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COURT FILE NUMBER	2101-05019
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE OF	CALGARY
MATTER	IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED AND IN THE MATTER OF THE COMPROMISE OR ARRANGEMENT OF COALSPUR MINES (OPERATIONS) LTD.
DOCUMENT	**BENCH BRIEF OF THE APPLICANT RIDLEY TERMINALS INC.**
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TABLE OF CONTENTS

I. INTRODUCTION

1. Coalspur Mines (Operations) Ltd. ("**Coalspur**") and Ridley Terminals Inc. (the "**Applicant**" or "**Ridley**") entered into various agreements whereby Ridley was to be the exclusive port utilized by Coalspur for the shipment of its thermal coal. Throughout their relationship, Ridley has provided numerous accommodations and incurred significant costs upgrading its equipment to accommodate Coalspur's intended growth. [redacted]

2. In support of the disclaimer, Coalspur primarily relies upon monetary savings that it alleges will result from the disclaimer. Not only does Ridley dispute the quantum of the alleged savings but furthermore takes the position that such savings are not necessary for Coalspur to restructure or continue as a going concern, as Coalspur's liquidity issues upon which it commenced proceedings under the *Companies' Creditors Arrangement Act* ("**CCAA**"), are quickly resolving themselves. Therefore, the disclaimer does not meet the requisite factors under the CCAA.

3. Ridley submits that this Court should exercise its discretion under section 32 of the CCAA to deny the disclaimer as Coalspur has acted in bad faith and is misusing the CCAA process to avoid its contractual obligations in circumstances where it is neither necessary and where the impacts of such action will have significant financial consequences for Ridley, including impacts on its own solvency to the significant detriment of its stakeholders.

4. In any event, Ridley submits that Coalspur was obligated to continue to comply with its obligations during the 30-day notice period prescribed in section 32 of the CCAA and, by commencing shipping to Westshore Terminals Ltd. ("**Westshore**") on May 7, 2021, Coalspur and Westshore acted contrary to their statutory obligation of good faith and contrary to the intent of section 32 of the CCAA.

II. FACTS

Background

5. The Ridley Terminal, along with Westshore's terminal in Delta, British Columbia (the "**Westshore Terminal**") and Teck Resource Inc.'s ("**Teck**") terminal in North Vancouver, British Columbia ("**Neptune Terminal**"), are the only three operating terminals that handle coal on the west coast of North America.[1] Neptune Terminal only serves Teck.

Previous Agreements

6. In or around 2011, Coalspur and Ridley entered into an agreement whereby Ridley would provide to Coalspur up to 8.5 million metric tonnes of port allocation for a period up to 21 years (the "**2011 Agreement**").[2] In or around March 2012, Ridley and Coalspur agreed to extend Coalspur's port allocation to up to 10.7 million metric tonnes, with an option for a further 1.8 million metric tonnes (the "**2012 Amended Agreement**").[3] From the period of 2011 to 2014, Ridley invested approximately $70 to $100 million specifically in furtherance of the 2011 Agreement and the 2012 Amended Agreement.[4]

7. In or around February 2015, KC Euroholdings S.à.r.l. ("**KCE**"), an entity affiliated with Cline Group LLC ("**Cline**") entered into an agreement to acquire Coalspur.[5] Cline, in contemplation of its proposed acquisition of Coalspur, sought to terminate the 2011 Agreement and the 2012 Amended Agreement, in exchange for Ridley retaining the deposit fees totaling $42.8 million previously paid to Ridley by Coalspur.[6] Ridley accepted the proposal.[7]

The Agreements

8. In or around November 2016, Coalspur re-engaged Ridley in discussions about a new service agreement to ship coal from its Vista Coal Mine Project (the "**Project**") located near the

[1] Affidavit of Cordell Dixon sworn May 21, 2021 ("**Dixon Affidavit**") at para 7
[2] Dixon Affidavit at para 11
[3] Dixon Affidavit at para 13
[4] Dixon Affidavit at para 14
[5] Dixon Affidavit at para 16
[6] Dixon Affidavit at para 19
[7] Dixon Affidavit at para 19

City of Hinton, Alberta through the Ridley Terminal (the "**Terminal Services Agreement**").[8] Coalspur represented to Ridley that it would eventually deliver a volume of approximately 12 million metric tonnes of coal annually.[9] Westshore did not have the present or future capacity for this volume at this time.[10] Ridley did – it could offer to Coalspur both an initial capacity of up to 6.75 million metric tonnes as well as the future capacity to handle 12 million metric tonnes of coal, provided it completed additional capital investment.[11]

9. The parties executed the Terminal Services Agreement in or around July 10, 2018, taking effect on January 1, 2018.[12] The Terminal Services Agreement contemplates that, among other things, all production from the Project destined for export from North America will be shipped exclusively through the Ridley Terminal ("**Exclusivity Clause**").[13] Further, the Terminal Services Agreement requires that Coalspur deliver a minimum throughput of 90% of the declared contract volume or pay a shortfall payment of $6 per metric tonne and that Coalspur maintain a letter of credit in favor of Ridley in the amount of $10 million.[14]

10. The Exclusivity Clause was critical to Ridley and it would not have entered into the Terminal Services Agreement without it. It provided assurance for Ridley to invest in capital improvements to handle the anticipated tonnage from Coalspur.[15] In exchange, Ridley agreed to build in significant scaling rates to the throughput rates set out in section 4.1 of the Terminal Services Agreement (the "**Throughput Rates**"): as certain volume milestones are met, the rate decreases.

