

**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 EXHIBIT "A"**

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**BOOK OF AUTHORITIES OF THE RESPONDING PARTY  
THE AD HOC COMMITTEE**

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**January 11, 2010**

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# TAB 1

1992 CarswellBC 524, 15 C.B.R. (3d) 265, 72 B.C.L.R. (2d) 368, 19 B.C.A.C. 134, 34 W.A.C. 134

1992 CarswellBC 524

Pacific National Lease Holding Corp., Re

Re PACIFIC NATIONAL LEASE HOLDING CORPORATION, PACIFIC NATIONAL FINANCIAL CORPORATION, PACIFIC NATIONAL LEASING CORPORATION, PACIFIC NATIONAL VEHICLE LEASING CORPORATION, SOUTHBOROUGH HOLDINGS INC. and PAC NAT EQUITIES CORPORATION

British Columbia Court of Appeal

Macfarlane J.A. [in Chambers]

Heard: October 22, 1992

Judgment: October 28, 1992

Docket: Doc. Vancouver CA016047

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Counsel: *H.C. Ritchie Clark* and *D.D. Nugent*, for petitioners (appellants).

*W.E.J. Skelly*, for Sun Life Trust Company.

*M.P. Carroll*, for Mutual Life Assurance Company of Canada.

*W.C. Kaplan*, for Comcorp Financial Services Inc. and National Trust.

*H.W. Veenstra*, for National Bank of Canada.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Application of Act.

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Court refusing to authorize company to set aside funds to fulfil its obligations under Employment Standards Act — Company applying for leave to appeal from order — Leave being denied as appeal likely to delay or frustrate re-organization efforts — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-46 — Employment Standards Act, R.S.B.C. 1979, c. 10.

The petitioners made an application under the *Companies' Creditors Arrangement Act* ("CCAA") for a stay of all proceedings so that they might attempt a re-organization of their affairs. The stay was granted, but the petitioners subsequently applied to set aside over \$1 million in a trust fund to meet their obligations under the *Employment Standards Act* (B.C.). The petitioners' application was dismissed because to allow the petitioners' application would be an unacceptable alteration of the status quo in effect when the order was granted. The petitioners sought leave to appeal.

**Held:**

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The application was dismissed.

In supervising a proceeding under the CCAA, orders are made, and orders are varied as changing circumstances require. Orders depend upon a careful and delicate balancing of a variety of interests and problems. In that context, appellate proceedings may well upset the balance and delay or frustrate the process under the CCAA. Accordingly, it was not appropriate to grant leave to appeal.

**Cases considered:**

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

*Westar Mining Ltd., Re* (1992), 14 C.B.R. (3d) 95 (B.C. S.C.) — *referred to*

**Statutes considered:**

Bank Act, R.S.C. 1985, c. B-1.

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

Employment Standards Act, R.S.B.C. 1979, c. 10.

Application for leave to appeal from order made under Companies' Creditors Arrangement Act.

***Macfarlane J.A.:***

1 This is an application for leave to appeal an order of Mr. Justice Brenner pronounced August 17, 1992 pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "C.C.A.A.").

2 The petitioners had become insolvent prior to July 22, 1992 when they made an application under the C.C.A.A. for a stay of all proceedings so that they might attempt a reorganization of their affairs as contemplated by the C.C.A.A.

3 Mr. Justice Brenner made an ex parte order on July 23, 1992. The effect of the order was to stay all proceedings against the petitioners.

4 The order permitted the petitioners to maintain in trust a sum not exceeding \$1,500,000, to satisfy the potential liabilities of directors and officers of the petitioner companies with respect to the payment of wages under provincial legislation and remittances in connection therewith pursuant to federal legislation. The petitioners had previously established that fund to protect its directors and officers from potential personal liability under the *Employment Standards Act*, R.S.B.C. 1979, c. 10, for failing to make the payments mandated by that statute.

5 On July 31, 1992 Mr. Justice Brenner heard a number of applications brought by various interested parties seeking to set aside the ex parte stay order or, if the stay order was not set aside, to vary its terms. Mr. Justice Brenner amended and replaced the stay order with an order on terms proposed by the parties. That order has not yet been entered and has gone through a number of amendments. The order provided that on an interim basis, pending the hearing and determination of an application on the merits of the issues, the petitioners should not, without further order of the court, make any payment to any employee or employees of the petitioners in respect of unpaid wages, severance, termination, lay-off, vacation pay or other benefits arising or otherwise payable as a result of the termination of an employee or employees.

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6 The merits were argued in August, and on August 17 Mr. Justice Brenner delivered the reasons for judgment and made the order which is the subject of this application.

7 The operative portions of the order read as follows:

THIS COURT ORDERS that the application by the Petitioners to make statutory severance payments or to maintain a trust fund to indemnify its directors and officers with respect to statutory severance payments is dismissed;

THIS COURT FURTHER ORDERS that any proceedings that may be brought by employees of the Petitioners to compel payment of statutory severance payments are stayed.

8 The appeal concerns the order made under para. 1 of the order, not against the stay granted in para. 2.

9 The reasons for judgment of Mr. Justice Brenner are careful and detailed and are contained in 17 pages. The reasons contain a review of the essential facts, including the circumstances which gave rise to the financial difficulties of the petitioners, the competing arguments with respect to the need and the ability to make severance payments to employees whose services had been terminated, a consideration of the purposes of the C.C.A.A., the principle derived from the judgment of Mr. Justice Macdonald in *Re Westar Mining Ltd.*, unreported reasons for judgment, August 11, 1992 [now reported at 14 C.B.R. (3d) 95 (B.C. S.C.)] (which dealt with a similar issue), and the application of that principle to the facts of this case.

10 The essential facts are that the petitioners are a group of interrelated companies that have carried on a leasing business for some years. Just prior to the commencement of the C.C.A.A. proceedings the petitioners had over \$246,000,000 in lease portfolios under administration. They had a workforce of approximately 230 which, by the time Mr. Justice Brenner gave his reasons on August 17, 1992, had been reduced to 60. The provisions of the *Employment Standards Act* had not, by August 17, 1992, given rise to any actual liability with respect to the severance of the employees who had left the company. The potential liability was not known but the company said that it could be as much as \$1,500,000.

11 Mr. Skelly informed me, upon the hearing of the application, that the latest information indicated a liability for severance pay in an amount of approximately \$850,000 and for vacation pay in an amount of approximately \$150,000 for a total potential liability of \$1,000,000. I understand from counsel that once the funders are repaid there may be as much as \$61,000,000 available to meet other liabilities.

12 Mr. Clark, for the petitioners, was not prepared to concede that the potential liability had been reduced, and submits that a trust fund of about \$1,300,000 is required.

13 The petitioners were in the business of purchasing equipment or vehicles and entering into leases with third parties. The initial purchases were financed with security on such leases granted in favour of National Bank of Canada and by way of a trust deed in favour of Canada Trust Company and Royal Trust Company. Additional financial advances were obtained from the other respondents, who are 27 other financial institutions, referred to in the material as the "funders." The funders advanced moneys and took security, in part by way of assignment of the lease revenue stream. The moneys advanced by the funders exceeded the amount which the petitioners had paid for the equipment or vehicles. The difference, together with other revenue, was the petitioners' profit.

14 The arrangements with the funders provided that the petitioners would continue the ongoing administration of the leases, including collection of the monthly lease payments, which would be forwarded to the funders.

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15 The petitioners got into financial difficulties, which they revealed to the funders. The funders and the petitioners were not able to agree to a plan to deal with this crisis. As a result the petitioners sought protection under the C.C.A.A.

16 The appellants seek an order of this court setting aside the order made August 17, 1992, and authorizing the petitioners to comply with the statutes governing their operations (and in particular the *Employment Standards Act*) and permitting them to continue to maintain the trust funds with respect to possible claims against directors and officers arising out of the various federal and provincial statutes.

17 The petitioners assert that Mr. Justice Brenner erred:

18 1. In ordering the appellants not to abide by the relevant mandatory statutory provisions including those under the *Employment Standards Act*, requiring the appellants to pay all the statutory payments in full, and thereby ordering the appellants to breach a mandatory statute regarding statutory payments.

