — Directors — Removal of directors — Jurisdiction of court to remove directors — Restructuring supervised by court under Companies' Creditors Arrangement Act — Supervising judge erring in removing directors based on apprehension that directors would not act in best interests of corporation — In context of restructuring, court not having inherent jurisdiction to remove directors — Removal of directors governed by normal principles of corporate law and not by court's authority under s. 11 of Companies' Creditors Arrangement Act to supervise restructuring — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

Debtor and creditor — Arrangements — Removal of directors — Jurisdiction of court to remove directors — Restructuring supervised by court under the Companies' Creditors Arrangement Act — Supervising judge erring in removing directors based on apprehension that directors would not act in best interests of corporation — In context of restructuring, court not having inherent jurisdiction to remove directors — Removal of directors governed by normal principles of corporate law and not by court's authority under s. 11 of Companies' Creditors Arrangement Act to supervise restructuring — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

On January 29, 2004, Stelco Inc. ("Stelco") obtained protection from creditors under the *Companies' Creditors Arrangement Act* ("*CCAA*"). Subsequently, while a restructuring under the *CCAA* was under way, Clearwater Capital Management Inc. ("Clearwater") and Equilibrium Capital Management Inc. ("Equilibrium") acquired a 20 per cent holding in the outstanding publicly traded common shares of Stelco. Michael Woollcombe and Roland Keiper, who were associated with Clearwater and Equilibrium, asked to be appointed to the Stelco board of directors, which had been depleted as a result of resignations. Their request was supported by other shareholders who, together with Clearwater and Equilibrium, represented about 40 per cent of the common shareholders. On February 18, 2005, the Board acceded to the request and Woollcombe and Keiper were appointed to the Board. On the same day as their appointments, the board of directors began consideration of competing bids that had been received as a result of a court-approved capital raising process that had become the focus of the *CCAA* restructuring.

The appointment of Woollcombe and Keiper to the Board incensed the employees of Stelco. They applied to the court to have the appointments set aside. The employees argued that there was a reasonable apprehension that Woollcombe

and Keiper would not be able to act in the best interests of Stelco as opposed to their own best interests as shareholders. Purporting to rely on the court's inherent jurisdiction and the discretion provided by the *CCAA*, on February 25, 2005, Farley J. ordered Woollcombe and Keiper removed from the Board.

Woollcombe and Keiper applied for leave to appeal the order of Farley J. and if leave be granted, that the order be set aside on the grounds that (a) Farley J. did not have the jurisdiction to make the order under the provisions of the *CCAA*, (b) even if he did have jurisdiction, the reasonable apprehension of bias test had no application to the removal of directors, (c) he had erred in interfering with the exercise by the Board of its business judgment in filling the vacancies on the Board, and (d) in any event, the facts did not meet any test that would justify the removal of directors by a court.

Held, leave to appeal should be granted, and the appeal should be allowed.

The appeal involved the scope of a judge's discretion under s. 11 of the *CCAA*, in the context of corporate governance decisions made during the course of the plan negotiating and approval process of the *CCAA*. In particular, it involved the court's power, if any, to make an order removing directors under s. 11 of the *CCAA*. The order to remove directors could not be founded on inherent jurisdiction. Inherent jurisdiction is a power derived from the very nature of the court as a superior court of law, and it permits the court to maintain its authority and to prevent its process from being obstructed and abused. However, inherent jurisdiction does not operate where Parliament or the legislature has acted and, in the *CCAA* context, the discretion given by s. 11 to stay proceedings against the debtor corporation and the discretion given by s. 6 to approve a plan which appears to be reasonable and fair supplanted the need to resort to inherent jurisdiction. A judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a *CCAA* proceeding. The order in this case could not be founded on inherent jurisdiction because it was designed to supervise the company's process, not the court's process.

The issue then was the nature of the court's power under s. 11 of the *CCAA*. The s. 11 discretion is not open-ended and unfettered. Its exercise was guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. What the court does under s. 11 is establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. In the course of acting as referee, the court has authority 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. The court is not entitled to usurp the role of the directors and management in conducting what are in substance the company's restructuring efforts. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. The court is not catapulted into the shoes of the board of directors or into the seat of the chair of the board when acting in its supervisory role in the restructuring.

The matters relating to the removal of directors did not fall within the court's discretion under s. 11. The fact that s. 11 did not itself provide the authority for a *CCAA* judge to order the removal of directors, however, did not mean that the supervising judge was powerless to make such an order. Section 20 of the *CCAA* offered a gateway to the oppression remedy and other provisions of the *Canada*

Business Corporations Act, R.S.C. 1985, c. C-44 ("*CBCA*") and similar provincial statutes. The powers of a judge under s. 11 of the *CCAA* may be applied together with the provisions of the *CBCA*, including the oppression remedy provisions of that statute.

Court removal of directors is an exceptional remedy and one that is rarely exercised in corporate law. In determining whether directors have fallen foul of their obligations, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office. The evidence in this case was far from reaching the standard for removal, and the record would not support a finding of oppression, even if one had been sought. The record did not support a finding that there was a sufficient risk of misconduct to warrant a conclusion of oppression. Further, Farley J.'s borrowing the administrative law notion of apprehension of bias was foreign to the principles that govern the election, appointment and removal of directors and to corporate governance considerations in general. There was nothing in the *CBCA* or other corporate legislation that envisaged the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment. The issue to be determined was not whether there was a connection between a director and other shareholders or stakeholders, but rather whether there was some conduct on the part of the director that would justify the imposition of a corrective sanction. An apprehension of bias approach did not fit this sort of analysis.

For these reasons, Farley J. erred in declaring the appointment of Woollcombe and Keiper as directors of Stelco of no force and effect, and the appeal should be allowed.

Cases referred to

Alberta Pacific Terminals Ltd. (Re), [1991] B.C.J. No. 1065, 8 C.B.R. (3d) 99 (S.C.); *Algoma Steel Inc. (Re)*, [2001] O.J. No. 1943, 147 O.A.C. 291, 25 C.B.R. (4th) 194 (C.A.); *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78, [2003] O.J. No. 71, 39 C.B.R. (4th) 5 (C.A.), revg in part [2001] O.J. No. 5046, 30 C.B.R. (4th) 163 (S.C.J.); *Babcock & Wilcox Canada Ltd. (Re)* [2000] O.J. No. 786, 18 C.B.R. (4th) 157, 5 B.L.R. (3d) 75 (S.C.J.); *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, 57 D.L.R. (3d) 1, 5 N.R. 515, [1976] 1 W.W.R. 1, 20 C.B.R. (N.S.) 240; *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, [1995] S.C.J. No. 29, 25 O.R. (3d) 480*n*, 128 D.L.R. (4th) 73, 187 N.R. 241, 24 B.L.R. (2d) 161; *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, [1991] O.J. No. 683, 45 O.A.C. 320, 80 D.L.R. (4th) 161, 1 B.L.R. (2d) 225 (C.A.); *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2004] O.J. No. 4722, 1 B.L.R. (4th) 186 (S.C.J.); *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*, [1990] B.C.J. No. 2384, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136, 4 C.B.R. (3d) 311 (C.A.); *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.* [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (C.A.); *Country Style Foods Services Inc. (Re)*, [2002] O.J. No. 1377, 158 O.A.C. 30 (C.A.); *Dylex Ltd. (Re)*, [1995] O.J. No. 595, 31 C.B.R. (3d) 106 (Gen. Div.); *Ivaco Inc. (Re)*, [2004] O.J. No. 2483, 3 C.B.R. (5th) 33 (S.C.J.); *Lehndorff General Partner Ltd. (Re)*, [1993] O.J. No. 14, 9 B.L.R. (2d) 275, 17 C.B.R. (3d) 24 (Gen. Div.); *London Finance Corp. Ltd. v. Banking Service Corp. Ltd.*, [1922] O.J. No. 378, 23 O.W.N. 138 (H.C.); *Olympia & York Developments Ltd. (Re)* (1993), 12 O.R. (3d) 500, [1993] O.J. No. 545, 17 C.B.R. (3d) 1 (Gen. Div.) (*sub nom. Olympia & York Dev. v. Royal Trust Co.*); *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, 244 D.L.R. (4th) 564, 2004 SCC 68, 49 B.L.R. (3d) 165, 4 C.B.R. (5th) 215; *R. v. Sharpe*, [2001] 1 S.C.R. 45, [2001]

S.C.J. No. 3, 88 B.C.L.R. (3d) 1, 194 D.L.R. (4th) 1, [2001] 6 W.W.R. 1, 86 C.R.R. (2d) 1, 150 C.C.C. (3d) 321, 39 C.R. (5th) 72, [2001] SCC 2; *Richtree Inc. (Re)* (2005), 74 O.R. (3d) 174, [2005] O.J. No. 251, 7 C.B.R. (5th) 294 (S.C.J.); *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, [1998] S.C.J. No. 2, 36 O.R. (3d) 418*n*, 154 D.L.R. (4th) 193, 221 N.R. 241, 50 C.B.R. (3d) 163, 33 C.C.E.L. (2d) 173, 98 CLLC 210-006 (*sub nom. Ontario Ministry of Labour v. Rizzo & Rizzo Shoes Ltd., Adrien v. Ontario Ministry of Labour*); *Royal Oak Mines Inc. (Re)*, [1999] O.J. No. 864, 7 C.B.R. (4th) 293, 96 O.T.C. 279 (Gen. Div.); *Sammi Atlas Inc. (Re)*, [1998] O.J. No. 1089, 3 C.B.R. (4th) 171 (Gen. Div.); *Stephenson v. Vokes* (1896), 27 O.R. 691, [1896] O.J. No. 191 (H.C.J.); *Westar Mining Ltd. (Re)*, [1992] B.C.J. No. 1360, 14 C.B.R. (3d) 88, 70 B.C.L.R. (2d) 6, [1992] 6 W.W.R. 331 (S.C.)

Statutes referred to

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Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 11 [as am.], 20 [as am.]

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Peterson, D.H., *Shareholder Remedies in Canada*, looseleaf (Markham: LexisNexis—Butterworths, 1989)

Sullivan, R., *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002)

APPLICATION for leave to appeal and, if leave is granted, an appeal from the order of Farley J., reported at [2005] O.J. No. 729, 7 C.B.R. (5th) 307 (S.C.J.), removing two directors from the board of directors of Stelco Inc.

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The judgment of the court was delivered by

BLAIR J.A.: —

Part I — Introduction

[1] Stelco Inc. and four of its wholly-owned subsidiaries obtained protection from their creditors under the *Companies' Creditors Arrangement Act* (the "*CCAA*")[1] on January 29, 2004. Since that time, the Stelco Group has been engaged in a high profile, and sometimes controversial, process of economic restructuring. Since October 2004, the restructuring has revolved around a court-approved capital raising process which, by February 2005, had generated a number of competitive bids for the Stelco Group.

[2] Farley J., an experienced judge of the Superior Court Commercial List in Toronto, has been supervising the *CCAA* process from the outset.

[3] The appellants, Michael Woollcombe and Roland Keiper, are associated with two companies — Clearwater Capital Management Inc. and Equilibrium Capital Management Inc. — which, respectively, hold approximately 20 per cent of the outstanding publicly traded common shares of Stelco. Most of these shares have been acquired while the *CCAA* process has been ongoing, and Messrs. Woollcombe and Keiper have made it clear publicly that they believe there is good shareholder value in Stelco in spite of the restructuring. The reason they are able to take this position is that there has been a solid turn around in worldwide steel markets, as a result of which Stelco, although remaining in insolvency protection, is earning annual operating profits.

[4] The Stelco board of directors (the "Board") has been depleted as a result of resignations, and in January of this year Messrs. Woollcombe and Keiper expressed an interest in being appointed to the Board. They were supported in this request by other shareholders who, together with Clearwater and Equilibrium, represent about 40 per cent of the Stelco common shareholders. On February 18, 2005, the Board appointed the appellants directors. In announcing the appointments publicly, Stelco said in a press release:

> After careful consideration, and given potential recoveries at the end of the company's restructuring process, the Board responded favourably to the requests by making the appointments announced today.
>
> Richard Drouin, Chairman of Stelco's Board of Directors, said: "I'm pleased to welcome Roland Keiper and Michael Woollcombe to the Board. Their

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1 R.S.C. 1985, c. C-36, as amended.

> experience and their perspective will assist the Board as it strives to serve the best interests of all our stakeholders. We look forward to their positive contribution."

[5] On the same day, the Board began its consideration of the various competing bids that had been received through the capital raising process.

[6] The appointments of the appellants to the Board incensed the employee stakeholders of Stelco (the "Employees"), represented by the respondent Retired Salaried Beneficiaries of Stelco and the respondent United Steelworkers of America ("USWA"). Outstanding pension liabilities to current and retired employees are said to be Stelco's largest long-term liability — exceeding several billion dollars. The Employees perceive they do not have the same, or very much, economic leverage in what has sometimes been referred to as "the bare knuckled arena" of the restructuring process. At the same time, they are amongst the most financially vulnerable stakeholders in the piece. They see the appointments of Messrs. Woollcombe and Keiper to the Board as a threat to their well being in the restructuring process because the appointments provide the appellants, and the shareholders they represent, with direct access to sensitive information relating to the competing bids to which other stakeholders (including themselves) are not privy.

[7] The Employees fear that the participation of the two major shareholder representatives will tilt the bid process in favour of maximizing shareholder value at the expense of bids that might be more favourable to the interests of the Employees. They sought and obtained an order from Farley J. removing Messrs. Woollcombe and Keiper from their short-lived position of directors, essentially on the basis of that apprehension.

[8] The Employees argue that there is a reasonable apprehension the appellants would not be able to act in the best interests of the corporation — as opposed to their own best interests as shareholders — in considering the bids. They say this is so because of prior public statements by the appellants about enhancing shareholder value in Stelco, because of the appellants' linkage to such a large shareholder group, because of their earlier failed bid in the restructuring, and because of their opposition to a capital proposal made in the proceeding by Deutsche Bank (known as the "Stalking Horse Bid"). They submit further that the appointments have poisoned the atmosphere of the restructuring process, and that the Board made the appointments under threat of facing a potential shareholders' meeting where the members of the Board would be replaced en masse.

[9] On the other hand, Messrs. Woollcombe and Keiper seek to set aside the order of Farley J. on the grounds that (a) he did not have the jurisdiction to make the order under the provisions of the *CCAA*, (b) even if he did have jurisdiction, the reasonable apprehension of bias test applied by the motion judge has no application to the removal of directors, (c) the motion judge erred in interfering with the exercise by the Board of its business judgment in filling the vacancies on the Board, and (d) the facts do not meet any test that would justify the removal of directors by a court in any event.

[10] For the reasons that follow, I would grant leave to appeal, allow the appeal and order the reinstatement of the applicants to the Board.

Part II — Additional Facts

[11] Before the initial *CCAA* order on January 29, 2004, the shareholders of Stelco had last met at their annual general meeting on April 29, 2003. At that meeting they elected 11 directors to the Board. By the date of the initial order, three of those directors had resigned, and on November 30, 2004, a fourth did as well, leaving the company with only seven directors.

[12] Stelco's articles provide for the Board to be made up of a minimum of ten and a maximum of 20 directors. Consequently, after the last resignation, the company's corporate governance committee began to take steps to search for new directors. They had not succeeded in finding any prior to the approach by the appellants in January 2005.

[13] Messrs. Woollcombe and Keiper had been accumulating shares in Stelco and had been participating in the *CCAA* proceedings for some time before their request to be appointed to the Board, through their companies, Clearwater and Equilibrium. Clearwater and Equilibrium are privately held, Ontario-based investment management firms. Mr. Keiper is the president of Equilibrium and associated with Clearwater. Mr. Woollcombe is a consultant to Clearwater. The motion judge found that they "come as a package".

[14] In October 2004, Stelco sought court approval of its proposed method of raising capital. On October 19, 2004, Farley J. issued what has been referred to as the Initial Capital Process Order. This order set out a process by which Stelco, under the direction of the Board, would solicit bids, discuss the bids with stakeholders, evaluate the bids and report on the bids to the court.

[15] On November 9, 2004, Clearwater and Equilibrium announced they had formed an investor group and had made a

capital proposal to Stelco. The proposal involved the raising of $125 million through a rights offering. Mr. Keiper stated at the time that he believed "the value of Stelco's equity would have the opportunity to increase substantially if Stelco emerged from *CCAA* while minimizing dilution of its shareholders." The Clearwater proposal was not accepted.

[16] A few days later, on November 14, 2004, Stelco approved the Stalking Horse Bid. Clearwater and Equilibrium opposed the Deutsche Bank proposal. Mr. Keiper criticized it for not providing sufficient value to existing shareholders. However, on November 29, 2004, Farley J. approved the Stalking Horse Bid and amended the Initial Capital Process Order accordingly. The order set out the various channels of communication between Stelco, the monitor, potential bidders and the stakeholders. It provided that members of the Board were to see the details of the different bids before the Board selected one or more of the offers.

[17] Subsequently, over a period of two and a half months, the shareholding position of Clearwater and Equilibrium increased from approximately five per cent as at November 19, to 14.9 per cent as at January 25, 2005, and finally to approximately 20 per cent on a fully diluted basis as at January 31, 2005. On January 25, Clearwater and Equilibrium announced that they had reached an understanding jointly to pursue efforts to maximize shareholder value at Stelco. A press release stated:

> Such efforts will include seeking to ensure that the interests of Stelco's equity holders are appropriately protected by its board of directors and, ultimately, that Stelco's equity holders have an appropriate say, by vote or otherwise, in determining the future course of Stelco.

[18] On February 1, 2005, Messrs. Keiper and Woollcombe and other representatives of Clearwater and Equilibrium met with Mr. Drouin and other Board members to discuss their views of Stelco and a fair outcome for all stakeholders in the proceedings. Mr. Keiper made a detailed presentation, as Mr. Drouin testified, "encouraging the Board to examine how Stelco might improve its value through enhanced disclosure and other steps". Mr. Keiper expressed confidence that "there was value to the equity of Stelco", and added that he had backed this view up by investing millions of dollars of his own money in Stelco shares. At that meeting, Clearwater and Equilibrium requested that Messrs. Woollcombe and Keiper be added to the Board and to Stelco's restructuring committee. In this respect, they were supported by other shareholders holding about another 20 per cent of the company's common shares.

[19] At paras. 17 and 18 of his affidavit, Mr. Drouin, summarized his appraisal of the situation:

> 17. It was my assessment that each of Mr. Keiper and Mr. Woollcombe had personal qualities which would allow them to make a significant contribution to the Board in terms of their backgrounds and their knowledge of the steel industry generally and Stelco in particular. In addition I was aware that their appointment to the Board was supported by approximately 40 per cent of the shareholders. In the event that these shareholders successfully requisitioned a shareholders meeting they were in a position to determine the composition of the entire Board.
>
> 18. I considered it essential that there be continuity of the Board through the *CCAA* process. I formed the view that the combination of existing Board members and these additional members would provide Stelco with the most appropriate board composition in the circumstances. The other members of the Board also shared my views.

[20] In order to ensure that the appellants understood their duties as potential Board members and, particularly that "they would no longer be able to consider only the interests of shareholders alone but would have fiduciary responsibilities as a Board member to the corporation as a whole", Mr. Drouin and others held several further meetings with Mr. Woollcombe and Mr. Keiper. These discussions "included areas of independence, standards, fiduciary duties, the role of the Board Restructuring Committee and confidentiality matters". Mr. Woollcombe and Mr. Keiper gave their assurances that they fully understood the nature and extent of their prospective duties, and would abide by them. In addition, they agreed and confirmed that:

(a) Mr. Woollcombe would no longer be an advisor to Clearwater and Equilibrium with respect to Stelco;

(b) Clearwater and Equilibrium would no longer be represented by counsel in the *CCAA* proceedings; and

(c) Clearwater and Equilibrium then had no involvement in, and would have no future involvement, in any bid for Stelco.

[21] On the basis of the foregoing — and satisfied "that Messrs. Keiper and Woollcombe would make a positive contribution to the various issues before the Board both in [the] restructuring and the ongoing operation of the business" — the Board made the appointments on February 18, 2005.

[22] Seven days later, the motion judge found it "appropriate, just, necessary and reasonable to declare" those appointments "to be of no force and effect" and to remove Messrs. Woollcombe and Keiper from the Board. He did so not on the basis of any actual conduct on the part of the appellants as directors of Stelco but

because there was some risk of anticipated conduct in the future. The gist of the motion judge's rationale is found in the following passage from his reasons (at para. 23):

> In these particular circumstances and aside from the Board feeling coerced into the appointments for the sake of continuing stability, I am not of the view that it would be appropriate to wait and see if there was any explicit action on behalf of K and W while conducting themselves as Board members which would demonstrate that they had not lived up to their obligations to be "neutral". They may well conduct themselves beyond reproach. But if they did not, the fallout would be very detrimental to Stelco and its ability to successfully emerge. What would happen to the bids in such a dogfight? I fear that it would be trying to put Humpty Dumpty back together again. The same situation would prevail even if K and W conducted themselves beyond reproach but with the Board continuing to be concerned that they not do anything seemingly offensive to the bloc. The risk to the process and to Stelco in its emergence is simply too great to risk the wait and see approach.

Part III — Leave to Appeal

[23] Because of the "real time" dynamic of this restructuring project, Laskin J.A. granted an order on March 4, 2005, expediting the appellants' motion for leave to appeal, directing that it be heard orally and, if leave be granted, directing that the appeal be heard at the same time. The leave motion and the appeal were argued together, by order of the panel, on March 18, 2005.

[24] This court has said that it will only sparingly grant leave to appeal in the context of a *CCAA* proceeding and will only do so where there are "serious and arguable grounds that are of real and significant interest to the parties": *Country Style Food Services Inc. (Re)*, [2002] O.J. No. 1377, 158 O.A.C. 30 (C.A.), at para. 15. This criterion is determined in accordance with a four-pronged test, namely,

(a) whether the point on appeal is of significance to the practice;

(b) whether the point is of significance to the action;

(c) whether the appeal is *prima facie* meritorious or frivolous;

(d) whether the appeal will unduly hinder the progress of the action.

[25] Counsel agree that (d) above is not relevant to this proceeding, given the expedited nature of the hearing. In my view, the tests set out in (a) – (c) are met in the circumstances, and as such, leave should be granted. The issue of the court's jurisdiction to intervene in corporate governance issues during a *CCAA* restructuring, and the scope of its discretion in doing so, are questions of considerable importance to the practice and on

which there is little appellate jurisprudence. While Messrs. Woollcombe and Keiper are pursuing their remedies in their own right, and the company and its directors did not take an active role in the proceedings in this court, the Board and the company did stand by their decision to appoint the new directors at the hearing before the motion judge and in this court, and the question of who is to be involved in the Board's decision-making process continues to be of importance to the *CCAA* proceedings. From the reasons that follow it will be evident that in my view the appeal has merit.

[26] Leave to appeal is therefore granted.

Part IV — The Appeal

The Positions of the Parties

[27] The appellants submit that,

(a) in exercising its discretion under the *CCAA*, the court is not exercising its "inherent jurisdiction" as a superior court;

(b) there is no jurisdiction under the *CCAA* to remove duly elected or appointed directors, notwithstanding the broad discretion provided by s. 11 of that Act; and that,

(c) even if there is jurisdiction, the motion judge erred:

  (i) by relying upon the administrative law test for reasonable apprehension of bias in determining that the directors should be removed;

  (ii) by rejecting the application of the "business judgment" rule to the unanimous decision of the Board to appoint two new directors; and,

  (iii) by concluding that Clearwater and Equilibrium, the shareholders with whom the appellants are associated, were focussed solely on a short-term investment horizon, without any evidence to that effect, and therefore concluding that there was a tangible risk that the appellants would not be neutral and act in the best interests of Stelco and all stakeholders in carrying out their duties as directors.

[28] The respondents' arguments are rooted in fairness and process. They say, first, that the appointment of the appellants as directors has poisoned the atmosphere of the *CCAA* proceedings and, second, that it threatens to undermine the even-handedness and integrity of the capital raising process, thus jeopardizing the

ability of the court at the end of the day to approve any compromise or arrangement emerging from that process. The respondents contend that Farley J. had jurisdiction to ensure the integrity of the *CCAA* process, including the capital raising process Stelco had asked him to approve, and that this court should not interfere with his decision that it was necessary to remove Messrs. Woollcombe and Keiper from the Board in order to ensure the integrity of that process. A judge exercising a supervisory function during a *CCAA* proceeding is owed considerable deference: *Re Algoma Steel Inc.*, [2001] O.J. No. 1943, 25 C.B.R. (4th) 194 (C.A.), at para. 8.

[29] The crux of the respondents' concern is well-articulated in the following excerpt from para. 72 of the factum of the Retired Salaried Beneficiaries:

> The appointments of Keiper and Woollcombe violated every tenet of fairness in the restructuring process that is supposed to lead to a plan of arrangement. One stakeholder group — particular investment funds that have acquired Stelco shares during the *CCAA* itself — have been provided with privileged access to the capital raising process, and voting seats on the Corporation's Board of Directors and Restructuring Committee. No other stakeholder has been treated in remotely the same way. To the contrary, the salaried retirees have been completely excluded from the capital raising process and have no say whatsoever in the Corporation's decision-making process.

[30] The respondents submit that fairness, and the perception of fairness, underpin the *CCAA* process, and depend upon effective judicial supervision: see *Re Olympia & York Development Ltd.* (1993), 12 O.R. (3d) 500, [1993] O.J. No. 545 (Gen. Div.); *Re Ivaco Inc.*, [2004] O.J. No. 2483, 3 C.B.R. (5th) 33 (S.C.J.), at paras. 15-16. The motion judge reasonably decided to remove the appellants as directors in the circumstances, they say, and this court should not interfere.

Jurisdiction

[31] The motion judge concluded that he had the power to rescind the appointments of the two directors on the basis of his "inherent jurisdiction" and "the discretion given to the court pursuant to the *CCAA*". He was not asked to, nor did he attempt to rest his jurisdiction on other statutory powers imported into the *CCAA*.

[32] The *CCAA* is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: *Babcock & Wilcox Canada Ltd. (Re)*, [2000] O.J. No. 786, 5 B.L.R. (3d) 75 (S.C.J.), at para. 11. See also, *Chef Ready Foods Ltd. v. Hong Kong Bank of Canada*, [1990] B.C.J. No. 2384, 4 C.B.R. (3d) 311 (C.A.), at p. 320 C.B.R.; *Re Lehndorff General Partners Ltd.*, [1993] O.J. No. 14,

17 C.B.R. (3d) 24 (Gen. Div.). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the *CCAA*, as the source of judicial power in a *CCAA* proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see *Re Dylex Ltd.*, [1995] O.J. No. 595, 31 C.B.R. (3d) 106 (Gen. Div. (Commercial List)), *Royal Oak Mines Inc. (Re)*, [1999] O.J. No. 864, 7 C.B.R. (4th) 293 (Gen. Div. (Commercial List)); and *Westar Mining Ltd. (Re)*, [1992] B.C.J. No. 1360, 70 B.C.L.R. (2d) 6 (S.C.).

[33] It is not necessary, for purposes of this appeal, to determine whether inherent jurisdiction is excluded for all supervisory purposes under the *CCAA*, by reason of the existence of the statutory discretionary regime provided in that Act. In my opinion, however, the better view is that in carrying out his or her supervisory functions under the legislation, the judge is not exercising inherent jurisdiction but rather the statutory discretion provided by s. 11 of the *CCAA* and supplemented by other statutory powers that may be imported into the exercise of the s. 11 discretion from other statutes through s. 20 of the *CCAA*.

Inherent jurisdiction

[34] Inherent jurisdiction is a power derived "from the very nature of the court as a superior court of law", permitting the court "to maintain its authority and to prevent its process being obstructed and abused". It embodies the authority of the judiciary to control its own process and the lawyers and other officials connected with the court and its process, in order "to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner". See I.H. Jacob, "The Inherent Jurisdiction of the Court" (1970) 23 Current Legal Problems 27-28. In *Halsbury's Laws of England*, 4th ed. (London: LexisNexis UK, 1973–), vol. 37, at para. 14, the concept is described as follows:

> In sum, it may be said that the inherent jurisdiction of the court is a virile and viable doctrine, and has been defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, in particularly to ensure the observation of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them.

[35] In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the legislature has acted. As Farley J. noted in *Royal Oak Mines, supra*, inherent jurisdiction is "not limitless; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should

not be brought into play" (para. 4). See also, *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, 57 D.L.R. (3d) 1, at p. 480 S.C.R.; *Richtree Inc. (Re)* (2005), 74 O.R. (3d) 174, [2005] O.J. No. 251 (S.C.J.).

[36] In the *CCAA* context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In that regard, I agree with the comment of Newbury J.A. in *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.*, [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (C.A.), at para. 46, that:

> . . . the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the *CCAA*. . . . This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above,[2] rather than the integrity of their own process.

[37] As Jacob observes, in his article "The Inherent Jurisdiction of the Court", *supra*, at p. 25:

> The inherent jurisdiction of the court is a concept which must be distinguished from the exercise of judicial discretion. These two concepts resemble each other, particularly in their operation, and they often appear to overlap, and are therefore sometimes confused the one with the other. There is nevertheless a vital juridical distinction between jurisdiction and discretion, which must always be observed.

[38] I do not mean to suggest that inherent jurisdiction can never apply in a *CCAA* context. The court retains the ability to control its own process, should the need arise. There is a distinction, however — difficult as it may be to draw — between the *court's* process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the *company's* process, on the other hand. The court simply supervises the latter

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2 The reference is to the decisions in *Dyle*, *Royal Oak Mines* and *Westar*, cited above.

process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose".[3] Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a *CCAA* proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process.

The section 11 discretion

[39] This appeal involves the scope of a supervisory judge's discretion under s. 11 of the *CCAA*, in the context of corporate governance decisions made during the course of the plan negotiating and approval process and, in particular, whether that discretion extends to the removal of directors in that environment. In my view, the s. 11 discretion — in spite of its considerable breadth and flexibility — does not permit the exercise of such a power in and of itself. There may be situations where a judge in a *CCAA* proceeding would be justified in ordering the removal of directors pursuant to the oppression remedy provisions found in s. 241 of the *Canada Business Corporation Act*, R.S.C. 1985, c. C-44 ("*CBCA*"), and imported into the exercise of the s. 11 discretion through s. 20 of the *CCAA*. However, this was not argued in the present case, and the facts before the court would not justify the removal of Messrs. Woollcombe and Keiper on oppression remedy grounds.

[40] The pertinent portions of s. 11 of the *CCAA* provide as follows:

> *Powers of court*
>
> 11(1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.
>
> . . . . .
>
> *Initial application court orders*
>
> (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days.
>
> (*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

3 See para. 43, *infra*, where I elaborate on this distinction.

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Other than initial application court orders

(4) A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

(*a*) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

. . . . .

Burden of proof on application

(6) The court shall not make an order under subsection (3) or (4) unless

(*a*) the applicant satisfies the court that circumstances exist that make such an order appropriate; and

(*b*) in the case of an order under subsection (4), the applicant also satisfied the court that the applicant has acted, and is acting, in good faith and with due diligence.