11. Ridley has invested approximately $59 million in capital expenditures and investments specifically to service the Terminal Services Agreement and the anticipated volumes of coal

[8] Dixon Affidavit at paras 20, 21
[9] The Affidavit of Robert Booker sworn May 21, 2021 ("**Booker Affidavit**") at para 44
[10] Booker Affidavit at para 8(e)
[11] Booker Affidavit at para 44
[12] Dixon Affidavit, at para 20
[13] Dixon Affidavit at para 21
[14] Dixon Affidavit at para 23
[15] Dixon Affidavit at para 24

shipments from Coalspur.[16] Ridley would not have made these investments but for the Exclusivity Clause and the minimum throughput provisions.[17]

12. Coalspur has consistently failed to hit its targets. Coalspur delivered by rail 1,048,341 metric tonnes of coal in 2019 and 4,257,940 metric tonnes of coal in 2020.[18] [redacted]

13. In or around July 2020, Ridley and Coalspur entered into a settlement agreement whereby Coalspur agreed to pay Ridley $9,413,648 in shortfall penalties, a portion of which was recoverable via withdrawing from a letter of credit held by Ridley as security, and the remainder under a throughput rate surcharge on each metric tonne of future cargo (the "**Settlement Agreement**").[20] Although Ridley had a right to arbitrate for the full amount of shortfall penalties owing of $10.5 million, it sought to collaborate with Coalspur in good faith to achieve an amicable resolution in light of Coalspur's cash position at the time.[21] It did so.

14. [redacted]

[16] Dixon Affidavit at para 24
[17] Dixon Affidavit at para 25
[18] Booker Affidavit at para 47
[19] Transcripts of Questioning on Affidavit of Donald Samuel Swartz II on June 17, 2021 ("**Swartz Transcripts**") at p.13, L17 - p.14, L10
[20] Booker Affidavit at para 15
[21] Booker Affidavit at para 16
[22] Swartz Transcripts at p.17, L22 - p.18, L1
[23] Swartz Transcripts at p. 17, L22 - p.27, L11

[redacted]

15. In or around February 2021, Ridley was again in the position of seeking to recover overdue payment from Coalspur.[25] In or around February 13, 2021, Ridley and Coalspur entered the Letter Agreement to facilitate repayment of approximately $11.6 Million (the "**Letter Agreement**", collectively with the Terminal Services Agreement and Settlement Agreement, the "**Agreements**").[26]

16. From March 2021 onwards, Coalspur continued to engage Ridley in without prejudice negotiations regarding further economic relief from the Terminal Services Agreement.[27] As of April 14, 2021, Coalspur owed Ridley the sum of $11,287,950.08 under the Agreements, comprising of shortfall payments due and owing by Coalspur for 2019 and 2020, and various throughput rate surcharges.[28]

17. On or about April 19, 2021, Coalspur informed Ridley that it intended to file proceedings under the CCAA, but assured Ridley of its intentions to negotiate to obtain a resolution.[29] On April 23, the parties reached a tentative agreement for a buyout of the Agreements in exchange for a payment of $18 million.[30] With respect to the payment of the $18 million, Ridley unilaterally terminated these without prejudice discussions regarding a buyout of the Agreements on the evening of April 23 after Coalspur sought to renegotiate agreed upon conditions for the cash buyout.[31] However, Ridley was still prepared to continue to entertain rate discussions and alternate terms.[32]

[24] Answer to Undertaking No. 1 to the Questioning of Swartz
[25] Booker Affidavit at para 20
[26] Booker Affidavit at para 22
[27] Booker Affidavit at para 24
[28] Booker Affidavit at para 28
[29] Booker Affidavit at para 29
[30] Booker Affidavit at para 30
[31] Booker Affidavit at para 31
[32] Transcripts from the Questioning of Robert Booker on June 3, 2021 ("**Booker Transcripts**") at p 16, L16-25 - p 17, L1

Coalspur Commences the CCAA Proceedings

18. On or about April 22, 2021, Ridley received, among other things, Coalspur's application to commence proceedings under the CCAA.[33] The application asserted the need for CCAA protection as a result of liquidity issues resulting from obligations owed to Trafigura Lte. Ltd. ("**Trafigura**") that were triggered as a result of rising coal prices and an Alberta Energy Regulator permitting issue which was resolved prior to the CCAA proceedings.[34] On April 26, 2021, Coalspur was granted an initial order under the CCAA.