19 2. In ruling that he had the inherent jurisdiction under the *Companies' Creditors Arrangement Act* or otherwise to order the appellants to breach the *Employment Standards Act* regarding statutory payments and thereby order the petitioners to commit offences under such statute.

20 3. In failing to properly apply the relevant legal principles applicable to a decision regarding the payment of statutory payments including such payments to former employees.

21 4. In ruling that the payment of unpaid wages and holiday and vacation pay accruing to the appellants' employees was to be treated in the same manner as severance pay.

22 5. In suspending the provisions of the July 23, 1992 order authorizing the trust fund.

23 6. In failing to provide any protection to the directors and officers of the appellants by way of the trust fund when ordering the petitioners to breach the *Employment Standards Act*, thereby exposing the directors and officers of the petitioners to liabilities under that statute and to prosecution for offences thereunder.

24 I understand the submission of the respondents to be that the real issue is whether a judge, acting pursuant to the powers given by the C.C.A.A., may make an order the purpose of which is to hold all creditors at bay pending an attempted reorganization of the affairs of a company, and which is intended to prevent a creditor obtaining a preference which it would not have if the attempted reorganization fails and bankruptcy occurs.

25 I think that the answer is given in *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311, [1991] 2 W.W.R. 136, 51 B.C.L.R. (2d) 84 (C.A.). In that case Mr. Justice Gibbs, at pp. 88-89 [B.C.L.R.], said:

The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. It is available to any company incorporated in Canada with assets or business activities in Canada that is not a bank, a railway company, a telegraph company, an insurance company, a trust company, or a loan company. When a company has recourse to the C.C.A.A. the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Obviously time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success, there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11.

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26 In the same case, at p. 92, Mr. Justice Gibbs considered whether security given under the *Bank Act* [R.S.C. 1985, c. B-1] gave preference to the bank over other creditors, despite the provisions of the C.C.A.A. He said:

It is apparent from these excerpts and from the wording of the statute that, in contrast with ss. 178 and 179 of the *Bank Act* which are preoccupied with the competing rights and duties of the borrower and the lender, the C.C.A.A. serves the interests of a broad constituency of investors, creditors and employees. If a bank's rights in respect of s. 178 security are accorded a unique status which renders those rights immune from the provisions of the C.C.A.A., the protection afforded that constituency for any company which has granted s. 178 security will be largely illusory. It will be illusory because almost inevitably the realization by the bank on its security will destroy the company as a going concern. Here, for example, if the bank signifies and collects the accounts receivable, Chef Ready will be deprived of working capital. Collapse and liquidation must necessarily follow. The lesson will be that where s. 178 security is present a single creditor can frustrate the public policy objectives of the C.C.A.A. There will be two classes of debtor companies: those for whom there are prospects for recovery under the C.C.A.A.; and those for whom the C.C.A.A. may be irrelevant dependent upon the whim of the s. 178 security holder. Given the economic circumstances which prevailed when the C.C.A.A. was enacted, it is difficult to imagine that the legislators of the day intended that result to follow.

27 Mr. Justice Brenner, after reviewing that and other authorities, said:

(1) The purpose of the C.C.A.A. is to allow an insolvent company a reasonable period of time to reorganize its affairs and prepare and file a plan for its continued operation subject to the requisite approval of the creditors and the court.

(2) The C.C.A.A. is intended to serve not only the company's creditors but also a broad constituency which includes the shareholders and the employees.

(3) During the stay period the Act is intended to prevent manoeuvres for positioning amongst the creditors of the company.

(4) The function of the court during the stay period is to play a supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure.

(5) The status quo does not mean preservation of the relative pre-debt status of each creditor. Since the companies under C.C.A.A. orders continue to operate and having regard to the broad constituency of interests the Act is intended to serve, preservation of the status quo is not intended to create a rigid freeze of relative pre-stay positions.

(6) The court has a broad discretion to apply these principles to the facts of a particular case.

Counsel do not suggest that statement of principles is incorrect.

28 Mr. Justice Brenner then referred to the judgment of Mr. Justice Macdonald in *Westar*, supra, and concluded:

In my view, to allow the petitioners to make statutory severance payments or to authorize a fund out of the company's operating revenues for that purpose would be an unacceptable alteration of the status quo in effect when the order was granted.

29 He said earlier that he did not understand Mr. Justice Macdonald to be saying in *Westar* that in no case should a

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court ever authorize severance payments when a company is operating under the C.C.A.A.

30 He held, in effect, that it was a proper exercise of the discretion given to a judge under the C.C.A.A. to order that no preference be given to any creditor while a reorganization was being attempted under the C.C.A.A.

31 It appears to me that an order which treats creditors alike is in accord with the purpose of the C.C.A.A. Without the provisions of that statute the petitioner companies might soon be in bankruptcy, and the priority which the employees now have would be lost. The process provided by the C.C.A.A. is an interim one. Generally, it suspends but does not determine the ultimate rights of any creditor. In the end it may result in the rights of employees being protected, but in the meantime it preserves the status quo and protects all creditors while a reorganization is being attempted.

32 So far as the directors and officers are concerned, they were personally liable for potential claims under the *Employment Standards Act* before July 22. Nothing has changed. No authority has been cited to show that the directors and officers have a preferred right over other potential creditors.

33 This case is not so much about the rights of employees as creditors, but the right of the court under the C.C.A.A. to serve not the special interests of the directors and officers of the company but the broader constituency referred to in *Chef Ready Foods Ltd.*, supra. Such a decision may inevitably conflict with provincial legislation, but the broad purposes of the C.C.A.A. must be served.

34 In this case Mr. Justice Brenner reviewed the evidence and made certain findings of fact. He concluded that it would be an unacceptable alteration of the status quo for the petitioners to make statutory severance payments or to authorize a fund out of the companies' operating revenues for that purpose. He also found that there was no evidence before him that the petitioners' operation will be impaired if terminated employees do not receive severance pay and instead become creditors of the company. He said that there was no evidence that the directors and officers will resign and be unavailable to assist the company in its organization plans.

35 Despite what I have said, there may be an arguable case for the petitioners to present to a panel of this court on discreet questions of law. But I am of the view that this court should exercise its powers sparingly when it is asked to intervene with respect to questions which arise under the C.C.A.A. The process of management which the Act has assigned to the trial court is an ongoing one. In this case a number of orders have been made. Some, including the one under appeal, have not been settled or entered. Other applications are pending. The process contemplated by the Act is continuing.

36 A colleague has suggested that a judge exercising a supervisory function under the C.C.A.A. is more like a judge hearing a trial, who makes orders in the course of that trial, than a chambers judge who makes interlocutory orders in proceedings for which he has no further responsibility.

37 Also, we know that in a case where a judgment has not been entered, it may be open to a judge to reconsider his or her judgment and alter its terms. In supervising a proceeding under the C.C.A.A. orders are made, and orders are varied as changing circumstances require. Orders depend upon a careful and delicate balancing of a variety of interests and of problems. In that context appellate proceedings may well upset the balance, and delay or frustrate the process under the C.C.A.A. I do not say that leave will never be granted in a C.C.A.A. proceeding. But the effect upon all parties concerned will be an important consideration in deciding whether leave ought to be granted.

38 In all the circumstances I would refuse leave to appeal.

*Application dismissed.*

END OF DOCUMENT

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# TAB 2

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2003 CarswellOnt 115

Algoma Steel Inc. v. Union Gas Ltd.

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 and the Business Corporations Act,  
R.S.O. 1990, c. B-16

In the Matter of a Proposed Plan of Arrangement With Respect to Algoma Steel Inc.

Algoma Steel Inc., Applicant (Respondent in Appeal) and Union Gas Limited, Respondent (Appellant in Appeal)

Ontario Court of Appeal

Weiler, Rosenberg, Feldman JJ.A.

Heard: September 10, 2002

Judgment: January 17, 2003

Docket: CA C37904

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Proceedings: reversing in part (2001), 30 C.B.R. (4th) 163 (Ont. S.C.J. [Commercial List])

Counsel: *Geoff R. Hall*, for Algoma Steel Inc.

*James P. Dube*, for Union Gas Ltd.