[41] The rule of statutory interpretation that has now been accepted by the Supreme Court of Canada, in such cases as *R. v. Sharpe*, [2001] 1 S.C.R. 45, [2001] S.C.J. No. 3, at para. 33, and *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, [1998] S.C.J. No. 2, at para. 21, is articulated in E.A. Driedger, *The Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) as follows:

> Today, there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament.

See also Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002), at p. 262.

[42] The interpretation of s. 11 advanced above is true to these principles. It is consistent with the purpose and scheme of the *CCAA*, as articulated in para. 38 above, and with the fact that corporate governance matters are dealt with in other statutes. In addition, it honours the historical reluctance of courts to intervene in such matters, or to second-guess the business decisions

made by directors and officers in the course of managing the business and affairs of the corporation.

[43] Mr. Leon and Mr. Swan argue that matters relating to the removal of directors do not fall within the court's discretion under s. 11 because they fall outside of the parameters of the court's role in the restructuring process, in contrast to the company's role in the restructuring process. The court's role is defined by the "on such terms as may be imposed" jurisdiction under subparas. 11(3)(*a*)–(*c*) and 11(4)(*a*)–(*c*) of the *CCAA* to stay, or restrain, or prohibit proceedings against the company during the "breathing space" period for negotiations and a plan. I agree.

[44] What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in *Lehndorff*, *supra*, at para. 5, "to make order[s] 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". But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance *the company's* restructuring efforts.

[45] With these principles in mind, I turn to an analysis of the various factors underlying the interpretation of the s. 11 discretion.

[46] I start with the proposition that at common law directors could not be removed from office during the term for which they were elected or appointed: *London Finance Corp. Ltd. v. Banking Service Corp. Ltd.*, [1922] O.J. No. 378, 23 O.W.N. 138 (H.C.); *Stephenson v. Vokes*, [1896] O.J. No. 191, 27 O.R. 691 (H.C.J.). The authority to remove must therefore be found in statute law.

[47] In Canada, the *CBCA* and its provincial equivalents govern the election, appointment and removal of directors, as well as providing for their duties and responsibilities. Shareholders elect directors, but the directors may fill vacancies that occur on the board of directors pending a further shareholders meeting:

CBCA, ss. 106(3) and 111.[4] The specific power *to remove* directors is vested in the shareholders by s. 109(1) of the *CBCA*. However, s. 241 empowers the court — where it finds that oppression as therein defined exists — to "make any interim or final order it thinks fit", including (s. 241(3)(*e*)) "an order appointing directors in place of or in addition to all or any of the directors then in office". This power has been utilized to remove directors, but in very rare cases, and only in circumstances where there has been actual conduct rising to the level of misconduct required to trigger oppression remedy relief: see, for example, *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2004] O.J. No. 4722, 1 B.L.R. (4th) 186 (S.C.J.).

[48] There is therefore a statutory scheme under the *CBCA* (and similar provincial corporate legislation) providing for the election, appointment *and removal* of directors. Where another applicable statute confers jurisdiction with respect to a matter, a broad and undefined discretion provided in one statute cannot be used to supplant or override the other applicable statute. There is no legislative "gap" to fill. See *Baxter Student Housing Ltd. v. College Housing Cooperative Ltd.*, *supra*, at p. 480 S.C.R.; *Royal Oak Mines Inc. (Re)*, *supra*; and *Richtree Inc. (Re)*, *supra*.

[49] At para. 7 of his reasons, the motion judge said:

> The board is charged with the standard duty of "manage[ing], [*sic*] or supervising the management, of the business and affairs of the corporation": s. 102(1) *CBCA*. *Ordinarily the Court will not interfere with the composition of the board of directors. However, if there is good and sufficient valid reason to do so, then the Court must not hesitate to do so to correct a problem.* The directors should not be required to constantly look over their shoulders for this would be the sure recipe for board paralysis which would be so detrimental to a restructuring process; thus interested parties should only initiate a motion where it is reasonably obvious that there is a problem, actual or poised to become actual.

(Emphasis added)

[50] Respectfully, I see no authority in s. 11 of the *CCAA* for the court to interfere with the composition of a board of directors on such a basis.

[51] Court removal of directors is an exceptional remedy, and one that is rarely exercised in corporate law. This reluctance is rooted in the historical unwillingness of courts to interfere with the internal management of corporate affairs and in the court's well-established deference to decisions made by directors and officers in

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4 It is the latter authority that the directors of Stelco exercised when appointing the appellants to the Stelco Board.

the exercise of their business judgment when managing the business and affairs of the corporation. These factors also bolster the view that where the *CCAA* is silent on the issue, the court should not read into the s. 11 discretion an extraordinary power — which the courts are disinclined to exercise in any event — except to the extent that that power may be introduced through the application of other legislation, and on the same principles that apply to the application of the provisions of the other legislation.

The oppression remedy gateway

[52] The fact that s. 11 does not itself provide the authority for a *CCAA* judge to order the removal of directors does not mean that the supervising judge is powerless to make such an order, however. Section 20 of the *CCAA* offers a gateway to the oppression remedy and other provisions of the *CBCA* and similar provincial statutes. Section 20 states:

> 20. The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

[53] The *CBCA* is legislation that "makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them". Accordingly, the powers of a judge under s. 11 of the *CCAA* may be applied together with the provisions of the *CBCA*, including the oppression remedy provisions of that statute. I do not read s. 20 as limiting the application of outside legislation to the provisions of such legislation dealing specifically with the sanctioning of compromises and arrangements between the company and its shareholders. The grammatical structure of s. 20 mandates a broader interpretation and the oppression remedy is, therefore, available to a supervising judge in appropriate circumstances.

[54] I do not accept the respondents' argument that the motion judge had the authority to order the removal of the appellants by virtue of the power contained in s. 145(2)(*b*) of the *CBCA* to make an order "declaring the result of the disputed election or appointment" of directors. In my view, s. 145 relates to the procedures underlying disputed elections or appointments, and not to disputes over the composition of the board of directors itself. Here, it is conceded that the appointment of Messrs. Woollcombe and Keiper as directors complied with all relevant statutory requirements. Farley J. quite properly did not seek to base his jurisdiction on any such authority.

The level of conduct required

[55] Colin Campbell J. recently invoked the oppression remedy to remove directors, without appointing anyone in their place, in *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, *supra*. The bar is high. In reviewing the applicable law, C. Campbell J. said (para. 68):

> Director removal is *an extraordinary remedy* and certainly should be *imposed most sparingly*. As a starting point, I accept the basic proposition set out in Peterson, "Shareholder Remedies in Canada".[5]
>
> > SS. 18.172 *Removing and appointing directors to the board is an extreme form of judicial intervention*. The board of directors is elected by the shareholders, vested with the power to manage the corporation, and appoints the officers of the company who undertake to conduct the day-to-day affairs of the corporation. [Footnote omitted.] It is clear that the board of directors has control over policymaking and management of the corporation. *By tampering with a board, a court directly affects the management of the corporation*. If a reasonable balance between protection of corporate stakeholders and the freedom of management to conduct the affairs of the business in an efficient manner is desired, altering the board of directors should be *a measure of last resort*. The order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or directors would remedy the oppressive conduct without a receiver or receiver-manager.

(Emphasis added)

[56] C. Campbell J. found that the continued involvement of the Ravelston directors in the *Hollinger* situation would "significantly impede" the interests of the public shareholders and that those directors were "motivated by putting their interests first, not those of the company" (paras. 82-83). The evidence in this case is far from reaching any such benchmark, however, and the record would not support a finding of oppression, even if one had been sought.

[57] Everyone accepts that there is no evidence the appellants have conducted themselves, as directors — in which capacity they participated over two days in the bid consideration exercise — in anything but a neutral fashion, having regard to the best interests of Stelco and all of the stakeholders. The motion judge acknowledged that the appellants "may well conduct themselves beyond reproach". However, he simply decided there was a risk — a reasonable apprehension — that Messrs. Woollcombe and Keiper would not live up to their obligations to be neutral in the future.

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5 Dennis H. Peterson, *Shareholder Remedies in Canada*, looseleaf (Markham: LexisNexis — Butterworths, 1989), at 18-47.

[58] The risk or apprehension appears to have been founded essentially on three things: (1) the earlier public statements made by Mr. Keiper about "maximizing shareholder value"; (2) the conduct of Clearwater and Equilibrium in criticizing and opposing the Stalking Horse Bid; and (3) the motion judge's opinion that Clearwater and Equilibrium — the shareholders represented by the appellants on the Board — had a "vision" that "usually does not encompass any significant concern for the long-term competitiveness and viability of an emerging corporation", as a result of which the appellants would approach their directors' duties looking to liquidate their shares on the basis of a "short-term hold" rather than with the best interests of Stelco in mind. The motion judge transposed these concerns into anticipated predisposed conduct on the part of the appellants as directors, despite their apparent understanding of their duties as directors and their assurances that they would act in the best interests of Stelco. He therefore concluded that "the risk to the process and to Stelco in its emergence [was] simply too great to risk the wait and see approach".

[59] Directors have obligations under s. 122(1) of the *CBCA* (a) to act honestly and in good faith with a view to the best interest of the corporation (the "statutory fiduciary duty" obligation), and (b) to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (the "duty of care" obligation). They are also subject to control under the oppression remedy provisions of s. 241. The general nature of these duties does not change when the company approaches, or finds itself in, insolvency: *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, at paras. 42-49.

[60] In *Peoples* the Supreme Court noted that "the interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders" (para. 43), but also accepted "as an accurate statement of the law that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment" (para. 42). Importantly as well — in the context of "the shifting interest and incentives of shareholders and creditors" — the court stated (para. 47):

> In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in

> its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders.

[61] In determining whether directors have fallen foul of those obligations, however, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office. Although the motion judge concluded that there was a risk of harm to the Stelco process if Messrs. Woollcombe and Keiper remained as directors, he did not assess the level of that risk. The record does not support a finding that there was a sufficient risk of sufficient misconduct to warrant a conclusion of oppression. The motion judge was not asked to make such a finding, and he did not do so.

[62] The respondents argue that this court should not interfere with the decision of the motion judge on grounds of deference. They point out that the motion judge has been case-managing the restructuring of Stelco under the *CCAA* for over 14 months and is intimately familiar with the circumstances of Stelco as it seeks to restructure itself and emerge from court protection.

[63] There is no question that the decisions of judges acting in a supervisory role under the *CCAA*, and particularly those of experienced commercial list judges, are entitled to great deference: see *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78, [2003] O.J. No. 71 (C.A.), at para. 16. The discretion must be exercised judicially and in accordance with the principles governing its operation. Here, respectfully, the motion judge misconstrued his authority, and made an order that he was not empowered to make in the circumstances.

[64] The appellants argued that the motion judge made a number of findings without any evidence to support them. Given my decision with respect to jurisdiction, it is not necessary for me to address that issue.

The business judgment rule

[65] The appellants argue as well that the motion judge erred in failing to defer to the unanimous decision of the Stelco directors in deciding to appoint them to the Stelco Board. It is well-established that judges supervising restructuring proceedings — and courts in general — will be very hesitant to second-guess the business decisions of directors and management. As the Supreme Court of Canada said in *Peoples*, *supra*, at para. 67:

> Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making . . .

[66] In *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, [1991] O.J. No. 683 (C.A.), at p. 320 O.R., this court adopted the following statement by the trial judge, Anderson J.:

> Business decisions, honestly made, should not be subjected to microscopic examination. There should be no interference simply because a decision is unpopular with the minority.[6]

[67] McKinlay J.A. then went on to say [at p. 320 O.R.]:

> There can be no doubt that on an application under s. 234[7] the trial judge is required to consider the nature of the impugned acts and the method in which they were carried out. That does not meant that the trial judge should substitute his own business judgment for that of managers, directors, or a committee such as the one involved in assessing this transaction. Indeed, it would generally be impossible for him to do so, regardless of the amount of evidence before him. He is dealing with the matter at a different time and place; it is unlikely that he will have the background knowledge and expertise of the individuals involved; he could have little or no knowledge of the background and skills of the persons who would be carrying out any proposed plan; and it is unlikely that he would have any knowledge of the specialized market in which the corporation operated. In short, he does not know enough to make the business decision required.

[68] Although a judge supervising a *CCAA* proceeding develops a certain "feel" for the corporate dynamics and a certain sense of direction for the restructuring, this caution is worth keeping in mind. See also *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.*, *supra*; *Sammi Atlas Inc. (Re)*, [1998] O.J. No. 1089, 3 C.B.R. (4th) 171 (Gen. Div.); *Olympia & York Developments Ltd. (Re)*, *supra*; *Re Alberta Pacific Terminals Ltd.*, [1991] B.C.J. No. 1065, 8 C.B.R. (4th) 99 (S.C.). The court is not catapulted into the shoes of the board of directors, or into the seat of the chair of the board, when acting in its supervisory role in the restructuring.

[69] Here, the motion judge was alive to the "business judgment" dimension in the situation he faced. He distinguished the application of the rule from the circumstances, however, stating at para. 18 of his reasons:

> With respect I do not see the present situation as involving the "management of the business and affairs of the corporation", but rather as a quasi-constitutional aspect of the corporation entrusted albeit to the Board pursuant to s. 111(1) of the *CBCA*. I agree that where a board is actually engaged in the business of a judgment situation, the board should be given appropriate deference. However, to the contrary in this situation, I do not see it as a

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6 Or, I would add, unpopular with other stakeholders.

7 Now s. 241.

situation calling for (as asserted) more deference, but rather considerably less than that. With regard to this decision of the Board having impact upon the capital raising process, as I conclude it would, then similarly deference ought not to be given.

[70] I do not see the distinction between the directors' role in "the management of the business and affairs of the corporation" (*CBCA*, s. 102) — which describes the directors' overall responsibilities — and their role with respect to a "quasi-constitutional aspect of the corporation" (*i.e.*, in filling out the composition of the board of directors in the event of a vacancy). The "affairs" of the corporation are defined in s. 2 of the *CBCA* as meaning "the relationships among a corporation, its affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate". Corporate governance decisions relate directly to such relationships and are at the heart of the Board's business decision-making role regarding the corporation's business *and* affairs. The dynamics of such decisions, and the intricate balancing of competing interests and other corporate-related factors that goes into making them, are no more within the purview of the court's knowledge and expertise than other business decisions, and they deserve the same deferential approach. Respectfully, the motion judge erred in declining to give effect to the business judgment rule in the circumstances of this case.

[71] This is not to say that the conduct of the Board in appointing the appellants as directors may never come under review by the supervising judge. The court must ultimately approve and sanction the plan of compromise or arrangement as finally negotiated and accepted by the company and its creditors and stakeholders. The plan must be found to be fair and reasonable before it can be sanctioned. If the Board's decision to appoint the appellants has somehow so tainted the capital raising process that those criteria are not met, any eventual plan that is put forward will fail.

[72] The respondents submit that it makes no sense for the court to have jurisdiction to declare the process flawed only after the process has run its course. Such an approach to the restructuring process would be inefficient and a waste of resources. While there is some merit in this argument, the court cannot grant itself jurisdiction where it does not exist. Moreover, there are a plethora of checks and balances in the negotiating process itself that moderate the risk of the process becoming irretrievably tainted in this fashion — not the least of which is the restraining effect of the prospect of such a consequence. I do not think that this argument can prevail. In addition, the court at all times retains its broad and

flexible supervisory jurisdiction — a jurisdiction which feeds the creativity that makes the *CCAA* work so well — in order to address fairness and process concerns along the way. This case relates only to the court's exceptional power to order the removal of directors.

The reasonable apprehension of bias analogy

[73] In exercising what he saw as his discretion to remove the appellants as directors, the motion judge thought it would be useful to "borrow the concept of reasonable apprehension of bias . . . with suitable adjustments for the nature of the decision making involved" (para. 8). He stressed that "there was absolutely no allegation against [Mr. Woollcombe and Mr. Keiper] of any actual 'bias' or its equivalent" (para. 8). He acknowledged that neither was alleged to have done anything wrong since their appointments as directors, and that at the time of their appointments the appellants had confirmed to the Board that they understood and would abide by their duties and responsibilities as directors, including the responsibility to act in the best interests of the corporation and not in their own interests as shareholders. In the end, however, he concluded that because of their prior public statements that they intended to "pursue efforts to maximize shareholder value at Stelco", and because of the nature of their business and the way in which they had been accumulating their shareholding position during the restructuring, and because of their linkage to 40 per cent of the common shareholders, there was a risk that the appellants would not conduct themselves in a neutral fashion in the best interests of the corporation as directors.

[74] In my view, the administrative law notion of apprehension of bias is foreign to the principles that govern the election, appointment and removal of directors, and to corporate governance considerations in general. Apprehension of bias is a concept that ordinarily applies to those who preside over judicial or quasi-judicial decision-making bodies, such as courts, administrative tribunals or arbitration boards. Its application is inapposite in the business decision-making context of corporate law. There is nothing in the *CBCA* or other corporate legislation that envisages the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment.

[75] Instead, the conduct of directors is governed by their common law and statutory obligations to act honestly and in good faith with a view to the best interests of the corporation, and to exercise the care, diligence and skill that a reasonably

prudent person would exercise in comparable circumstances (*CBCA*, s. 122(1)(*a*) and (*b*)). The directors also have fiduciary obligations to the corporation, and they are liable to oppression remedy proceedings in appropriate circumstances. These remedies are available to aggrieved complainants — including the respondents in this case — but they depend for their applicability on the director having engaged in conduct justifying the imposition of a remedy.

[76] If the respondents are correct, and reasonable apprehension that directors may not act neutrally because they are aligned with a particular group of shareholders or stakeholders is sufficient for removal, all nominee directors in Canadian corporations, and all management directors, would automatically be disqualified from serving. No one suggests this should be the case. Moreover, as Iacobucci J. noted in *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, [1995] S.C.J. No. 29, at para. 35, "persons are assumed to act in good faith unless proven otherwise". With respect, the motion judge approached the circumstances before him from exactly the opposite direction. It is commonplace in corporate/commercial affairs that there are connections between directors and various stakeholders and that conflicts will exist from time to time. Even where there are conflicts of interest, however, directors are not removed from the board of directors; they are simply obliged to disclose the conflict and, in appropriate cases, to abstain from voting. The issue to be determined is not whether there is a connection between a director and other shareholders or stakeholders, but rather whether there has been some conduct on the part of the director that will justify the imposition of a corrective sanction. An apprehension of bias approach does not fit this sort of analysis.

Part V — Disposition

[77] For the foregoing reasons, then, I am satisfied that the motion judge erred in declaring the appointment of Messrs. Woollcombe and Keiper as directors of Stelco of no force and effect.

[78] I would grant leave to appeal, allow the appeal and set aside the order of Farley J. dated February 25, 2005.

[79] Counsel have agreed that there shall be no costs of the appeal.

Order accordingly.

TAB "2"

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended and in the Matter of a Proposed Plan in the Compromise or Arrangement with respect to Stelco Inc., and other Applicants Listed in Schedule "A"

[Indexed as: Stelco Inc. (Re) (No. 2)]

Court of Appeal for Ontario, Feldman J.A. (In Chambers)
April 12, 2005

Debtor and creditor — Companies' Creditors Arrangement Act — Court of Appeal holding that supervising judge in Companies' Creditors Arrangement Act proceedings had no jurisdiction under that Act to order removal of directors of company unless oppression remedy applied — Employees of company seeking leave to appeal that judgment — Employees bringing motion for stay of execution of order of Court of Appeal pending decision of Supreme Court of Canada on leave application — Motion dismissed — Court of Appeal having jurisdiction under s. 65.1(1) of Supreme Court Act to consider motion for stay — Issue of court's jurisdiction to remove directors being serious and important — Both sides claiming that they would suffer irreparable harm if board was not composed as they wished during restructuring process — Because restructuring process was proceeding, grant of stay would effectively reinstate order of supervising judge and exclude two directors from process — Interests of justice requiring that no stay be ordered — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 — Supreme Court Act, R.S.C. 1985, c. S-26.

The Court of Appeal reversed the decision of the supervising judge in proceedings under the *Companies' Creditors Arrangement Act* ("*CCAA*") in which he ordered the removal of two directors from the board of the Company. The Court of Appeal held that the judge had no jurisdiction under the *CCAA* to remove directors unless the oppression remedy applied, which it did not. The applicants represented retired and active salaried employees of the Company. They sought leave to appeal the judgment of the Court of Appeal to the Supreme Court of Canada, and brought a motion for an order under s. 65.1 of the *Supreme Court Act*, for a stay of execution of the order pending the decision of the Supreme Court on the leave application.

Held, the motion should be dismissed.

The Court of Appeal had jurisdiction under s. 65.1(1) of the *Supreme Court Act* to consider the stay application pending the Supreme Court's decision whether to grant leave to appeal. It was only when leave had been granted that s. 15(3) of the *CCAA* applied.

The issue of the jurisdiction of the court to remove directors was a serious and important one. Both sides said they would suffer irreparable harm if the board was not composed as they wished during the next few months of the restructuring process and that the balance of convenience therefore favoured their side. As the restructuring was proceeding, the issue would be moot by the time the appeal was heard. A stay would effectively implement the decision of the supervising judge to remove two directors from the board, a decision which the Court of Appeal held that the judge had no jurisdiction to make. The interests of justice required that no stay be granted at this time.

Cases referred to

Circuit World Corp. v. Lesperance, [1997] O.J. No. 2081, 33 O.R. (3d) 674, 100 O.A.C. 221 (C.A.); *Confederation Treasury Services Ltd. (Trustee of) v. Ernst & Young*, [1997] 2 S.C.R. 5, [1997] S.C.J. No. 79; *Country Style Food Services Inc. (Re)*, [2002] O.J. No. 1377, 158 O.A.C. 30; *International Corona Resources Ltd. v. Lac Minerals Ltd.*, [1986] O.J. No. 2128, 21 C.P.C. (2d) 252 (C.A.); *Multitech Warehouse Direct Inc. (Re)* [1995] A.J. No. 663, 32 Alta. L.R. (3d) 62 (C.A.); *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311, [1994] S.C.J. No. 17, 54 C.P.R. (3d) 114, 20 C.R.R. (2d) D-7, 111 D.L.R. (4th) 385; *Steinberg Inc. (Re)*, [1993] Q.J. No. 860 (C.A.); *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5, [2005] O.J. No. 1171, 9 C.B.R. (5th) 135, 196 O.A.C. 142 (C.A.); *Stelco Inc. (Re)*, [2005] O.J. No. 802, 8 C.B.R. (5th) 150 (C.A.); *Stelco Inc. (Re)*, [2005] O.J. No. 730, 7 C.B.R. (5th) 310 (S.C.J.)

Statutes referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 15 [as am.], 58(1) [as am.]
Supreme Court Act, R.S.C. 1985, c. S-26, ss. 65 [as am.], 65.1(1) [as am.]

MOTION for a stay pending appeal.

Murray Gold and *Andrew J. Hatnay*, for applicants Retired Salaried Beneficiaries of Stelco Inc., CHT Steel Company Inc., Stelpipe Ltd., Stelwire Ltd. and Welland Pipe Ltd.

John R. Varley, for applicants Active Salaried Employee Representative.

Richard B. Swan, for respondents Michael Woollcombe and Roland Keiper.

Michael Barrack, for Stelco Inc.

Lawrence Thacker, for respondent Board of Directors of Stelco Inc.

Kyla Mahar, for the Monitor.

[1] FELDMAN J.A. (In Chambers): — The applicants representing the retired salaried employees and the active salaried employees of Stelco Inc. (the "Company") have sought leave to appeal the judgment of this court, ((2005), 75 O.R. (3d) 5, [2005] O.J. No. 1171 (C.A.)) dated March 31, 2005, to the Supreme Court of Canada. In that judgment, this court reversed the decision of the supervising judge in the *CCAA* proceedings where he ordered the removal of two directors from the board of the Company. This court held that the judge had no jurisdiction under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*") to remove directors of a company unless the oppression remedy applied, which it did not in the case.

[2] The applicants now move for an order under s. 65.1(1) of the *Supreme Court Act*, R.S.C. 1985, c. S-26 staying the execution of

the order of this court pending the decision of the Supreme Court on the leave application. They intend to join with their application for leave to appeal an application for an expedited determination of the leave motion. The effect of any stay would be to reinstate the order of the supervising judge until such time as the Supreme Court determines whether it will grant leave to appeal the judgment of this court.

[3] The motion for a stay is opposed by the two directors, by the Company and by the board of directors of the Company. The monitor appeared on the motion but took no position on it. One of the unions that had sought the original order and responded on the appeal, the United Steelworkers of America, did not appear or take a position on the stay motion.

[4] The first issue raised by the respondents in their material is the jurisdiction of this court to grant a stay. Section 65.1(1) of the *Supreme Court Act* provides:

> 65.1(1) The Court, the court appealed from or a judge of either of those courts may, on the request of the party who has served and filed a notice of application for leave to appeal, order that proceedings be stayed with respect to the judgment from which leave to appeal is being sought, on the terms deemed appropriate.

[5] The Supreme Court's jurisprudence since the amendment of the section in 1994 makes it clear that when leave to appeal to the Supreme Court is sought, applications for a stay of the decision being appealed are to be brought routinely at first instance to the court appealed from rather than to the Supreme Court. See *Confederation Treasury Services Ltd. (Trustee of) v. Ernst & Young*, [1997] 2 S.C.R. 5, [1997] S.C.J. No. 79. That was done in this case. The respondent's factum, however, referred to s. 15(3) of the *CCAA*, suggesting that that section may have the effect of conferring exclusive jurisdiction on the Supreme Court to grant stays on applications for leave to appeal under the *CCAA*. The matter was clarified to my satisfaction in oral argument.

[6] Section 15(3) of the *CCAA* provides:

> 15(3) No appeal to the Supreme Court of Canada shall operate as a stay of proceedings unless and to the extent ordered by that Court.

That section does not refer to applications for leave to appeal but only to appeals.

[7] Under s. 65(1) of the *Supreme Court Act*, when a notice of appeal is served and filed along with security as required, there is, with some exceptions, an automatic stay of execution in the cause. Section 15(3) of the *CCAA* states that under that Act there is no stay of execution on an appeal, "unless and to the extent ordered by that Court [the Supreme Court of Canada]". These

sections deal only with stays actually on appeal. Once leave has been granted, s. 58(1)(*b*) of the *Supreme Court Act* provides that a notice of appeal shall be served and filed. By my reading, it is only when that step is taken that s. 15(3) of the *CCAA* applies.

[8] I conclude, therefore, that this court does have jurisdiction under s. 65.1(1) of the *Supreme Court Act* to consider this application for a stay pending the Supreme Court's decision whether to grant leave to appeal.

[9] The next issue is the application of the three-pronged test from *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311, [1994] S.C.J. No. 17: (1) whether there is a serious question to be tried, (2) whether the applicant will suffer irreparable harm if the stay is not granted, [and] (3) the balance of convenience.

[10] The threshold for the first prong of the test, a serious issue to be tried, is normally set fairly low, in that it is often described as a question that is not frivolous. However, counsel for the respondent Company relied on para. 51 [p. 338 S.C.R.] of the *RJR-MacDonald* judgment, which describes two exceptions to that rule, one of which is where the effect of the stay will be tantamount to a final determination of the action because of timing issues. It is submitted that that is the case in this matter, because the restructuring process is proceeding and the board of directors is meeting to develop a plan of arrangement with the target date for presentation of the plan being May 30, 2005. By granting a stay, the effect would be to reinstate the order of the supervising judge and to exclude the two directors from the board while the process is proceeding.

[11] The respondent Company submits that in assessing the potential merit of the proposed appeal, for the purposes of determining whether to grant a stay in these circumstances, this court must be of the view both that leave to appeal is likely to be granted by the Supreme Court, and also that the appeal will be successful and the Supreme Court will reverse the decision of this court. I cannot accept this submission. Clearly, it would be anomalous indeed for this court, and particularly for a member of the panel that heard and decided the appeal, to be of the view that the decision is likely to be reversed on appeal. Nor can this court know or assess whether this will be one of the relatively few cases in which the Supreme Court will decide to grant leave to appeal, given that many factors go into its decisions on leave with the relative importance of the question at issue in the case being only one of them.

[12] Having said that, in *CCAA* proceedings this court, following other appellate courts, has said that leave will be granted

only sparingly where there are "serious and arguable grounds that are of real and significant interest to the parties": *Re Country Style Food Services Inc.*, [2002] O.J. No. 1377, 158 O.A.C. 30, at para. 15; *Re Multitech Warehouse Direct Inc.*, [1995] A.J. No. 663, 32 Alta. L.R. (3d) 62 (C.A.), at para. 3; *Re Steinberg Inc.*, [1993] Q.J. No. 860 (C.A.). In its decision of March 31, 2005, this court granted leave to appeal because the case involved the court's jurisdiction in *CCAA* proceedings to intervene in corporate governance decisions, a matter of importance in the conduct of *CCAA* restructuring proceedings and a matter on which there was little appellate authority. The issue remains an important one, and therefore qualifies under the ordinary test as a serious issue to be tried.

[13] I next turn to the question of irreparable harm to the applicants. The applicants claim that the denial of a stay "threatens the successful restructuring of Stelco". They say that the two disputed directors, who are or represent substantial shareholders of the company, are motivated to boost share prices in the short term rather than seek a viable long-term restructuring plan. They raise the spectre of the eventual bankruptcy of Stelco, even if it emerges from the current *CCAA* protection, if the restructuring plan is not viable for the long term. Finally, they say that the reinstatement of the two directors "has caused a return of the lack of confidence in Stelco's *CCAA* restructuring process among the Salaried Retirees and other key stakeholders". They conclude that if the stakeholders are distrustful, they will negotiate not for a good faith plan but instead for remedies that maximize their own positions, which will result in a flawed plan and, eventually, the future bankruptcy of the Company.

[14] These concerns about the alleged selfish motivation of the two directors and the "poisoned atmosphere" of the restructuring process were also raised by the applicants as the basis for upholding the decision of the supervising judge to remove the two directors. On the issue of the potential misconduct of the directors in carrying out their duties during the restructuring, this court in its March 31, 2005 decision, observed that on the record there was no evidence of improper conduct of the two directors, and that the supervising judge concluded only that there was a risk that they would not live up to their obligations in the future. This court then held at para. 61 that: "[i]n determining whether directors have fallen foul of those obligations, however, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office" and "[t]he

record does not support a finding that there was a sufficient risk of sufficient misconduct to warrant a conclusion of oppression".

[15] This court also addressed the concern that the process would now become flawed and tainted by observing, at paras. 71 and 72, that the *CCAA* court retains its supervisory power and jurisdiction over both the ultimate approval of the plan as well as the ongoing *CCAA* process itself, to ensure fairness and approval of the best plan possible for the future viability of the company.

[16] The applicants essentially say that they retain the same fear for the future of the process and of the Company that they have felt and expressed since the two new directors were elected to the board. Although this court has addressed these concerns by pointing out that they are only speculative, it is understandable that if the applicants continue to perceive a concern with the ongoing fairness of the process as it goes forward while they await the decision of the Supreme Court on the leave motion, that they would view that concern as irreparable harm to them as stakeholders in that process.