19. [redacted]

20. On or around May 3, 2021, Coalspur resumed operations.[36] Ridley was not contacted with respect to expected rail delivery.[37]

21. [redacted]

22. On May 6, 2021, Coalspur sought and obtained an extension of the stay period of the CCAA proceedings to July 23, 2021.[39] Coalspur did not disclose its negotiations with Westshore to its stakeholders or the court in advance of or during this hearing. Ridley took no position on this application, as there had been no indication that Coalspur intended to repudiate or disclaim the Agreements.[40]

23. On the morning of May 7, 2021, Ridley learned through CN Rail that Coalspur had shipped its coal to a marine terminal other than the Ridley Terminal.[41] Ridley took this to mean that it was

[33] Booker Affidavit at para 33
[34] Affidavit of Michael Beyer, sworn April 19, 2021 ("**Beyer Affidavit No. 1**") at para. 101
[35] Swartz Transcripts p.29, L11-12
[36] Booker Affidavit at para. 36
[37] Booker Affidavit at para. 36
[38] Booker Affidavit at Exhibit 6, Swartz Transcript at p.29, L19-22, p.31 L15-19
[39] Booker Affidavit at para. 39
[40] Booker Affidavit at para. 39
[41] Booker Affidavit at para. 40

being shipped to the Westshore Terminal, in light of the recently opened capacity at Westshore.[42] Ridley made inquiries of Coalspur as to why it was diverting shipments of coal, and received no response.[43]

24. Later, on the afternoon of May 7, 2021, Coalspur delivered to Ridley notice of its intention to disclaim the Agreements ("**Notice to Disclaim**").[44]

25. Despite demand from Ridley, Coalspur did not reroute the product en route to Westshore back to Ridley and continued shipping its product to Westshore.

III. ISSUES

26. The issues before this court are:

(a) Whether disclaimer of the Ridley Agreement should be permitted;

(b) Whether the breach of the Ridley Agreement prior to disclaimer is a pre-filing unsecured claim; and

(c) The potential application of the duty of good faith.

IV. LAW AND ARGUMENT

A. The Agreements Should Not Be Disclaimed

27. A disclaimer of a contract impacts both the debtor company and its stakeholders. A disclaimer can substantially increase the debt facing the estate or result in the divestiture of a substantial benefit.[45] In this instance, both would occur.

28. A disclaimer of a contract is in essence a repudiation where the innocent party is not allowed the election to accept or not accept. As such, disclaimer necessarily includes a confiscation of legal rights of the innocent party.

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[42] Booker Affidavit at para. 40
[43] Booker Affidavit at paras. 37, 38
[44] Booker Affidavit at para 41
[45] *League Assets Corp. (Re),* 2016 BCSC 2262 at para. 49 **[TAB 1]**

29. Section 32(4) of the *CCAA*[46] sets out specific factors that a court must consider in determining whether a disclaimer should be exercised, specifically:

(a) whether the monitor approved the proposed disclaimer or resiliation;

(b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and

(c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

30. These factors are not exhaustive.[47] In considering a proposed disclaimer, the court is to analyze the circumstances in their entirety, considering the impacts on all stakeholders and inquiring into the fairness to all parties.[48] Further, stakeholders are entitled to understand the "range of alternatives available" to understand whether the disclaimer should be approved.[49]

31. Section 32(4) of the *CCAA* is silent with respect to the relative importance of any one of the factors to be considered and is not restricted to the listed factors. Overall, the Court must balance the benefit of the proposed disclaimer against the detrimental impact.[50]

32. At its most basic level, the disclaimer or termination of a contract must be "fair, appropriate, reasonable, and must have been issued after good faith negotiations".[51]

33. In consideration of each of the factors set out in section 32(4) it is clear that the disclaimer should not be approved. Further and in the alternative, the debtor should not be permitted to take advantage of the discretionary relief provided for under section 32 of the CCAA when it has acted improperly, as it has in this instance.

[46] *Companies' Creditors Arrangement Act,* R.S.C. 1985, c C-36, as amended ("CCAA") at section 32 **[TAB 2]**
[47] *Re Aveos Fleet Performance,* 2012 QCCS 6795 at para. 39 **[TAB 3]**
[48] *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.,* 2003 BCCA 344 at para 35 **[TAB 4]**
[49] *The Clover on Yonge Inc.,* 2020 ONSC 5444 at para 23 **[TAB 5]**
[50] *Laurentian University of Sudbury,* 2021 ONSC 3272 at para. 44 **[TAB 6[**
[51] *Re Allarco Entertainment Inc*., 2009 ABQB 503 ("Re Allarco"), at para. 59 **[TAB 7]**

Approval by the Monitor

34. Approval by a Monitor is not determinative as to whether the disclaimer should be approved. The Monitor acknowledges that the Court is the only authority for the adjudication of the matters in this dispute.[52]

35. While Ridley understands that the Monitor approved the disclaimer, it appears that the Monitor was not in a position to have full regard for the factors set out in section 32 of the CCAA and specifically the impacts of the disclaimer on other stakeholders, including Ridley. It is further clear that the decision was made on a rush basis with limited information before the Monitor. While the Monitor has sought to supplement its reasons through the Third Report of the Monitor, it is clear that the Monitor continues to fail to consider whether the disclaimer is necessary or to adequately consider the impacts on Ridley. Further, while the Monitor has compared the Westshore Agreement against the Agreements, it has not consider the settlement options put forward by Ridley.