Subject: Corporate and Commercial; Public; Insolvency

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

On April 23, 2001, debtor obtained initial order under Companies' Creditors Arrangement Act — As of date of order, debtor owed creditor \$461,244 under 2000 gas services contract and \$1,265,934 under 2000 assignment agreement — 2000 gas services contract was contingent upon 2000 assignment agreement which was attached to it as schedule — At same time debtor was entitled to rebate from creditor of approximately \$2.2 million as result of overpayment for gas services in 1999 at which time relationship between parties had been governed by 1998 buy-sell contract — Creditor brought motion for order allowing it to set off amounts owed to it by debtor against rebate — Motion was granted in part — Motions judge held that creditor had not established claim for legal set-off as rebate was not liquidated amount — Motions judge held that creditor had established claim for equitable set-off in relation to amount owing under 2000 gas services contract — Creditor appealed — Appeal allowed in part — Motions judge did not err with respect to legal set-off but did err in limiting scope of equitable set-off — Connection between 2000 gas services contract and 2000 assignment agreement was so close that amounts owing on them could not be severed for purposes of equitable set-off — Close connection also existed between 1998 contract and both of 2000 contracts as they all

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facilitated supply of gas to debtor — To allow debtor to insist on payment of rebate arising under 1998 contract without allowing creditor to set-off all amounts owing under 2000 arrangement would be manifestly unjust — 2000 arrangement was nothing more than successor arrangement to accomplish what had been done under 1998 contract — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Public utilities --- Operation of utility — Collection of utility charges — General

On April 23, 2001, debtor obtained initial order under Companies' Creditors Arrangement Act — As of date of order, debtor owed creditor \$461,244 under 2000 gas services contract and \$1,265,934 under 2000 assignment agreement — 2000 gas services contract was contingent upon 2000 assignment agreement which was attached to it as schedule — At same time debtor was entitled to rebate from creditor of approximately \$2.2 million as result of overpayment for gas services in 1999 at which time relationship between parties had been governed by 1998 buy-sell contract — Creditor brought motion for order allowing it to set off amounts owed to it by debtor against rebate — Motion was granted in part — Motions judge held that creditor had not established claim for legal set-off as rebate was not liquidated amount — Motions judge held that creditor had established claim for equitable set-off in relation to amount owing under 2000 gas services contract — Creditor appealed — Appeal allowed in part — Motions judge did not err with respect to legal set-off but did err in limiting scope of equitable set-off — Connection between 2000 gas services contract and 2000 assignment agreement was so close that amounts owing on them could not be severed for purposes of equitable set-off — Close connection also existed between 1998 contract and both of 2000 contracts as they all facilitated supply of gas to debtor — To allow debtor to insist on payment of rebate arising under 1998 contract without allowing creditor to set-off all amounts owing under 2000 arrangement would be manifestly unjust — 2000 arrangement was nothing more than successor arrangement to accomplish what had been done under 1998 contract — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Creditors and debtors --- Payment by debtor — Mode of payment — Set-off

On April 23, 2001, debtor obtained initial order under Companies' Creditors Arrangement Act — As of date of order, debtor owed creditor \$461,244 under 2000 gas services contract and \$1,265,934 under 2000 assignment agreement — 2000 gas services contract was contingent upon 2000 assignment agreement which was attached to it as schedule — At same time debtor was entitled to rebate from creditor of approximately \$2.2 million as result of overpayment for gas services in 1999 at which time relationship between parties had been governed by 1998 buy-sell contract — Creditor brought motion for order allowing it to set off amounts owed to it by debtor against rebate — Motion was granted in part — Motions judge held that creditor had not established claim for legal set-off as rebate was not liquidated amount — Motions judge held that creditor had established claim for equitable set-off in relation to amount owing under 2000 gas services contract — Creditor appealed — Appeal allowed in part — Motions judge did not err with respect to legal set-off but did err in limiting scope of equitable set-off — Connection between 2000 gas services contract and 2000 assignment agreement was so close that amounts owing on them could not be severed for purposes of equitable set-off — Close connection also existed between 1998 contract and both of 2000 contracts as they all facilitated supply of gas to debtor — To allow debtor to insist on payment of rebate arising under 1998 contract without allowing creditor to set-off all amounts owing under 2000 arrangement would be manifestly unjust — 2000 arrangement was nothing more than successor arrangement to accomplish what had been done under 1998 contract — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Choses in action --- Equities to which assignments subject — Right of set-off

On April 23, 2001, debtor obtained initial order under Companies' Creditors Arrangement Act — As of date of order, debtor owed creditor \$461,244 under 2000 gas services contract and \$1,265,934 under 2000 assignment agreement — 2000 gas services contract was contingent upon 2000 assignment agreement which was attached to it as schedule — At same time debtor was entitled to rebate from creditor of approximately \$2.2 million as result of overpayment for gas services in 1999 at which time relationship between parties had been governed by 1998 buy-sell contract — Creditor brought motion for order allowing it to set off amounts owed to it by debtor against rebate — Motion was

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granted in part — Motions judge held that creditor had not established claim for legal set-off as rebate was not liquidated amount — Motions judge held that creditor had established claim for equitable set-off in relation to amount owing under 2000 gas services contract — Creditor appealed — Appeal allowed in part — Motions judge did not err with respect to legal set-off but did err in limiting scope of equitable set-off — Connection between 2000 gas services contract and 2000 assignment agreement was so close that amounts owing on them could not be severed for purposes of equitable set-off — Close connection also existed between 1998 contract and both of 2000 contracts as they all facilitated supply of gas to debtor — To allow debtor to insist on payment of rebate arising under 1998 contract without allowing creditor to set-off all amounts owing under 2000 arrangement would be manifestly unjust — 2000 arrangement was nothing more than successor arrangement to accomplish what had been done under 1998 contract — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

**Cases considered by Rosenberg J.A.:**

Cam-Net Communications v. Vancouver Telephone Co., 182 D.L.R. (4th) 436, 1999 BCCA 751, 1999 CarswellBC 2808, 71 B.C.L.R. (3d) 226, 132 B.C.A.C. 52, 215 W.A.C. 52, 2 B.L.R. (3d) 118, 17 C.B.R. (4th) 26 (B.C. C.A.) — considered

Coba Industries Ltd. v. Millie's Holdings (Canada) Ltd., 36 R.P.R. 259, 20 D.L.R. (4th) 689, 65 B.C.L.R. 31, [1985] 6 W.W.R. 14, 1985 CarswellBC 214 (B.C. C.A.) — followed

Equity Waste Management of Canada Corp. v. Halton Hills (Town), 1997 CarswellOnt 3270, 40 M.P.L.R. (2d) 107, 103 O.A.C. 324, 35 O.R. (3d) 321 (Ont. C.A.) — considered

Federal Commerce & Navigation Co. v. Molena Alpha Inc., [1978] Q.B. 927, [1978] 3 All E.R. 1066, [1978] 3 W.L.R. 309, [1978] 2 Lloyd's Rep. 132 (Eng. Q.B.) — followed

Federal Commerce & Navigation Co. v. Molena Alpha Inc. (1978), [1979] A.C. 757, [1979] 1 All E.R. 307, [1979] 1 Lloyd's Rep. 201 (U.K. H.L.) — referred to

Housen v. Nikolaisen, 2002 SCC 33, 2002 CarswellSask 178, 2002 CarswellSask 179, 286 N.R. 1, 10 C.C.L.T. (3d) 157, 211 D.L.R. (4th) 577, [2002] 7 W.W.R. 1, 219 Sask. R. 1, 272 W.A.C. 1, 30 M.P.L.R. (3d) 1 (S.C.C.) — considered

Telford v. Holt, 21 C.P.C. (2d) 1, [1987] 2 S.C.R. 193, 41 D.L.R. (4th) 385, 78 N.R. 321, (sub nom. Holt v. Telford) [1987] 6 W.W.R. 385, 54 Alta. L.R. (2d) 193, 81 A.R. 385, 37 B.L.R. 241, 46 R.P.R. 234, 1987 CarswellAlta 188, 1987 CarswellAlta 583 (S.C.C.) — followed

**Statutes considered:**

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

Generally — referred to

s. 13 — referred to

s. 18.1 [en. 1997, c. 12, s. 125] — considered

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

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s. 111 — considered

s. 111(1) — referred to

s. 111(2) — referred to

APPEAL by creditor from judgment reported at 2001 CarswellOnt 4518, 30 C.B.R. (4th) 163 (Ont. S.C.J. [Commercial List]), refusing to allow legal set-off and limiting scope of equitable set-off.