[17] The third criterion for a stay is the balance of convenience. The applicants say that the balance of convenience favours a stay. First, they say that the stay will be of relatively short duration as they expect a decision from the Supreme Court on the leave motion on an expedited basis within three to four months. Second, their position is that the stay will restore the *status quo* as it was before the two directors were appointed to the board. Third, they argue that Stelco's board can proceed to do its work without the new directors so that there is no prejudice to the board or to the restructuring process in the interim.

[18] The respondents' position is that the applicants will suffer no irreparable harm if a stay is not granted and that the balance of convenience strongly favours denying a stay. They point to the fact that the applicants sought the original motion before the supervising judge to remove the two directors on the basis of urgency. The need to remove any uncertainty was acknowledged to be important and a cogent reason for this court to hear and decide the appeal from the order of the supervising judge on an expedited basis ([2005] O.J. No. 802, 8 C.B.R. (5th) 150 (C.A.)). They argue that it is inconsistent with the position taken all along in this proceeding to now say that a period of three to four months (or possibly longer) of further uncertainty is acceptable or fair to the parties or the restructuring process.

[19] Further, the board is currently actively meeting and developing a restructuring plan, as directed by the restructuring judge in his reasons ([2005] O.J. No. 730, 7 C.B.R. (5th) 310 (S.C.J.). The respondents say that the issue of the constitution of the board of

the Company during this process is the very issue that was considered of such importance that it had to be dealt with on an urgent basis by this court. They argue that if the process now proceeds at this key juncture without the two directors who have been held to be properly on the board, it will inevitably cause significant inconvenience to both the board and to the restructuring process itself.

[20] It appears that the next few months will be a critical period in the restructuring process. If that is not the case, as counsel for one of the applicants suggested, then the importance of the stay is minimized. However, on the basis that the board is now going to proceed to develop a viable restructuring plan following the rejection of all bids that arose from the capital raising process, this is a crucial time. The question, therefore, is which *status quo* should be put in place during this time? Each side says that the balance of convenience favours the composition of the board with which that side is most comfortable during this period.

[21] In applying the three-part test, the court is to balance the three factors in a way that addresses the interests of justice in all the circumstances. See: *Circuit World Corp. v. Lesperance* (1997), 33 O.R. (3d) 674, [1997] O.J. No. 2081 (C.A.); *International Corona Resources Ltd. v. Lac Minerals Ltd.*, [1986] O.J. No. 2128, 21 C.P.C. (2d) 252 (C.A.).

[22] In this case, the issue of the jurisdiction of the court to remove directors is a serious and important issue. Both sides say they will suffer irreparable harm if the board is not composed as they want during the next few months of the restructuring process and that the balance of convenience therefore favours their side. If the next few months are crucial, then the stay itself (or the denial of the stay) will implement the effective result of the appeal. Certainly by the time any appeal is heard in the normal course, the issue for these parties will be moot.

[23] On the basis that the restructuring is proceeding and that the next few months may well be critical, I then turn to the interests of justice in all the circumstances: is it just that the applicants should be granted a stay that would effectively implement the decision of the supervising judge to remove the two directors from the board, when this court has held that the judge had no jurisdiction to make that order? Or is it just that the decision of this court, which sets aside an order made without jurisdiction, be implemented until the Supreme Court decides whether to grant leave to appeal (and if so, whether to grant a stay at that time)? Viewing the matter in this way, I am compelled to the conclusion that the interests of justice require that no stay be ordered at this time.

[24] The applicants raise again in their material, as they did on the appeal, the concern that by gaining a position on the board, the two shareholder representatives have been given an unequal advantage and role in the restructuring process to the exclusion of other stakeholders, and that this causes both actual unfairness and the perception of unfairness in the current restructuring process. As was stated in this court's March 31, 2005 decision, the supervising judge has wide powers under the *CCAA* to ensure that the process is fair and equitable and is structured to ensure that the sanctioned plan is fair and reasonable. The purpose is for a new viable economic entity to emerge from protection. Because the supervising judge has the power and the creative scope to craft other ways to alleviate the concerns of the applicants, as well as the ultimate power of approval of the plan, the irreparable harm that the applicants perceive in terms of the perception of a poisoned atmosphere is potentially "reparable" within the restructuring process.

[25] For the reasons set out, the motion for a stay of this court's decision of March 31, 2005, pending the decision of the Supreme Court whether to grant leave to appeal, is dismissed. The parties advised that there should be no costs of this motion.

Motion dismissed.

Her Majesty the Queen v. Walsh

[Indexed as: R. v. Walsh]

Court of Appeal for Ontario, Feldman J.A. (in Chambers)
February 18, 2005

Criminal law — Bail — Bail pending appeal — Jurisdiction — Accused on parole seeking release on bail pending appeal — Accused convicted of possession and distributing child pornography — Accused wanting to suspend parole condition prohibiting him from having access to computers and Internet — Accused released on parole in "custody" for purposes of s. 679 of Criminal Code — Accused granted bail with supervised access to computers and Internet for employment purposes — Criminal Code, R.S.C. 1985, c. C-46, s. 679.

The accused was sentenced to two years less a day in prison and three years' probation for creating and distributing child pornography. After serving several months of his sentence, he was released on parole. He appealed his conviction and sentence, and brought an application for bail pending appeal. He wanted a condition of his parole that restricted his access to computers to be suspended because he wished to pursue a career in computers.

TAB "3"

[Indexed as: **Ivaco Inc., Re**]

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF IVACO INC. AND THE APPLICANTS LISTED IN SCHEDULE "A"

Ontario Superior Court of Justice [Commercial List]

Cumming J.

Heard: June 9, 2004

Judgment: June 10, 2004

Docket: 03-CL-5145

M.P. Gottlieb for Applicants
Michael E. Barrack, Geoff R. Hall for QIT
E. Lamek for National Bank of Canada
Peter Howard for Monitor, Ernst & Young Inc.
D.V. MacDonald for Bank of Nova Scotia
J.T. Porter for UBS
Ken Rosenberg for United Steel Workers of Canada

Bankruptcy and insolvency —— Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues —— Company began proceedings under Companies Creditors Arrangement Act — Company sought directions on possible sale proposal — Corporate restructuring officer to be part of sales process — Parties agreed that monitor could observe negotiations between QIT and bidders, and that disclosure be made of supply agreement between QIT and company — Corporate restructuring officer was required to understand all aspects of possible sale.

Statutes considered:

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

RULING regarding arrangement under *Companies' Creditors Arrangement Act*.

***Cumming J.*:**

The Motion

1 The moving party Applicants, Ivaco Rolling Mills Limited Partnership, comprising some eight affiliated corporations ("IRM"), seek directions from the Court in respect of the sales process for its business under the *Companies' Creditors Arrangement Act* ("*CCAA*"). The motion raises an important issue relating to the respective roles of the Monitor and Chief Restructuring Officer in that

process. The Court provided a decision at the conclusion of the hearing, with reasons to follow.

Background

2 IRM is engaged in the steel manufacturing and processing business in Canada. QIT-Fer Et Titane Inc. ("QIT") is a major supplier to IRM of steel billets pursuant to a long-standing supply agreement. QIT is also a major unsecured creditor of IRM, being owed some $62 million.

3 The Applicants obtained an Initial Order under the *CCAA* September 16, 2003. A Chief Restructuring Officer ("CRO") was appointed October 24, 2003.

4 On December 11, 2003 this Court authorized IRM to pursue a dual-track restructuring process: one track is a stand-alone restructuring plan; the second track is the pursuit of a sales process.

5 The Monitor, the CRO and the unsecured creditors of IRM have a concern that QIT seeks a way whereby it will be paid the monies owing to it by IRM outside the parameter of the *CCAA* proceeding. The record gives some force to this concern.

6 A Court Order dated March 22, 2004 authorized a limited number of prospective purchasers to submit offers for the assets of one or more of the Applicants. Some four bidders have now submitted proposals in this regard. Understandably, it is a condition of the proposals that the bidders be able to satisfy themselves as to the nature and status of the historical and existing relationship between QIT and IRM and the nature of any relationship for the future between a buyer of IRM's business and QIT.

7 The concern that has been raised by the Monitor, CRO and a number of IRM's creditors is that QIT may seek to enter into a relationship with a bidder whereby QIT could achieve some recovery of IRM's pre-filing debt of $62 million at the expense of other unsecured creditors.

8 Any purchaser of IRM requires a supply contract with QIT as there are no apparent competitors for its product sold to IRM. The concern is that QIT could insist upon a supply arrangement with the bidder at an unreasonably high price with the bidder offering an unreasonably low price for the assets of IRM. The creditors, Monitor, and the Applicants are concerned that QIT might enter into a supply arrangement with a bidder at the expense of IRM by virtue of the price for IRM's assets being lower than would otherwise be the case in a normal market transaction.

9 Meetings have been set up to take place between the bidders, the Applicants through the CRO, the Monitor and QIT with a view to determining whether any one or more bidder can achieve a supply agreement with QIT within a context of a satisfactory unconditional bid by that bidder for the assets of one or more of the Applicants.

The Issue

10 Several issues raised at the outset of the motion were settled by agreement as discussions progressed. It is not necessary to discuss these settled issues. The settled position provides that the Monitor can observe the negotiations to take place between QIT and each bidder. The settled position also provides that disclosure can be made to bidders of the existing supply agreement between IRM and QIT.

11 A single issue remained for determination by the Court at the conclusion of the hearing, being whether or not the CRO was to be part of the sales process. QIT took the position that the CRO should not be part of the process. The Applicants, the Monitor and the other major unsecured creditors all took the position that the CRO should be part of the sales process. Only QIT, supported by the United Steel Workers of Canada, took the contrary view.

12 The only support for QIT came from the United Steel Workers of Canada, being the Union representing the workers of IRM through a collective bargaining agreement. The position expressed by counsel for the Union was that the continuity of IRM's business is critical to the direct welfare of its employees and is of indirect benefit to the community at large. There is a clear public interest in the welfare of the workers. Undoubtedly, that is a correct, and important observation.

13 Thus, counsel for the Union argued further, the Court should accede to the position of QIT even though it might result in a failure to maximize the value of the IRM assets through the *CAA* proceeding. In my view, the Union's quite proper concern for the welfare of the workers cannot justify trumping the concern of creditors that they be treated fairly. Nor would it ever be in the broader notion of the public interest to allow a sales process perceived to be unfair to go forward. The public policy underlying the *CCAA* and its objectives would be undermined. Indeed, it might well be that any proposed sale would not then garner the requisite support of creditors required for approval under the *CCAA*. It might be that the business of IRM is more likely to fail, to the ultimate disadvantage of its workers, through a compromise to the integrity of the sales process. In any event, the Court could not sanction a proposed plan of compromise that was the result of an unfair process.

14 QIT professes that if the CRO takes part in the negotiations between the bidders and QIT that this will necessarily inhibit the sales process. QIT claims this will be so because bidders will be reluctant to provide confidential information to QIT, and vice-versa, while recognizing that the CRO may then use that information to enhance an alternative stand-alone restructuring plan and consequentially advise against acceptance of the bidder's proposal.

Disposition

15 There are certain fundamentals to a *CCAA* proceeding relevant to a determination of the issue at hand. First, there cannot be a sales process whereby one unsecured creditor secures a secret benefit or advantage over the other unsecured creditors. Such a result would be the equivalent of providing a preference for that creditor. Fairness to all the creditors is a prerequisite to a satisfactory sales process. Second, the sales process must be seen to be fair. That is, there must be transparency.

16 Third, the sales process is to be determined by the Court after considering the advice of the Monitor and the position of the Applicants and their creditors. The sales process is not dictated by a supplier *qua* supplier. It may be the supplier does not wish to participate in the sales process given the nature of the process. That is for the supplier to determine in its own self-interest. In the situation at hand, QIT conceivably might say that it would rather lose its supplier relationship with IRM or a successor, to its apparent significant economic detriment, than proceed in the sales process.

17 The CRO's attendance and participation in the sales process is critical because he is the independent party who must understand all the various bids and weigh each against the possibility of a stand-alone restructuring. He must ultimately make recommendations that engender confidence as being advanced on the best information and advice possible. The CRO is an active part of the negotiations in the sales process. He is not involved as a relatively passive observer in the manner of the Monitor.

18 The sales process has been determined by the Applicants with the approval of the Court. The CRO represents the Applicants in that process. The intended sales process is one of trilateral negotiations. If QIT, IRM or any bidder wishes to discontinue such negotiations at any time that is, of course, that party's right. It is in the obvious self-interest of IRM, QIT, and any bidder to maintain the existing QIT to IRM (or successor) supply relationship. It would seem to be a win — win — win situation to come to a tripartite agreement. While no one can be ordered to enter into any new agreement every participant is required to engage in a sales process that is fair and is seen to be fair. The CRO is involved with the purpose of achieving the best result for the Applicants and a result which will be approved by the requisite number of creditors.

19 Turning to the instant situation, there are a number of Applicants with different unsecured creditors for different Applicants. It is necessary that any negotiated sale (or restructuring) take into account such complexities so that fairness is achieved for all the creditors (and is seen to be achieved.)

20 QIT proposed that the CRO would be excluded from the negotiations unless his presence was requested by either a bidder or by QIT. I disagree. In my view, the CRO has the right to attend and participate throughout the entirety of the negotiations in the sales process. In the event that a discrete issue arises in the

context of a particular bidder's negotiations with QIT, such that there is disagreement as to whether the Monitor or CRO should be absent, then the further direction of the Court can be sought in the context of that specific issue. This will allow for QIT's expressed concerns for bidders in the negotiation process to be taken into account, should this be necessary. It is noted incidentally that no bidder has come forward in the hearing at hand to support QIT in respect of its expressed concerns about the sales process.

21 Absent some compelling, exceptional factor to the contrary (not seen here), in my view, the Court should accept an applicant's proposed sales process under the *CCAA*, when it has been recommended by the Monitor and is supported by the disinterested major creditors. The Court has the discretion to stipulate a variation to such a proposed sales process plan. However, the exercising of such discretion would seem appropriate in only very exceptional circumstances.

22 An Order will issue in the form attached hereto as Annex "A". There are no costs granted to any party.

Order accordingly.

ANNEX "A"

Court File No. 03-CL-5145

ONTARIO SUPERIOR COURT OF JUSTICE COMMERCIAL LIST

THE HONOURABLE MR. JUSTICE CUMMING

WEDNESDAY, THE 9th DAY OF JUNE, 2004

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 IVACO INC. AND THE APPLICANTS LISTED IN SCHEDULE "A"

ORDER

THIS MOTION, made by the Applicants for directions with respect to the sales process in respect of discussions involving QIT Fer et Titane Inc. ("QIT"), was heard this day at 393 University, Toronto.

ON READING the Notice of Motion, the Tenth Report of the Monitor, Ernst & Young Inc., the Affidavit of Randall C. Benson, the Affidavit of Gary A. O'Brien, and the Supplementary Affidavit of Randall C. Benson, and on hearing the submissions of counsel for the Applicants, the Monitor, QIT, the Informal Committee of Noteholders, the United Steelworkers of America, the Bank of Nova Scotia, the National Bank of Canada and UBS Securities LLC:

1. THIS COURT ORDERS that the time for service of the Notice of Motion and the Motion Record herein is abridged so that the motion is properly returnable

today, and that any requirement for service of the Notice of Motion and of the Motion Record upon any party not served is dispensed with.

2. THIS COURT ORDERS that the sales process in respect of discussions involving QIT shall be governed by the following procedure:

(a) QIT shall have seven days from the date of this Order to meet with the bidders who have submitted final proposals in the second round of the sales process authorized by order of this court dated March 22, 2004. The Monitor and CRO shall have the right to attend and participate in all such meetings. At the conclusion of the seven day period, QIT shall inform the Monitor of those bidders with whom it is prepared to conduct further negotiations. After considering the views of QIT and the Applicants, the Monitor shall identify to the Applicants and QIT the bidders with whom further negotiations shall occur (the "Bidders"). If either QIT or the Applicants disagree with the Monitor then they may apply to the court for directions.

(b) After the Bidders have been identified, QIT shall disclose relevant portions of the long-term supply agreement dated April 15, 1999 between QIT and Ivaco Rolling Mills Limited Partnership ("IRM") which QIT claims has been terminated and which the Applicants claim has not been terminated (the "Agreement") to the Bidders, under appropriate confidentiality arrangements. QIT and the Monitor shall have discussions to determine what portions of the Agreement are relevant and to determine appropriate confidentiality arrangements. If they cannot agree, they shall seek further directions from the court. Further, if the Applicants do not agree with the determination of QIT and the Monitor as to what portions of the Agreement are relevant, they shall be at liberty to apply to the court for further directions regarding the disclosure of the Agreement. This order shall be without prejudice to the Applicants' position that the Agreement is not confidential and that it may disclose the entire Agreement.

(c) QIT shall then undertake negotiations with the Bidders. The Monitor and CRO shall be entitled to attend and participate in these negotiations so as to be in a position to report to the court on the outcome of them. No other parties shall participate in the negotiations, except that at the request of either QIT or a Bidder technical personnel from the Applicants will be entitled to participate in order to give necessary technical assistance. If the parties cannot agree on the appropriate participation of additional persons they shall seek further directions from the court. At the request of QIT and a Bidder, the Monitor may in its discretion absent itself from parts of negotiations which it considers best to proceed privately. If the Monitor refuses such request, QIT or the Bidder may apply to the court for directions. At the request of QIT or a Bidder, the CRO may in his discretion absent himself from parts of negotiations which he considers best to proceed privately. If the CRO refuses such request, QIT or the Bidder may apply to the court for directions.

(d) The negotiations and meetings referred to shall be conducted under appropriate confidentiality arrangements.

SCHEDULE "A"

APPLICANTS FILING FOR CCAA

1. Ivaco Inc.
2. Ivaco Rolling Mills Inc.
3. Ifastgroupe Inc.
4. IFC (Fasteners) Inc.
5. Ifastgroupe Realty Inc.
6. Docap (1985) Corporation
7. Florida Sub One Holdings, Inc.
8. 3632610 Canada Inc.

TAB "4"

REPORTS OF CASES

DETERMINED IN

ONTARIO COURTS

Royal Bank of Canada v. Soundair Corp., Canadian Pension Capital Ltd. and Canadian Insurers Capital Corp.

[Indexed as: Royal Bank of Canada v. Soundair Corp.]

Court of Appeal for Ontario, Goodman, McKinlay and Galligan JJ.A.
July 3, 1991

Debtor and creditor — Receivers — Court-appointed receiver accepting offer to purchase assets against wishes of secured creditors — Receiver acting properly and prudently — Wishes of creditors not determinative — Court approval of sale confirmed on appeal.

Air Toronto was a division of Soundair. In April 1990, one of Soundair's creditors, the Royal Bank, appointed a receiver to operate Air Toronto and sell it as a going concern. The receiver was authorized to sell Air Toronto to Air Canada, or, if that sale could not be completed, to negotiate and sell Air Toronto to another person. Air Canada made an offer which the receiver rejected. The receiver then entered into negotiations with Canadian Airlines International (Canadian); two subsidiaries of Canadian, Ontario Express Ltd. and Frontier Airlines Ltd., made an offer to purchase on March 6, 1991 (the OEL offer). Air Canada and a creditor of Soundair, CCFL, presented an offer to purchase to the receiver on March 7, 1991 through 922, a company formed for that purpose (the 922 offer). The receiver declined the 922 offer because it contained an unacceptable condition and accepted the OEL offer. 922 made a second offer, which was virtually identical to the first one except that the unacceptable condition had been removed. In proceedings before Rosenberg J., an order was made approving the sale of Air Toronto to OEL and dismissing the 922 offer. CCFL appealed.

Held, the appeal should be dismissed.

Per Galligan J.A.: When deciding whether a receiver has acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer, and should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. The decision to sell to OEL was a sound one in the circumstances faced by the receiver on March 8, 1991. Prices in other offers received after the receiver has agreed to a sale have relevance only if they show that the price contained in the accepted offer was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. If they do not do so, they should not be considered upon a motion to confirm a sale recommended

by a court-appointed receiver. If the 922 offer was better than the OEL offer, it was only marginally better and did not lead to an inference that the disposition strategy of the receiver was improvident.

While the primary concern of a receiver is the protecting of the interests of creditors, a secondary but important consideration is the integrity of the process by which the sale is effected. The court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

The failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto did not result in the process being unfair, as there was no proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL.

The fact that the 922 offer was supported by Soundair's secured creditors did not mean that the court should have given effect to their wishes. Creditors who asked the court to appoint a receiver to dispose of assets (and therefore insulated themselves from the risks of acting privately) should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale by the receiver. If the court decides that a court-appointed receiver has acted providently and properly (as the receiver did in this case), the views of creditors should not be determinative.

Per McKinlay J.A. (concurring in the result): While the procedure carried out by the receiver in this case was appropriate, given the unfolding of events and the unique nature of the assets involved, it was not a procedure which was likely to be appropriate in many receivership sales.

Per Goodman J.A. (dissenting): The fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. The creditors in this case were convinced that acceptance of the 922 offer was in their best interest and the evidence supported that belief. Although the receiver acted in good faith, the process which it used was unfair insofar as 922 was concerned and improvident insofar as the secured creditors were concerned.

Cases referred to

Beauty Counsellors of Canada Ltd. (Re) (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.); *British Columbia Development Corp. v. Spun Cast Industries Inc.* (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.); *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.); *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 22 C.P.C. (2d) 131, 67 C.B.R. (N.S.) 320 (note), 39 D.L.R. (4th) 526 (H.C.J.); *Salima Investments Ltd. v. Bank of Montreal* (1985), 41 Alta. L.R. (2d) 58, 65 A.R. 372, 59 C.B.R. (N.S.) 242, 21 D.L.R. (4th) 473 (C.A.); *Selkirk (Re)* (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.); *Selkirk (Re)* (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.)

Statutes referred to

Employment Standards Act, R.S.O. 1980, c. 137
Environmental Protection Act, R.S.O. 1980, c. 141

APPEAL from the judgment of the General Division, Rosenberg J., May 1, 1991, approving the sale of an airline by a receiver.

J.B. Berkow and *Steven H. Goldman*, for appellants.
John T. Morin, Q.C., for Air Canada.
L.A.J. Barnes and *Lawrence E. Ritchie*, for Royal Bank of Canada.
Sean F. Dunphy and *G.K. Ketcheson* for Ernst & Young Inc., receiver of Soundair Corp., respondent.
W.G. Horton, for Ontario Express Ltd.
Nancy J. Spies, for Frontier Air Ltd.

GALLIGAN J.A.:—This is an appeal from the order of Rosenberg J. made on May 1, 1991 (Gen. Div.). By that order, he approved the sale of Air Toronto to Ontario Express Limited and Frontier Air Limited and he dismissed a motion to approve an offer to purchase Air Toronto by 922246 Ontario Limited.

It is necessary at the outset to give some background to the dispute. Soundair Corporation (Soundair) is a corporation engaged in the air transport business. It has three divisions. One of them is Air Toronto. Air Toronto operates a scheduled airline from Toronto to a number of mid-sized cities in the United States of America. Its routes serve as feeders to several of Air Canada's routes. Pursuant to a connector agreement, Air Canada provides some services to Air Toronto and benefits from the feeder traffic provided by it. The operational relationship between Air Canada and Air Toronto is a close one.

In the latter part of 1989 and the early part of 1990, Soundair was in financial difficulty. Soundair has two secured creditors who have an interest in the assets of Air Toronto. The Royal Bank of Canada (the Royal Bank) is owed at least $65,000,000. The appellants Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively called CCFL) are owed approximately $9,500,000. Those creditors will have a deficiency expected to be in excess of $50,000,000 on the winding-up of Soundair.

On April 26, 1990, upon the motion of the Royal Bank, O'Brien J. appointed Ernst & Young Inc. (the receiver) as receiver of all of the assets, property and undertakings of Soundair. The order required the receiver to operate Air Toronto and sell it as a going concern. Because of the close relationship between Air Toronto and Air Canada, it was contemplated that the receiver would

obtain the assistance of Air Canada to operate Air Toronto. The order authorized the receiver:

> (b) to enter into contractual arrangements with Air Canada to retain a manager or operator, including Air Canada, to manage and operate Air Toronto under the supervision of Ernst & Young Inc. until the completion of the sale of Air Toronto to Air Canada or other person . . .

Also because of the close relationship, it was expected that Air Canada would purchase Air Toronto. To that end, the order of O'Brien J. authorized the receiver:

> (c) to negotiate and do all things necessary or desirable to complete a sale of Air Toronto to Air Canada and, if a sale to Air Canada cannot be completed, to negotiate and sell Air Toronto to another person, subject to terms and conditions approved by this Court.

Over a period of several weeks following that order, negotiations directed towards the sale of Air Toronto took place between the receiver and Air Canada. Air Canada had an agreement with the receiver that it would have exclusive negotiating rights during that period. I do not think it is necessary to review those negotiations, but I note that Air Canada had complete access to all of the operations of Air Toronto and conducted due diligence examinations. It became thoroughly acquainted with every aspect of Air Toronto's operations.

Those negotiations came to an end when an offer made by Air Canada on June 19, 1990, was considered unsatisfactory by the receiver. The offer was not accepted and lapsed. Having regard to the tenor of Air Canada's negotiating stance and a letter sent by its solicitors on July 20, 1990, I think that the receiver was eminently reasonable when it decided that there was no realistic possibility of selling Air Toronto to Air Canada.

The receiver then looked elsewhere. Air Toronto's feeder business is very attractive, but it only has value to a national airline. The receiver concluded reasonably, therefore, that it was commercially necessary for one of Canada's two national airlines to be involved in any sale of Air Toronto. Realistically, there were only two possible purchasers whether direct or indirect. They were Air Canada and Canadian Airlines International.

It was well known in the air transport industry that Air Toronto was for sale. During the months following the collapse of the negotiations with Air Canada, the receiver tried unsuccessfully to find viable purchasers. In late 1990, the receiver turned to Canadian Airlines International, the only realistic alternative. Negotiations began between them. Those negotiations led to a letter of intent dated February 11, 1991. On March 6, 1991, the

receiver received an offer from Ontario Express Limited and Frontier Airlines Limited, who are subsidiaries of Canadian Airlines International. This offer is called the OEL offer.

In the meantime, Air Canada and CCFL were having discussions about making an offer for the purchase of Air Toronto. They formed 922246 Ontario Limited (922) for the purpose of purchasing Air Toronto. On March 1, 1991, CCFL wrote to the receiver saying that it proposed to make an offer. On March 7, 1991, Air Canada and CCFL presented an offer to the receiver in the name of 922. For convenience, its offers are called the 922 offers.

The first 922 offer contained a condition which was unacceptable to the receiver. I will refer to that condition in more detail later. The receiver declined the 922 offer and on March 8, 1991, accepted the OEL offer. Subsequently, 922 obtained an order allowing it to make a second offer. It then submitted an offer which was virtually identical to that of March 7, 1991, except that the unacceptable condition had been removed.

The proceedings before Rosenberg J. then followed. He approved the sale to OEL and dismissed a motion for the acceptance of the 922 offer. Before Rosenberg J., and in this court, both CCFL and the Royal Bank supported the acceptance of the second 922 offer.

There are only two issues which must be resolved in this appeal. They are:

(1) Did the receiver act properly when it entered into an agreement to sell Air Toronto to OEL?

(2) What effect does the support of the 922 offer by the secured creditors have on the result?

I will deal with the two issues separately.

I. DID THE RECEIVER ACT PROPERLY IN AGREEING TO SELL TO OEL?

Before dealing with that issue there are three general observations which I think I should make. The first is that the sale of an airline as a going concern is a very complex process. The best method of selling an airline at the best price is something far removed from the expertise of a court. When a court appoints a receiver to use its commercial expertise to sell an airline, it is inescapable that it intends to rely upon the receiver's expertise and not upon its own. Therefore, the court must place a great deal of confidence in the actions taken and in the opinions formed by the receiver. It should also assume that the receiver is acting properly unless the contrary is clearly shown. The second obser-

vation is that the court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver. The third observation which I wish to make is that the conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court.

The order of O'Brien J. provided that if the receiver could not complete the sale to Air Canada that it was "to negotiate and sell Air Toronto to another person". The court did not say how the receiver was to negotiate the sale. It did not say it was to call for bids or conduct an auction. It told the receiver to negotiate and sell. It obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially in the discretion of the receiver. I think, therefore, that the court should not review minutely the process of the sale when, broadly speaking, it appears to the court to be a just process.

As did Rosenberg J., I adopt as correct the statement made by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.), at pp. 92-94 O.R., pp. 531-33 D.L.R., of the duties which a court must perform when deciding whether a receiver who has sold a property acted properly. When he set out the court's duties, he did not put them in any order of priority, nor do I. I summarize those duties as follows:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. It should consider the interests of all parties.
3. It should consider the efficacy and integrity of the process by which offers are obtained.
4. It should consider whether there has been unfairness in the working out of the process.

I intend to discuss the performance of those duties separately.

1. *Did the receiver make a sufficient effort to get the best price and did it act providently?*

Having regard to the fact that it was highly unlikely that a commercially viable sale could be made to anyone but the two national airlines, or to someone supported by either of them, it is my view that the receiver acted wisely and reasonably when it negotiated only with Air Canada and Canadian Airlines International. Furthermore, when Air Canada said that it would submit no further offers and gave the impression that it would not participate further in the receiver's efforts to sell, the only course reasonably open to the receiver was to negotiate with Canadian

Airlines International. Realistically, there was nowhere else to go but to Canadian Airlines International. In doing so, it is my opinion that the receiver made sufficient efforts to sell the airline.

When the receiver got the OEL offer on March 6, 1991, it was over ten months since it had been charged with the responsibility of selling Air Toronto. Until then, the receiver had not received one offer which it thought was acceptable. After substantial efforts to sell the airline over that period, I find it difficult to think that the receiver acted improvidently in accepting the only acceptable offer which it had.

On March 8, 1991, the date when the receiver accepted the OEL offer, it had only two offers, the OEL offer which was acceptable, and the 922 offer which contained an unacceptable condition. I cannot see how the receiver, assuming for the moment that the price was reasonable, could have done anything but accept the OEL offer.

When deciding whether a receiver had acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer. In this case, the court should look at the receiver's conduct in the light of the information it had when it made its decision on March 8, 1991. The court should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. To do so, in my view, would derogate from the mandate to sell given to the receiver by the order of O'Brien J. I agree with and adopt what was said by Anderson J. in *Crown Trust v. Rosenberg*, *supra*, at p. 112 O.R., p. 551 D.L.R.:

> Its decision was made as a matter of business judgment *on the elements then available to it.* It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.
>
> If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

(Emphasis added)

I also agree with and adopt what was said by Macdonald J.A. in *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), at p. 11 C.B.R., p. 314 N.S.R.:

> In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances *at the time existing* it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement.