36. [redacted]

Enhancement of the Restructuring

37. The Report of the Standing Senate Committee provides the following direction regarding what the debtor must establish to support a disclaimer under section 32 of the CCAA:

> In particular: the debtor should be obliged to establish inability or serious hardship in restructuring the enterprise without the disclaimer; the co-contracting party should be permitted to file a claim in damages in the restructuring; and, where a collective agreement is being disclaimed, the debtor should also have the burden of establishing that post-filing negotiations have been carried on, in good faith, for relief of too onerous aspects of the collective agreement and should establish

[52] Third Report of FTI Consulting Canada Inc., in its capacity as Monitor of Coalspur Mines (Operations) Ltd. ("**Third Report**") at para. 19
[53] Swartz Transcripts at p.30, L21 - p.31, L10; p.44, L8 - 19
[54] Swartz Transcripts at p.36, L8-p.37,L19

> in Court that the disclaimer is necessary in order to allow for a viable restructuring[55]

38. Ridley submits that the disclaimer will have no impact, let alone a serious one, on the prospects of a viable compromise or arrangement as it is clear that all that is required for Coalspur to successfully exit the CCAA proceedings is time.

39. Coalspur's evidence in these proceedings is that its operations have significant value, and that the CCAA proceedings are only necessary as a result of a permitting issue with the Alberta Energy Regulator ("**AER**") which required it to shut down the mine in February 2021 at a time that it needed to pay Trafigura $59.9 million pursuant to a hedge obligation.[56] Since the commencement of these CCAA proceedings, Coalspur has resumed operations and its cash flow statement provides for repayment of Trafigura in July. The majority of Coalspur's remaining debt is to a non-arms' length party, namely the Cline Trust Company LLC. This is debt that Coalspur does not even track as part of its debt servicing obligations, and would not be due until the end of 2021 at the earliest (aside from an alleged *ipso facto* default based on these proceedings themselves).[57]

40. Coalspur's internal projections and publically available data indicate that the Agreements are not unreasonably impacting Coalspur's cash-flow and subsequently Coalspur's ability to satisfy its creditors through these CCAA proceedings.[58]

41. Based on cash flow projections provided by Coalspur to Ridley and present and future thermal coal prices, Coalspur is likely cash flow positive and earning profits in the range of $8-9 (USD) on each metric tonne of coal mined from the Project.[59] These profits are likely even greater now given the record high coal prices.

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[55] Debtors and Creditors Sharing The Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act Report of the Standing Senate Committee on Banking, Trade and Commerce (November 2003) at p. 137 **[TAB 8]**
[56] Affidavit of Michael Beyer sworn April 19, 2021 ("Beyer Affidavit") at para 6
[57] Bland Transcripts at p.13, L13 - 19
[58] Dixon Affidavit at para. 28
[59] Dixon Affidavit at para. 31

42. It is clear that the issues that resulted in Coalspur' liquidity issues - Trafigura and AER permitting - have been resolved. All Coalspur, needed was time to address its liquidity issues, which is being accomplished by way of the stay of proceedings.

43. By denying the disclaimer, the Court will maintain the status quo to enable Coalspur to proceed in a manner that benefits all of its creditors.[60]

44. In *Doman Industries Ltd. Re.,* the Court denied a request to disclaim agreements where the evidence was simply that a company would be more profitable if the contracts were terminated. In denying the disclaimer the court found that the loss of opportunity of being more profitable did not outweigh the prejudice associated with the disclaimer.[61]

45. [redacted]

However, those savings are not sufficient to justify the disclaimer, particularly where it would come at significant financial hardship to Ridley as discussed below.

The Disclaimer will cause Significant Financial Hardship

46. One of the purposes of the weighing requirement under section 32 is to prevent the creation of a situation where a disclaimer puts creditors into precarious financial situations.[63]

47. It is the uncontroverted evidence of Ridley that the disclaimer will cause significant harm to Ridley and may result in its own insolvency. A disclaimer would entitle Ridley's lender to demand immediate payment of $164 million outstanding under a loan agreement for a term ending on December 31, 2027 (the "**Ridley Loan**") as the Agreements constitute "Material Contracts" under the Ridley Loan. Ridley is unlikely to be able to raise sufficient funds to satisfy this debt call.[64] Contrary to the suggestion by Coalspur, Ridley's financial performance from 2019 is not

[60] *Re Lehndorff General Partner Ltd.,* [1993] O.J. No. 14 at paras. 6-8 **[TAB 9]**
[61] *Doman Industries Ltd. Re.,* 2004 BCSC 733 at para. 35, 38 **[TAB 10]**
[62] Swartz Transcripts at p. 53, L24 - p.54, L5
[63] *Re Jacob Boutique,* 2011 QCCS 276 at paras. 52-53 **[TAB 11]**
[64] Booker Affidavit at para 63

evidence of its current financial health as in 2019, unlike today, Ridley was a Crown corporation that did not need to pay taxes.[65]

48. The Agreements constitute approximately 40% of the volume handled at the Ridley Terminal[66] – a disclaimer would force Ridley to halt its significant capital spending to date in service of the Terminal Services Agreement and fundamentally alter its operations, which it is ill-equipped to do in the short-run.[67]

49. In a similar situation, in *Bank of Montreal v. Probe,* this court rejected a request by a receiver to disclaim a gas processing agreement to seek an alternative arrangement. The agreement at issue was designed to provide for the long term viability of a facility operator through requiring Probe, the debtor to guarantee minimum volumes. While the court acknowledged that the agreements depress the value of Probe's assets, it found that the disclaimer would be unfair as it would deprive the operator of the rights it bargained for and provide no similar disadvantage to Probe.[68] A similar result would occur if a disclaimer was granted in this instance.