***Rosenberg J.A.:***

1 This appeal from an Order of Farley J. concerns the application of legal and equitable set-off in the context of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended. On April 23, 2001, the respondent Algoma Steel Inc. obtained an initial order under the *CCAA*. At that time, Algoma was indebted to the appellant Union Gas Limited under two contracts (the 2000 contracts) for gas services in March and April of 2001 amounting to just under \$2 million. At the same time, Algoma was entitled to a rebate from Union of approximately \$2.2 million plus interest as a result of an overpayment for gas services in 1999. Union sought to set off amounts owed to it by Algoma against the 1999 rebate. The motions judge held that Union had not established a claim for legal set-off. He held that Union had made out a claim for an equitable set-off but only in relation to one of the contracts in the amount of \$461,244. Because of various orders made in the *CCAA* proceedings this means that Union must pay the entire amount of the 1999 rebate less the \$461,244 and is not entitled to payment of \$1,265,934 owed to it under the 2000 contract. Union submits that the motions judge erred in refusing to allow legal set-off and, in the alternative, erred in limiting the scope of equitable set-off.

2 In my view, the motions judge did not err with respect to legal set-off but did err with respect to equitable set-off. Accordingly, I would allow the appeal with costs.

**The Facts**

***The relationship between Algoma and Union***

3 The facts are based entirely upon affidavits filed by two employees of Union. Algoma filed no affidavits and did not cross-examine the Union employees. I begin with a summary of the facts that lead to Algoma's entitlement to the \$2.2 million rebate. In 1999, Algoma obtained gas on a buy/sell arrangement under which Algoma bought natural gas from a resource supplier (presumably in Western Canada) and sold the gas to Union. Union arranged for the transportation of the gas on its own account and then sold the gas back to Algoma in Ontario when it was needed. In 1999, the relationship between Union and Algoma was governed by a contract commencing November 1, 1998 and terminating on October 31, 1999. This contract was subject to automatic renewal for successive one-year periods.[FN1]

4 Under the 1998 contract, Algoma was required to pay for the gas services in accordance with Union's rate schedule as approved by the Ontario Energy Board. These rates are based on many factors including projected costs of gas. If those projections are found to be either too high or too low following the end of a calendar year, Algoma may have either overpaid or underpaid Union. To track actual costs with projected costs, Union established deferral accounts for the various classes of customers. Algoma is in a Rate 100 class. As it happened, in 1999, Algoma and the other Rate 100 customers overpaid and were entitled to a rebate. However, Union could not repay its customers without approval from the Board. Union therefore made an application to the Board in which it proposed to pay the rebates to the customers. The total rebate for the Rate 100 class is just under \$4 million. According to the affidavit of the Union employee, Algoma's share of the rebate "approximates \$2.2 million". Algoma is also entitled to interest on the rebate accruing from January 1, 2000 at a rate set by the Board.

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5 In its July 21, 2001 decision, the Board approved Union's proposal. But instead of authorizing immediate payment, the Board directed Union to bring forward the balances in all of the year 2000 deferral accounts for review. In a further decision dated October 16, 2001, the Board directed Union to continue to hold the balances in the deferral accounts until the 2001 and 2002 rates are implemented and 2000 and 2001 deferral balances are disposed of. According to the Union employee's affidavit, this will not affect Algoma's rebate because it is not entitled to share in the 2000 and 2001 deferral accounts. By the time of the hearing before the motions judge, the Board had not yet indicated when Union could pay the rebate to its customers, including Algoma.

6 I will now deal with the contracts that governed the Union/Algoma relationship when the *CCAA* orders were made. In 2000, Algoma changed its relationship with Union so that it no longer had a buy-sell arrangement. In October 2000, the parties entered into two new contracts. These contracts may conveniently be referred to as the 2000 gas services contract and the assignment agreement. Both contracts covered almost the same period; from November 1, 2000 to October 31, 2001 for the 2000 gas services contract and November 1, 2000 to November 1, 2001 for the assignment agreement. As a result of the new arrangement, Algoma no longer sold the gas to Union and repurchased it from Union in Ontario. Rather, Union assigned its right to access gas transportation capacity directly from TransCanada Pipelines Limited ("TCPL") through Union's contract with TCPL. Algoma thus paid TCPL directly. Importantly, however, if Algoma failed to pay TCPL for use of gas transportation capacity being accessed by it, Union was required to pay TCPL. Algoma was then required to indemnify Union.

7 Under the 2000 gas services contract, Union continued to transport the gas from Union's metering station at the TCPL pipeline to the Algoma plant. That contract included this term:

This agreement is contingent upon the TCPL Assignment Agreement which is attached as Schedule D and forms an integral part of this arrangement. In the event either of these agreements terminate, the other agreement shall also terminate, unless agreed to otherwise by the parties.

8 As of the April 23, 2001 *CCAA* order, Algoma owed Union \$461,244 under the 2000 gas services contract. Further, because Algoma failed to pay TCPL for gas transportation services obtained by Algoma under the assignment agreement, Union was obliged to indemnify TCPL in the amount of \$1,265,934. It is these two amounts that Union seeks to set off against the 1999 rebate. As indicated, the motions judge only allowed Union to set off the former amount.

### ***The CCAA Proceedings***

9 On April 23, 2001, Algoma obtained an initial order under the *CCAA*. As part of that order, the right of any claimant to assert, enforce or exercise any right of set-off or consolidation of accounts was stayed during the stay period. On November 9, 2001, while the stay period was still in force, Algoma obtained an order to authorize meetings of its creditors to consider its Plan of Arrangement, to establish a process for proving claims and for the subsequent barring of those claims in return for participating in the Plan. Under this order, an unsecured creditor that had not filed a proof of claim was deemed to have filed one in the amount as valued by Algoma. The creditor was then barred from making or enforcing any such deemed claim after December 12, 2001. Union did not file a proof of claim since it took the view that there was no net balance due from Algoma to Union once the 1999 rebate was factored in. Algoma denied that Union was entitled to a set-off and deemed Union's claim to be in the amounts of \$461,244 and \$1,265,934.

10 As a result, on November 27, 2001, Union moved before Farley J. for a declaration that its rights of set-off referable to its dealings with Algoma up to April 23, 2001 were not affected by the *CCAA* proceedings. In this way, it sought to prevent its claims from being deemed to have been the subject of a proof of claim and then deemed to have been barred after December 12, 2001. Union relied upon s. 18.1 of the *CCAA*, which preserves rights of set-off. I will set out that section in full below.

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### The Reasons of the Motions Judge

11 The motions judge noted that a condition for application of legal set-off is that the obligations must be debts, in the sense that they are liquidated amounts. After reviewing the Board rulings and various letters by Union to Algoma, the motions judge concluded that the 1999 rebate was not a liquidated amount. He noted that in the Union employee's affidavit the rebate "approximates \$2.2 million". Further communications between Union and its Rate 100 customers suggested that there might not even be a rebate, depending on the decision of the Board. He therefore held that legal set-off had not been made out.

12 As to equitable set-off, the motions judge held that the 2000 gas services contract was in substance a continuation of the 1998 contract. He concluded that there was a "close connection sufficient to ground equitable set-off as to the gas supply portion of the October 15, 2000 Agreement vis-à-vis any rebate which is authorized by the Board, but not any monies owing by Algoma to Union as a result of the November 1, 2000 Transportation Agreement." He therefore limited the equitable set-off as indicated above.

### Analysis

#### General Principles

13 Algoma does not dispute that the law of set-off applies notwithstanding the *CCAA* proceedings. Section 18.1 of the Act makes this clear:

The law of set-off applies to all claims made against a debtor company and to all actions instituted by it for the recovery of debts due to the company in the same manner and to the same extent as if the company were plaintiff or defendant, as the case may be.

14 Algoma does, however, submit that set-off claims should be carefully scrutinized where *CCAA* proceedings are underway because the effect is to give preference to certain creditors. As Rowles J.A. said in *Cam-Net Communications v. Vancouver Telephone Co.* (1999), 71 B.C.L.R. (3d) 226 (B.C. C.A.), at 235:

Using, or rather misusing, the law of set-off is one example of how persons with a claim against the company in reorganization might attempt to escape the *CCAA* compromise. A party claiming set-off ... realizes its claim on a dollar-for-dollar basis while other creditors, who participated in the *CCAA* proceedings, have their claims reduced substantially. For this reason, the legislative intent animating the *CCAA* reorganization regime requires that courts remain vigilant to claims of set-off in the reorganization context.