(Emphasis added)

On March 8, 1991, the receiver had two offers. One was the OEL offer which it considered satisfactory but which could be withdrawn by OEL at any time before it was accepted. The receiver also had the 922 offer which contained a condition that was totally unacceptable. It had no other offers. It was faced with the dilemma of whether it should decline to accept the OEL offer and run the risk of it being withdrawn, in the hope that an acceptable offer would be forthcoming from 922. An affidavit filed by the president of the receiver describes the dilemma which the receiver faced, and the judgment made in the light of that dilemma:

> 24. An asset purchase agreement was received by Ernst & Young on March 7, 1991 which was dated March 6, 1991. This agreement was received from CCFL in respect of their offer to purchase the assets and undertaking of Air Toronto. Apart from financial considerations, which will be considered in a subsequent affidavit, the *Receiver determined that it would not be prudent to delay acceptance of the OEL agreement to negotiate a highly uncertain arrangement with Air Canada and CCFL.* Air Canada had the benefit of an "exclusive" in negotiations for Air Toronto and had clearly indicated its intention to take itself out of the running while ensuring that no other party could seek to purchase Air Toronto and maintain the Air Canada connector arrangement vital to its survival. The CCFL offer represented a radical reversal of this position by Air Canada at the eleventh hour. However, it contained a significant number of conditions to closing which were entirely beyond the control of the Receiver. As well, the CCFL offer came less than 24 hours before signing of the agreement with OEL which had been negotiated over a period of months, at great time and expense.

(Emphasis added)

I am convinced that the decision made was a sound one in the circumstances faced by the receiver on March 8, 1991.

I now turn to consider whether the price contained in the OEL offer was one which it was provident to accept. At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after ten months of trying to sell the airline, is strong evidence that the price in it was reasonable. In a deteriorating economy, I doubt that it would have been wise to wait any longer.

I mentioned earlier that, pursuant to an order, 922 was permitted to present a second offer. During the hearing of the

appeal, counsel compared at great length the price contained in the second 922 offer with the price contained in the OEL offer. Counsel put forth various hypotheses supporting their contentions that one offer was better than the other.

It is my opinion that the price contained in the 922 offer is relevant only if it shows that the price obtained by the Receiver in the OEL offer was not a reasonable one. In *Crown Trust v. Rosenberg*, *supra*, Anderson J., at p. 113 O.R., p. 551 D.L.R., discussed the comparison of offers in the following way:

> No doubt, as the cases have indicated, situations might arise where the disparity was so great as to call in question the adequacy of the mechanism which had produced the offers. It is not so here, and in my view that is substantially an end of the matter.

In two judgments, Saunders J. considered the circumstances in which an offer submitted after the receiver had agreed to a sale should be considered by the court. The first is *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.), at p. 247:

> If, for example, in this case there had been a second offer of a substantially higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out his function of endeavouring to obtain the best price for the property.

The second is *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.), at p. 243:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate.

In *Re Selkirk* (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.), at p. 142, McRae J. expressed a similar view:

> The court will not lightly withhold approval of a sale by the receiver, particularly in a case such as this where the receiver is given rather wide discretionary authority as per the order of Mr. Justice Trainor and, of course, where the receiver is an officer of this court. Only in a case where there seems to be some unfairness in the process of the sale or *where there are substantially higher offers which would tend to show that the sale was improvident* will the court withhold approval. It is important that the court recognize the commercial exigencies that would flow if prospective purchasers are allowed to wait until the sale is in court for approval before submitting their final offer. This is something that must be discouraged.

(Emphasis added)

What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the

receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered *bona fide* into an agreement with the receiver, can only lead to chaos, and must be discouraged.

If, however, the subsequent offer is so substantially higher than the sale recommended by the receiver, then it may be that the receiver has not conducted the sale properly. In such circumstances, the court would be justified itself in entering into the sale process by considering competitive bids. However, I think that that process should be entered into only if the court is satisfied that the receiver has not properly conducted the sale which it has recommended to the court.

It is necessary to consider the two offers. Rosenberg J. held that the 922 offer was slightly better or marginally better than the OEL offer. He concluded that the difference in the two offers did not show that the sale process adopted by the receiver was inadequate or improvident.

Counsel for the appellants complained about the manner in which Rosenberg J. conducted the hearing of the motion to confirm the OEL sale. The complaint was, that when they began to discuss a comparison of the two offers, Rosenberg J. said that he considered the 922 offer to be better than the OEL offer. Counsel said that when that comment was made, they did not think it necessary to argue further the question of the difference in value between the two offers. They complain that the finding that the 922 offer was only marginally better or slightly better than the OEL offer was made without them having had the opportunity to argue that the 922 offer was substantially better or significantly better than the OEL offer. I cannot understand how counsel could have thought that by expressing the opinion that the 922 offer was better, Rosenberg J. was saying that it was a significantly or substantially better one. Nor can I comprehend how counsel took the comment to mean that they were foreclosed from arguing that the offer was significantly or substantially better. If there was some misunderstanding on the part of counsel, it should have been raised before Rosenberg J. at the time. I am sure that if it had been, the misunderstanding would have been cleared up quickly. Nevertheless, this court permitted extensive argument dealing with the comparison of the two offers.

The 922 offer provided for $6,000,000 cash to be paid on closing with a royalty based upon a percentage of Air Toronto profits over a period of five years up to a maximum of $3,000,000. The OEL offer provided for a payment of $2,000,000 on closing with a royalty paid on gross revenues over a five-year period. In the short term, the 922 offer is obviously better because there is substantially more cash up front. The chances of future returns are substantially greater in the OEL offer because royalties are paid on gross revenues while the royalties under the 922 offer are paid only on profits. There is an element of risk involved in each offer.

The receiver studied the two offers. It compared them and took into account the risks, the advantages and the disadvantages of each. It considered the appropriate contingencies. It is not necessary to outline the factors which were taken into account by the receiver because the manager of its insolvency practice filed an affidavit outlining the considerations which were weighed in its evaluation of the two offers. They seem to me to be reasonable ones. That affidavit concluded with the following paragraph:

> 24. On the basis of these considerations the Receiver has approved the OEL offer and has concluded that it represents the achievement of the highest possible value at this time for the Air Toronto division of SoundAir.

The court appointed the receiver to conduct the sale of Air Toronto and entrusted it with the responsibility of deciding what is the best offer. I put great weight upon the opinion of the receiver. It swore to the court which appointed it that the OEL offer represents the achievement of the highest possible value at this time for Air Toronto. I have not been convinced that the receiver was wrong when he made that assessment. I am, therefore, of the opinion that the 922 offer does not demonstrate any failure upon the part of the receiver to act properly and providently.

It follows that if Rosenberg J. was correct when he found that the 922 offer was in fact better, I agree with him that it could only have been slightly or marginally better. The 922 offer does not lead to an inference that the disposition strategy of the receiver was inadequate, unsuccessful or improvident, nor that the price was unreasonable.

I am, therefore, of the opinion that the receiver made a sufficient effort to get the best price and has not acted improvidently.

2. *Consideration of the interests of all parties*

It is well established that the primary interest is that of the creditors of the debtor: see *Crown Trust Co. v. Rosenberg*, *supra*, and *Re Selkirk* (1986, Saunders J.), *supra*. However, as Saunders J. pointed out in *Re Beauty Counsellors*, *supra*, at p. 244 C.B.R., "it is not the only or overriding consideration".

In my opinion, there are other persons whose interests require consideration. In an appropriate case, the interests of the debtor must be taken into account. I think also, in a case such as this, where a purchaser has bargained at some length and doubtless at considerable expense with the receiver, the interests of the purchaser ought to be taken into account. While it is not explicitly stated in such cases as *Crown Trust Co. v. Rosenberg*, *supra*, *Re Selkirk* (1986, Saunders J.), *supra*, *Re Beauty Counsellors*, *supra*, *Re Selkirk* (1987, McRae J.), *supra*, and *Cameron*, *supra*, I think they clearly imply that the interests of a person who has negotiated an agreement with a court-appointed receiver are very important.

In this case, the interests of all parties who would have an interest in the process were considered by the receiver and by Rosenberg J.

3. *Consideration of the efficacy and integrity of the process by which the offer was obtained*

While it is accepted that the primary concern of a receiver is the protecting of the interests of the creditors, there is a secondary but very important consideration and that is the integrity of the process by which the sale is effected. This is particularly so in the case of a sale of such a unique asset as an airline as a going concern.

The importance of a court protecting the integrity of the process has been stated in a number of cases. First, I refer to *Re Selkirk* (1986), *supra*, where Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.
>
> In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in *Cameron v. Bank of N.S.* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), where he said at p. 11:
>
> > In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is

> reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a finding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard — this would be an intolerable situation.
>
> While those remarks may have been made in the context of a bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

In *Salima Investments Ltd. v. Bank of Montreal* (1985), 41 Alta. L.R. (2d) 58, 21 D.L.R. (4th) 473 (C.A.), at p. 61 Alta. L.R., p. 476 D.L.R., the Alberta Court of Appeal said that sale by tender is not necessarily the best way to sell a business as an ongoing concern. It went on to say that when some other method is used which is provident, the court should not undermine the process by refusing to confirm the sale.

Finally, I refer to the reasoning of Anderson J. in *Crown Trust Co. v. Rosenberg, supra,* at p. 124 O.R., pp. 562-63 D.L.R.:

> While every proper effort must always be made to assure maximum recovery consistent with the limitations inherent in the process, no method has yet been devised to entirely eliminate those limitations or to avoid their consequences. *Certainly it is not to be found in loosening the entire foundation of the system. Thus to compare the results of the process in this case with what might have been recovered in some other set of circumstances is neither logical nor practical.*

(Emphasis added)

It is my opinion that the court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

Before this court, counsel for those opposing the confirmation of the sale to OEL suggested many different ways in which the receiver could have conducted the process other than the way which he did. However, the evidence does not convince me that the receiver used an improper method of attempting to sell the airline. The answer to those submissions is found in the comment of Anderson J. in *Crown Trust Co. v. Rosenberg, supra,* at p. 109 O.R., p. 548 D.L.R.:

> The court ought not to sit as on appeal from the decision of the Receiver,

reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise.

It would be a futile and duplicitous exercise for this court to examine in minute detail all of the circumstances leading up to the acceptance of the OEL offer. Having considered the process adopted by the receiver, it is my opinion that the process adopted was a reasonable and prudent one.

4. *Was there unfairness in the process?*

As a general rule, I do not think it appropriate for the court to go into the minutia of the process or of the selling strategy adopted by the receiver. However, the court has a responsibility to decide whether the process was fair. The only part of this process which I could find that might give even a superficial impression of unfairness is the failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto.

I will outline the circumstances which relate to the allegation that the receiver was unfair in failing to provide an offering memorandum. In the latter part of 1990, as part of its selling strategy, the receiver was in the process of preparing an offering memorandum to give to persons who expressed an interest in the purchase of Air Toronto. The offering memorandum got as far as draft form, but was never released to anyone, although a copy of the draft eventually got into the hands of CCFL before it submitted the first 922 offer on March 7, 1991. A copy of the offering memorandum forms part of the record and it seems to me to be little more than puffery, without any hard information which a sophisticated purchaser would require in order to make a serious bid.

The offering memorandum had not been completed by February 11, 1991. On that date, the receiver entered into the letter of intent to negotiate with OEL. The letter of intent contained a provision that during its currency the receiver would not negotiate with any other party. The letter of intent was renewed from time to time until the OEL offer was received on March 6, 1991.

The receiver did not proceed with the offering memorandum because to do so would violate the spirit, if not the letter, of its letter of intent with OEL.

I do not think that the conduct of the receiver shows any unfairness towards 922. When I speak of 922, I do so in the context that Air Canada and CCFL are identified with it. I start by saying that the receiver acted reasonably when it entered into

exclusive negotiations with OEL. I find it strange that a company, with which Air Canada is closely and intimately involved, would say that it was unfair for the receiver to enter into a time-limited agreement to negotiate exclusively with OEL. That is precisely the arrangement which Air Canada insisted upon when it negotiated with the receiver in the spring and summer of 1990. If it was not unfair for Air Canada to have such an agreement, I do not understand why it was unfair for OEL to have a similar one. In fact, both Air Canada and OEL in its turn were acting reasonably when they required exclusive negotiating rights to prevent their negotiations from being used as a bargaining lever with other potential purchasers. The fact that Air Canada insisted upon an exclusive negotiating right while it was negotiating with the receiver demonstrates the commercial efficacy of OEL being given the same right during its negotiations with the receiver. I see no unfairness on the part of the receiver when it honoured its letter of intent with OEL by not releasing the offering memorandum during the negotiations with OEL.

Moreover, I am not prepared top find that 922 was in any way prejudiced by the fact that it did not have an offering memorandum. It made an offer on March 7, 1991, which it contends to this day was a better offer than that of OEL. 922 has not convinced me that if it had an offering memorandum its offer would have been any different or any better than it actually was. The fatal problem with the first 922 offer was that it contained a condition which was completely unacceptable to the receiver. The receiver properly, in my opinion, rejected the offer out of hand because of that condition. That condition did not relate to any information which could have conceivably been in an offering memorandum prepared by the receiver. It was about the resolution of a dispute between CCFL and the Royal Bank, something the receiver knew nothing about.

Further evidence of the lack of prejudice which the absence of an offering memorandum has caused 922 is found in CCFL's stance before this court. During argument, its counsel suggested, as a possible resolution of this appeal, that this court should call for new bids, evaluate them and then order a sale to the party who put in the better bid. In such a case, counsel for CCFL said that 922 would be prepared to bid within seven days of the court's decision. I would have thought that, if there were anything to CCFL's suggestion that the failure to provide an offering memorandum was unfair to 922, it would have told the court that it needed more information before it would be able to make a bid.

I am satisfied that Air Canada and CCFL have, and at all times had, all of the information which they would have needed to make what to them would be a commercially viable offer to the receiver. I think that an offering memorandum was of no commercial consequence to them, but the absence of one has since become a valuable tactical weapon.

It is my opinion that there is no convincing proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL. Therefore, the failure to provide an offering memorandum was neither unfair nor did it prejudice the obtaining of a better price on March 8, 1991, than that contained in the OEL offer. I would not give effect to the contention that the process adopted by the receiver was an unfair one.

There are two statements by Anderson J. contained in *Crown Trust Co. v. Rosenberg, supra*, which I adopt as my own. The first is at p. 109 O.R., p. 548 D.L.R.:

> The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

The second is at p. 111 O.R., p. 550 D.L.R.:

> It is equally clear, in my view, though perhaps not so clearly enunciated, that it is only in an exceptional case that the court will intervene and proceed contrary to the Receiver's recommendations if satisfied, as I am, that the Receiver has acted reasonably, prudently and fairly and not arbitrarily.

In this case the receiver acted reasonably, prudently, fairly and not arbitrarily. I am of the opinion, therefore, that the process adopted by the receiver in reaching an agreement was a just one.

In his reasons for judgment, after discussing the circumstances leading to the 922 offer, Rosenberg J. said this [at p. 31 of the reasons]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

I agree.

The receiver made proper and sufficient efforts to get the best price that it could for the assets of Air Toronto. It adopted a reasonable and effective process to sell the airline which was fair to all persons who might be interested in purchasing it. It is my opinion, therefore, that the receiver properly carried out the

mandate which was given to it by the order of O'Brien J. It follows that Rosenberg J. was correct when he confirmed the sale to OEL.

II. THE EFFECT OF THE SUPPORT OF THE 922 OFFER BY THE TWO SECURED CREDITORS

As I noted earlier, the 922 offer was supported before Rosenberg J., and in this court, by CCFL and by the Royal Bank, the two secured creditors. It was argued that, because the interests of the creditors are primary, the court ought to give effect to their wish that the 922 offer be accepted. I would not accede to that suggestion for two reasons.

The first reason is related to the fact that the creditors chose to have a receiver appointed by the court. It was open to them to appoint a private receiver pursuant to the authority of their security documents. Had they done so, then they would have had control of the process and could have sold Air Toronto to whom they wished. However, acting privately and controlling the process involves some risks. The appointment of a receiver by the court insulates the creditors from those risks. But insulation from those risks carries with it the loss of control over the process of disposition of the assets. As I have attempted to explain in these reasons, when a receiver's sale is before the court for confirmation the only issues are the propriety of the conduct of the receiver and whether it acted providently. The function of the court at that stage is not to step in and do the receiver's work or change the sale strategy adopted by the receiver. Creditors who asked the court to appoint a receiver to dispose of assets should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale made by the receiver. That would take away all respect for the process of sale by a court-appointed receiver.

There can be no doubt that the interests of the creditor are an important consideration in determining whether the receiver has properly conducted a sale. The opinion of the creditors as to which offer ought to be accepted is something to be taken into account. But, if the court decides that the receiver has acted properly and providently, those views are not necessarily determinative. Because, in this case, the receiver acted properly and providently, I do not think that the views of the creditors should override the considered judgment of the receiver.

The second reason is that, in the particular circumstances of this case, I do not think the support of CCFL and the Royal Bank of

the 922 offer is entitled to any weight. The support given by CCFL can be dealt with summarily. It is a co-owner of 922. It is hardly surprising and not very impressive to hear that it supports the offer which it is making for the debtors' assets.

The support by the Royal Bank requires more consideration and involves some reference to the circumstances. On March 6, 1991, when the first 922 offer was made, there was in existence an interlender agreement between the Royal Bank and CCFL. That agreement dealt with the share of the proceeds of the sale of Air Toronto which each creditor would receive. At the time, a dispute between the Royal Bank and CCFL about the interpretation of that agreement was pending in the courts. The unacceptable condition in the first 922 offer related to the settlement of the interlender dispute. The condition required that the dispute be resolved in a way which would substantially favour CCFL. It required that CCFL receive $3,375,000 of the $6,000,000 cash payment and the balance, including the royalties, if any, be paid to the Royal Bank. The Royal Bank did not agree with that split of the sale proceeds.

On April 5, 1991, the Royal Bank and CCFL agreed to settle the interlender dispute. The settlement was that if the 922 offer was accepted by the court, CCFL would receive only $1,000,000 and the Royal Bank would receive $5,000,000 plus any royalties which might be paid. It was only in consideration of that settlement that the Royal Bank agreed to support the 922 offer.

The Royal Bank's support of the 922 offer is so affected by the very substantial benefit which it wanted to obtain from the settlement of the interlender dispute that, in my opinion, its support is devoid of any objectivity. I think it has no weight.

While there may be circumstances where the unanimous support by the creditors of a particular offer could conceivably override the proper and provident conduct of a sale by a receiver, I do not think that this is such a case. This is a case where the receiver has acted properly and in a provident way. It would make a mockery out of the judicial process, under which a mandate was given to this receiver to sell this airline, if the support by these creditors of the 922 offer were permitted to carry the day. I give no weight to the support which they give to the 922 offer.

In its factum, the receiver pointed out that, because of greater liabilities imposed upon private receivers by various statutes such as the *Employment Standards Act*, R.S.O. 1980, c. 137, and the *Environmental Protection Act*, R.S.O. 1980, c. 141, it is likely that more and more the courts will be asked to appoint receivers

in insolvencies. In those circumstances, I think that creditors who ask for court-appointed receivers and business people who choose to deal with those receivers should know that if those receivers act properly and providently their decisions and judgments will be given great weight by the courts who appoint them. I have decided this appeal in the way I have in order to assure business people who deal with court-appointed receivers that they can have confidence that an agreement which they make with a court-appointed receiver will be far more than a platform upon which others may bargain at the court approval stage. I think that persons who enter into agreements with court-appointed receivers, following a disposition procedure that is appropriate given the nature of the assets involved, should expect that their bargain will be confirmed by the court.

The process is very important. It should be carefully protected so that the ability of court-appointed receivers to negotiate the best price possible is strengthened and supported. Because this receiver acted properly and providently in entering into the OEL agreement, I am of the opinion that Rosenberg J. was right when he approved the sale to OEL and dismissed the motion to approve the 922 offer.

I would, accordingly, dismiss the appeal. I would award the receiver, OEL and Frontier Airlines Limited their costs out of the Soundair estate, those of the receiver on a solicitor-and-client scale. I would make no order as to the costs of any of the other parties or interveners.

MCKINLAY J.A. (concurring in the result):—I agree with Galligan J.A. in result, but wish to emphasize that I do so on the basis that the undertaking being sold in this case was of a very special and unusual nature. It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. Consequently, in all cases, the court should carefully scrutinize the procedure followed by the receiver to determine whether it satisfies the tests set out by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.). While the procedure carried out by the receiver in this case, as described by Galligan J.A., was appropriate, given the unfolding of events and the unique nature of the assets involved, it is not a procedure that is likely to be appropriate in many receivership sales.

I should like to add that where there is a small number of creditors who are the only parties with a real interest in the proceeds of the sale (*i.e.*, where it is clear that the highest price attainable would result in recovery so low that no other creditors, shareholders, guarantors, *etc.*, could possibly benefit therefrom), the wishes of the interested creditors should be very seriously considered by the receiver. It is true, as Galligan J.A. points out, that in seeking the court appointment of a receiver, the moving parties also seek the protection of the court in carrying out the receiver's functions. However, it is also true that in utilizing the court process the moving parties have opened the whole process to detailed scrutiny by all involved, and have probably added significantly to their costs and consequent shortfall as a result of so doing. The adoption of the court process should in no way diminish the rights of any party, and most certainly not the rights of the only parties with a real interest. Where a receiver asks for court approval of a sale which is opposed by the only parties in interest, the court should scrutinize with great care the procedure followed by the receiver. I agree with Galligan J.A. that in this case that was done. I am satisfied that the rights of all parties were properly considered by the receiver, by the learned motions court judge, and by Galligan J.A.

GOODMAN J.A. (dissenting):—I have had the opportunity of reading the reasons for judgment herein of Galligan and McKinlay JJ.A. Respectfully, I am unable to agree with their conclusion.

The case at bar is an exceptional one in the sense that upon the application made for approval of the sale of the assets of Air Toronto two competing offers were placed before Rosenberg J. Those two offers were that of Frontier Airlines Ltd. and Ontario Express Limited (OEL) and that of 922246 Ontario Limited (922), a company incorporated for the purpose of acquiring Air Toronto. Its shares were owned equally by Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively CCFL) and Air Canada. It was conceded by all parties to these proceedings that the only persons who had any interest in the proceeds of the sale were two secured creditors, *viz.*, CCFL and the Royal Bank of Canada (the Bank). Those two creditors were unanimous in their position that they desired the court to approve the sale to 922. We were not referred to nor am I aware of any case where a court has refused to abide by the unanimous wishes of the only interested creditors for the approval of a specific offer made in receivership proceedings.

In *British Columbia Development Corp. v. Spun Cast Industries Inc.* (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.), Berger J. said at p. 95 B.C.L.R., p. 30 C.B.R.:

> Here all of those with a financial stake in the plant have joined in seeking the court's approval of the sale to Fincas. This court does not having a roving commission to decide what is best for investors and businessmen when they have agreed among themselves what course of action they should follow. It is their money.

I agree with that statement. It is particularly apt to this case. The two secured creditors will suffer a shortfall of approximately $50,000,000. They have a tremendous interest in the sale of assets which form part of their security. I agree with the finding of Rosenberg J., Gen. Div., May 1, 1991, that the offer of 922 is superior to that of OEL. He concluded that the 922 offer is marginally superior. If by that he meant that mathematically it was likely to provide slightly more in the way of proceeds it is difficult to take issue with that finding. If on the other hand he meant that having regard to all considerations it was only marginally superior, I cannot agree. He said in his reasons [pp. 17-18]:

> I have come to the conclusion that knowledgeable creditors such as the Royal Bank would prefer the 922 offer even if the other factors influencing their decision were not present. No matter what adjustments had to be made, the 922 offer results in more cash immediately. Creditors facing the type of loss the Royal Bank is taking in this case would not be anxious to rely on contingencies especially in the present circumstances surrounding the airline industry.

I agree with that statement completely. It is apparent that the difference between the two offers insofar as cash on closing is concerned amounts to approximately $3,000,000 to $4,000,000. The Bank submitted that it did not wish to gamble any further with respect to its investment and that the acceptance and court approval of the OEL offer, in effect, supplanted its position as a secured creditor with respect to the amount owing over and above the down payment and placed it in the position of a joint entrepreneur but one with no control. This results from the fact that the OEL offer did not provide for any security for any funds which might be forthcoming over and above the initial downpayment on closing.

In *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), Hart J.A., speaking for the majority of the court, said at p. 10 C.B.R., p. 312 N.S.R.:

> Here we are dealing with a receiver appointed at the instance of one major creditor, who chose to insert in the contract of sale a provision making it subject to the approval of the court. This, in my opinion, shows an intention on behalf of the parties to invoke the normal equitable doctrines which place

> the court in the position of looking to the interests of all persons concerned before giving its blessing to a particular transaction submitted for approval. In these circumstances the court would not consider itself bound by the contract entered into in good faith by the receiver but would have to look to the broader picture to see that the contract was for the benefit of the creditors as a whole. When there was evidence that a higher price was readily available for the property the chambers judge was, in my opinion, justified in exercising his discretion as he did. Otherwise he could have deprived the creditors of a substantial sum of money.

This statement is apposite to the circumstances of the case at bar. I hasten to add that in my opinion it is not only price which is to be considered in the exercise of the judge's discretion. It may very well be, as I believe to be so in this case, that the amount of cash is the most important element in determining which of the two offers is for the benefit and in the best interest of the creditors.

It is my view, and the statement of Hart J.A. is consistent therewith, that the fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. I agree completely with the views expressed by McKinlay J.A. in that regard in her reasons.

It is my further view that any negotiations which took place between the only two interested creditors in deciding to support the approval of the 922 offer were not relevant to the determination by the presiding judge of the issues involved in the motion for approval of either one of the two offers nor are they relevant in determining the outcome of this appeal. It is sufficient that the two creditors have decided unanimously what is in their best interest and the appeal must be considered in the light of that decision. It so happens, however, that there is ample evidence to support their conclusion that the approval of the 922 offer is in their best interests.

I am satisfied that the interests of the creditors are the prime consideration for both the receiver and the court. In *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.) Saunders J. said at p. 243:

> This does not mean that a court should ignore a new and higher bid made after acceptance where there has been no unfairness in the process. The interests of the creditors, while not the only consideration, are the prime consideration.

I agree with that statement of the law. In *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.) Saunders J. heard an application

for court approval for the sale by the sheriff of real property in bankruptcy proceedings. The sheriff had been previously ordered to list the property for sale subject to approval of the court. Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interests of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with the commercial efficacy and integrity.

I am in agreement with that statement as a matter of general principle. Saunders J. further stated that he adopted the principles stated by Macdonald J.A. in *Cameron*, *supra*, at pp. 92-94 O.R., pp. 531-33 D.L.R., quoted by Galligan J.A. in his reasons. In *Cameron*, the remarks of Macdonald J.A. related to situations involving the calling of bids and fixing a time limit for the making of such bids. In those circumstances the process is so clear as a matter of commercial practice that an interference by the court in such process might have a deleterious effect on the efficacy of receivership proceedings in other cases. But Macdonald J.A. recognized that even in bid or tender cases where the offeror for whose bid approval is sought has complied with all requirements a court might not approve the agreement of purchase and sale entered into by the receiver. He said at pp. 11-12 C.B.R., p. 314 N.S.R.:

> There are, of course, many reasons why a court might not approve an agreement of purchase and sale, viz., where the offer accepted is so low in relation to the appraised value as to be unrealistic; or, where the circumstances indicate that insufficient time was allowed for the making of bids or that inadequate notice of sale by bid was given (where the receiver sells property by the bid method); or, where it can be said that the proposed sale is not in the best interest of either the creditors or the owner. Court approval must involve the delicate balancing of competing interests and not simply a consideration of the interests of the creditors.

The deficiency in the present case is so large that there has been no suggestion of a competing interest between the owner and the creditors.

I agree that the same reasoning may apply to a negotiation process leading to a private sale but the procedure and process applicable to private sales of a wide variety of businesses and undertakings with the multiplicity of individual considerations applicable and perhaps peculiar to the particular business is not so clearly established that a departure by the court from the process adopted by the receiver in a particular case will result in commercial chaos to the detriment of future receivership

proceedings. Each case must be decided on its own merits and it is necessary to consider the process used by the receiver in the present proceedings and to determine whether it was unfair, improvident or inadequate.

It is important to note at the outset that Rosenberg J. made the following statement in his reasons [p. 15]:

> On March 8, 1991 the trustee accepted the OEL offer subject to court approval. The receiver at that time had no other offer before it that was in final form or could possibly be accepted. The receiver had at the time the knowledge that Air Canada with CCFL had not bargained in good faith and had not fulfilled the promise of its letter of March 1. The receiver was justified in assuming that Air Canada and CCFL's offer was a long way from being in an acceptable form and that Air Canada and CCFL's objective was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada.

In my opinion there was no evidence before him or before this court to indicate that Air Canada with CCFL had not bargained in good faith and that the receiver had knowledge of such lack of good faith. Indeed, on this appeal, counsel for the receiver stated that he was not alleging Air Canada and CCFL had not bargained in good faith. Air Canada had frankly stated at the time that it had made its offer to purchase which was eventually refused by the receiver that it would not become involved in an "auction" to purchase the undertaking of Air Canada and that, although it would fulfil its contractual obligations to provide connecting services to Air Toronto, it would do no more than it was legally required to do insofar as facilitating the purchase of Air Toronto by any other person. In so doing Air Canada may have been playing "hard ball" as its behaviour was characterized by some of the counsel for opposing parties. It was nevertheless merely openly asserting its legal position as it was entitled to do.

Furthermore there was no evidence before Rosenberg J. or this court that the receiver had assumed that Air Canada and CCFL's objective in making an offer was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada. Indeed, there was no evidence to support such an assumption in any event although it is clear that 922 and through it CCFL and Air Canada were endeavouring to present an offer to purchase which would be accepted and/or approved by the court in preference to the offer made by OEL.

To the extent that approval of the OEL agreement by Rosenberg J. was based on the alleged lack of good faith in

bargaining and improper motivation with respect to connector traffic on the part of Air Canada and CCFL, it cannot be supported.

I would also point out that, rather than saying there was no other offer before it that was final in form, it would have been more accurate to have said that there was *no unconditional* offer before it.

In considering the material and evidence placed before the court I am satisfied that the receiver was at all times acting in good faith. I have reached the conclusion, however, that the process which he used was unfair insofar as 922 is concerned and improvident insofar as the two secured creditors are concerned.

Air Canada had been negotiating with Soundair Corporation for the purchase from it of Air Toronto for a considerable period of time prior to the appointment of a receiver by the court. It had given a letter of intent indicating a prospective sale price of $18,000,000. After the appointment of the receiver, by agreement dated April 30, 1990, Air Canada continued its negotiations for the purchase of Air Toronto with the receiver. Although this agreement contained a clause which provided that the receiver "shall not negotiate for the sale . . . of Air Toronto with any person except Air Canada", it further provided that the receiver would not be in breach of that provision merely by receiving unsolicited offers for all or any of the assets of Air Toronto. In addition, the agreement, which had a term commencing on April 30, 1990, could be terminated on the fifth business day following the delivery of a written notice of termination by one party to the other. I point out this provision merely to indicate that the exclusivity privilege extended by the Receiver to Air Canada was of short duration at the receiver's option.

As a result of due diligence investigations carried out by Air Canada during the month of April, May and June of 1990, Air Canada reduced its offer to 8.1 million dollars conditional upon there being $4,000,000 in tangible assets. The offer was made on June 14, 1990 and was open for acceptance until June 29, 1990.