50. Further, a disclaimer would cause significant hardship to the small and already disadvantaged community in Prince Rupert.[69] Ridley has already terminated the employment of twenty staff and union members, including four women and five members of the First Nations, due to the financial hardship flowing from Coalspur's ongoing breach of the Agreements.[70] Ridley will have to make additional rounds of layoffs to 15% of its personnel in the fall.[71] Further, the loss of employment associated with a disclaimer of the Agreements disproportionally affects the Prince Rupert workforce, as compared with the unionized personnel hired at Westshore, who may secure comparable employment at marine terminals along the Fraser River and Vancouver's inner harbor.[72]

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[65] Dixon Transcripts at p.18, L13-25
[66] Booker Affidavit at para 65
[67] Booker Affidavit at para 62
[68] *Bank of Montreal v. Probe Exploration Inc.,* para.36-38 **[TAB 12]**
[69] Booker Affidavit at para 69
[70] Booker Affidavit at para 66
[71] Booker Affidavit at para 66
[72] Booker Affidavit at para 68

51. In the circumstances, it is clear that the disclaimer will result in significant financial hardship, not only for Ridley but also First Nations and the Port Rupert community. This harm, greatly outweighs the purported benefits of the disclaimer which are not even necessary for Coalspur's restructuring. Further, contrary to the assertions of the Monitor and Coalspur, it is not answer to say that because Coalspur has not previously complied with its contractual obligations and shipped the amounts contracted for, that Ridley would not be significantly harmed by a disclaimer. As a result of the Agreements and representations made by Coalspur, Ridley has incurred significant costs and secured a loan which is now at risk of default should the disclaimer be upheld.

Failure to Consider Alternatives

52. To approve a disclaimer, the termination must be fair, appropriate, reasonable, and must have been issued after good faith negotiations.[73] In this instance negotiations have yet to conclude, with no negotiations taking place following the commencement of the CCAA proceedings despite Coalspur's indication that it would do so.

53. [redacted]

54. Rather than continuing such discussions in good faith with Ridley, Coalspur is now seeking to disclaim the Agreements without consequence and in total disregard of the impacts of its actions on Ridley. The ability to disclaim a contract under section 32 is discretionary relief; a debtor is not automatically entitled to do so. In these circumstances, it is inequitable for Coalspur to utilize this discretionary relief, reserved for circumstances where it is necessary to disclaim an agreement in order for a restructuring to occur. The proposed disclaimer should be denied. In the alternative, Coalspur should be directed to compensate Ridley fairly as a result of the harm and inequities caused.

[73] Re *Allarco, supra* at para 59 **[TAB 7]**
[74] Booker Transcripts at p. 16, L16-25, p. 17, L 1, p.28 L6-13; Swartz Transcripts at p. 57, L 8-16

B. Duty to Perform During the Notice Period

55. Section 32(5) of the CCAA provides that an agreement is disclaimed or resiliated:

(a) if no application is made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1);

(b) if the court dismisses the application made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1) or on any later day fixed by the court; or

(c) if the court orders that the agreement is disclaimed or resiliated under subsection (3), on the day that is 30 days after the day on which the company gives notice or on any later day fixed by the court.

56. The official summary of Bill C-12 states the following with regard to the amendment of section 32(5) in 2007:

> If an application is made in response to the notice, but the court dismisses the application, the agreement is disclaimed or resiliated within 30 days after the day on which the debtor gives notice. If the debtor applies to the court for an order to disclaim or resiliate the agreement, and the court grants the order, the agreement is disclaimed or resiliated 30 days after the day on which the debtor gives notice or any later day fixed by the court (clause 26, section 65.11(6) BIA; and clause 76, section 32(5) CCAA).[75]

57. Accordingly, a notice of disclaimer does not take effect until at least 30 days after the notice is provided, if at all. Until then, the agreement is in effect, and any failure to comply with contractual obligations therein must constitute a post-filing breach. To find otherwise, would render the notice period irrelevant and prejudice parties already negatively impacted by the stay of proceedings which prohibits them from exercising remedies that would otherwise be available. Further, it could usurp the authority of the Court through rendering it unable to provide adequate relief as harm occurring during that 30 day period, may not be able to be undone.

[75] Marcia Jones, 39th Parliament, 2nd Session: Bill C-12: An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act, the Wage Earner Protection Program Act and chapter 47 of the Statutes of Canada, 2005 p. 21 **[TAB 13]**

58. Coalspur takes the position that this Honourable Court's decision in *Bellatrix Exploration Ltd.,* 2020 ABQB 809 ("**Bellatrix**") provides authority to breach the Ridley Agreements during the notice period and further supports a finding that any breach can only result in a pre-filing unsecured claim.

59. Bellatrix is clearly distinguishable on its facts in that it concerned an eligible financial contract ("**EFC**"). Unlike the case with EFC's, which are expressly afforded unique treatment under the CCAA, Ridley's rights were stayed as a result of the CCAA proceedings and thus Ridley necessarily relied on the notice provisions to provide a level of protection in the event of a disclaimer.