15 I accept this principle, but I do not see it as a concern in this case. Union operates within a highly regulated regime and the disposition of the rebate is subject to scrutiny by a specialized tribunal. The amounts owing by Algoma to Union are not in doubt.

16 There was some dispute between the parties about the standard of review by this court of the decision of the motions judge. Counsel for Union seemed to suggest that because there is no right of appeal in *CCAA* proceedings and appeals are relatively rare, it was open to this court to review the decision of the motions judge on a standard of correctness even where that decision turned on findings of fact and inferences to be drawn from those facts. In my view, the usual standard of review in appeal proceedings applies and this court is required to give deference to the findings of the motions judge even where, as here, the decision is based on a paper record. The fact that there is no right of appeal and the appeal is only with leave under s. 13 of the Act only reinforces that conclusion. Decisions in the *CCAA* context must often be made quickly. They are, as in this case, usually made by a judge with considerable expertise in the area who has been managing the *CCAA* proceedings and is intimately familiar with the context and the issues at stake.

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17 This court and the Supreme Court of Canada have variously described the standard of appellate review. In *Equity Waste Management of Canada Corp. v. Halton Hills (Town)* (1997), 35 O.R. (3d) 321 (Ont. C.A.), at 336, Laskin J.A. wrote as follows:

Therefore, although the entire record before a trial judge or a motion judge consists of documentary or written evidence, as it does in this case, the judge's factual findings are entitled to deference on appeal. What standard of deference applies in such a case? It is not easy to articulate a standard less deferential than "manifest error" but falling short of "correctness". I suggest that it may simply be a matter of weight or emphasis, or that, plausibly, a uniform standard of appellate review should be applied to a trial judge's findings of fact, whether the evidence is entirely oral, entirely documentary or, more typically, a combination of the two.

What is important for this appeal is the kind of error that justifies intervention by an appellate court. An error of law obviously justifies intervention. An appellate court may interfere with a finding of fact if the trial judge or motion judge disregarded, misapprehended, or failed to appreciate relevant evidence, made a finding not reasonably supported by the evidence, or drew an unreasonable inference from the evidence.

18 More recently the Supreme Court in *Housen v. Nikolaisen* (2002), 211 D.L.R. (4th) 577 (S.C.C.), discussed at some length the standard of appellate review where the appellate court is called upon to review inferences from facts. The court concluded that the standard is one of considerable deference. Iacobucci and Major JJ. described the standard at para. 23 as follows:

We reiterate that it is not the role of appellate courts to second-guess the weight to be assigned to the various items of evidence. *If there is no palpable and overriding error with respect to the underlying facts that the trial judge relies on to draw the inference, then it is only where the inference-drawing process itself is palpably in error that an appellate court can interfere with the factual conclusion.* The appellate court is not free to interfere with a factual conclusion that it disagrees with where such disagreement stems from a difference of opinion over the weight to be assigned to the underlying facts [emphasis added].

19 On the other hand, where the issue concerns application of a legal standard to a set of facts the question is one of mixed fact and law and a somewhat less deferential standard may be appropriate, although not the standard of correctness required for questions of law. This was described as follows at para. 28:

However, where the error does not amount to an error of law, a higher standard is mandated. Where the trier of fact has considered all the evidence that the law requires him or her to consider and still comes to the wrong conclusion, then this amounts to an error of mixed law and fact and is subject to a more stringent standard of review: Southam, supra, at paras. 41 and 45. While easy to state, this distinction can be difficult in practice because matters of mixed law and fact fall along a spectrum of particularity. This difficulty was pointed out in Southam, supra, at para. 37:

... the matrices of facts at issue in some cases are so particular, indeed so unique, that decisions about whether they satisfy legal tests do not have any great precedential value. If a court were to decide that driving at a certain speed on a certain road under certain conditions was negligent, its decision would not have any great value as a precedent. *In short, as the level of generality of the challenged proposition approaches utter particularity, the matter approaches pure application, and hence draws nigh to being an unqualified question of mixed law and fact.* See R. P. Kerans, Standards of Review Employed by Appellate Courts (1994), at pp. 103-108. Of course, it is not easy to say precisely where the line should be drawn; though in most cases it should be sufficiently clear whether the dispute is over a general proposition that might qualify as a principle of law or over a very particular set of circumstances that is not apt to be of much interest to judges and lawyers in the future [emphasis added].

20 It seems to me that this appeal concerns both inferences from facts and a question of mixed fact and law. The motions judge's decision about the application of legal set-off turned exclusively on the inferences to be drawn from

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the undisputed facts in the affidavits. His decision that Union had not shown the rebate as a debt was fact specific. Although Union argues that the motions judge overlooked important facts and misapprehended certain facts, I am not persuaded that the motions judge made any palpable or overriding error. To the contrary, I am satisfied that his decision is supported by the evidence.

21 The decision about equitable set-off is somewhat different since it involves application of a legal standard to a set of facts. As such, it is a question of mixed law and fact. While the assessment by the motions judge is entitled to deference, I am nevertheless of the view that the motions judge erred in his application of the test for equitable set-off to these particular facts.

### *Legal Set-Off*

22 Section 111 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43 provides the statutory framework for legal set-off. Subsections (1) and (2) provide:

(1) In an action for payment of a debt, the defendant may, by way of defence, claim the right to set off against the plaintiff's claim a debt owed by the plaintiff to the defendant.

(2) Mutual debts may be set off against each other even if they are of a different nature.

23 The only question on the application of legal set-off in this case was whether the rebate was a debt for the purpose of s. 111. Union accepts that debt means a liquidated sum and argues that the rebate is a liquidated sum because the amount is ascertainable and, save for interest, can neither increase nor decrease. Union submits that the amount is ascertainable and fixed because the Board has accepted its proposal for calculating the amount of the rebate. It also relies on the affidavit evidence that Algoma's share of the rebate for Rate 100 customers will be unaffected by the adjustments for the years 2000 and 2001 deferral accounts.

24 The motions judge, however, was not prepared to draw that inference from the affidavit evidence. He relied upon the fact that Union only provided an estimate of the rebate and his reading of the Board decisions that did not explicitly state that Algoma or any of the other customers would receive a rebate. He also relied upon Union's own communications to its Rate 100 customers that suggested the amount of the rebate was not fixed. In his submissions, counsel for Algoma pointed out a number of facts upon which the decision by the motions judge could rest and that could support the inferences drawn. Counsel pointed out that to overturn the decision of the motions judge, this court would have to be satisfied of the following:

(1) That it was appropriate to sever off the interest part of the rebate, since the rate had not yet been set by the Board.

(2) That no significance should be attached to the use of the term "approximate" in the Union employee's description of the amount of the rebate.

(3) That no significance should be attached to the fact that Union had not provided an exact figure for the amount of the rebate.

(4) That the communications by Union to Algoma and its other customers concerning the uncertainty of the amount of the rebate had no significance.

(5) That there is no significance to the fact that the Board continues to prevent Union from releasing the rebate to Algoma; put another way, that the Board has no good reason for holding up disposition of the rebate.

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(6) That the amounts of the rebates cannot change as a result of events in 2002.

25 I am not prepared to say that the motions judge's decision disclosed a palpable and overriding error. Since his decision is supported by the evidence, the evidence supplied by Union itself, this aspect of the appeal must be dismissed.

### ***Equitable Set-Off***

26 Equitable set-off is available where there is a claim for a sum whether liquidated or unliquidated. In *Telford v. Holt* (1987), 41 D.L.R. (4th) 385 (S.C.C.) at 398-99, Wilson J., speaking for the court, approved a statement of the applicable principles for equitable set-off found in *Coba Industries Ltd. v. Millie's Holdings (Canada) Ltd.* (1985), 20 D.L.R. (4th) 689 (B.C. C.A.) at 696-97. Those principles can be summarized as follows:

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

27 In one way or another the first three principles, but particularly the third, are in issue in this case. Put shortly, is the 1999 rebate from the 1998 gas services contract so clearly connected with the amounts owing under the 2000 assignment agreement that it would be manifestly unjust to enforce payment of the rebate without taking into account the amounts owing under the assignment agreement? The motions judge recognized that the assignment agreement was integral to the 2000 gas services agreement, but he refused equitable set-off for the amounts owing under the assignment agreement because it was not the same type of contract as the supply of gas by Union. In my view, this was not a sufficient reason to refuse equitable set-off given the interrelationship between the two 2000 agreements.