By amending agreement dated June 19, 1990 the receiver was released from its covenant to refrain from negotiating for the sale of the Air Toronto business and assets to any person other than Air Canada. By virtue of this amending agreement the receiver had put itself in the position of having a firm offer in hand with the right to negotiate and accept offers from other persons. Air Canada in these circumstances was in the subservient position. The receiver, in the exercise of its judgment and discretion,

allowed the Air Canada offer to lapse. On July 20, 1990 Air Canada served a notice of termination of the April 30, 1990 agreement. a

Apparently as a result of advice received from the receiver to the effect that the receiver intended to conduct an auction for the sale of the assets and business of the Air Toronto Division of Soundair Corporation, the solicitors for Air Canada advised the receiver by letter dated July 20, 1990 in part as follows: b

> Air Canada has instructed us to advise you that it does not intend to submit a further offer in the auction process.

This statement together with other statements set forth in the letter was sufficient to indicate that Air Canada was not interested in purchasing Air Toronto in the process apparently c contemplated by the receiver at that time. It did not form a proper foundation for the receiver to conclude that there was no realistic possibility of selling Air Toronto to Air Canada, either alone or in conjunction with some other person, in different circumstances. In June 1990 the receiver was of the opinion that d the fair value of Air Toronto was between $10,000,000 and $12,000,000.

In August 1990 the receiver contacted a number of interested parties. A number of offers were received which were not deemed to be satisfactory. One such offer, received on August 20, 1990, e came as a joint offer from OEL and Air Ontario (an Air Canada connector). It was for the sum of $3,000,000 for the good will relating to certain Air Toronto routes but did not include the purchase of any tangible assets or leasehold interests.

In December 1990 the receiver was approached by the management of Canadian Partner (operated by OEL) for the f purpose of evaluating the benefits of an amalgamated Air Toronto/Air Partner operation. The negotiations continued from December of 1990 to February of 1991 culminating in the OEL agreement dated March 8, 1991.

On or before December, 1990, CCFL advised the receiver that g it intended to make a bid for the Air Toronto assets. The receiver, in August of 1990, for the purpose of facilitating the sale of Air Toronto assets, commenced the preparation of an operating memorandum. He prepared no less than six draft operating memoranda with dates from October 1990 through March 1, 1991. h None of these were distributed to any prospective bidder despite requests having been received therefor, with the exception of an early draft provided to CCFL without the receiver's knowledge.

During the period December 1990 to the end of January 1991,

the receiver advised CCFL that the offering memorandum was in the process of being prepared and would be ready soon for distribution. He further advised CCFL that it should await the receipt of the memorandum before submitting a formal offer to purchase the Air Toronto assets.

By late January CCFL had become aware that the receiver was negotiating with OEL for the sale of Air Toronto. In fact, on February 11, 1991, the receiver signed a letter of intent with OEL wherein it had specifically agreed not to negotiate with any other potential bidders or solicit any offers from others.

By letter dated February 25, 1991, the solicitors for CCFL made a written request to the Receiver for the offering memorandum. The receiver did not reply to the letter because he felt he was precluded from so doing by the provisions of the letter of intent dated February 11, 1991. Other prospective purchasers were also unsuccessful in obtaining the promised memorandum to assist them in preparing their bids. It should be noted that exclusivity provision of the letter of intent expired on February 20, 1991. This provision was extended on three occasions, *viz.*, February 19, 22 and March 5, 1991. It is clear that from a legal standpoint the receiver, by refusing to extend the time, could have dealt with other prospective purchasers and specifically with 922.

It was not until March 1, 1991 that CCFL had obtained sufficient information to enable it to make a bid through 922. It succeeded in so doing through its own efforts through sources other than the receiver. By that time the receiver had already entered into the letter of intent with OEL. Notwithstanding the fact that the receiver knew since December of 1990 that CCFL wished to make a bid for the assets of Air Toronto (and there is no evidence to suggest that at any time such a bid would be in conjunction with Air Canada or that Air Canada was in any way connected with CCFL) it took no steps to provide CCFL with information necessary to enable it to make an intelligent bid and, indeed, suggested delaying the making of the bid until an offering memorandum had been prepared and provided. In the meantime by entering into the letter of intent with OEL it put itself in a position where it could not negotiate with CCFL or provide the information requested.

On February 28, 1991, the solicitors for CCFL telephoned the receiver and were advised for the first time that the receiver had made a business decision to negotiate solely with OEL and would not negotiate with anyone else in the interim.

By letter dated March 1, 1991 CCFL advised the receiver that it intended to submit a bid. It set forth the essential terms of the bid and stated that it would be subject to customary commercial provisions. On March 7, 1991 CCFL and Air Canada, jointly through 922, submitted an offer to purchase Air Toronto upon the terms set forth in the letter dated March 1, 1991. It included a provision that the offer was conditional upon the interpretation of an interlender agreement which set out the relative distribution of proceeds as between CCFL and the Royal Bank. It is common ground that it was a condition over which the receiver had no control and accordingly would not have been acceptable on that ground alone. The receiver did not, however, contact CCFL in order to negotiate or request the removal of the condition although it appears that its agreement with OEL not to negotiate with any person other than OEL expired on March 6, 1991.

The fact of the matter is that by March 7, 1991, the receiver had received the offer from OEL which was subsequently approved by Rosenberg J. That offer was accepted by the receiver on March 8, 1991. Notwithstanding the fact that OEL had been negotiating the purchase for a period of approximately three months the offer contained a provision for the sole benefit of the purchaser that it was subject to the purchaser obtaining:

> . . . a financing commitment within 45 days of the date hereof in an amount not less than the Purchase Price from the Royal Bank of Canada or other financial institution upon terms and conditions acceptable to them. In the event that such a financing commitment is not obtained within such 45 day period, the purchaser or OEL shall have the right to terminate this agreement upon giving written notice of termination to the vendor on the first Business Day following the expiry of the said period.

The purchaser was also given the right to waive the condition.

In effect the agreement was tantamount to a 45-day option to purchase excluding the right of any other person to purchase Air Toronto during that period of time and thereafter if the condition was fulfilled or waived. The agreement was, of course, stated to be subject to court approval.

In my opinion the process and procedure adopted by the receiver was unfair to CCFL. Although it was aware from December 1990 that CCFL was interested in making an offer, it effectively delayed the making of such offer by continually referring to the preparation of the offering memorandum. It did not endeavour during the period December 1990 to March 7, 1991 to negotiate with CCFL in any way the possible terms of purchase and sale agreement. In the result no offer was sought from CCFL by the receiver prior to February 11, 1991 and thereafter it put

itself in the position of being unable to negotiate with anyone other than OEL. The receiver, then, on March 8, 1991 chose to accept an offer which was conditional in nature without prior consultation with CCFL (922) to see whether it was prepared to remove the condition in its offer.

I do not doubt that the receiver felt that it was more likely that the condition in the OEL offer would be fulfilled than the condition in the 922 offer. It may be that the receiver, having negotiated for a period of three months with OEL, was fearful that it might lose the offer if OEL discovered that it was negotiating with another person. Nevertheless it seems to me that it was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to it. The potential loss was that of an agreement which amounted to little more than an option in favour of the offeror.

In my opinion the procedure adopted by the receiver was unfair to CCFL in that, in effect, it gave OEL the opportunity of engaging in exclusive negotiations for a period of three months notwithstanding the fact that it knew CCFL was interested in making an offer. The receiver did not indicate a deadline by which offers were to be submitted and it did not at any time indicate the structure or nature of an offer which might be acceptable to it.

In his reasons Rosenberg J. stated that as of March 1, CCFL and Air Canada had all the information that they needed and any allegations of unfairness in the negotiating process by the receiver had disappeared. He said [p. 31]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

If he meant by "acceptable in form" that it was acceptable to the receiver, then obviously OEL had the unfair advantage of its lengthy negotiations with the receiver to ascertain what kind of an offer would be acceptable to the receiver. If, on the other hand, he meant that the 922 offer was unacceptable in its form because it was conditional, it can hardly be said that the OEL offer was more acceptable in this regard as it contained a condition with respect to financing terms and conditions "*acceptable to them*".

It should be noted that on March 13, 1991 the representatives of 922 first met with the receiver to review its offer of March 7, 1991 and at the request of the receiver withdrew the inter-lender

condition from its offer. On March 14, 1991 OEL removed the financing condition from its offer. By order of Rosenberg J. dated March 26, 1991, CCFL was given until April 5, 1991 to submit a bid and on April 5, 1991, 922 submitted its offer with the inter-lender condition removed.

In my opinion the offer accepted by the receiver is improvident and unfair insofar as the two creditors are concerned. It is not improvident in the sense that the price offered by 922 greatly exceeded that offered by OEL. In the final analysis it may not be greater at all. The salient fact is that the cash down payment in the 922 offer constitutes approximately two-thirds of the contemplated sale price whereas the cash down payment in the OEL transaction constitutes approximately 20 to 25 per cent of the contemplated sale price. In terms of absolute dollars, the down payment in the 922 offer would likely exceed that provided for in the OEL agreement by approximately $3,000,000 to $4,000,000.

In *Re Beauty Counsellors of Canada Ltd.*, *supra*, Saunders J. said at p. 243 C.B.R.:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate. In such a case the proper course might be to refuse approval and to ask the trustee to recommence the process.

I accept that statement as being an accurate statement of the law. I would add, however, as previously indicated, that in determining what is the best price for the estate the receiver or court should not limit its consideration to which offer provides for the greater sale price. The amount of down payment and the provision or lack thereof to secure payment of the balance of the purchase price over and above the down payment may be the most important factor to be considered and I am of the view that is so in the present case. It is clear that that was the view of the only creditors who can benefit from the sale of Air Toronto.

I note that in the case at bar the 922 offer in conditional form was presented to the receiver before it accepted the OEL offer. The receiver in good faith, although I believe mistakenly, decided that the OEL offer was the better offer. At that time the receiver did not have the benefit of the views of the two secured creditors in that regard. At the time of the application for approval before Rosenberg J. the stated preference of the two interested creditors was made quite clear. He found as a fact that knowledgeable creditors would not be anxious to rely on contingencies in the present circumstances surrounding the airline industry. It is

reasonable to expect that a receiver would be no less knowledgeable in that regard and it is his primary duty to protect the interests of the creditors. In my view it was an improvident act on the part of the receiver to have accepted the conditional offer made by OEL and Rosenberg J. erred in failing to dismiss the application of the receiver for approval of the OEL offer. It would be most inequitable to foist upon the two creditors who have already been seriously hurt more unnecessary contingencies.

Although in other circumstances it might be appropriate to ask the receiver to recommence the process, in my opinion, it would not be appropriate to do so in this case. The only two interested creditors support the acceptance of the 922 offer and the court should so order.

Although I would be prepared to dispose of the case on the grounds stated above, some comment should be addressed to the question of interference by the court with the process and procedure adopted by the receiver.

I am in agreement with the view expressed by McKinlay J.A. in her reasons that the undertaking being sold in this case was of a very special and unusual nature. As a result the procedure adopted by the receiver was somewhat unusual. At the outset, in accordance with the terms of the receiving order, it dealt solely with Air Canada. It then appears that the receiver contemplated a sale of the assets by way of auction and still later contemplated the preparation and distribution of an offering memorandum inviting bids. At some point, without advice to CCFL, it abandoned that idea and reverted to exclusive negotiations with one interested party. This entire process is not one which is customary or widely accepted as a general practice in the commercial world. It was somewhat unique having regard to the circumstances of this case. In my opinion the refusal of the court to approve the offer accepted by the receiver would not reflect on the integrity of procedures followed by court-appointed receivers and is not the type of refusal which will have a tendency to undermine the future confidence of business persons in dealing with receivers.

Rosenberg J. stated that the Royal Bank was aware of the process used and tacitly approved it. He said it knew the terms of the letter of intent in February 1991 and made no comment. The Royal Bank did, however, indicate to the receiver that it was not satisfied with the contemplated price nor the amount of the down payment. It did not, however, tell the receiver to adopt a different process in endeavouring to sell the Air Toronto assets. It is not

clear from the material filed that at the time it became aware of the letter of intent, it knew that CCFL was interested in purchasing Air Toronto.

I am further of the opinion that a prospective purchaser who has been given an opportunity to engage in exclusive negotiations with a receiver for relatively short periods of time which are extended from time to time by the receiver and who then makes a conditional offer, the condition of which is for his sole benefit and must be fulfilled to his satisfaction unless waived by him, and which he knows is to be subject to court approval, cannot legitimately claim to have been unfairly dealt with if the court refuses to approve the offer and approves a substantially better one.

In conclusion I feel that I must comment on the statement made by Galligan J.A. in his reasons to the effect that the suggestion made by counsel for 922 constitutes evidence of lack of prejudice resulting from the absence of an offering memorandum. It should be pointed out that the court invited counsel to indicate the manner in which the problem should be resolved in the event that the court concluded that the order approving the OEL offer should be set aside. There was no evidence before the court with respect to what additional information may have been acquired by CCFL since March 8, 1991 and no inquiry was made in that regard. Accordingly, I am of the view that no adverse inference should be drawn from the proposal made as a result of the court's invitation.

For the above reasons I would allow the appeal with one set of costs to CCFL-922, set aside the order of Rosenberg J., dismiss the receiver's motion with one set of costs to CCFL-922 and order that the assets of Air Toronto be sold to numbered corporation 922246 on the terms set forth in its offer with appropriate adjustments to provide for the delay in its execution. Costs awarded shall be payable out of the estate of Soundair Corporation. The costs incurred by the receiver in making the application and responding to the appeal shall be paid to him out of the assets of the estate of Soundair Corporation on a solicitor-and-client basis. I would make no order as to costs of any of the other parties or interveners.

Appeal dismissed.

TAB "5"

Case Name:

Boutique Euphoria inc. (Re)

IN THE MATTER OF THE COMPROMISE OR ARRANGEMENT OF : BOUTIQUE EUPHORIA INC. and LINGERIE STUDIO INC., Petitioners
and
RAYMON CHABOT INC., Monitor

[2007] Q.J. No. 20435

2007 QCCS 7129

No.: 500-11-030746-073

Quebec Superior Court
District of Montreal

The Honourable Clément Gascon, J.S.C.

Heard: July 18 and 19, 2007.
Oral Judgment: July 19, 2007.
Reasons transcribed and revised: July 26, 2007.

(82 paras.)

Counsel:

Me Bertrand Giroux, BCF, Attorneys for the Debtors.

Me Alain Tardif, McCarthy, Tétrault, Attorneys for the Monitor.

Me Alain Gaul, Davies, Ward, Philipps & Vineberg, Attorneys for Lilianne Lingerie.

Me Gordon Levine, Kugler, Kandestin, Attorneys for Cirex Group Inc.

Me Robert Pancer, Phillips Friedman Kotler, Attorneys for Collection Arial Inc.

REASONS FOR JUDGMENT RENDERED ORALLY ON A "REQUÊTE AFIN D'OBTENIR L'APPROBATION DE LA COUR POUR LA MISE EN PLACE D'UN PROCESSUS DE SOLLICITATION D'OFFRES" (# 26)

1 Under that conditions, if any, should a Court approve a stalking horse bid process in the context of a CCAA restructuring? Should a priority charge be created to protect the payment of the termination fee attached to such bid process?

2 These are, in short, the two questions that this judgment addresses.

3 The factual context is the following.

THE FACTS

4 On June 18 2007 this Court issued an Initial Order pursuant to Sections 4, 5 and 11 of the CCAA with respect to two companies Euphoria Boutique Inc. (EBI) and Lingerie Studio Inc. (LSI).

5 As it was indicated in this Initial Order, EBI and LSI are two entities involved in the lingerie field. EBI is a retailer of lingerie, it operates fifteen (15) stores under the trade name Moments Intimes and two (2) stores under the trade name Victoire Delage. LSI is a wholesaler of lingerie. The sole shareholder of both is Ace Style International Ltd (ACE).

6 EBI acquired these seventeen (17) stores on March 4, 2004 from Boutiques San Francisco Incorporées, together with the equipment, inventory, trademarks and assets necessary to operate the retail lingerie business previously owned by the latter.

7 EBI employs one hundred twenty-eight (128) people, one hundred eight (108) in its retail stores and twenty (20) at its head office, while LSI employs nine (9) persons.

8 The Initial Order was issued for a period of thirty (30) days. It expired on July 18 2007. It has been renewed until today, pending the issuance of this judgment.

9 It is noteworthy to remind the parties of three paragraphs of the reasons given for the issuance of this initial Order.

> [15] Cirex main concern is the following. Failing the appointment of an interim receiver, it considers that the process under the CCAA will lack either transparency or proper surveillance by an independent person. Its concern is expressed as follows.
>
> [16] In a nutshell, Cirex believes that without an interim receiver, there is a risk that EBI or LSI will proceed with a rapid sale or disposition of their assets, without any opportunity for their creditors, including Cirex, to either participate

> in the process or insure that it is made at the best available conditions.
>
> [...]
>
> [26] That said, it is too early at this stage to conclude that the CCAA is merely used here for a pure liquidation process or that is the only potential outcome of the process contemplated. This issue, if need be, will be addressed at a later point.

10 At the present time some thirty days after this Initial Order, the likely outcome of the CCAA process is not very positive.

11 According to the Monitors first report of July 16 2007[1], the actual situation of EBI and LSI is as follows.

12 EBI has suffered important losses over the last financial exercise. Its operations may be viable if they are integrated within a more important group in order to reduce its fixed costs. LSI has no viability.

13 Simply put, LSI must be liquidated and the assets of EBI must all be sold so that they be potentially integrated within another organization.

14 The description of the liabilities of both entities indicates that there are in total Secured Creditors for over 23 millions dollars and Unsecured Creditors for in excess of 11,2 millions dollars,

15 At the moment, it is fair to say that this liquidate and sale process will likely trigger no more than 1.2 to 1.6 million dollars in recovery, in the best-case scenario.

16 Thus the Unsecured Creditors will not receive a penny and the secured claims, as they stand now, will not be covered in totality.

17 It is faced with this background that the Monitor presents its Motion to the Court.

THE MOTION

18 The Motion is entitled "Requête du contrôleur afin d'obtenir l'approbation de la Cour pour la mise en place d'un processus de solicitation d'offres".

19 In a nutshell, the Monitor is asking the Court to approve what is otherwise known as a "stalking horse" bid process.

20 Such a process is described as follows by Professor Janis Sarra[2], perhaps the most trusted writer on CCAA issues in Canada at the moment:

> Stalking horse processes under the CCAA are a relatively new phenomenon. The term "stalking horse" comes originally from using a horse of a painted screen of a horse to serve as a screen to camouflage hunters as the stalked their prey. In the insolvency context, it is used to signify a situation where the debtor makes an agreement with a potential bidder for a sale of the debtor's assets or business, and that agreement forms part of a process whereby an auction or tendering process is conducted to see if there is a better and higher bidder that will result in greater returns to creditors. The premise is that the stalking horse has undertaken considerable due diligence in determining the value of the debtor corporation, and other potential bidders can rely, to an extent, on the value attached by that bidder based on that due diligence.

21 Here, the stalking horse bidder is Lilianne Lingerie and its offer (or stalking horse bid) is filed under seal as Exhibit R-3 for confidentiality reasons. Because of that, the Court will refrain from stating openly in this judgment the figures contained in this offer. Those who needed to know the figures are already aware of them.

22 The main features of the Lilianne offer are the following:

1. It covers twelve 912) out of seventeen (17) stores of EBI and all inventory of both entities. Five (5) location are thus excluded;
2. The offer is for a total amount of X $, namely X $ for the twelve (12) stores or X $ for each, and X $ for the inventory, namely X $ for LSI and X $ for EBI;
3. It includes offers of employment to employees of the retail locations not excluded, but it entails the termination of all employees of LSI and those of the head office of EBI, as well as its districts and areas managers;
4. It provides that there will be a termination fee of X $ (partly reduced at the hearing) payable to Lilianne if a "Superior Offer" is received by the Monitor pursuant to the bid process. A Superior Offer is defined as one that provides for a minimal cash consideration of X $ for the assets already described. This amount was also slightly reduced at the hearing.

23 The bidding process that the Monitor wants to put in place on the basis of this stalking horse bid is to begin as soon as judgment is rendered, for a completion date of August 7.

24 The Monitor identifies a list of potential interested parties[3] who will be asked for their interest in bidding through a document entitled "Call for Overbids-Stalking Horse Notice."

25 The Call for Overbids documentation states that the overbid must be received by August 7,

2007, that it must be made for an amount of cash consideration only, and that it should exceed the amount of the Superior Offer.

26 It finally makes reference to the contemplated Assets Purchase Agreement whose terms are already agreed to by the stalking horse bidder. These terms include a mention that the purchased assets are transferred free and clear of any charges. In other words, it takes as an assumption that this Court will issue a vesting order with respect to the purchased assets.

27 The Motion is contested by one Secured Creditor, Cirex, and an Unsecured one, Arianne Lingerie.

28 Suffice to say here that they are of the view that the stalking horse bid process proposed by the Monitor should not be sanctioned by the Court for two main reasons:

a) The process followed by the Monitor was not in line with the prerequisites for a proper stalking horse bid process;
b) The termination fee claimed by the stalking horse bidder is excessive.

ANALYSIS AND DISCUSSION

29 As Professor Sarra says in her book published in the spring of 2007[4], "Stalking horse processes under the CCAA are a relatively new phenomenon. (...)".

30 Besides the comments found in Professor Sarras book at pages 18 to 123, Counsels and the Court have indeed identified merely two articles in terms of writing on the subject in Canada[5].

31 The first one is the article by Dowdall and Dietrich entitled "Do Staking Horses Have a Place in Intra-Canadian Insolvencies?"[6]. The second one is the article of Fitch and Jackson entitled "Face the Music: The A & B. Sound CCAA Proceeding - A Stalking Horse of a Different Colour"[7].

32 Both are published in the Annual Review of Insolvency Law (2005), a publication regrouping the articles discussed at the annual conference on insolvency organized by Professor Sarra.

33 In terms of case law, there is not much more. Barely three reported Canadian decisions have explored and discussed the stalking horse bid process.

34 One is that of Stelco[8] of Farley J., of the Ontario Superior Court of Justice rendered in 2004. Another one is that of Tiger Brand Knitting Co.[9] Campbell J., also of the Ontario Superior Court of Justice, issued in 2005. The last one is the decision rendered in 2005 by the British Columbia Supreme Court (Madam Justice Brown) in the A & B Sound restructuring. The main features of that decision are summarized in the second article referred to before.

35 There are no decisions rendered in Quebec on this issue.

36 Even though the process is a new phenomenon, unknown of in CCAA proceedings in Quebec, it does not mean that it should not be considered. In theory, nothing prevents a Court in this province from assessing whether or not such a sale process should be implemented in a given situation. It all depends upon the applicable circumstances.

37 Bearing that in mind, and based on this Court's review of the above-mentioned doctrine, articles and case law, it is fair to say that the following four factors, while not necessarily exhaustive, are important considerations in assessing whether or not a stalking horse bid process should be approved and authorized:

1. Has there been some control exercised at the first stage of the competition (namely that to become the stalking horse bidder) and to what extent?

   Two main reasons explain that first consideration.

   On the one hand, the stalking horse bid establishes the benchmark to attract other bids and its accuracy is therefore key to the integrity of the whole process.

   On the other hand, as the stalking horse bid is normally subject to a break up fee, it is even more important that it be accurate, as the call for overbids will have to exceed a certain margin over and above the stalking horse bid.

   In other words, some assurances should exist that the horse chosen is indeed the right one.

2. Is there a need for stability within a very short time frame for the debtor to continue operations and the restructuring contemplated to be successful?

   This second consideration is explained by the fact that the stalking horse bid process is generally more stringent and less flexible than a traditional call for tenders process. As a result, to resort to such a process, time should normally be of the essence.

3. Are the economic incentives for the stalking horse bidder, in terms of break up fee, topping fee and overbid increments protection, fair and

reasonable.

This third consideration is justified by the fact that excessive economic incentives in terms of a break up fee or other fee may chill the market and deter other potential bidders. Thus rendering the process inefficient ant and, in fact inadequate in terms of meeting its goal. The concept of fairness to a bidders here comes to mind.

4. Are the time lines contemplated reasonable to insure a fair process at the second stage of the competition, namely that to become the successful over bidder?

This fourth consideration is obviously also linked the fairness of the bid process to ensure inasmuch as possible, an equal opportunity to all interested bidders.

38 In this case the Court is of the view that the stalking to horse bid process followed by the Monitor does not satisfy the first and third considerations expressed before. Hence, it should not be authorized as sought.

39 Her is why.

40 First, the Court is not satisfied that there has been proper control exercised over the choice of the stalking horse bidder.

41 According to the evidence heard, and mostly that of the Monitor himself, there has been no attempt made to canvass the market in order to see if any other party would be interested in becoming a stalking horse bidder.

42 The Monitor has elected to merely negotiate the conditions of the stalking horse bid with one entity, namely Lilianne.

43 The main reasons given were that prior to the CCAA Initial Order, Lilianne had an accepted offer to buy most of the contemplated assets and that the order offer received at that time by the Debtors was not anywhere close to what Lilianne was then willing to pay.

44 The Court finds theses explanations not convincing.

45 A stalking horse bid a very different than any normal bid, and the Monitor had simply nothing to compare the Lilianne's stalking horse bid to.

46 Not only was this the situation but the Monitor had not even completed his own evaluation of the leases that according to Lilianne's witness, represent the only real value of the purchased assets.

47 Yet, if the Monitor said in his testimony before the Court that this evaluation was requested by him in order to "...bench-marqué les offres...". It has still to be received.

48 As result, the Monitor had simply no benchmark whatsoever against which to assess the Lilianne's stalking horse bid.

49 Thus is surprising and indeed difficult to accept in this case, mostly when one remembers the prior concerns expressed by Cirex at the initial Order Stage, as stated in paragraphs 15 and 16 of the Judgment rendered by this Court.

50 This is even more so when one considers that the same locations, no less than three year ago, were the subject of a call for tenders in a sale of assets process conducted under the CCAA in the Boutiques San Francisco restructuring.

51 In that process, ultimately won by Ace the current shareholder of EBI and LSI, there were five (5) bids received and two identified as the best ones: that of Ace and that of another entity.

52 Nonetheless that entity, while identified in Exhibit R-4 as one to whom the call for overbids should be sent, was not even contacted, if not simply to enquire for its interest in becoming a stalking horse bidder.

53 Furthermore, not trying to canvass any other entity is difficult to understand when the Monitor tells the Court that he apparently received many calls of organizations showing interest in the Debtor's assets.

54 In short, based on the evidence presented in front of the Court, it appears that any competitive element has been ignored at the first stage of this stalking horse bid process.

55 In the article of Dowdall and Dietrich referred to before[10], they mention the following:

> Courts have given non reason to why away from the auction process solely on the basis that tender is better. Courts have, in fact, given the signal that, as long as the process meets the principles as laid out in Soundair, the process will be considered acceptable. (...)

56 In this Soundair[11] case, the Ontario Court of Appeal summarized as follows the duties a court must perform when deciding whether a receiver who has sold property acted appropriately:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. It should consider the interest of all parties.

3. It should consider the efficacy and integrity of the process by which offers are obtained.
4. It should consider whether there has been unfairness in the working out of the process.

57 In the judgment of the Ontario Superior Court of Justice in Tiger Brand Knitting Co. Re[12], Campbell J. cites the same extract from Soundair in the context of a sale process that ended up turning to be a stalking horse bid process.

58 After the citation, he said this:

> 35. To my mind, those same duties of the Court are implicit in a marketing and sale process pursuant to Court Order under the CCAA.

59 Interestingly, in that case, there was a sale process first initiate that generated a number of offers, the best of which was then chosen to become the stalking horse bid in the amended sale process.

60 Here, the Court is not convinced that the Monitor has made sufficient efforts to get the best price at the stalking horse bid level. He merely focussed on one alternative, with no consideration for the others. Even in the context of CCAA restructuring, this is hardly acceptable.

61 In the present situation it is even more true as a fey days or a couple of weeks delay would not have made, in all likelihood much of a difference in the scenarios contemplated.

62 That is not all.

63 Second based on what the Court understands as being the applicable standards, the Court also considers that the Monitor has no established that the break up fee a overbid increments protection of the stalking horse bidder are fair and reasonable.

64 On that issue Dowdall and Dietrich[13] say the following:

> (...) The U.S. courts seem to have settled in on break fees in the range if 1-2 per cent as being reasonable.
>
> Courts in the U.S. have examined break-fee arrangements with the concern that excessive break fees would chill the market and deter other potential bidders; however, commentators also suggest that break fees are necessary to attract a first bidder and get the auction process going. Generally, three lines of analysis have been used by courts to determine the appropriateness of the break fee.

First, in some situations courts have relied on the business-judgment rule and left to the seller's discretion the appropriateness of the existence of and/or amount of a break fee.

Second, courts in some situations have taken a harder look and applied a more thorough best interest of the estate test. For example in Re Hupp Industries [140 B.R. 191 (Bank N.D. Ohio 1992)] the court stated that the business-judgment rule was not appropriate in the insolvency context with respect to break fees because of the potentially detrimental effect that the allowance of such a fee would have on the debtor's estate. The court suggested the following factors be examined before approval of a break fee:

1. whether the fee requested co-relates with a maximization of value to the debtor's estate;
2. whether the request is arm's-length;
3. whether the principal stakeholder are supportive;
4. whether the break-up fee constitutes a fair and reasonable percentage of the proposed purchase price;
5. whether the dollar amount of the break-up fee would have a "chilling effect" on the market;
6. the existence of available safeguards; and
7. whether there exists a substantial adverse impact upon unsecured creditors where such creditors are in opposition.

Thins, some U.S. case law has indicated that break fees should only be allowed to the extent that they compensate the stalking-horse bidder for the administrative expense associated with such role.

65 Looking at these three lines of analysis, the Court disregards the first one as not satisfactory. Merely relying upon the business-judgment rule and seller's discretion to assess the appropriateness of the break up fee is not for a court to properly exercise its judgment and jurisdiction.

66 As for the other two lines of analysis, both the doctrine and the case law appear to suggest that break up fees of 1 to 3 per cent are normally seen as reasonable. While this may sometimes vary depending upon the circumstances, the economic incentives of the stalking horse bidder here well exceed 10 per cent. Based on these authorities they indeed appear excessive in terms of mere percentages.

67 The Court's conclusion may have been different if in accordance with the third line of analysis suggested before, some indications of the real administrative expenses associated with this stalking horse bidder role would have been given.

68 However this evidence is absent and there is simply no manner for this Court to gauge the appropriateness of these fees under the circumstances.

69 To the contrary the testimony of Liliannes witness appears to indicate that a good part of the amount of these fees relates to a compensation for its now useless efforts to arrive at an agreement with the Debtors in May 2007.

70 Such agreement has not been implemented because of the CCAA proceedings. As this, witness said, "il se sent brimé" because of that, since Lilianne needed to reassess the whole inventory value.

71 While these complaints may well be legitimate, the Court does not consider that in the context of a stalking horse bid process the break up fee exists to cover that. These fees must rather be related to the stalking horse bid process itself and the efforts undertaken towards that end.