60. In Bellatrix, the debtor did not seek or obtain a stay of the rights of the contractual counterparty. By contrast here, Coalspur has sought and obtained a stay of the rights of Ridley. Ridley is enjoined from refusing to perform its obligations under the Ridley Agreements. Ridley cannot bring enforcement proceedings. Ridley cannot bring injunction proceedings. And Ridley has no election to accept Coalspur's repudiatory conduct or instead affirm the Ridley Agreements and sue for specific performance. Having sought injunctive relief, it would be unconscionable to allow Coalspur to take advantage of the injunction by its own repudiatory conduct.

61. Further, unlike in Bellatrix, Coalspur has done more than merely stopped performing under the Agreements. Coalspur misled Ridley as to its intentions, and proceeded to expressly breach the Exclusivity Clause by commencing shipping through Ridley's competitor at the significant expense of Ridley and its employees, when it was in a position to comply with its obligations. It is important to note that the main savings touted by Coalspur are with respect to pre-filing amounts owed.

62. In the unreported decision of *Credit Suisse AG v Southern Pacific Resource*, transcript dated October 28, 2016, this Honourable Court awarded ongoing fees during the disclaimer notice period in a non-EFC contract. As set out in the Receiver's Report, a notice of disclaimer was issued on April 15, 2015 to Altex effective May 15, 2015. Upon issuing the disclaimer, the debtor ceased shipment under the contract. The debtor made payments for the month of April but did not make payment of the pro-rated fee for May 1 to May 15. This Honourable Court found "With respect to whether Altex is entitled to a pro rata portion of the unrevised capital cost for the period of May

1st to 15th, 2015, I accept that even though services were not rendered, the notice period under the disclaimer was 30 days and that thus Altex is entitled to $69,918.61 as calculated by the receiver."[76]

63. The *Southern Pacific Resource* decision, provides support for the proposition that there is an obligation to perform or provide compensation in lieu during the 30-day notice period. In further support of the proposition that performance is still required during the 30-day notice period, is the *Target Canada Co. (Re)* decision whereby the pharmacies were given at least 60 days to continue their operations prior to the disclaimers becoming effective. The Court found this approach to be equitable.[77]

64. Not only should the disclaimer be denied as it does not satisfy the factors set out in section 32, but for the reasons provided above and consistent with the legislative intent, Coalspur should be required to compensate Ridley for the damages that occurred following issuance of the notice of disclaimer to date, or alternatively if the disclaimer is allowed during the 30-day notice period.

C. Coalspur's Conduct Amounts to Bad Faith

65. [redacted]

66. Section 18.6 of the CCAA provides[79]:

> (1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.

[76] Receiver's First Report; October 28, 2016 Transcripts from the Southern Pacific Application at p.34, L30-40 **[TAB 14]**
[77] *Target Canada Co. (Re),* 2015 ONSC 1028 at paras. 28-30 **[TAB 15]**
[78] Booker Affidavit at paras. 37-41
[79] *CCAA, supra* at section 18.6 **[TAB 2]**

(2) If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the court may make any order that it considers appropriate in the circumstances.

67. Bad faith exists where it cannot be said that the termination is fair and reasonable.[80] This is such a situation.

68. The parameters of bad faith have been cited as follows:

> The court will find bad faith conduct where a debtor, creditor or their professionals fail to meet the requirements to act candidly, honestly, forthrightly and reasonably in their dealings with one another and the court; where parties act capriciously and arbitrarily; or where they lie or otherwise knowingly mislead each other about matters relating to the insolvency proceedings.[81]

69. In a recent proceeding, Justice Dunphy of the Ontario Superior Court of Justice found a lender to be acting in bad faith within CCAA proceedings due to a lack of flexibility and willingness to compromise on what was viewed as a simple issue, specifically the execution of an agreement.[82] Not only does this signal a willingness of courts to find bad faith conduct, but such conduct can be found specifically in relation to business arrangements.

70. The statutory duty of good faith can be further informed by the common law. In its 2020 *Callow* decision, the Supreme Court found that the duty of honest performance can be breached by misleading the other party, even if the misleading occurs through silence.[83]

71. [redacted]

[80] *Doman Industries Ltd., Re*, 2004 CarswellBC 1545 (B.C.C.A. in Chambers) at para. 10 **[TAB 16]**
[81] *Bellatrix Exploration Ltd.,* 2020 ABQB 809 at para. 105 **[TAB 17]**
[82] *BMO v 2592931 Ont Inc*., 2921 ONSC 4412 at para. 35 **[TAB 18]**
[83] *C.M. Callow Inc v Zollinger*, 2020 SCC 45 **[TAB 19]**
[84] Swartz Transcripts at p.28, L1 - p.31, L24, p.40, L5-9

72. Coalspur breached its good faith obligations both prior to and following the commencement of the CCAA Proceedings. Not only through its silence did it mislead Ridley with respect to its intentions regarding the Agreements, but further through negotiating and entering into an agreement with Ridley's competitor notwithstanding the exclusivity provision. Through its actions, Coalspur has harmed not only Ridley and the community of Port Rupert but the other stakeholders of Coalspur through the millions in provable claims resulting from its actions should the disclaimer be upheld.