28 Kelly R. Palmer in *The Law of Set-Off in Canada* (1993) traces the evolution of the doctrine of equitable set-off from a very strict test in which the "claim raised in set-off had to impeach the title of the plaintiff's claim" [at p. 89] to a somewhat more flexible approach based upon fairness. The leading cases describing, in some fashion, the more modern test are *Coba Industries*; *Telford* and *Federal Commerce & Navigation Co. v. Molena Alpha Inc.*, [1978] 3 All E.R. 1066 (Eng. Q.B.) [affirmed on other grounds at (1978), [1979] A.C. 757 (U.K. H.L.)].

29 It seems to me that a very helpful test is set out in a passage from the reasons of Lord Denning in *Federal Commerce* at p. 1078 and which was quoted with apparent approval by Wilson J. in *Telford* at p. 400:

*We have to ask ourselves: what should we do now so as to ensure fair dealing between the parties? ... This question must be asked in each case as it arises for decision; and then, from case to case, we shall build up a series of precedents to guide those who come after us. But one thing is quite clear: it is not every cross-claim which can be deducted. It is only cross-claims that arise out of the same transaction or are closely connected with it. And it is only cross-claims which go directly to impeach the plaintiff's demands, that is, so closely connected with his demands that it would be manifestly unjust to allow him to enforce payment without taking into account the*

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*cross-claim* [emphasis added].

30 In my view, there is such a close connection between the 2000 gas services contract and the 2000 assignment agreement, that the amounts owing on them cannot be severed for the purposes of equitable set-off. The assignment agreement is attached as a schedule to the 2000 gas services contract and in the event either of the agreements terminates, the other terminates, unless otherwise agreed to by the parties. The parties agreed in the 2000 gas services contract that it was "contingent upon" the assignment agreement and that the latter formed an integral part of the latter. Accepting the correctness of the motion judge's determination that the 1998 and 2000 gas services contracts exhibit a sufficient degree of connection to justify equitable set-off, it seems to me that it would be manifestly unjust to allow Algoma to insist on payment of the rebate arising under the former without allowing Union to set-off all the amounts owing under the 2000 arrangement.

31 The relationship between the parties under the 2000 contracts is different than the relationship under the 1998 contract but they are in a sense nothing more than a successor arrangement to accomplish what had been done under the 1998 contract. Admittedly, under the 2000 assignment agreement, the underlying relationship was between TCPL and Union. Union only became entitled to collect from Algoma because Algoma failed to pay the charges that TCPL was entitled to collect from Union. Under the agreement, Algoma agreed to indemnify Union in those circumstances. However, there is a close connection between the 1998 contract and both of the 2000 contracts because they all, in one way or another, facilitate the supply of gas to Algoma.

32 A helpful example is *Coba Industries*, which was approved by Wilson J. in *Telford*. Palmer describes the facts of *Coba Industries* at p. 133 of his text:

Hp entered a sale and leaseback of property with the defendant, in the course of which Hp obtained a second mortgage over the property and granted a lease to the defendant. The lease payments were calculated to be sufficient to cover the mortgage payments. Hp assigned the mortgage to the plaintiff who notified the assignment to the defendant. When Hp fell into arrears on the lease, the defendant ceased making mortgage payments. The plaintiff sued for foreclosure, and was met with a claim for set-off.

33 Macfarlane J.A., writing for the court in *Coba Industries*, found several facts that established the close connection necessary for equitable set-off. He wrote at p. 700:

I think this evidence demonstrates that, from the outset, it was at the heart of any liability on the part of [the defendant] that [Hp] provide and assure payments under the leases sufficient to satisfy payments from time to time under both mortgages.

34 The 1998 contract and 2000 agreements exhibit this kind of connection. Given that the motions judge found that it would be manifestly unjust not to permit Union to set off the amounts owing on the 2000 gas services contract, I conclude that it would be manifestly unjust to allow Algoma to enforce payment of the 2000 rebate without taking into account its liability to Union under the assignment agreement, which formed an integral part of the arrangement between the parties.

#### **Disposition**

35 Accordingly, I would allow the appeal with costs on a partial indemnity basis. In accordance with the written submissions of the parties, costs are fixed at \$33,111.29.

*Appeal allowed in part.*

FN1 Although not stated explicitly in the affidavits, it appears that the contract did renew for a further year.

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# TAB 3

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2000 CarswellAlta 503

Canadian Airlines Corp., Re

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

In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c.B-15., as amended, Section 185

In the Matter of Canadian Airlines Corporation and Canadian Airlines International Ltd.

Resurgence Asset Management LLC, Applicant and Canadian Airlines Corporation and Canadian Airlines International Ltd., Respondents

Alberta Court of Appeal [In Chambers]

Wittmann J.A.

Heard: May 18, 2000

Judgment: May 29, 2000

Docket: Calgary Appeal 00-18816

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Proceedings: (May 12, 2000), Doc. Calgary 0001-05071 [Alta. Q.B.]

Counsel: *D. Haigh, Q.C.*, and *D. Nishimura*, for Applicant.

*A.L. Friend, Q.C.*, and *H.M. Kay, Q.C.*, for Respondents.

*S. Dunphy*, for Air Canada.

*A.J. McConnell*, for Bank of Nova Scotia Trust Company of New York and Montreal Trust Co. of Canada.

*P.T. McCarthy, Q.C.*, for Price Waterhouse Coopers.

Subject: Corporate and Commercial; Insolvency

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

Applicant was unsecured creditor of C Corp. — Board appointed by A Corp. caused C Corp. to commence proceedings under CCAA under which A Corp. stood to gain substantial benefits — Proposed plan of compromise and arrangement filed under Act — Order made that classification of creditors not be fragmented to exclude A Corp. as separate class from applicant in terms of unsecured creditors, that A Corp. be entitled to vote on plan pursuant to s. 6 of

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Act, that there be no separation of unsecured creditors of two divisions of C Corp. for voting purposes, and that votes in respect of claims assigned to A Corp. be recorded and tabulated separately for purpose of consideration in application for court approval of plan — Applicant brought application for leave to appeal that order — Application dismissed — Decisions of supervising judge under Act entitled to considerable deference — Person seeking leave to appeal required to show error in principle of law or palpable and overriding error of fact — Exercise of discretion by reviewing judge not subject to review so long as discretion exercised judicially — Reviewing judge made no error of law — Applicant failed to make out prima facie meritorious case — Granting of leave would likely unduly hinder progress of action — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 6.

**Cases considered by Wittmann J.A.:**

*Blue Range Resource Corp., Re* (1999), 244 A.R. 103, 209 W.A.C. 103, 12 C.B.R. (4th) 186 (Alta. C.A.) — referred to

*Blue Range Resource Corp., Re*, (sub nom. *Blue Range Resources Corp., Re*) 250 A.R. 172, (sub nom. *Blue Range Resources Corp., Re*) 213 W.A.C. 172, 15 C.B.R. (4th) 160, 2000 ABCA 3 (Alta. C.A. [In Chambers]) — referred to

*Blue Range Resource Corp., Re* (2000), (sub nom. *Blue Range Resources Corp., Re*) 250 A.R. 239, (sub nom. *Blue Range Resources Corp., Re*) 213 W.A.C. 239, 15 C.B.R. (4th) 192 (Alta. C.A. [In Chambers]) — referred to

*Fairview Industries Ltd., Re* (1991), 11 C.B.R. (3d) 71, (sub nom. *Fairview Industries Ltd., Re (No. 3)*) 109 N.S.R. (2d) 32, (sub nom. *Fairview Industries Ltd., Re (No. 3)*) 297 A.P.R. 32 (N.S. T.D.) — referred to

*Med Finance Co. S.A. v. Bank of Montreal* (1993), 24 B.C.A.C. 318, 40 W.A.C. 318, 22 C.B.R. (3d) 279 (B.C. C.A.) — referred to