72 All in all, these two important issues are sufficient for this Court not to give its blessing to the suggested process. In doing so, the Court fully realize that another process, like a traditional call for tenders, may not trigger a better result. That may well be and only time will tell.

73 Notwithstanding mere uncertainty is not enough in itself for this Court to approve a process that is not satisfactory for the above reasons.

74 From that standpoint, Cirex's Counsel is right in saying that what transpires here is that the Court is asked to ratify a transaction that is presented as a "fait accompli", with no proper canvassing of the market to start with and a break up fee of a magnitude high enough to chill out the over bidders. The whole process would thus be flawed.

75 One may add that in the situation of a restructuring that is, in reality, a liquidation leading to minimal recovery if any, for the Creditors, it is even more important to ensure that the process followed is beyond reproach.

76 The Court does not have the elements to so conclude in this case.

77 That being so, it is unnecessary to comment further on the possibility of granting a priority charge for the break up fee attached to this stalking horse bid process, and also asked by the Monitor.

78 Suffice to say at this stage that none of the authorities cited on the subject seems to discuss this and that the request appears awkward at first sight.

79 The termination fee is, in essence, included in the over bids to be received. There thus appears to be many other ways to guarantee its payment. It seems doubtful that using the extraordinary measure of the creation of a priority charge would consequently be appropriate in such situations.

80 In closing, this is not a matter that warrants the granting of costs in favour of anyone.

FOR THESE REASONS GIVEN VERBALLY AND REGISTERED, THE COURT:

81 DISMISSES the Monitors Motion;

82 WITHOUT COSTS.

CLÉMENT GASCON, J.S.C.

cp/s/qlcys/qlabl

1 Exhibit R-1.

2 Janis P. SARRA, "Rescue! : The Companie's Creditors Arrangement Act" (Toronto: Carswell, 2007), at 118.

3 Exhibit R-4.

4 Supra note 2.

5 After giving these reasons orally, the Court found one article published in Quebec that discusses the stalking horse bid process. In his article entitled "Les processus de vente - Maximiser la réalisation et prévenir les litiges", published as part of the 3rd Advanced Conference on Bankruptcy and Insolvency of the Canadian Institute, Montreal, September 22, 2003, Roger SIMARD describes the process in his section dealing with the American Sale Process, at pages 53 to 58. He does not refer to any reported decision rendered by a Canadian Court on the subject.

6 Daniel R. DOWDALL and Jane O. DIETRICH, "Do Staking Horses Have a Place in Intra-Canadian Insolvencies?" in Janis Sarra, ed., Annual Review of Insolvency Law, 2005 (Toronto : Carswell, 2006), at 1-14.

7 Michael FITCH and Kibben JACKSON, "Face the Music: the A & B. Sound CCAA Proceeding - A Stalking Horse of a different Colour", in Janis Sarra, ed., Annual Review of

Insolvency Law, 2005 (Toronto: Carswell, 2006), at 15-36.

8 Stelco Inc., Re (2004), 2004 CarswellOnt 5076 (Ont. S.C.J. [Commercial List]).

9 Tiger Brand Knitting Co., Re (2005), 9 C.B.R. (5th), 315 (Ont. S.C.J. [Commercial List]), leave to appeal refused (2005), 19 C.B.R. (5th) 53 (Ont. C.A.).

10 Supra note 6, at 10.

11 Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1 (Ont. C.A.) at para. 16.

12 Supra note 9, at. para. 34.

13 Supra note 6, at 6 and 7.

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TAB "6"

[Indexed as: **Laurentian Bank of Canada v. World Vintners Corp.**]

In the Matter of the Bankruptcy and Insolvency Act, R.S.C. 1985, c.B-3, Section 47(1), as Amended

Laurentian Bank of Canada, (Applicant) v. World Vintners Corporation, Wine Art Ltd., The Ultimate Winery Systems Inc. and Wine Kitz Franchise Corp., (Respondents)

Ontario Superior Court of Justice

Cumming J.

Heard: July 19, 2002

Judgment: July 19, 2002

Docket: 02-CL-4591

A. Kauffman, *K. McEachern*, for Laurentian Bank
Mahesh Uttamchandani, for KPMG Inc.
Fraser Hughes, for Franchisees
Roger Jaipargas, for Rudolf Keller, Paklab Products Inc.
P. Shea, for First Ontario Labour Sponsored
Graham Smith, for names Respondents (World Vintners Group)
Stephen Schwartz, for Business Development Corporation ("BDC"), Bank of Montreal Credit Corporation ("BMCC")
Howard Manis, for Mosti Mondiale Inc. ("Mondiale")
John Chapman, for Wine Kitz Prairies Inc.

Receivers — Conduct and liability of receiver — General conduct of receiver — Bank was primary secured creditor of debtor group of companies under general security agreement — Debtor defaulted on loans from bank and experienced liquidity crisis — Restructuring discussions were unsuccessful — Bank took position that to preserve value of business it was necessary that assets and undertaking be sold forthwith — Bank brought application for appointment of interim receiver and for approval on two days' notice of agreement for immediate sale of assets to new company run by existing management — Application granted in part — Interim receiver appointed and application for approval of immediate sale to existing management adjourned for six days — Process of sale of assets by court-appointed receiver is within control of court — Process of sale did not appear fair and commercially reasonable — In order for there to be confidence in fairness of "going concern" sale, competitive bidding process with reasonable opportunity for informed arm's-length purchasers to bid was required — Proposed sale would extinguish approximately $6 million in claims of existing creditors — Bank and existing management had observed rapidly deteriorating financial situation over several months but waited until cash crisis before taking action.

Bankruptcy — Interim receiver — Miscellaneous issues — Bank was primary secured creditor of debtor group of companies under general security agreement — Debtor

defaulted on loans from bank and experienced liquidity crisis — Restructuring discussions were unsuccessful — Bank took position that to preserve value of business it was necessary that assets and undertaking be sold forthwith — Bank brought application for appointment of interim receiver and for approval on two days' notice of agreement for immediate sale of assets to new company run by existing management — Application granted in part — Interim receiver appointed and application for approval of immediate sale to existing management adjourned for six days — Process of sale of assets by court-appointed receiver is within control of court — Process of sale did not appear fair and commercially reasonable — In order for there to be confidence in fairness of "going concern" sale, competitive bidding process with reasonable opportunity for informed arm's-length purchasers to bid was required — Proposed sale would extinguish approximately $6 million in claims of existing creditors — Bank and existing management had observed rapidly deteriorating financial situation over several months but waited until cash crisis before taking action.

Cases considered by *Cumming J.*:

Royal Bank v. Soundair Corp., 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205 (Ont. C.A.) — considered

APPLICATION by bank for appointment of interim receiver and approval of agreement for immediate sale of assets to existing management.

***Cumming J.*:**

The Application

1 The Bank is the primary secured creditor under a GSA of the respondent group of companies ("Vintners"). Vintners' business manufactures kits for individuals to make their own wine or beer, with 87 franchise stores and 26 corporate stores owned directly. Vintners has been in default under loan facilities with the Bank since at least March 22, 2002.

2 KPMG was engaged March 6, 2002 by the Bank to review the affairs of Vintners. The Bank was advised by KPMG April 17, 2002 that Vintners was experiencing a liquidity crisis and had exhausted their operating line. The draft financial statements for the fiscal year ending January 31, 2002 indicate a net loss of about $2.8 million.

3 KPMG reported that an immediate cash injection was required. Discussions took place amongst the various stakeholders with a view to restructuring the indebtedness. These discussions were unsuccessful. Vintners has now literally run out of capital. The indebtedness to the Bank was $2,499,627.16 as of July 4, 2002. The Bank states that to preserve the value of the business it is necessary that an Interim Receiver be appointed and that the assets and undertaking be sold forthwith.

4 Hence, the Bank applies for (1) the appointment of KPMG as an Interim Receiver and (2) approval of the terms and conditions of an agreement of

purchase and sale, vesting title in the purchased assets from Newco, free and clear of all claims.

5 The application was signed July 10, 2002, returnable July 12, 2002. There was significant opposition to the proposed sale evidenced July 12. This included subordinated creditors BDC and BMCC. The subordinated creditors claims totaled about $3,784,000 as of July 4, 2002.

6 Paklab/Keller, an unsecured trade supplier, is owed some $1,691,838.93. It is apparent from the record that Paklab/Keller and other trade creditors were taken by complete surprise by the Application. Paklab/Keller learned of the Application by happenstance through corporate searches July 11, 2002.

7 The payables of Vintners total some $4.9 million as at June 30, 2002. KPMG reports that Vintners switched suppliers several times in the last year and owes about $3 million to companies Vintners no longer does business with.

8 The proposed purchase price of $3,410,000. would meet the payroll and rent obligations of $465,000. and the indebtedness to the Bank The present indebtedness to the Bank is about $2.715 million.

9 KPMG estimates the net realizable value of assets on liquidation to be only $2.1 to $2.9 million. The costs of an interim receivership, if there is an immediate sale, are estimated to be about $150,000. Understandably, Newco's offer is supported by the Bank who may otherwise incur a shortfall of up to $1million.

10 The Bank emphasizes the continuing, rapid financial deterioration of Vintners, that Vintners has now run out of sugar and wine concentrate and expresses the concern of understandably nervous employees and franchisees. The Bank states that it will oppose any third party funding of a 'going concern' Interim Receivership with the Receiver's certificate ranking in priority to the Bank's position as, in the Bank's view, there is not adequate protection with respect to the Bank's debt.

11 When the application was first returned July 12, Epstein J. adjourned it until 2: 30 p.m. today, July 19, to give interested parties further time, until 2:00 p.m. July 18, to offer to purchase the assets.

12 An affidavit sworn July 18, 2002 by a solicitor for some nine franchisees attaches a letter to KPMG of that date in which a long list of asserted grievances are asserted against Vintners' existing management and litigation by a franchisee in Alberta is referred to.

13 The second report as proposed Interim Receiver, KPMG, states that seven parties expressed potential interest in purchasing the assets. Four of these parties, including Newco, executed a confidentiality agreement, and the three outside parties inspected the premises.

14 Newco is the only party to come forward with an offer. This present, revised offer provides for a purchase price of $3,335,000, with $2,765,000 of the

purchase price being payable in cash and the balance through certain assumed liabilities. The offer is conditional upon the granting of the vesting order.

15 KPMG recommends approval of the sale.

Disposition

16 This hearing commenced at 2:30 p.m. and adjourned at 8:00 p.m. There is no question that given the record that KPMG is to be appointed as an Interim Receiver. Indeed, there is no opposition to the motion in this regard.

17 The contentious issue relates to the proposed immediate sale to Newco.

18 The creditor, Paklab/Keller has made submissions. That firm has sent a representative from Italy to conduct its due diligence before deciding as to whether to make an offer to purchase. It is clear that the firm has gone to some considerable expense and been making best efforts to determine its position as a prospective purchaser but has simply not had sufficient time to do so. Hence, it was unable to make an offer within the past six day time period.

19 The secured creditors BDC and BMCC have made submissions to extend the time further for offers. The nine franchisees and the regional franchisee present also submit that there should be an extension of time.

20 First Ontario Labour Sponsored Investment Fund Ltd., a creditor, advises that it is taking an equity position in Newco together with existing management but that Newco will not extend its present offer beyond today. That is, Newco will not hold open its offer for a further period of time.

21 The Bank and the proposed Interim Receiver state that the proposed immediate sale should be approved. Alternatively, they submit there should be an immediate liquidation. I disagree.

22 The Bank could have appointed KPMG as an Interim Receiver under its GSA in March or April. Instead, it has observed a continually, rapidly deteriorating financial situation over three or four months and only at the point in time when Vintners is completely out of money and there is a crisis asks the Court to approve a sale to existing management on two days notice.

23 Existing management has seen the continually, rapidly deteriorating financial situation over several months but, so far as the record shows, has not tried at all itself to find an arms-length purchaser for the business in the marketplace. The proposed sale would extinguish the claims of at least $5 or $ 6 million of existing creditors.

24 The process for the sale of a business by an Interim Receiver must be seen to be fair and commercially reasonable. The existing process does not meet that criterion.

25 Paragraph 29 of the requested approval order put forward by the Bank reads:

> This Court orders and declares that the purchase price set out in the Asset Purchase Agreement is fair and commercially reasonable and was arrived at in a commercially reasonable manner.

26 This Court does not agree that the process followed supports the statement that there can be any confidence that the purchase price offered by Newco is fair and was arrived at in a commercially reasonable manner. I say this because the only path to confidence in a 'going-concern' sale is through a competitive bidding process in the marketplace with a reasonable opportunity for informed arms-length purchasers to bid.

27 In *Royal Bank. v. Soundair Corp.* (1991), 4 O.R. (3d) 1 (Ont. C.A.) at 17, Galligan J.A. contrasts the situations of a creditor acting privately in appointing a receiver and thus controlling the process of a sale of assets, albeit with certain risks, and that of the appointment of a receiver by a court with a subsequent receiver's sale. The process of a sale of assets by a court-appointed receiver *is within the control of the Court.*

28 In effect, the Bank and management of Vintners ask the Court that they, not this Court, control the process of the sale and that the Court simply sanction the inadequate and unseemly process they have established. I say this because it is their own actions or inaction that have created the present dire situation. They then submit that because this situation is critical the only choice for the Court is to choose the probable least disadvantageous course of action presently available and approve the sale to Newco, the existing management. They say in effect that because it is now very improbable, given the financial condition of Vintners, that anyone other than the Bank can ever recover anything at all through a third party purchase of assets after a normative process of solicitation of offers and a sale, that the Court should simply hold its nose and approve the Newco offer. Newco compounds this difficulty by insisting that its present offer be immediately accepted or it is off the table today.

29 Considering all the circumstances, in my view it is reasonable to achieve some greater assurance that the sale process is seen to be fair by keeping the bidding process open for some further period of time. Paklab/Keller, BDC, BMO, Mondiale (a new prospective purchaser) and the franchisees present all agree that a further six days to 2:00 p.m. on July 25, 2002 is reasonable and that due diligence for the interested parties present can be completed by then. KPMG can also immediately advise all those known parties who previously indicated some interest of the extended period for offers.

30 KPMG is to be given limited terms of reference as Interim Receiver. The Bank refuses to fund the Interim Receiver for this extended period. KPMG will have to borrow monies for some matters, such as to purchase supplies for franchisees and corporate stores and to pay employees. Any such borrowing by

KPMG, together with its fees and any disbursements it makes as Interim Receiver shall constitute a first charge against the assets of Vintners. While this extension of six days is itself less than ideal, considering all the circumstances it is a fair balancing of the interests of all the stakeholders given the present difficult situation.

31 For the reasons given, the Order signed is to issue forthwith. The Application is adjourned to July 26, 2002 at 2:00 pm. While the final disposition of the Application remains, of course, within the discretion of the Court, the expectation at this time, given the above course of events, is that an offer recommended for acceptance by KPMG will be approved or, if there is no offer to be so recommended, that KPMG's terms of reference will be expanded to those seen in a normative order for an Interim Receiver and Vintners will proceed to a liquidation.

Application granted in part.

TAB "7"

applicable and collectible bodily injury liability and property damage liability insurance for its ownership, use or operation, but does not include an automobile owned by or registered in the name of the insured or his or her spouse.

O.E.F. 44 — Family Protection Endorsement

1. Subject to section 2, in this endorsement,

1.1 "automobile" means a vehicle for which motor vehicle liability insurance would be required if it were subject to the law of Ontario

. . . . .

1.5 "inadequately insured motorist" means

(a) the identified owner or identified driver of an automobile for which the total motor vehicle liability insurance or bonds, cash deposits or other financial guarantees as required by law in lieu of insurance, obtained by the owner or driver is less than the limit of family protection coverage; or

(b) the identified owner or identified driver of an uninsured automobile as defined in Part D of the Policy;

. . . . .

3. In consideration of the premium indicated for this endorsement on the Certificate of Insurance, the insurer shall indemnify an eligible claimant for the amount that he or she is legally entitled to recover from an inadequately insured motorist as compensatory damages in respect of bodily injury to or death of an insured person arising directly or indirectly from the use or operation of an automobile.

Maple Leaf Foods Inc. et al. v. Schneider Corporation et al.

Pente Investment Management Ltd. et al. v. Schneider Corporation et al.

[Indexed as: Maple Leaf Foods Inc. v. Schneider Corp.]

Court of Appeal for Ontario, Osborne, Weiler and Feldman JJ.A.
October 20, 1998

Corporations — Take-over bid — Directors not having obligation to conduct auction of company's shares where company is for sale — Public statements by members of family which controlled company not giving rise to reasonable expectations in non-family shareholders that auction would be held — Trial judge not erring in holding that offer for shares not "exclusionary" so as to trigger coattail provisions in target company's articles of incorporation.

M Inc. announced its intention to make an unsolicited take-over bid for S Co. (a competitor of M Inc. which was controlled by the S family) at $19 a share. The Board of Directors of S Co. established a special committee consisting of independent non-family directors to review the M Inc. offer and to consider other alternatives. Subsequently, M Inc. made an offer of $22 a share, but this offer was rejected by the family. Ultimately, the family told the special committee that the only offer it would accept was an offer made by SF Inc. that, at the time, was equal to $25 a share. In order for the family to accept the SF Inc. offer, which would have had the effect of enabling SF Inc. to "lock-up" control of S Co., the Board had to take certain steps which, on the advice of the special committee, it took. Despite this, M Inc. made a further offer of $29 a share to S Co.'s common and Class A shareholders. While M Inc. offered the same premium to the Class A non-voting shareholders as it did to the holders of common voting shares, it claimed that its bid triggered the coattail provisions in S Co.'s articles of incorporation because the conditions attached to its bid for the non-voting shares was not identical to the condition attached to its bid for the common shares. As a result, M Inc. claimed that the effect of its bid was to convert the non-voting Class A shares into common voting shares. Supported by two small shareholders of S Co., M Inc. attacked the actions of the special committee on the basis that it was not in fact independent and that the advice it gave to the Board was not in the best interests of S Co. and its shareholders. M Inc. took the position that public statements made by the family created an expectation that an auction for the family shares would be held and that those shares would be sold to the highest bidder.

M Inc. brought an action seeking to have the agreement between the family and SF Inc. invalidated. The action was dismissed. M Inc. appealed.

Held, the appeal should be dismissed.

The trial judge did not err in finding that the special committee and the directors exercised their powers and discharged their duties honestly and in good faith with a view to the best interests of S Co. and that they exercised the care, diligence and skill that a reasonable and prudent person would exercise in comparable circumstances in relation to dealing with the take-over bid situation. He also did not err in finding that because S Co. was known to be controlled by the family which could decide whether or not to sell its shares, the company was never truly in play and no public expectation was created that an auction would be held. In Ontario, an auction need not be held every time there is a change in control of a company. An auction is merely one way to prevent the conflicts of interest that may arise when there is a change of control by requiring that directors act in a neutral manner towards a number of bidders. The family did not seek to sell its controlling interest in S Co. The Board received an offer from M Inc. that it felt was inadequate but, in the final analysis, the best way to judge its adequacy was to determine if higher bids could be elicited through a market canvass. The fact that a market canvass was conducted did not mean that the family would agree to sell its stake. Having undertaken a market canvass, there was no obligation on the special committee to turn this canvass into an auction, particularly because to do so was to assume the risk that the competing offers that the market canvass had generated might be withdrawn.

The trial judge did not err in his interpretation of the coattail provisions. Coattail provisions are designed to ensure that if the common voting shareholders wish to accept an offer that will lead to a change in control and if the price or terms offered to the common voting shareholders are more favourable than those offered to the holders of non-voting shares, the non-voting shareholders

get an opportunity to participate in any change of control premium. If the holders of restricted shares, such as non-voting shares, are excluded from participating in the common voting share takeover bid, they will then be given a right of conversion of their restricted or non-voting shares into common voting shares. Coattail provisions are intended to encourage non-exclusionary bids. The trial judge found that to the extent that M Inc.'s bid did not exclude the Class A shareholders from the premium being offered for the family's shares, the coattail provisions were not triggered. Read literally, the coattail provision in question provided that if even a single common share was tendered to the offer for the common shares, the company making the offer would have to pay for all the Class A shares tendered whether or not any Class A shares were actually taken up and purchased or acquired. However, the wording of a coattail provision must be given an interpretation which accords with its object and the intention of the framers of the provision, and the interpretation of a coattail provision must be viewed objectively and as a reasonably prudent business person would view it. The purpose of adopting a coattail provision is to discourage exclusionary offers, whereas a literal reading of S Co.'s coattail provision gave the opposite effect. In this case, it appeared to the shareholders that the offers were the same because the amount to be paid to both classes of shareholders was the same. M Inc. understood how its offers would be perceived. If, instead, M Inc. was of the opinion that its offer was exclusionary, it could have said in its offering circular that it intended to apply to the appropriate authorities to have the issue of whether or not the offer was exclusionary determined in court. The interpretation of M Inc.'s offers adopted by the trial judge was consistent with the way a reasonably prudent business person would construe the offer. The trial judge did not err in holding that the M Inc. offer for common shares was not an exclusionary offer and that the coattail provisions in the articles of incorporation had not been triggered.

Brant Investments Ltd. v. Keep Rite Inc. (1991), 3 O.R. (3d) 289, 45 O.A.C. 320, 80 D.L.R. (4th) 161, 1 B.L.R. (2d) 225 (C.A.), affg (1987), 60 O.R. (2d) 737, 42 D.L.R. (4th) 15, 37 B.L.R. 65 (H.C.J.), supp. reasons 61 O.R. (2d) 469, 43 D.L.R. (4th) 141 (H.C.J.); *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, 160 D.L.R. (4th) 131, 38 B.L.R. (2d) 196 (Gen. Div.); *Paramount Communications v. QVC Network Inc.*, 637 A.2d 34 (Del. 1934); *Revlon v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), **consd**

Other cases referred to

347883 Alberta Ltd. v. Producers Pipelines Inc. (1991), 92 Sask. R. 81, 80 D.L.R. (4th) 359, [1991] 4 W.W.R. 577, 3 B.L.R. (2d) 237 (C.A.); *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.), affg (1991), 3 B.L.R. (2d) 123 (Ont. Gen. Div.); *Amchem Products Inc. v. British Columbia (Workers' Compensation Board)*, [1993] 1 S.C.R. 897, 77 B.C.L.R. (2d) 62, 102 D.L.R. (4th) 96, 150 N.R. 321, [1993] 3 W.W.R. 441, 14 C.P.C. (3d) 1; *Arthur v. Signum Communications Ltd.*, [1993] O.J. No. 1928 (Div. Ct.); *Barkan v. Amsted Industries Inc.*, 567 A.2d 1279 (Del. 1989); *Canadian Tire Corp. (Re)* (1987), 35 B.L.R. 118 (Ont. Div. Ct.); *Exco Corp. v. Nova Scotia Savings & Loan Co.* (1987), 78 N.S.R. (2d) 91, 193 A.P.R. 91, 35 B.L.R. 149 (S.C.); *First Boston, Inc. Shareholders Litigation (In re)*, [1990] Fed. Sec. L. Rep., para. 95, 322 (Del. 1990); *Fort Howard Corp. Shareholders Litig. (In re)*, Del. Ch., C.A. No. 991, 1988 WL 83147; *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481, 23 B.L.R. (2d) 286 (C.A.); *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254, 37 D.L.R. (4th) 193 (Div. Ct.), affg (1986), 59 O.R. (2d) 255, 37 D.L.R. (4th) 194 (H.C.J.); *Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27, 36 O.R. (3d) 418*n*, 154 D.L.R. (4th) 193, 221 N.R.

241, 50 C.B.R. (3d) 163, 33 C.C.E.L. (2d) 173, 98 C.L.L.C. ¶210-006; *Saunders v. Cathton Holdings Ltd.* (1997), 43 B.C.L.R. (3d) 129, 88 B.C.A.C. 264, [1998] 5 W.W.R. 363, 36 B.L.R. (2d) 151; *Slattery v. Slattery*, [1945] O.R. 811 (C.A.); *Teck Corp. v. Millar* (1973), 33 D.L.R. (3d) 288 (B.C.S.C.); *Themadel Foundation v. Third Canadian General Investment Trust Ltd.* (1998), 38 O.R. (3d) 749 (C.A.); *Westfair Foods Ltd. v. Watt* (1991), 79 Alta. L.R. (2d) 363, 79 D.L.R. (4th) 48, [1991] 4 W.W.R. 695, 5 B.L.R. (2d) 160 (C.A.), affg (1990), 73 Alta. L.R. (2d) 326, [1990] 4 W.W.R. 685, 48 B.L.R. 43 (Q.B.), leave to appeal to S.C.C. refused [1991] 2 S.C.R. viii

Statutes referred to

Business Corporations Act, R.S.O. 1990, c. B.16, ss. 134, 248
Canadian Business Corporations Act, R.S.C. 1985, c. C-44

Authorities referred to

Dreidger on the Construction of Statutes, 3rd ed. (Toronto: Butterworths, 1994), p. 131
Langan, *Maxwell on the Interpretation of Statutes*, 12th ed. (London: Sweet & Maxwell, 1969), p. 228
Morden, "The Partnership of Bench and Bar" (1982), 16 *Law Soc. Gaz.* 46, pp. 89-95

APPEAL from a judgment of Farley J. (1998), 40 B.L.R. (2d) 244 (Gen. Div.) dismissing an action to invalidate an agreement for the sale of shares.

Lyndon A.J. Barnes and *David A. Stamp*, for appellant, Maple Leaf Foods.

Harvey T. Strosberg, Q.C., *G. Wesley Voorheis* and *Michael Woollcombe*, for appellants, Pente Investment Management Ltd. and Cascade Holdings Ltd.

James D.G. Douglas and *Freya J. Kristjanson*, for respondents, J.M. Schneider Family Holdings.

Thomas G. Heintzman, Q.C., *R. Paul Steep* and *Susan Rothfels*, for respondent, Smithfield Foods, Inc.

Alan H. Mark, *Jessica A. Kimmel* and *Nando De Luca*, for respondents, Schneider Corporation, Douglas W. Dodds, Gerald A. Hooper, Frederick D. Morash, Larry J. Pearson, Brian J. Ruby, Ronald J. Simmons and Hugh W. Sloan.

The judgment of the court was delivered by

WEILER J.A.: —

OVERVIEW

The appellants are Maple Leaf Foods Inc. ("Maple Leaf"), a bidder for the shares of Schneider Corporation ("Schneider"), and two small shareholders of Schneider who are supporting Maple Leaf. They raise two principal issues. The first concerns the duties of a special committee of the Board of Directors of Schneider Corporation and of the Board itself when dealing with a bid for change of control of the company. The second involves the interpretation of a provision in the articles of a company commonly known as the "coattail provision".

Schneider Corporation is an 108-year-old Ontario corporation that is controlled by members of the Schneider Family ("the Family")[1] through a holding company. The issued share capital of Schneider consists of common voting shares and Class A non-voting shares. Both classes of shares trade on the Toronto Stock Exchange, with the Class A shares representing most of the equity in the company. Although the Family only owns 17 per cent of the non-voting shares, the Family controls the company because it owns approximately 75 per cent of the common voting shares.

On November 5, 1997, Maple Leaf, a competitor of Schneider, announced its intention to make an unsolicited take-over bid for Schneider at $19 a share, through its holding company SCH. In response, the Board established a special committee consisting of the independent non-family directors to review the Maple Leaf offer and to consider other alternatives. Subsequently Maple Leaf itself made an offer of $22 a share, but this offer was rejected by the Family. Ultimately, the Family told the special committee that the only offer it would accept was an offer made by Smithfield Foods, an American company that, at the time, was equal to $25 a share. In order for the Family to accept the Smithfield offer, which would have had the effect of enabling Smithfield to "lock-up" control of Schneider, the Board had to take certain

[1] There are four branches of the Schneider Family. In this appeal, "Family" refers to: the collective family holding company J.M. Schneider Family Holdings Limited (Family Holdings); the four individual family holding companies (Harbour Glen Securities Limited, Kinspan Investments Limited, Laurel Ridge Investments Limited, and Jadebridge Holdings Limited); and seven of the eight Family members who serve as directors of Family Holdings, Herbert J. Schneider, Frederick P. Schneider, Jean M. Hawkings, Betty L. Schneider, Anne Fontana, Eric Schneider, and Bruce Hawkings.

steps which, on the advice of the special committee, it took. Despite this, and after the Family had agreed to the Smithfield offer, on December 22, 1997, Maple Leaf made a further offer of $29 a share to Schneider's common and Class A shareholders.

The law as it relates to the general duties of the directors of a company is well known. The directors of a company have an obligation to act honestly and in good faith in the best interests of the corporation: s. 134(1)(*a*) *Business Corporations Act*, R.S.O. 1990, c. B.16 (the "OBCA"). Further, in discharging their obligations, the directors must exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances: s. 134(1)(*b*). If the actions of the directors unfairly disregard the interests of a shareholder, unfairly prejudiced those interests, or are oppressive to them, s. 248 of the OBCA comes into play and allows the court to grant any remedy it thinks fit.[2]

The appellants attack the actions of the special committee on the basis, first, that it was not in fact independent, and second, that the advice given by the special committee to the Board was not in the best interests of Schneider and its shareholders. The appellants allege that the special committee did not act independently because it allowed Dodds, the Chief Executive Officer of Schneider, to negotiate on the Committee's behalf with potential bidders. Furthermore, the appellants submit that Dodds and the members of the special committee were unduly deferential to the wishes of the Family. The appellants' position is that public statements made by the Family created an expectation that an auction for the controlling block of shares of Schneider (the Family shares) would be held and that those shares would be sold to the highest bidder. The appellants say that, because Maple Leaf was not given a chance to bid after the Smithfield offer of $25 a share was received, the special committee, in acceding to the Family's request to accept the Smithfield offer, truncated the auction process. Maple Leaf and the other appellants seek to have this court invalidate the agreement between the Family and Smithfield on the basis that the process undertaken by the special committee and the Board, which led to the Family's agreement with Smithfield, unfairly disregarded the interests of the non-Family shareholders and unfairly prejudiced them.

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2 For the sake of convenience I will refer to s. 248 as the "oppression remedy". For ease of reference the text of ss. 134 and 248 is attached to these reasons as an appendix [at p. 214 *post*].

The second issue involves the coattail provision in Schneider's articles. A typical coattail provision provides that if an offer is made for the voting shares of a corporation and the non-voting shareholders are excluded from that offer because an identical bid is not made for their shares, the non-voting shareholders have the right to convert their non-voting shares to common voting shares. They can then tender to the offer for the common shares.

Maple Leaf offered the same premium to the Class A non-voting shareholders as it did to the holders of common voting shares. But Maple Leaf claims that its bid nonetheless triggered the coattail provision in Schneider's articles because the condition attached to its bid for the non-voting shares was not identical to the condition attached to its bid for the common shares. As a result, Maple Leaf says that the effect of its bid was to convert the non-voting Class A shares into common voting shares. If all Class A non-voting shares were converted into common voting shares the Family's percentage of common voting shares would be diluted to a level where the Family's support might not be necessary for Maple Leaf's bid to be successful. Maple Leaf might then be able to gain control of Schneider despite the Family's lock-up agreement with Smithfield.