V. CONCLUSION

73. Companies should not be able to utilize the CCAA process to disclaim Agreements to simply obtain a better deal. A disclaimer of the Agreements should not be permitted in the circumstances. Further, Coalspur should not be allowed to avoid its obligations during the Notice period and should be directed to compensate Ridley accordingly. Ridley respectfully requests that:

(a) The disclaimer be denied; and

(b) Coalspur be directed to pay to Ridley the amounts it would have been entitled post-filing had it shipped to Ridley as opposed to Westshore.

ALL OF WHICH IS RESPECTFULLY SUBMITTED at Calgary, Alberta this 2nd day of July, 2021.

BENNETT JONES LLP

Per: _____

David Gruber / Keely Cameron
Counsel for the Applicant,
Ridley Terminals Inc.

Table of Authorities

TAB

TAB 1

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: *League Assets Corp. (Re),*
2016 BCSC 2262

Date: 20161202
Docket: S137743
Registry: Vancouver

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

And

**In The Matter of the *Business Corporations Act,*
S.B.C. 2002, c. 57, As Amended**

And

**In The Matter of the *Canada Business Corporations Act*,
R.S.C. 1985, c. C-44, As Amended**

And

**In The Matter of a Plan of Compromise and Arrangement
of League Assets Corp. and Those Parties Listed on Schedule "A"**

Petitioners

Before: The Honourable Madam Justice Fitzpatrick

Reasons for Judgment

Counsel for the Petitioners:	Katie Mak
Counsel for ANB Canada Inc.:	Jeff Lee, Q.C. Adam Kaukas
Counsel for PricewaterhouseCoopers Inc., the Monitor	Jeremy Dacks
Place and Date of Hearing:	Vancouver, B.C. November 18, 2016
Place and Date of Judgment:	Vancouver, B.C. December 2, 2016

INTRODUCTION

[1] These proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended, (the "*CCAA*") are soon coming to an end. The Monitor is now preparing for the final distributions to the creditors and investors and completing the remaining administrative matters in accordance with the Wind-Up Plan, as defined and approved in the Wind-Up Implementation Order dated December 11, 2015.

[2] One of the last matters to be addressed is the determination of the claim advanced by ANB Canada Inc. ("ANB") against IGW Industrial Limited Partnership ("IGW Industrial"). ANB claims a break fee of $500,000 arising from a purchase and sale transaction that did not complete shortly after these proceedings began.

[3] IGW Industrial, as supported by the Monitor, disputes ANB's claim to the break fee. As a result, ANB now applies for an order that its claim be allowed.

BACKGROUND FACTS

(1) The Purchase and Sale Agreement

[4] In 2013, IGW Industrial was the beneficial owner of commercial property in LaSalle, Quebec (the "LaSalle Property") and the legal and beneficial owner of the shares in 8255220 Canada Inc. ("825"). 825 held the registered legal title to the LaSalle Property on behalf of IGW Industrial.

[5] On May 29, 2013, IGW Industrial and NorRock Realty Finance Corporation ("NorRock") entered into an agreement of purchase and sale (the "Agreement"). NorRock is a predecessor company of ANB.

[6] Pursuant to the Agreement, IGW Industrial, as vendor, agreed to sell and NorRock, as purchaser, agreed to purchase the beneficial title to the LaSalle Property and the legal and beneficial title to the shares in 825. The Agreement was later modified by agreements made June 19, 2013 and August 29, 2013.

[7] The purchase price to be paid by NorRock under the Agreement was $17 million; however, this was a non-cash transaction, in that this amount was to be satisfied by the assumption by NorRock of 825's debt ($11.2 million) and the balance ($5.8 million) by the issuance of NorRock shares.

[8] The Agreement also provided that NorRock would obtain the approval of the TSX Venture Exchange ("TSXV") to be listed as a Tier 1 or Tier 2 issuer on the TSXV (the "Regulatory Approvals").

[9] Section 3.1 of the Agreement provided that IGW Industrial's obligation to carry out the transaction was subject to the fulfillment of certain conditions (the "Vendor's Conditions") on or before the Closing Date, including the following:

a) all of the terms, covenants and conditions of the Agreement to be complied with or performed by NorRock on or before the times contemplated in the Agreement would have been complied with or performed in all material respects (s. 3.1(c));

b) the Closing Date would occur on or before the Outside Date, provided that the failure of the Closing Date to occur by the Outside Date was not principally as a result of IGW Industrial's failure to fulfil any of its obligations or breaching any of its representations and warranties in the Agreement (s. 3.1(d)); and

c) the Regulatory Approvals would have been obtained, including acceptance by the TSXV of the transactions contemplated in the Agreement along with the other concurrent transactions to be completed by NorRock as set out in the Information Circular and Press Release, being sufficient to constitute a reactivation of NorRock to list its shares as a Tier 1 or Tier 2 issuer on the TSXV (s. 3.1(f)).

[10] Section 3.2 of the Agreement provided that NorRock's obligation to carry out the transaction was subject to the fulfillment of certain conditions (the "Purchaser's Conditions") on or before the Closing Date, including the following:

a) during the period from the date of execution of the Agreement to the Closing Date, there would be no Order made or any Legal Proceeding commenced or threatened against either party which in the result, could enjoin, prevent or adversely affect the right of NorRock to acquire or retain the LaSalle Property or the shares in 825 (s. 3.2(k));

b) all Regulatory Approvals would have been obtained (s. 3.2(l)); and

c) the Closing Date would occur on or before the Outside Date, provided the failure of the Closing Date to occur by the Outside Date was not principally as a result of NorRock failing to fulfil any of its obligations or breaching any of its representations and warranties in the Agreement (s. 3.2(n)).