*Multitech Warehouse Direct Inc., Re* (1995), 32 Alta. L.R. (3d) 62 (Alta. C.A.) — referred to

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

*Northland Properties Ltd., Re* (1988), 31 B.C.L.R. (2d) 35, 73 C.B.R. (N.S.) 166 (B.C. S.C.) — referred to

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

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

*Pacific National Lease Holding Corp., Re* (1992), 72 B.C.L.R. (2d) 368, 19 B.C.A.C. 134, 34 W.A.C. 134, 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]) — considered

*Power Consolidated (China) Pulp Inc. v. British Columbia Resources Investment Corp.* (1988), 19 C.P.C. (3d) 396 (B.C. C.A.) — referred to

*Royal Bank v. Fracmaster Ltd.* (1999), (sub nom. *UTI Energy Corp. v. Fracmaster Ltd.*) 244 A.R. 93, (sub nom. *UTI Energy Corp. v. Fracmaster Ltd.*) 209 W.A.C. 93, 11 C.B.R. (4th) 230 (Alta. C.A.) — considered

2000 CarswellAlta 503, 2000 ABCA 149, 80 Alta. L.R. (3d) 213, 19 C.B.R. (4th) 33, 261 A.R. 120, 225 W.A.C. 120, [2000] A.J. No. 610

*Savage v. Amoco Acquisition Co.* (1988), 59 Alta. L.R. (2d) 260, 68 C.B.R. (N.S.) 154, 40 B.L.R. 188, (sub nom. *Amoco Acquisition Co. v. Savage*) 87 A.R. 321 (Alta. C.A.) — referred to

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

*Smoky River Coal Ltd., Re.* (sub nom. *Luscar Ltd. v. Smoky River Coal Ltd.*) 237 A.R. 83, (sub nom. *Luscar Ltd. v. Smoky River Coal Ltd.*) 197 W.A.C. 83, 1999 ABCA 62 (Alta. C.A.) — referred to

*Smoky River Coal Ltd., Re.* 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94 (Alta. C.A.) — considered

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

*Wellington Building Corp., Re.* 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (Ont. S.C.) — referred to

*Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206 (B.C. S.C.) — referred to

#### **Statutes considered:**

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

s. 2 "secured creditor" — considered

s. 2 "unsecured creditor" — considered

s. 4 — considered

s. 5 — considered

s. 6 — considered

s. 6(a) — considered

s. 6(b) — considered

s. 13 — considered

APPLICATION for leave to appeal from judgment reported at (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.).

#### **Memorandum of decision. Wittmann J.A.:**

##### **Introduction**

1 This is an application for leave to appeal the decision of Paperny, J. made on May 12, 2000, pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (*CCAA*). The applicant, Resurgence Asset Management LLC (Resurgence), is an unsecured creditor by virtue of its holding 58.2 per cent of U.S.

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\$100,000,000.00 unsecured notes issued by Canadian Airlines Corporation (CAC)

2 CAC and Canadian Airlines International Ltd. (CAIL) (collectively Canadian) commenced proceedings under the CCAA on March 24, 2000.

3 A proposed Plan of Compromise and Arrangement (the Plan) has been filed in this matter regarding CAC and CAIL, pursuant to the CCAA.

4 The decision of Paperny, J. May 12, 2000 (the Decision) ordered, among other things, that the classification of creditors not be fragmented to exclude Air Canada as a separate class from Resurgence in terms of the unsecured creditors; that Air Canada should be entitled to vote on the Plan pursuant to s. 6 of the CCAA at the creditors' meeting to be held May 26, 2000; that there be no separation of unsecured creditors of CAC from unsecured creditors of CAIL for voting purposes; and that votes in respect of claims assigned to Air Canada, be recorded and tabulated separately, for the purpose of consideration in the application for court approval of the Plan (the Fairness Hearing).

#### **Leave to Appeal Under the CCAA**

5 The section of the CCAA governing appeals to this Court is as follows:

13. Except in the Yukon Territory, any person dissatisfied with an order or a decision made under this Act may appeal therefrom on obtaining leave of the judge appealed from or of the court or a judge of the court to which the appeal lies and on such terms as to security and in other respects as the judge or court directs.

6 The criterion to be applied in an application for leave to appeal pursuant to the CCAA is not in dispute. The general criterion is embodied in the concept that there must be serious and arguable grounds that are of real and significant interest to the parties: *Re Multitech Warehouse Direct Inc.* (1995), 32 Alta. L.R. (3d) 62 (Alta. C.A.) at 63; *Re Smoky River Coal Ltd.* (1999), 237 A.R. 83 (Alta. C.A.); *Re Blue Range Resource Corp.* (1999), 244 A.R. 103 (Alta. C.A.); *Re Blue Range Resource Corp.* (2000), 15 C.B.R. (4th) 160 (Alta. C.A. [In Chambers]); *Re Blue Range Resource Corp.* (2000), 15 C.B.R. (4th) 192 (Alta. C.A. [In Chambers]).

7 Subsumed in the general criterion are four applicable elements which originated in *Power Consolidated (China) Pulp Inc. v. British Columbia Resources Investment Corp.* (1988), 19 C.P.C. (3d) 396 (B.C. C.A.), and were adopted in *Med Finance Co. S.A. v. Bank of Montreal* (1993), 22 C.B.R. (3d) 279 (B.C. C.A.). McLachlin, J.A. (as she then was) set forth the elements in *Power Consolidated* as follows at p.397:

- (1) whether the point on appeal is of significance to the practice;
- (2) whether the point raised is of significance to the action itself;
- (3) whether the appeal is *prima facie* meritorious or, on the other hand, whether it is frivolous; and
- (4) whether the appeal will unduly hinder the progress of the action.

These elements have been considered and applied by this Court, and were not in dispute before me as proper elements of the applicable criterion.

#### **Facts**

8 On or about October 19, 1999, Air Canada announced its intention to make a bid for CAC and to proceed to

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complete a merger subject to a restructuring of Canadian's debt. On or about November 5, 1999, following a ruling by the Quebec Superior Court, a competing offer by Airline Industry Revitalization Co. Inc. was withdrawn and Air Canada indicated that it would proceed with its offer for CAC.

9 On or about November 11, 1999, Air Canada caused the incorporation of 853350 Alberta Ltd. (853350), for the sole purpose of acquiring the majority of the shares of CAC. At the time of incorporation, Air Canada held 10 per cent of the shares of 853350. Paul Farrar, among others, holds the remaining 90 per cent of the shares of 853350.

10 On or about November 11, 1999, Air Canada, through 853350, offered to purchase the outstanding shares of CAC at a price of \$2.00 per share for a total of \$92,000,000.00 for all of the issued and outstanding voting and non-voting shares of CAC.

11 On or about January 4, 2000, Air Canada and 853350 acquired 82 per cent of CAC's outstanding common shares for approximately \$75,000,000.00 plus the preferred shares of CAIL for a purchase price of \$59,000,000.00. Air Canada then replaced the Board of Directors of CAC with its own nominees.

12 Substantially all of the aircraft making up the fleet of Canadian are held by Air Canada through lease arrangements with various lessors or other aircraft financial agencies. These arrangements were the result of negotiations with lessors, jointly conducted by Air Canada and Canadian.

13 In general, these arrangements include the following:

(i) the leases have been renegotiated to reflect contemporary fair market value (or below) based on two independent desk top valuations; and

(ii) the present value of the difference between the financial terms under the previous lease arrangements and the renegotiated fair market value terms was characterized as "unsecured deficiency," reflected in a Promissory Note payable to the lessor from Canadian and assigned by the lessor to Air Canada.

14 In the result, Air Canada has acquired or is in the process of acquiring all but eight of the deficiency claims of aircraft lessors or financiers listed in Schedule "B" to the Plan in the total amount of \$253,506,944.00. Air Canada intends to vote those claims as an unsecured creditor under the Plan.

15 The executory contracts claims listed in Schedule "B" to the Plan total \$110,677,000.00, of which \$108,907,000.00 is the claim of Loyalty Management Group Canada Inc. (Loyalty), an entity with a long term contract with Canadian to purchase air miles. The claim is subject to an agreement of settlement between Loyalty, Canadian and Air Canada. Air Canada was assigned the Loyalty unsecured claim.