Farley J. dismissed the appellants' actions [reported 40 B.L.R. (2d) 244]. In relation to the first issue, he concluded that the special committee and the directors "exercised their powers and discharged their duties honestly, and in good faith, with a view to the best interests of Schneider and that they exercised the care, diligence and skill that a reasonable and prudent person would exercise in comparable circumstances in relation to dealing with the take over bid situation." He also found that because Schneider was known to be controlled by the Family which could decide whether or not to sell its shares, the company was never truly in play and no public expectation was created that an auction would be held.

In relation to the second issue, Farley J. found that to the extent that Maple Leaf's bid did not exclude the Class A shareholders from the premium being offered for the Family's shares, the coattail provisions were not triggered. Even if Maple Leaf's offers were exclusionary, he held that the conversion rights did not arise because, pursuant to Schneider's articles, the Family had filed certificates undertaking not to accept an exclusionary offer without giving written notice to its transfer agent. For the reasons which follow, I am of the opinion that Farley J. was correct.

THE OPPRESSION CLAIMS, REASONABLE EXPECTATIONS AND THE DUTIES OF OFFICERS AND DIRECTORS

a

Facts

I do not propose to repeat all of the facts outlined in the reasons of Farley J. and the facta of the parties, but some further information is essential to understand the issues which must be
b determined on this appeal.

The Board of Schneider consists of nine persons: two members of the Schneider Family (Eric Schneider and Anne Fontana), two members of senior management (Douglas Dodds, the chairman of the board and chief executive officer, and Gerald Hooper, the
c chief financial officer), and five outside directors who are all successful business persons with no connection to the Schneider Family. The Board established a special committee consisting of the five independent non-Family directors to review and consider the Maple Leaf offers and to make appropriate recommendations to the Board.

d The special committee retained Nesbitt Burns Inc. as its financial advisor and Goodman, Phillips & Vineberg as its legal advisor.

The first SCH/Maple Leaf offers for Schneider were formally made on November 14, 1997 to both the common voting and
e Class A non-voting shareholders.

After the first SCH/Maple Leaf offers, the special committee through its financial and legal advisors, and the senior management of Schneider, commenced a process of contacting other parties that might be interested in acquiring Schneider. Schneider also established a data room containing confidential information
f to be provided to potential bidders. As a condition to being provided with access to the data room, potential bidders were required to sign a confidentiality agreement which contained a standstill provision that prevented them from acquiring or making any proposal to acquire shares of Schneider for two years
g without the written consent of the board of directors of Schneider. The form of confidentiality agreement used by Schneider provided that the only representatives of Schneider that potential bidders could contact were Dodds, the chairman and chief executive officer; Hooper, the chief financial officer; and Eric Schneider,
h the general counsel, secretary and a vice-president.

On November 23, 1997, the Board issued its directors' circular responding to the Maple Leaf offer and recommended that Schneider shareholders not tender to the Maple Leaf offer on the basis that, among other things, the Maple Leaf offer was not reflective of the fair value of the shares of Schneider and that the

Family had no intention of accepting the Maple Leaf offer. Under the heading "Alternatives to the Offers" the directors' circular stated:

> The Board of Directors is committed to maximizing Shareholder value. In this connection, the Corporation and Nesbitt Burns have held discussions with several interested parties concerning possible transactions which would result in Shareholders receiving greater value for their Shares than under the Maple Leaf Offers. The Board of Directors and Nesbitt Burns are actively exploring alternatives to maximize Shareholder value. The Schneider family, which collectively beneficially owns or controls approximately 75% of the Common Shares and approximately 17% of the Class A shares on a fully-diluted basis, has advised the Board of Directors that it might consider accepting a financially more attractive offer for its Shares.

Also on November 23, 1997, the Family confirmed in writing to the Board that:

> The undersigned also confirm that they might consider alternative control transactions involving the Corporation and acknowledge that, on the basis of such confirmation, Nesbitt Burns Inc., financial advisor to the special committee of the Board of Directors constituted to consider the Offers, is pursuing alternatives to the Offers.

On December 2, 1997, Schneider adopted a temporary shareholder rights plan. A rights plan is a common interim measure intended to give a Board time to see if there are other bids for a company and to stall an unsolicited or hostile take-over bid. Here, the rights plan provided that if a purchaser acquired 10 per cent or more of the shares of Schneider, both classes of shareholders had the right to purchase Class A shares at 50 per cent of the market price as at November 4, 1997 ($13.25) following a special meeting of shareholders. The press release announcing the rights plan stated:

> In the midst of ongoing discussions with several parties who have expressed interest in the company, the Board of Directors of Schneider Corporation today announced that, on the recommendation of its Special Committee, the Corporation has adopted a temporary Shareholder Rights Plan. This measure has been enacted to ensure that the Board and its advisers have the opportunity to fully explore all options for maximizing shareholder value . . . "The Board adopted the Rights Plan to create a stable environment in which it will have the time and flexibility it needs to explore and evaluate the options for maximizing value for all Schneider's shareholders" said Douglas W. Dodds, Chairman and CEO.

On December 11, 1997, Dodds wrote to Maple Leaf and requested that it deliver enhanced offers by December 12, 1997, stating that:

> The process of shareholder value maximization in which our Board of Directors has been engaged since receipt of your offers is fast approaching its climax. Schneider Corporation will be receiving alternative offers to the Maple Leaf Foods offers from interested parties by this Friday December 12,

> 1997 . . . Accordingly, we invite you to deliver to us your enhanced offers by this Friday. We encourage you to put forward your enhanced offers on a basis that most appropriately and fairly reflects the inherent and strategic values to Maple Leaf Foods of Schneider Corporation. Please also advise how we may be in contact with you and your advisers over this weekend.

a

On December 12, 1997, Maple Leaf increased its offer for Schneider shares to $22 per share and allowed Schneider's shareholders to elect to receive part of this consideration in the form of shares of Maple Leaf Foods Inc. On the same day, Schneider received written proposals from each of Booth Creek Inc. and Smithfield to acquire all of the shares of Schneider. The proposal from Booth Creek contemplated a take-over bid for all of the outstanding shares of Schneider at a price per share of $24.50 cash, conditional upon 66 2/3 per cent of the common voting shares and non-voting shares being deposited under the offer. The proposal from Smithfield contemplated a take-over bid for all of the outstanding shares of Schneider, with Schneider shareholders receiving shares exchangeable into shares of Smithfield. Based on the closing price of Smithfield shares on December 12, 1997, and the relevant exchange rate on that date, the Smithfield proposal was worth approximately $23 per share.

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Prior to the announcement of the unsolicited bid by Maple Leaf's subsidiary on November 5, 1997, the Family had no intention of selling its shares. By December 13, 1997, the Family had indicated a tentative preference to sell its shares to Smithfield and doubted that either Booth Creek or Maple Leaf would enhance their offers sufficiently that the Family would tender to them. However, the Family had made no decision to sell, and if they were to sell, to whom, or at what price. The criteria used by the Family to evaluate offers were first arrived at on December 13.

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On December 14, 1997, at a meeting of the Board of Directors, management advised that it believed that Schneider was "too big to be small and too small to be big", and that a strategic merger was in the best long-term interests of Schneider. The Family stated that it shared this belief. The Family also advised the board of directors that it had reviewed the amended Maple Leaf offer as well as the proposals from Booth Creek and Smithfield in terms of three factors: financial value, continuity of Schneider in a manner consistent with the Family's desires, and the effect of any transaction on customers and suppliers. The Family told the Board that, while the Smithfield proposal did not meet its financial adequacy criteria, it did meet the Family's other two criteria and that, assuming that Smithfield could satisfy the Family's financial adequacy criteria, a strategic merger would be in the best interests of Schneider.

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Following this, a meeting was held by a working group that included Dodds and advisers from Nesbitt Burns and Goodman's. This group made the decision that Dodds should go to see Luter, the Chairman of the Board and Chief Executive Officer of Smithfield, and enter into negotiations with Booth Creek.

On December 15, Dodds conducted further negotiations with Booth Creek and on the morning of December 16, he met with representatives of Smithfield, including Luter. Dodds explained why Schneider was historically undervalued.

Around lunchtime, Smithfield increased the value of its offer to $25 per share on the basis of the price of Smithfield's shares and the relevant exchange rate on that date. In addition, Dodds obtained Smithfield's agreement that it would not sell Schneider for at least two years, and would allow the Schneider family to appoint a representative to Smithfield's board of directors. Luter told Dodds that this was his best, last offer and that if he had any suspicion Schneider was using Smithfield's offer to try to obtain higher offers from others, he would withdraw his offer and make a public announcement disclaiming any interest in the company. The Smithfield offer was open until 8 a.m. on December 18. That same day, Dodds reported this offer to the Family and Mida, the director of mergers and acquisitions at Nesbitt Burns and an adviser to the special committee.

After Dodd's meeting with Luter, the Board issued an amended directors' circular recommending that Schneider shareholders not tender to the revised Maple Leaf offers. The Board of Directors did not disclose that the Family would evaluate the offers using criteria additional to financial considerations. Under the heading "Alternative Transactions" the circular stated:

> The Board of Directors has been actively engaged in a process of identifying other transactions that might result in greater value to Shareholders than was offered under the Original Offers. On December 12, 1997, the Board of Directors received proposals for, and is in the process of negotiating, alternative transactions which might result in greater value to Shareholders than is being offered under the Amended Maple Leaf Offers.

At 5 p.m. on December 17, 1997, Booth Creek made a revised written proposal to Schneider increasing the value of its offer to $25.50 cash and stated that its offer was open until 8 p.m. that same evening. At $25.50 the Booth Creek proposal was less attractive financially to the Family than the Smithfield share exchange proposal, which would yield them a tax saving of $4 per share. Non-family shareholders, depending on their individual tax position, might or might not be in the same position. Booth Creek, a private company, could not offer a share exchange transaction.

At the meeting of the Board on December 17, 1997, the Family announced that it wanted to accept the revised offer from Smithfield. Among other things, the Family stated to the Board that:

> We also think that it is important to reiterate that we as a family did not seek to sell this company but that through the process of the last 6 weeks we have come to the conclusion that now is the time to sell the control of the company.

At a subsequent meeting of the special committee that night, Nesbitt Burns advised that while the Smithfield proposal was within the $25-29 fair price range, the risk associated with adverse share price movement and exchange rate movement during the short period until the offer could be formally accepted should be reflected by applying a 6 per cent discount to the offer so that its present value was $23.50. Nesbitt Burns also told the Special Committee that, in its view, if the Smithfield offer were permitted to expire and no other change of control transaction involving Schneider were consummated, the shares of Schneider would settle in a trading range between $18 and $20 a share.

The special committee then recessed and Dodds made inquiries of Smithfield as to whether it would raise its offer. Smithfield refused to pay more but Dodds was successful in negotiating a slight improvement in the exchange rate aspect of the offer.

The original proposal, as submitted by Smithfield, contemplated that the transaction would proceed by way of a plan of arrangement or merger. That is, the Board would approve of the Family entering into a lock-up agreement for its shares with Smithfield, then the merger proposal would be voted upon by all shareholders and approved by the court. Before asking the shareholders and the court to approve the merger the Board would have had to provide an opinion that the transaction was fair. In light of Nesbitt Burns' discounted valuation of the Smithfield proposal, the Board was unwilling to do so.

To avoid the Board having to issue an opinion that the proposed transaction was fair, Smithfield made offers by way of take-over bids to acquire any and all common voting shares and all Class A shares of Schneider on the condition that the Family agree to tender its shares. The shares of Schneider were to be exchanged for .5415 of a share in a newly incorporated, wholly-owned Canadian subsidiary of Smithfield. Each whole exchangeable share would then be exchangeable for one common share in Smithfield. The structure of this second transaction meant that Smithfield might not be able to acquire two-thirds of the Class A shares and, therefore, might not be able to take Schneider private.

In order for the Family to accept the offer from Smithfield, it was still necessary for the Board to waive the standstill provision in the confidentiality agreement Smithfield signed and to remove the rights plan. The Family asked the board to do this. Upon the recommendation of the special committee, the Board did so. On December 18, 1997, the Family entered into the lock-up agreement.

On December 22, 1997, Maple Leaf announced that, despite the Family's lock-up agreement with Smithfield, it was increasing its offer to $29 per share, cash, conditional on obtaining two-thirds of each class of share. Prior to this, Maple Leaf entered into deposit agreements with two funds to buy Maple Leaf's shares at $29, no matter what the outcome of its latest bid was. On December 30, 1997, five Class A shareholders, holding in aggregate 675,000 shares, representing more than 10 per cent of the total Class A shares outstanding, wrote a letter to Schneider's Board of Directors complaining that "the actions or inaction of the Special Committee, together with those of the Schneider family have in effect, contaminated the value maximization process outlined by the board in its directors' circular and in its public statements."

Determining Whether the Directors Have Acted in the Best Interests of the Corporation

The mandate of the directors is to manage the company according to their best judgment; that judgment must be an informed judgment; it must have a reasonable basis. If there are no reasonable grounds to support an assertion by the directors that they have acted in the best interests of the company, a court will be justified in finding that the directors acted for an improper purpose: *Teck Corp. v. Millar* (1973), 33 D.L.R. (3d) 288 (B.C.S.C.) at pp. 315-16, adopted as the law in Ontario by Montgomery J. in *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 255, 37 D.L.R. (4th) 194 (H.C.J.), affirmed (1986), 59 O.R. (2d) 254, 37 D.L.R. (4th) 193 (Div. Ct.).

One way of determining whether the directors acted in the best interests of the company, according to Farley J., is to ask what was uppermost in the directors' minds after "a reasonable analysis of the situation.": *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 at p. 176 (Ont. Gen. Div.), affirmed (1991), 3 B.L.R. (2d) 113 (Ont. Div. Ct.); *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*, No. 98-CL-2821 (May 17, 1998), Toronto (Gen. Div.) [reported 39 O.R. (3d) 755, 160 D.L.R. (4th) 131]. It must be rec-

ognized that the directors are not the agents of the shareholders. The directors have absolute power to manage the affairs of the company even if their decisions contravene the express wishes of the majority shareholder: *Teck Corp. Ltd. v. Millar*, *supra*, at p. 307. However, acting in the best interests of the company does not necessarily mean that the directors must act in the best interests of one of the groups protected under s. 234. There may be a conflict between the interests of individual groups of shareholders and the best interests of the company: *Brant Investments Ltd. v. Keep Rite Inc.* (1987), 60 O.R. (2d) 737, 42 D.L.R. (4th) 15 (H.C.J.), affirmed (1991), 3 O.R. (3d) 289 at p. 301, 3 O.R. (3d) 289 (C.A.). Provided that the directors have acted honestly and reasonably, the court ought not to substitute its own business judgment for that of the Board of Directors: *Brant Investments v. Keep Rite Inc.*, *supra*, which deals with the analogous section of the *Canadian Business Corporations Act*, R.S.C. 1985, c. C-44. If the directors have unfairly disregarded the rights of a group of shareholders, the directors will not have acted reasonably in the best interests of the corporation and the court will intervene: *820099 Ontario Inc. v. Harold E. Ballard Ltd.*, *supra*.

The appellants have urged this court to consider the actions of the directors pursuant to a standard which is derived from statute law in the State of Delaware known as "enhanced scrutiny". The key features of the enhanced scrutiny test are a judicial determination of the adequacy of the decision-making process employed by the directors, and a judicial examination of the reasonableness of the directors' actions in light of the circumstances then existing: *Paramount Communications v. QVC Network Inc.*, 637 A.2d 34 at p. 45 (Del. 1934). The directors have the onus of satisfying the court that they were adequately informed and acted reasonably. Some Canadian authorities such as *Exco Corp. v. Nova Scotia Savings & Loan Co.* (1987), 35 B.L.R. 149, 78 N.S.R. (2d) 91 (S.C.) and *347883 Alberta Ltd. v. Producers Pipelines Inc.* (1991), 80 D.L.R. (4th) 359, 92 Sask. R. 81 (C.A.) have adopted a proper purpose test, which is similar to enhanced scrutiny in that it shifts the burden of proof to the directors to show that their acts are consistent only with the best interests of the company and inconsistent with any other interests. These cases recognize that there may be a conflict between the directors who manage the company and the interests of certain groups of shareholders, particularly those s. 248 is designed to protect, and have espoused shifting the burden of proof as a method of overcoming the potential conflict.

The law as it has evolved in Ontario and Delaware has the common requirements that the court must be satisfied that the directors have acted reasonably and fairly. The court looks to see that the directors made a *reasonable* decision *not a perfect* decision. Provided the decision taken is within a range of reasonableness, the court ought not to substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination. As long as the directors have selected one of several reasonable alternatives, deference is accorded to the board's decision: *Paramount*, *supra*, at p. 45; *Brant Investments*, *supra*, at p. 320; *Themadel Foundation v. Third Canadian General Investment Trust Ltd.* (1998), 38 O.R. (3d) 749 at p. 754 (C.A.). This formulation of deference to the decision of the Board is known as the "business judgment rule". The fact that alternative transactions were rejected by the directors is irrelevant unless it can be shown that a particular alternative was definitely available and clearly more beneficial to the company than the chosen transaction: *Brant Investments*, *supra*, at pp. 314-15.

A common method used to alleviate concerns that a conflict of interest exists between directors, who may be major shareholders, and the interests of a minority or non-voting group of shareholders, is the creation of a special committee from among the independent members of a board who do not have a conflict. The purpose of a special committee is to advise the Directors and to make a recommendation as to what the Board should do. It appears that under the law of Delaware, where a Board acts on the recommendation of a special committee, the decision will be accorded respect under the business judgment rule, provided that the special committee has discharged its role independently, in good faith, and with the understanding that in a situation where a change of control transaction is contemplated, the special committee can only agree to a transaction that is fair in the sense of being the best available in the circumstances: *In re First Boston, Inc. Shareholders Litigation*, [1990] Fed. Sec. L. Rep., para. 95, 322 (Del. 1990).

The duty of directors when dealing with a bid that will change control of a company is a rapidly developing area of law and, as I have indicated, Canadian authorities dealing with the question of the onus, or burden of proof, have not been uniform. In *Brant Investments*, *supra*, the issue whether the burden of proof is on the directors to justify their actions as being in the best interests of the company or on the shareholders challenging the actions of the company was also raised. McKinlay J.A., at pp. 311-12, found it unnecessary to decide the question because the trial judge had

dealt with the issues on a substantive basis, and his decision did not turn on which party had the onus or burden of proof.[3] The same is true in the present case.[4] I would add, however, that it may be that the burden of proof may not always rest on the same party when a change of control transaction is challenged. The real question is whether the directors of the target company successfully took steps to avoid a conflict of interest. If so, the rationale for shifting the burden of proof to the directors may not exist. If a board of directors has acted on the advice of a committee composed of persons having no conflict of interest, and that committee has acted independently, in good faith, and made an informed recommendation as to the best available transaction for the shareholders in the circumstances, the business judgment rule applies. The burden of proof is not an issue in such circumstances.

The members of the committee acted in good faith in the sense that they acted honestly. The committee's decision was also informed, in the sense that the committee was aware that any offer for Schneider's shares might be bettered by Maple Leaf, and that the Family would not sell to Maple Leaf. While the appellants have challenged Farley J.'s finding that the Family would

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3 Reversing the burden of proof was rejected by Farley J. in this case. He declined to adopt the test in this case and to place the burden of proof on the directors. He indicated that the rights of shareholders in Ontario were protected by s. 248 of the OBCA and he would apply it. The enhanced scrutiny standard was also rejected by Blair J. in *CW Shareholdings Inc.*, *supra*, at p. 27, in dealing with an application under the *Canadian Business Corporations Act* to set aside defensive measures taken by a company respecting a takeover. He commented that to the extent "enhanced scrutiny" imposed the initial evidentiary burden on the directors of a target company to justify their actions and their business decisions it went too far and did not represent the law in Ontario. While s. 248 of the OBCA does not clearly state on whom the onus lies, the use of the term "complainant" in s. 248 and the broad definition of a "complainant", which includes any other person whom the court considers a proper person, suggest that the onus is on the person alleging that the directors have unfairly prejudiced, disregarded, or acted oppressively towards the person. In many cases the facts necessary to found such a complaint will be in the knowledge of the person alleging them and the burden of adducing evidence on those facts should rest on that person. The cases arising under these sections are, however, fact specific. In cases where trust property is the subject of the litigation and it is alleged that a personal benefit has been given to members of the Board as a result of its actions, the Board may bear the burden of adducing evidence as to the nature of the transaction.

4 There are fewer and fewer situations today where the resolution of the question turns on the onus of proof. See the comments of Sopinka J. in *Amchem Products Inc. v. British Columbia (Workers' Compensation Board)*, [1993] 1 S.C.R. 897, 102 D.L.R. (4th) 96.

not sell to Maple Leaf, there is ample evidence to support this finding. Even at $29 a share, when tax considerations were factored in, the Maple Leaf offer was only as advantageous as the Smithfield offer to the Family, not more advantageous. Apart from financial criteria, Maple Leaf did not meet the Family's expressed concern about the effect of a change of control on the continuity of employment for Schneider's employees, the welfare of suppliers, and the relationship with its customers, whereas Smithfield did. Once again, the real questions are whether the committee was independent and whether the process undertaken by the special committee was in the best interests of Schneider and its shareholders in the circumstances. While *Paramount, supra*, indicates that non-financial considerations have a role to play in determining the best transaction available in the circumstances, here it was conceded that the court should only have regard to financial considerations.

The Special Committee

(i) *Should expert evidence have been admitted on the question whether the special committee was independent, and on the process by which the agreement with Smithfield was reached?*

Farley J. declined to admit the proposed evidence of the expert witnesses, Messrs. Cameron and Beck. The appellants seek to overturn the finding of Farley J., that the directors and the Family did not act improperly. In part, they do so on the basis that he erred by refusing to admit the proposed evidence of the two expert witnesses.

The proposed evidence of Messrs. Cameron and Beck was contained in two reports. The report of Mr. Beck was essentially a statement of his views on the legal rights and obligations which arose under Ontario law from a set of facts communicated to him. The report of Mr. Cameron consisted largely of his conclusions based on a set of assumed facts given to him and his inferences from those facts on the appropriateness of senior management's participation in negotiations with potential bidders, the process conducted by the special committee, and the expectations created by public statements made by the Family.

Farley J. ruled that the qualifications of the experts related to corporations, their securities, takeover bids and directors' obligations. He declined to receive the experts' reports on three bases: (1) that the opinions expressed related to domestic law, a matter upon which a court ought not to receive opinion evidence; (2) that

there was no specialized and standardized body of conduct to study in this area; and (3) that he did not need the assistance of the experts in understanding the evidence or the concepts and principles involved.

For the reasons given by Farley J., I would not give effect to this ground of appeal.

(ii) *Should members of Schneider's senior management, particularly Dodds, have been permitted to have a significant role in the sale negotiations with potential bidders?*

The appellants submit that Dodds had a conflict of interest because he had an interest in continued employment with Schneider and a further conflict arising out of his loyalty to the Family.

A potential conflict of interest arises because as a director of a target company, the senior executive has a duty to act in the best interests of the shareholders, but as a member of senior management the executive retains an interest in continued employment. In actively negotiating with a potential bidder the executive is negotiating with his potential boss or executioner. The appellants rely on the decision of Blair J. in *CW Shareholdings Inc.*, *supra*, for the proposition that no senior executive of a company being sold should be permitted to have a significant role in the sale process.

The raison d'être of a special committee independent of management and the controlling shareholder is to protect the interests of minority shareholders and to bring a measure of objectivity to the assessment of bids. If, as was the case in *CW Shareholdings*, senior management in the target company is a member of the special committee, the purpose in setting up the special committee might be compromised and less reliance placed on its assessment of a particular bid than if the committee were truly independent. Blair J. recognized this and he was critical of the role played by senior management in *CW Shareholdings*. In the end, however, he concluded that the involvement of management in the special committee did not so taint its approval of the Shaw Communications bid as to undermine the transaction. He also found that the committee had conducted itself in a fashion that enabled the directors to carry out their objective of maximizing shareholder value. In that case, Blair J. upheld the Board's decision, based upon the special committee's recommendation to enter into an agreement with Shaw that provided for a break fee and asset agreement in the event that its bid was not accepted.

A major distinction between the *CW Shareholdings* decision and this case is that senior management, including Dodds, was

not part of the special committee that was set up, and consequently had no vote as to whether to recommend a bid. A potential conflict of interest still existed, however, because of the active role Dodds played in negotiating with the bidders.

Farley J. recognized that in allowing Dodds and, to a lesser extent, Hooper, the chief financial officer of Schneider, to deal with bidders directly, a potential conflict of interest existed but that this had to be balanced against the benefits to be obtained. He stated:

> It would be appropriate, however, to comment as well [th]at the use of the two management directors, Dodds and Hooper, in dealing with the bidders and advisors directly, would not seem inappropriate. Potentially there could be conflict, but that must be balanced against the reasonable benefits to be obtained. They knew the operations of the business — what the bidders would be interested in and they were guided by the advisors. They reported to the special committee which could make the "final" decisions and give directions. Potential conflict was minimized by the bail-out packages granted them. From the material before me it would not appear that these management persons acted or behaved inappropriately overall. It would be undesirable to subject each step they took to isolated microscopic inspection. I note in passing that Dodds would have received approximately $1,000,000 in stock and options value extra if the Maple Leaf $29 offer had been accepted as opposed to the Smithfield one; of course no one but Maple Leaf knew how much it would have offered if it had been solicited on December 17.

Dodds' employment agreement entitled him to resign within two years following a change of control transaction with 30 months' severance. In *CW Shareholdings*, Blair J. commented that a golden parachute did not eliminate the potential for conflict of interest that exists when a member of senior management negotiates directly with bidders. Here, however, Dodds was not given any assurances by Smithfield of continued employment, although he knew that Smithfield intended to leave Schneider's management in place and allow it to operate as an autonomous unit. On the other hand, Dodds was given some assurance of continued employment by Maple Leaf if Schneider was taken over by it. He was told that he would manage the integration of Schneider for two years, and be a candidate to head the meat operations of the two companies. He was also told that he would retain his salary and be issued additional options in Maple Leaf. In addition, at the time, Dodds held 250,000 options in Schneider with a strike price of $13 and it was believed that Maple Leaf would top any bid that was openly made for Schneider. It seems that if there was any financial bias arising out of Dodds' self interest in continued employment it would have been a bias in favour of Maple Leaf.

The appellants also submit that Dodds had a conflict of interest in conducting the negotiations because his loyalties were to

the Schneider Family. But the Family did not ask Dodds to negotiate with potential bidders. After Nesbitt Burns suggested that Smithfield might be a potential bidder, Dodds' meetings with Smithfield were at the behest of the special committee, or its advisers, Nesbitt Burns and Goodman, Phillips & Vineberg. Farley J. found that the deadline for considering bids had been set by Mida, the vice-president of Nesbitt Burns and its director of mergers and acquisitions, as an appropriate deadline in order to prevent the process from stalling. He also found that it was appropriate for Dodds to keep the Family informed of the progress of the negotiations since they could veto any sale. Counsel for the appellants strenuously submitted that in as much as Dodds advised the Family of the result of his negotiations with Smithfield on December 16, and did not advise any member of the special committee of the negotiations, an inference should be drawn that Dodds' loyalties were to the Family and that this was illustrative of yet another conflict that Dodds had. The evidence indicates that although Dodds did not advise any members of the special committee directly on the 16th, he called Mida of Nesbitt Burns, the advisor to the special committee. It does not appear that Mida told anyone on the special committee of the Smithfield proposal, as the evidence indicates that the committee was unaware of it until it met on the evening of the 17th. In the circumstances there would appear to be no reason to impute bias to Dodds because of this omission.

The appellants also allege that it was Dodds' suggestion to Luter that Smithfield proceed by way of a takeover for any and all shares of Schneider — as opposed to a plan of arrangement — and that this suggestion also indicates Dodds' bias against Maple Leaf. The proposal to proceed by way of takeover as opposed to merger was not a suggestion that came from Dodds, but one that had been identified previously as the alternative Luter was prepared to pursue if the Board could not recommend the Smithfield proposal.

Farley J. found that Dodds pressed the negotiations with the bidders diligently and did nothing inappropriate. His conclusions are supported by the evidence. There is no merit in this ground of appeal.

Process Arguments

(i) *Should the special committee have been created?*

The appellants submit that by creating a special committee, hiring advisers, and setting up a data room, the Family used Schneider's money to better the offer from Maple Leaf, which

it was not entitled to do. In addition to being rejected by Farley J., a similar argument was rejected by Montgomery J. in *Olympia & York, supra*, at p. 272. The reason is obvious; the appointment of a special committee is intended to ensure that the interests of those the oppression remedy is intended to protect are not unfairly disregarded or prejudiced. It is clearly in the interests of a company, and of all shareholders, for alternatives to an unsolicited takeover offer to be explored. It might give the shareholders a higher price for their shares. The creation of a special committee was part of the process undertaken by the Board to obtain the best transaction available in the circumstances.

(ii) *Should the special committee have created a data room?*

The appellants' submission that proprietary confidential information obtained from the data room was a valuable corporate asset that was either given away to the acquiring company or dissipated must also fail. As Farley J. pointed out, access to the data room was essential in order to conduct a market canvass for alternative offers. Other bidders, particularly those who had not operated in the Canadian market, needed to gain an appreciation of market conditions, and of Schneider's business. That could only be obtained with access to Schneider's confidential information. No alternative bid would have been elicited without access to Schneider's confidential information. Maple Leaf, as a competitor of Schneider for many years, had an appreciation of market conditions and of Schneider's business and did not require further information in order to make its bid.

The decision to establish a data room at the company's expense was that of the special committee, made with full knowledge of the Family's position that it was not committed to selling. The Board did not seek the approval or the consent of the Family to establish the data room, for the use of information, or for the nature of the confidentiality agreements that were signed with prospective bidders.

In creating a data room the special committee acted independently and reasonably. The creation of a data room made confidential information available to all bidders as part of a process to get the best transaction available to the shareholders in the circumstances. I see no merit in this ground of appeal.

(iii) *Flawed committee process*

The appellants submit that the trial judge ignored or failed to appreciate the evidence given by Ruby, the chairman of the special

committee, to the effect that the special committee had no involvement in any negotiations with prospective bidders, that Dodds conducted the negotiations, and that the special committee did not consider whether Dodds had any conflict of interest. After considering the circumstances under which Dodds acted, I have already concluded that Dodds did not have a conflict of interest.

The special committee had no prior experience in dealing with a take-over bid and did not have the in-depth knowledge of Schneider that Dodds did. It was therefore appropriate for the special committee not to conduct the negotiations with potential bidders directly. Farley J. found that although the special committee did try to determine the views of the Family "recognizing its gatekeeper and veto role", there was no evidence that the approval of the Family was sought with respect to any decision taken by the special committee. The evidence supports the conclusion that the members of the special committee acted independently in the sense that they were free to deal with the impugned transaction on its merits. This ground of appeal also fails.