16 In the Plan, all unsecured creditors of both CAC and CAI are grouped in the same class for voting purposes.

17 Pursuant to the Plan, unsecured creditors will receive a payment of \$0.12 on the dollar for each \$1.00 of their claim unless the total amount of unsecured claims exceeds \$800 million, in which case, they will receive less. Air Canada will fund this Pro Rata Cash Amount. As a result of the assignments of the deficiency amounts in favour of Air Canada, if the Plan is approved, Air Canada will notionally be paying a substantial proportion of the Pro Rata Cash Amount to itself.

18 The Plan further contemplates Air Canada becoming the 100 per cent owner of Canadian through 853350.

19 On April 7, 2000, an Order was granted by Paperny, J., directing that the Plan be filed by the Petitioners; estab-

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lishing a claims dispute process; authorizing the calling of meetings for affected creditors to vote on the Plan to be held on May 26, 2000; authorizing the Petitioners to make application for an Order sanctioning the Plan on June 5, 2000; and providing other directions.

20 The April 7, 2000 Order established three classes of creditors: (a) the holders of Canadian Airlines Corporation 10 per cent Senior Secured Notes due 2005 (the Secured Noteholders); (b) the secured creditors of the Petitioners affected by the Plan (the Affected Secured Creditors); and (c) the unsecured creditors affected by the Plan (the Affected Unsecured Creditors).

21 On April 25, 2000, the Petitioners filed and served the Plan, in accordance with the Order of April 7, 2000. By Notice of Motion dated April 27, 2000, Resurgence brought an application, among other things, seeking "directions as to the classification and voting rights of the creditors ... (and) the quantum of the 'deficiency claims' assigned to Air Canada." Resurgence sought to have Air Canada excluded from voting as an unsecured creditor unless segregated into a separate class. Resurgence also sought to have the holders of the unsecured notes vote as a separate class.

22 The result of the April 27, 2000 motion by Resurgence is the Decision.

### **The Decision**

23 In the Decision, the supervising chambers judge referred to her order of April 14, 2000, wherein she approved transactions involving the re-negotiation of the aircraft leases. She referred to "about \$200,000,000.00 worth of concessions for CAIL" as "concessions or deficiency claims" which were quantified and reflected in promissory notes which were assigned to Air Canada in exchange for its guarantee of the aircraft leases. The monitor approved of the method of quantifying the claims and Paperny, J. approved the transactions, reserving the issue of classification and voting to her May 12 Decision.

24 The Plan provides for one class of unsecured creditor. The unsecured class is composed of a number of types of unsecured claims including executory contracts (e.g. Air Canada from Loyalty) unsecured notes (e.g. Resurgence), aircraft leases (e.g. Air Canada from lessors), litigation claims, real estate leases and the deficiencies, if any, of the senior secured noteholders.

25 In seeking to have Air Canada vote the promissory notes in a separate class Resurgence argued several factors before Paperny, J., as set out at pp. 4-5 of the Decision as follows:

1. The Air Canada appointed board caused Canadian to enter into these *CCAA* proceedings under which Air Canada stands to gain substantial benefits in its own operations and in the merged operations and ownership contemplated after the compromise of debts under the plan.
2. Air Canada is providing the fund of money to be distributed to the Affected Unsecured Creditors and will, therefore, end up paying itself a portion of that money if it is included in the Affected Unsecured Creditors' class and permitted to vote.
3. Air Canada gave no real consideration in acquiring the deficiency claims and manufactured them only to secure a 'yes' vote.

26 She then recited the argument made by Air Canada and Canadian to the effect that the legal rights associated with Air Canada's unsecured claims are the same as those associated with the other affected unsecured claimants, and that the matters raised by Resurgence relating to classification are really matters of fairness more appropriately dealt with in a Fairness Hearing scheduled to be held June 5, 2000.

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27 After observing that the *CCAA* offers no guidance with respect to the classification of claims, beyond identifying secured and unsecured categories and the possibility of classes within each category, and that the process has developed in case law, Paperny, J. embarked on a detailed analysis and consideration of the case law in this area including *Norcen Energy Resources Ltd. v. Oakwood Petroleum Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.); *Sovereign Life Assurance Co. v. Dodd* (1891), [1892] 2 Q.B. 573 (Eng. C.A.); *Re Fairview Industries Ltd.* (1991), 11 C.B.R. (3d) 71 (N.S. T.D.); *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.); *Re Woodward's Ltd.* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.); *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.) at 626; *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.); *Re Wellington Building Corp.*, [1934] O.R. 653, 16 C.B.R. 48 (Ont. S.C.). Paperny, J. also referred to an oft-cited article "Reorganization under the Companies Creditors Arrangement Act" by S. E. Edwards (1947), 25 Can. Bar Rev. 587. She concluded her legal analysis at pp.12-13 by setting forth the principles she found to be applicable in assessing commonality of interest as an appropriate test for the classification of creditors:

1. Commonality of interest should be viewed on the basis of the non-fragmentation test, not on an identity of interest test;
2. The interests to be considered are the legal interests the creditor holds qua creditor in relationship to the debtor company, prior to and under the plan as well as on liquidation;
3. The commonality of these interests are to be viewed purposively, bearing in mind the object of the *CCAA*, namely to facilitate reorganizations if at all possible;
4. In placing a broad and purposive interpretation on the *CCAA*, the court should be careful to resist classification approaches which would potentially jeopardize potentially viable plans.
5. Absent bad faith, the motivations of the creditors to approve or disapprove are irrelevant.
6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the plan in a similar manner.

### **The Standard of Review and Leave Applications**

28 The elements of the general criterion cannot be properly considered in a leave application without regard to the standard of review that this Court applies to appeals under the *CCAA*. If leave to appeal were to be granted, the applicable standard of review is succinctly set forth by Fruman, J.A. in *Royal Bank v. Fracmaster Ltd.* (1999), 244 A.R. 93 (Alta. C.A.) where she stated for the Court at p.95:

.... this is a court of review. It is not our task to reconsider the merits of the various offers and decide which proposal might be best. The decisions made by the Chambers judge involve a good measure of discretion, and are owed considerable deference. Whether or not we agree, we will only interfere if we conclude that she acted unreasonably, erred in principle or made a manifest error.

In another recent *CCAA* case from this Court, *Re Smoky River Coal Ltd.* (1999), 237 A.R. 326 (Alta. C.A.), Hunt, J.A., speaking for the unanimous Court, extensively reviewed the history and purpose of the *CCAA*, and observed at p.341:

The fact that an appeal lies only with leave of an appellate court (s. 13 *CCAA*) suggests that Parliament, mindful that *CCAA* cases often require quick decision-making, intended that most decisions be made by the supervising

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judge. This supports the view that those decisions should be interfered with only in clear cases.

29 The standard of review of this Court, in reviewing the *CCAA* decision of the supervising judge, is therefore one of correctness if there is an error of law. Otherwise, for an appellate court to interfere with the decision of the supervising judge, there must be a palpable and overriding error in the exercise of discretion or in findings of fact.

### Statutory Provisions

30 The *CCAA* includes provisions defining secured creditor, unsecured creditor, refers to classes of them, and provides for court approval of a plan of compromise or arrangement in the following sections:

### 2. Interpretation

.....

"secured creditor" means a holder of a mortgage, hypothec, pledge, charge, lien or privilege on or against, or any assignment, cession or transfer of, all or any property of a debtor company as security for indebtedness of the debtor company, or a holder of any bond of a debtor company secured by a mortgage, hypothec, pledge, charge, lien or privilege on or against, or any assignment, cession or transfer of, or a trust in respect of, all or any property of the debtor company, whether the holder or beneficiary is resident or domiciled within or outside Canada, and a trustee under any trust deed or other instrument securing any of those bonds shall be deemed to be a secured creditor for all purposes of this Act except for the purpose of voting at a creditors' meeting in respect of any of those bonds;

.....

"Unsecured creditor" means any creditor of a company who is not a secured creditor, whether resident or domiciled within or outside Canada, and a trustee for the holders of any unsecured bonds issue under a trust deed or other instrument running in favour of the trustee shall be deemed to be an unsecured creditor for all purposes of this Act except for the purpose of voting at a creditors' meeting in respect of any of those bonds.

### Compromises and Arrangements

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

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

.....

6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