(iv) *Should the special committee have insisted that Maple Leaf and any other interested party be given an opportunity to make their best and final offer prior to the board of directors of Schneider taking the steps that it did on December 17, 1997 to commit its shares to Smithfield?*

The appellants submit that the Board was obliged to keep the bidding process alive by going back to Maple Leaf after it received the Smithfield bid on December 17. This submission has two alternative premises: (1) the directors could only discharge their duty to act in the best interests of the corporation by conducting an auction of the shares of Schneider; (2) a public expectation had been created by the comments made by the Schneider family that an auction would be held and therefore both the Family and the Board were under a duty to ensure that an auction was conducted.

The appellant's first premise is wrong in law. The second is contrary to Farley J.'s findings of fact and those findings are supported by the evidence.

Was there a duty to conduct an auction of the shares of Schneider?

The decision in *Revlon v. McAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986), stands for the proposition that if a company is up for sale, the directors have an obligation to conduct an auction of the company's shares. *Revlon* is not the law in Ontario. In Ontario, an auction need not be held every time there is a change in control of a company.

An auction is merely one way to prevent the conflicts of interest that may arise when there is a change of control by requiring that directors act in a neutral manner toward a number of bidders: *Barkan v. Amsted Industries Inc.*, 567 A.2d 1279 at p. 1286 (Del. 1989). The more recent *Paramount* decision in the United States, *supra*, at pp. 43-45 has recast the obligation of directors when there is a bid for change of control as an obligation to seek the best value reasonably available to shareholders in the circumstances. This is a more flexible standard, which recognizes that the particular circumstances are important in determining the best transaction available, and that a board is not limited to considering only the amount of cash or consideration involved as would be the case with an auction: *Paramount*, *supra*, at p. 44. There is no single blueprint that directors must follow. Although the decision in *Paramount* and the other decisions of the courts in Delaware to which I have referred are not the law of Ontario, they can, however, offer some guidance.

When it becomes clear that a company is for sale and there are several bidders, an auction is an appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances. When the board has received a single offer and has no reliable grounds upon which to judge its adequacy, a canvass of the market to determine if higher bids may be elicited is appropriate, and may be necessary: *Barkan*, *supra*, at p. 1287, citing *In re Fort Howard Corp. Shareholders Litig.*, Del. Ch., C.A. No. 991, 1988 WL 83147.

The Family did not seek to sell its controlling interest in Schneider. The Board received an offer from Maple Leaf that it felt was inadequate, but, in the final analysis, the best way to judge its adequacy was to determine if higher bids could be elicited through a market canvass. The fact that a market canvass was conducted did not mean that the Family would agree to sell its stake. Indeed, Farley J. found as a fact that the Family's decision to sell was highly conditional on a satisfactory offer being received.

The appellant submits that there was considerable evidence indicating that the Schneider Family had by December 17, if not before, concluded that a sale of its shares was inevitable. Having undertaken a market canvass, however, there was no obligation on the special committee to turn this canvass into an auction, particularly because to do so was to assume the risk that the competing offers that the market canvass had generated might be withdrawn. There was no obligation on the special committee or the Board to go back to Maple Leaf on December 17 and ask it to make another offer. A market canvass and not an auction was being conducted;

the special committee and the Board only had a short time within which to consider Maple Leaf's offer; Maple Leaf had already been asked to make an appropriate offer and there was no certainty it would make a higher bid. There was an obligation on the special committee and the directors to consider the bids which their market canvass had realized in addition to Maple Leaf's bid. Farley J. found Maple Leaf knew, or should have known, that the bidding process was almost over when it made its $22 per share bid. Maple Leaf's board had authorized the issuance of enough Maple Leaf shares to finance a $29 a share bid for Schneider before the bidding process entered its final stage. Maple Leaf was nonetheless content to let its $22 bid stand despite knowing that there were competing bids that might be accepted in preference to its own, and despite the fact that Maple Leaf's board had authorized a higher $29 bid. This was a risk Maple Leaf chose to assume.

Was there a public expectation created by the Family that an auction would be held?

Conduct which disregards the *interests* of any shareholder and not simply a shareholder's legal rights will infringe s. 248 of the OBCA. This is because the oppression remedy is basically an equitable remedy and the court has jurisdiction to find an action is oppressive, unfairly prejudicial, or unfairly taken in disregard of the interests of a security holder if it is wrongful, even if it is not actually unlawful: *Westfair Foods Ltd. v. Watt*, [1990] 4 W.W.R. 685, 48 B.L.R. 43 (Alta. Q.B.), affirmed (1991), 4 W.W.R. 695, 79 D.L.R. (4th) 48 (Alta. C.A.), leave to appeal refused [1991] 2 S.C.R. viii.

A statement made to shareholders in a press release can create a public expectation that is deserving of protection through the oppression provisions of the OBCA. As Carthy J.A. stated in *Themadel Foundation*, *supra*, at p. 753:

> The public pronouncements of corporations, particularly those that are publicly traded, become its commitments to shareholders within the range of reasonable expectations that are objectively aroused.

While s. 248 protects the legitimate expectations of shareholders, those expectations must be reasonable in the circumstances and reasonableness is to be ascertained on an objective basis.[5] The interests of the shareholders of a company are intertwined with the expectations that have been created by the company's principals: *Naneff v. Con-Crete Holdings Ltd.* (1995), 23 O.R. (3d) 481,

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5 It is worthwhile noting however that on a subjective basis no shareholder testified that any public pronouncement made by the family created an expectation that an auction would be conducted.

23 B.L.R. (2d) 286 (C.A.). Therefore, the question is whether the statements made by the Family, and widely reported in press releases issued in response to Maple Leaf's bids, created a reasonable expectation that an auction would be held. Whether or not a reasonable expectation has been created is a question of fact: *Arthur v. Signum Communications Ltd.*, [1993] O.J. No. 1928 (Div. Ct.), Campbell J., for the court, at paras. 6-7. After examining the press releases and the evidence, Farley J. found that any expectations of the claimants, who were non-Family shareholders, were not reasonable or founded in fact.

A summary of his findings on this point is as follows:

— The Family's position on selling its controlling shareholding in Schneider was always conditional to a high degree. The Family only said that they "might consider" selling. The conditional nature of the Family's position was always clearly expressed by the Board in its public statements.

— It was inappropriate for Maple Leaf to ignore the plain meaning of the public statements made by the Family and the Board. Maple Leaf "wished" that there was an unrestricted auction for Schneider but in fact there never was.

— The claimants had not proved that their reasonable expectations were thwarted. "When the gatekeeper shareholder merely indicates that it 'might consider' accepting a more financially attractive offer, then the shareholders are speculating that a deal on that basis may come to pass in which they could participate."

There was more than adequate evidence to support these findings and they cannot be disturbed.

In as much as there was no reasonable expectation on the part of the non-Family shareholders that an auction would be held after receiving the last Smithfield bid, the special committee was not obliged to give Maple Leaf an opportunity to make a third bid for Schneider's shares.

Was the course of action and the advice given by the special committee in the best interests of Schneider and its shareholders? Should the special committee and the Board of Directors have refused to waive the standstill provisions in the confidentiality agreement with Smithfield?

The appellants allege that the advice given by the special committee to the Board of Schneider was not in Schneider's best

interests or those of its shareholders. They submit that the special committee should have refused to waive the standstill provi-
a sions in the confidentiality agreement with Schneider, thereby preventing the agreement between the Family and Smithfield. The appellants also submit that if the Board of Schneider could not enter into a share exchange with Smithfield because of fairness concerns it could not agree to a takeover bid. These submis-
b sions are really alternative ways of saying that the transaction with Smithfield was unfair to the non-Family shareholders, that it was not in the best interests of the company.

If the Smithfield offer can reasonably be considered to be the best available offer in the circumstances, then the Smithfield
c offer was not unfair or contrary to the best interests of the company. This is also essentially a fact driven question on which Farley J. made the following findings:

— The Smithfield offer was solicited by Schneider. Smithfield, a reluctant suitor, had to be "coaxed" to make a bid. Smith-
d field imposed a "no-shop" condition on its offer to the Schneider Family and did not want to haggle.

— There was no breach of confidence in the communications between Smithfield, and the Schneider Board and the Family. The spirit of the standstill provision between Smithfield
e and Schneider was honoured. Confidential information was used appropriately in the best interests of the shareholders. At all times the Schneider Board remained in control of the process dealing with the Smithfield offer.

f — It was reasonable for the Board to accommodate a transaction between Smithfield and the Family by waiving the standstill provision contained in the Smithfield confidentiality agreement in view of advice received that the share price of Schneider would fall back to a range of $18 to $20 per share in the absence of a change of control
g transaction.

— Maple Leaf could not have made an offer that would have been satisfactory to the Schneider Family at that time.

— The Board exercised their powers and discharged their
h duties honestly and in good faith.

— The Board pursued all available opportunities to maximize shareholder value and achieved reasonable results for all of the shareholders of Schneider.

— It was unfair to say that the special committee had the Family's interests uppermost in its mind not those of the shareholders generally, or the non-Family shareholders specifically. It was beyond the power of the special committee to insist that the Family give up its veto power and the special committee realized this.

As Farley J. emphasized, one of the particular circumstances having a bearing on a board of directors' attempts to obtain the best deal available in the circumstances was whether the company has a controlling shareholder. For example, in *Paramount, supra*, control of the corporation was not vested in a single person, entity, or group, but was widely held by a number of unaffiliated shareholders. In that case, the proposed sale of shares represented a premium for the change and consolidation of control of the company in a group that would have the power to materially alter the interests of the widely dispersed shareholders. Here, the control premium for the shares of Schneider belongs to the Family. The unaffiliated shareholders do not own, and are not giving up, the power to control the company's future.

Another distinction between this case and *Paramount* is that the offer from Maple Leaf, which was before the special committee at the time it was asked to make its decision, was considerably less than the Smithfield offer. In coming to its conclusion that it was not in the interests of the non-Family shareholders to prevent the Family from entering into a lockup agreement with Smithfield the Special Committee considered, among other things:

(a) that the shares would likely trade in the $18 to $20 range if no sale was effected;

(b) the position of the Family that it would not accept the Maple Leaf offer at $22 or the Booth Creek offer — or indeed any other offers from them;[6]

(c) that Smithfield would publicly withdraw its offer if the offer was shopped and, if this happened, the amount that Maple Leaf would be prepared to offer was problematic.

While Smithfield's offer was not within the range that Nesbitt Burns had placed on the shares as fair value, "a decent respect

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6 Recall that the Maple Leaf and the Booth Creek offers were worth considerably less to the Family and to the non-Family shareholders, provided they were in a similar tax position to the family. Smithfield's share exchange offer was worth approximately $4 a share more to them.

for reality forces one to admit that . . . advice [of an investment banker] is frequently a pale substitute for the dependable information that a canvass of the relevant market can provide": *Barkan, supra,* at p. 1287. It was widely known that a change of control was being considered, and few rival bids were forthcoming over an extended period of time: these facts support the decision to proceed with the impugned transaction.

The Board acted on the advice of the special committee in agreeing to facilitate the Smithfield bid by passing a resolution waiving the standstill provision, thereby allowing Smithfield to bid and to enter into the lock-up agreement with the Schneider Family. Unless another bid was received that was not conditional on the tender of any of the Schneider Family shares, which was highly unlikely, this decision by the Board had the effect of making the Smithfield bid the only one which would effectively be available to the shareholders. Implicit in the steps taken by the Board was a decision by the Board that the Smithfield bid was in the best interests of all the shareholders and therefore a bid which the Board could recommend to the shareholders.

The special committee was entitled to make, and did make, business and negotiating judgment calls which, having regard to the interests of the non-Family shareholders, were reasonable in the intense and time-limit-driven context. The deal with Smithfield was the only deal that the controlling shareholder was willing to consider. With respect to the alleged pre-empting of the process by not going back to Maple Leaf, Farley J. stated:

> . . . it appears that this merely prevented a further round of enquiry of Booth [Creek] and Maple Leaf which may or may not have elicited a higher bid than Smithfield whose last bid was tested.

If Maple Leaf was given an opportunity to top the Smithfield bid and that bid was then publicly withdrawn, then there was no guarantee that Maple Leaf would make a higher offer. There was no alternative bid which was definitely available and clearly more beneficial to Schneider and all its shareholders than the Smithfield bid. The Board acted on the advice of the special committee. The advice given and accepted was reasonable at the time and fair to the non-Family shareholders.

I would dismiss the first main ground of appeal.

THE COATTAIL PROVISIONS

There are three sub-issues here:

(a) whether Farley J. erred in his interpretation of the coattail provisions;

(b) whether, as held by Farley J., the filing of anti-conversion certificates by Schneider prevented the coattail provisions from being triggered; and

(c) whether Maple Leaf's failure to disclose the exclusionary nature of its offers in the take-over bid circulars and notices of variation is an omission of a material fact, and if so, what the remedy should be.

Did Farley J. Interpret the Coattail Provisions Correctly?

(i) *Facts re interpretation of coattail provisions*

Coattail provisions are designed to ensure that if the common voting shareholders wish to accept an offer that will lead to a change in control and if the price or terms offered to the common voting shareholders are more favourable than those offered to the holders of non-voting shares, the non-voting shareholders get an equal opportunity to participate in any change of control premium.

The provisions work in the following way. If the holders of restricted shares, such as non-voting shares, are excluded from participating in the common voting share takeover bid, they will then be given a right of conversion of their restricted or non-voting shares into common voting shares. Coattail provisions are intended to encourage non-exclusionary bids. When triggered, the non-voting shareholders then have the opportunity to participate in the take-over bid.

The Schneider Family proposed that a coattail provision be added to its articles of incorporation in a tradition of "fair dealing" in 1988, even though a company listed on the Toronto Stock Exchange ("TSE") was not required to have a coattail provision at that time. The Schneider coattails are consistent with the present TSE policy requirements. Mr. MacKay, Schneider's lawyer at the time, obtained the particular wording for the coattail from a precedent provided by the TSE. It was intended that the Class A shareholders would be entitled to share in the control premium only if the requisite number of common voting shareholders accepted the offer and the premium was in fact paid to the holders of common shares. Instead, in the coattail provision provided by the TSE as a precedent, and adopted by Schneider, even if it was apparent that a change of control would not take place because a sufficient number of common shares had not been acquired or purchased pursuant to the offer to the common shareholders, the company making the offer would have to take up and pay for all the shares held by the Class A shareholders who tendered to the offer.

Read literally, the coattail provision provided that if even a single common share was tendered to the offer for the common shares, the company making the offer would have to pay for all the Class A shares tendered whether or not any Class A shares were actually taken up and purchased or acquired. This is because the definition of exclusionary offer in para. 12(e) of the articles of Schneider uses the word "tendered" as opposed to the word "purchased" or "acquired".

Paragraph 12(e) defines an exclusionary offer as follows:

> (e) "Exclusionary Offer" means an offer to purchase common shares of the Corporation that:
>
> (i) must by reason of applicable securities legislation . . . be made to all or substantially all holders of common shares . . .; and
>
> (ii) is not made concurrently with an offer to purchase Class A Non-Voting shares that is identical to the offer to purchase common shares in terms of price per share and percentage of outstanding shares to be taken up exclusive of shares owned immediately prior to the offer by the Offeror and in all other material respects *and that has no condition attached other than the right not to take up and pay for shares tendered if no shares are tendered pursuant to the offer for common shares.*

(Emphasis added)

If the word *acquired* or *purchased* had been used in the definition of "exclusionary offer" instead of *tendered* there would not have been a problem with coattail provision. But Maple Leaf's lawyers recognized the problem. Maple Leaf's offer to purchase the common shares of Schneider was made concurrently with its offer to purchase the Class A shares. The offer to the Class A shareholders contained a condition entitling Maple Leaf not to take up and pay for any Class A shares deposited if Maple Leaf did not *acquire* any common shares pursuant to the offer to purchase common voting shares. This was not the condition permitted under the coattail provisions. The coattail provisions gave the right not to take up and pay for Class A shares if no common shares were *tendered*. Because the condition attaching to its Class A shares was different, Maple Leaf submits that its offer to the common shareholders was an exclusionary one.

(ii) *Findings of the trial judge*

With respect to the coattail provision in the articles of Schneider, Farley J. made the following findings:

— the so called "flaw" in the coattail was recognized by Maple Leaf well before it made its offer;

— a literal or technical interpretation of the wording of the Schneider coattail would be impractical and lead to a commercial absurdity;

— when Maple Leaf made its offer, the intention and the effect of the conditions it imposed in its offer was to make its offers identical for both the voting and non-voting shares of Schneider;

— Maple Leaf did not disclose to the shareholders that its offer was exclusionary in its original take-over bid circular or in any subsequent amendment to that circular prior to the announcement of the Smithfield lock-up agreement with Schneider on December 19, 1997. It was not until January 8, 1998, that Maple Leaf issued a notice of variation which disclosed to all shareholders for the first time its belief that its offer was exclusionary;

— Schneider's directors, on the other hand, described the Maple Leaf offer as a non-exclusionary offer in the directors' circular which was submitted to shareholders on November 23, 1997;

— he did not accept any of Maple Leaf's reasons for failing to disclose its belief that its offer was exclusionary.

With respect to Maple Leaf's failure to disclose its belief that it had made a non-exclusionary offer, the trial judge made the following findings:

— Maple Leaf put too narrow a focus on its obligation to disclose that its bid was designed to be exclusionary. It was inappropriate and misleading for Maple Leaf not to set out in an obvious fashion the information which a reasonable shareholder requires to make an informed decision;

— Maple Leaf "lay in the weeds" about its interpretation of the coattail, notwithstanding its knowledge of the Schneider directors' statement that Maple Leaf's offer was non-exclusionary. Maple Leaf did so because it did not want other competitive offerors to "twig" to its scheme;

— the technical interpretation now urged by Maple Leaf was not consistent with the intention of instituting the coattail at any time leading up to and including the time of the takeover.

In view of his findings, Farley J. held that the word "tender" should be construed as "tendered and taken up" thereby embodying the concept of "acquired" or "purchased".

Discussion

The following principles are of assistance in determining whether Farley J. correctly interpreted the coattail provisions:

— The interpretation of a word or words is not a technical exercise undertaken in isolation from the objective or purpose sought to be accomplished: see *Dreidger on the Construction of Statutes*, 3rd ed. (Toronto: Butterworths, 1994) at p. 131; thus, where giving a word its ordinary grammatical construction would lead to a contradiction of its apparent purpose or to a commercial absurdity, a construction may be put upon it which modifies the meaning of the word: P. St. J. Langan, *Maxwell on the Interpretation of Statutes*, 12th ed. (London: Sweet & Maxwell, 1969), at p. 228.

— A purposive approach is to be used whether one is interpreting a provision of a statute, a contract or other form of private legal document. In many respects the problems are the same in all three. A document is also a form of "sub-legislation" respecting those governed by its provisions: see Morden, "The Partnership of Bench and Bar" (1982), 16 *Law Soc. Gaz.* 46, and cases cited therein at pp. 89-95; *Dreidger on the Construction of Statutes*, at p. 131; *Maxwell on the Interpretation of Statutes*, at p. 228.

— The words of a statute to be interpreted are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act and the intention of Parliament: *Rizzo v. Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27, 154 D.L.R. (4th) 193. (This decision holds that although the literal reading of the words in the *Employment Standards Act* entitling an employee to severance, termination or vacation pay upon termination by the employer would not include the employer's bankruptcy, when the words are examined in their entire context they must be interpreted to include a termination *resulting from the bankruptcy of the employer*.) So, too, here, the wording of the coattail provision must be given an interpretation which accords with its object and the intention of the framers of the provision.

— The interpretation of a coattail provision must be viewed objectively and as a reasonably prudent business person would view it: *Saunders v. Cathton Holdings Ltd.* (1997), 88 B.C.A.C. 264 at p. 272, 36 B.L.R. (2d) 151.

— When the public interest is involved, evidence with respect to the understanding and intention of the provision is admissible to assist in determining whether a proposed interpretation is consistent with the public interest: *Re Canadian Tire Corp.* (1987), 35 B.L.R. 118 (Ont. Div. Ct.) at pp. 143-44.

The purpose of adopting a coattail provision is to discourage exclusionary offers, whereas a literal reading of Schneider's coattail provision gives the opposite effect. Certainty of meaning is of paramount importance in commercial transactions that affect the public. Those considering whether or not to tender to an offer to purchase their shares must know what investment decision they are making: see *Saunders*, *supra*, at pp. 272-73. In this instance, it appeared to the shareholders that the offers were the same because the amount to be paid to both classes of shareholders was the same. Maple Leaf understood how its offers would be perceived. If, instead, Maple Leaf was of the opinion that its offer was exclusionary, it could have said in its offering circular that it intended to apply to the appropriate authorities to have the issue of whether or not the offer was exclusionary determined in court as was done in *CW Shareholdings*, *supra*. Maple Leaf did not.

The interpretation of Maple Leaf's offers adopted by Farley J. is consistent with the way a reasonably prudent business person would construe the offer. The outcome he reaches is consistent with public expectations and is commercially sound. It employs a purposive approach. Farley J. did not err in holding that the Maple Leaf offer for common shares was not an "exclusionary offer" and that the coattail provisions in Schneider's articles had not been triggered.

THE ANTI-CONVERSION CERTIFICATES

Did Farley J. Err in his Conclusion That an Effective Anti-Conversion Certificate Had Been Filed?

The articles of Schneider provide that conversion of the Class A non-voting shares into common voting shares does not arise, even if an offer is an exclusionary offer, if the holders of 50 per cent or more of the common shares file a certificate with the transfer agent and the secretary of the corporation, under s. 16, indicating that they will not accept an exclusionary offer without giving the transfer agent written notice of their intention. Such a certificate can be a standing certificate filed before an offer is made (a 16(a) certificate), or a certificate filed within seven days of the making of an exclusionary offer (a 16(b) certificate). It is only if no certificate under s. 16 is filed that conversion rights arise.

The purpose of the filing of a s. 16(a) certificate with the transfer agent is to have an outside entity receive confirmation of the controlling shareholder's intention concerning exclusionary bids. Unless and until a bid for change of control of the company is made, the transfer agent does not have to take any further steps. As soon as possible after the seventh day after an offer is received, art. 17 and 18 of Schneider's articles require the transfer agent to send holders of Class A non-voting shares a notice advising them whether they are entitled to convert their Class A non-voting shares into common shares (presumably on the basis whether a s. 16(a) or s. 16(b) certificate is filed) and the reasons they are, or are not, entitled to convert their shares. The manifest purpose of the provision is to make the Class A non-voting shareholders aware of their rights.

Farley J. found as a fact that when the coattails were adopted, Schneider's secretary filed a 16(a) certificate under cover of May 2, 1988, with the transfer agent of Schneider which, at the time, was the Canada Trust Company.

Royal Trust Corporation succeeded Canada Trust as transfer agent for Schneider and later sold its transfer agency business to a company, which became CIBC Mellon Trust Company, Schneider's current transfer agent. Schneider did not file a new 16(a) certificate with Royal Trust when it became its transfer agent. CIBC Mellon has no record of having received the 1988 certificate from any source prior to receiving it from Goodman Phillips & Vineberg on December 29, 1997 — after the Maple Leaf offers had been made. A representative of CIBC Mellon testified that he would not expect Canada Trust to have forwarded the April 29, 1988 certificate to Royal Trust or its successors because CIBC Mellon's practice, and the practice in the industry generally, was not to do so. He testified that this is the type of document a company would redeliver. Mr. MacKay, however, testified that he had arranged for Canada Trust to deliver this certificate to Royal Trust. Farley J. accepted MacKay's evidence on this point. Assuming the certificate was received by Royal Trust, there was no evidence what Royal Trust did with the certificate once Royal Trust sold its business to CIBC Mellon.

Article 16 of Schneider simply states that the certificate is to be delivered to "the transfer agent". Farley J. stated:

> . . . the coattails provisions as provided for in the TSE precedent and adopted by Schneider provides for the certificate to be given to the transfer agent and to the secretary of Schneider. It does not say that it is to be given to the Secretary "for the time being". The context of the delivery of the certificate is that it be given to both at the same [general] time.

The articles of Schneider do not require the controlling shareholder to redeliver a s. 16(a) certificate when the company

changes transfer agents. Farley J. held that in the circumstances the s. 16(a) certificate did not have to be redelivered by Schneider. I agree with this interpretation. The role of a transfer agent is to maintain the records of a corporation. When there is a change in transfer agent, as with a change in trustee, it does not deprive the shareholders of the effect of the document. The notice to the original transfer agent is valid: see *Slattery v. Slattery*, [1945] O.R. 811 at p. 819 (C.A.).

Even if the Maple Leaf bid was an exclusionary bid the 16(a) certificate delivered in 1988 was effective and blocked the conversion of the Class A shares into common voting shares.

There is a further alternative argument raised in relation to the anti-conversion certificates. It is whether the filing of a s. 16(b) certificate after Maple Leaf's bid was made was effective.

Following notice that Maple Leaf's holding company SCH proposed to make a bid for Schneider, Eric Schneider delivered to himself as corporate secretary on November 11, 1997 a s. 16(b) certificate, but it was not provided to CIBC Mellon until December 22, 1997 and was therefore ineffective because it was not delivered within seven days of the "offer date" by SCH. On December 12, 1997, Maple Leaf, and not its holding company SCH, made a bid for the shares of Schneider and increased its offer to $22 a share. In addition, for the first time shares of Maple Leaf were offered as partial consideration for the shares of Schneider. Schneider again filed a s. 16(b) anti-conversion certificate dated December 19.

Farley J. found that the Family had a consistent intention to implement an effective anti-conversion certificate against any exclusionary offer. He acknowledged that under the ordinary principles of contract law a change in the essential terms of the offer such as occurred here between the November 11 offer and the December 12 offer, would be a new offer. He held, however, that the December 12 bid by Maple Leaf was not a new offer having regard to the definition of "Exclusionary Offer" contained in art. 12(e)(ii) of the coattails provision which says in part:

> . . . if an offer to purchase common shares is not an Exclusionary Offer . . . the varying of any term of such offer shall be deemed to constitute the making of a new offer unless an identical variation concurrently is made to the corresponding offer to purchase Class A Non-Voting shares;

I am of the opinion that Farley J. erred in holding that the December 12 offer by Maple Leaf was not a new offer on the basis of art. 12(e)(ii). The words construed by Farley J. are a saving provision. The saving provision presupposes that an offer was originally non-exclusionary and the offer is varied with the result that unequal terms are offered to the common

and Class A shareholders. In those circumstances the offer will be considered to be a new offer which is exclusionary. The deeming provision of article 12(e)(ii) does not deprive the controlling shareholder of the substantive right in art. 16(b) to file an anti-conversion certificate if the original offer made is exclusionary and the subsequent offer is also exclusionary but completely different as to its terms. This interpretation is supported by regard to art. 16(b). Under art. 16(b), the anti-conversion certificate must be delivered within seven days after "the offer date". The "offer date" is defined in art. 12(g):

> Offer Date means the date on which an Exclusionary Offer is made.

Thus, whenever an offer which is exclusionary is made, Schneider has seven days to deliver an anti-conversion certificate.

Based on both the wording of the articles and on general contract principles, the offer of December 12 was a new offer and the 16(b) anti-conversion certificate filed was effective.

The Omission of Maple Leaf to State that its Offers Were Exclusionary in its Offering Circular and the Effect, if any, of such Omission

Farley J. did not find it necessary to decide this issue and I am of the opinion that it is unnecessary to do so in view of my conclusions concerning the other issues raised.

DISPOSITION

For the reasons given, the appeals from the judgment of Farley J. are dismissed. Because I have held that Farley J. did not err in holding that the offer to purchase common shares made by Maple Leaf to shareholders of Schneider was not an exclusionary offer within the meaning of the articles of Schneider, it was not necessary to deal with the cross-appeals by the Family. I have, however, dealt with one aspect of the cross-appeals, namely, the effectiveness of the anti-conversion certificates. If it were necessary to do so, I would allow the cross-appeal to the extent necessary to grant relief in accordance with para. (a) of the Family's notice of cross-appeal. The balance of the cross-appeal has not been considered and is dismissed. If necessary, I would also allow the cross-appeal of Smithfield which relates to the same point, namely, the effectiveness of the anti-conversion certificates.

Counsel have asked to make further submissions concerning costs. I would invite the respondents to file their submissions in writing within 15 days from the release of these reasons and the

appellants ten days thereafter. Reply submissions respecting costs, if any, should be filed within a further five days.

Appeal dismissed.

APPENDIX

Business Corporations Act, R.S.C. 1995, c. B.16

134(1) Every director and officer of a corporation in exercising his or her powers and discharging his or her duties shall,

(*a*) act honestly and in good faith with a view to the best interests of the corporation; and

(*b*) exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

(2) Every director and officer of a corporation shall comply with this Act, the regulations, articles, by-laws and any unanimous shareholders agreement.

. . . . .

248(1) A complainant and, in the case of an offering corporation, the Commission may apply to the court for an order under this section.

(2) Where, upon an application under subsection (1), the court is satisfied that in respect of a corporation or any of its affiliates,

(*a*) any act or omission of the corporation or any of its affiliates effects or threatens to effect a result;

(*b*) the business or affairs of the corporation or any of its affiliates are, have been or are threatened to be carried on or conducted in a manner; or

(*c*) the powers of the directors of the corporation or any of its affiliates are, have been or are threatened to be exercised in a manner,

that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of.

(3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,

(*a*) an order restraining the conduct complained of;

(*b*) an order appointing a receiver or receiver-manager;

(*c*) an order to regulate a corporation's affairs by amending the articles or by-laws or creating or amending a unanimous shareholder agreement;

(*d*) an order directing an issue or exchange of securities;

(*e*) an order appointing directors in place of or in addition to all or any of the directors then in office;

(*f*) an order directing a corporation, subject to subsection (6), or any other person, to purchase securities of a security holder;

(*g*) an order directing a corporation, subject to subsection (6), or any other person, to pay to a security holder any part of the money paid by the security holder for securities;

(*h*) an order varying or setting aside a transaction or contract to which a corporation is a party and compensating the corporation or any other party to the transaction or contract;

(*i*) an order requiring a corporation, within a time specified by the court, to produce to the court or an interested person financial statements in the form required by section 154 or an accounting in such other form as the court may determine;

(*j*) an order compensating an aggrieved person;

(*k*) an order directing rectification of the registers or other records of a corporation under section 250;

(*l*) an order winding up the corporation under section 207;

(*m*) an order directing an investigation under Part XIII be made; and

(*n*) an order requiring the trial of any issue.

(4) Where an order made under this section directs amendment of the articles or by-laws of a corporation,

(*a*) the directors shall forthwith comply with subsection 186(4); and

(*b*) no other amendment to the articles or by-laws shall be made without the consent of the court, until the court otherwise orders.

(5) A shareholder is not entitled to dissent under section 185 if an amendment to the articles is effected under this section.

(6) A corporation shall not make a payment to a shareholder under clause (3)(*f*) or (*g*) if there are reasonable grounds for believing that,

(*a*) the corporation is or, after the payment, would be unable to pay its liabilities as they become due; or

(*b*) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities.

Levy-Russell Limited et al. v. Shieldings Incorporated et al.

[Indexed as: Levy-Russell Ltd. v. Shieldings Inc.]

Ontario Court (General Division), Sanderson J. December 10, 1998

Corporations — Oppression — Complainant — Judgment creditor — Plaintiffs bringing proceedings for oppression remedy — After trial ordered as means to resolve oppression proceeding, defendants moving