[11] The Agreement, as amended, provided that the transaction would close no later than the "Outside Date" of December 31, 2013, subject to NorRock obtaining the Regulatory Approvals (s. 2.2).

[12] The Agreement also addressed the result if any of the Vendor's Conditions and the Purchaser's Conditions were not satisfied. In particular:

a) if any of the Vendor's Conditions were not satisfied or waived by the Closing Date, IGW Industrial was permitted to terminate the Agreement (s. 3.3(b)); and

b) if any of the Purchaser's Conditions were not satisfied or waived by the Closing Date, NorRock was permitted to terminate the Agreement (s. 3.3(c)).

[13] The provision in the Agreement giving rise to ANB's claim is section 13.1 which provides for the payment of a break fee by IGW Industrial in certain circumstances. That section reads:

> Notwithstanding any other provision of this Agreement, if at any time after the execution of this Agreement, [IGW Industrial] terminates this Agreement in circumstances other than those set out in Section 3.1 [the Vendor's Conditions], then [IGW Industrial] will pay to [NorRock] the amount of

> $500,000.00 as a break fee (the "Break Fee") in immediately available funds to an account designed by [IGW Industrial]. …

[14] Accordingly, the sole issue to be determined is whether IGW Industrial terminated the Agreement pursuant to section 13.1 prior to the Closing/Outside Date so as to trigger an obligation to pay the break fee to NorRock.

(2) The *CCAA* Proceedings

[15] On October 18, 2013, the petitioners, which included IGW Industrial and 825, filed for creditor protection under the *CCAA*. On that date, an Initial Order was granted and PricewaterhouseCoopers Inc. was appointed as Monitor.

[16] As is usual, a stay of proceedings was imposed by the terms of the Initial Order. It is beyond debate that the seminal purpose of the stay is to maintain the *status quo* in some form so that the debtor companies are allowed some breathing space within which to hopefully reorganize their affairs and develop a plan in the future to address outstanding stakeholder claims.

[17] In that vein, the granting of the Initial Order had consequences for IGW Industrial and 825 in terms of their ability to deal with their assets and contracts after the filing, including relating to the LaSalle Property.

[18] Upon the granting of the Initial Order, IGW Industrial and 825 were prohibited from selling or disposing of their assets, save in the ordinary course of their business, unless authorized by court order: *CCAA*, s. 36(1).

[19] To similar effect, the Initial Order provided that IGW Industrial and 825 remained in possession and control of their properties and business undertakings and they were authorized to carry on business in the ordinary course and in a manner consistent with the preservation of those properties (para. 4). In addition, IGW Industrial and 825 were allowed to dispose of only certain redundant or non-material assets and that any other disposition of assets required the Monitor's, and perhaps the court's, approval (para. 12(a)). The LaSalle Property and the shares in 825 would have fallen into the latter category.

[20] The Initial Order also addressed the preservation of executory contract rights held by IGW Industrial, by which counterparties were prevented from taking steps to negatively affect those rights:

> 20. During the Stay Period, no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any … contract, agreement … in favour of or held by the Petitioners, except with the written consent of the Petitioners and the Monitor or leave of this Court.

[21] With respect to the petitioners, as a counterparty to any executory contract, s. 32 of the *CCAA* also applied so as to require the petitioners to obtain the Monitor's (and possibly the court's) approval if they should seek to disclaim any agreement. Section 32 specifies a process by which notice of any such disclaimer would be made and also the means by which objections to any disclaimer (by the counterparty or the monitor) would be addressed:

> 32 (1) Subject to subsections (2) and (3), a debtor company may — on notice given in the prescribed form and manner to the other parties to the agreement and the monitor — disclaim … any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer…
>
> (2) Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.
>
> (3) If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement be disclaimed or resiliated.
>
> ….

[22] All of the above statutory provisions and the provisions in the Initial Order clearly affected the Agreement and also, IGW Industrial and 825's ability to deal with their assets, including the LaSalle Property and the shares in 825.

[23] Later in these reasons, I will address the detailed context in which the *CCAA* proceedings unfolded over the months following the filing. At this stage, it should be noted that certain events in these proceedings took place in November 2013,

resulting in IGW Industrial and 825 remaining in full possession of their assets, albeit with the Monitor's and this Court's oversight in these proceedings.

[24] The Regulatory Approvals were never obtained by NorRock towards completing the transaction under the Agreement. In addition, following the *CCAA* filing and leading to the end of 2013, NorRock did not pursue any discussions with the Monitor or apply to the Court to force a completion of the transaction under the Agreement. In due course, the Outside Date of December 31, 2013 came and went and the transaction contemplated under the Agreement did not occur.

[25] In May 2014, the petitioners made the decision, in consultation with the Monitor, that a restructuring would not be viable. As a result, the LaSalle Property was listed for sale by the Monitor. The LaSalle Property was eventually sold pursuant to this Court's Approval and Vesting Order granted January 8, 2015.

(3) The Claims Process

[26] In accordance with the Claims Process Order dated January 23, 2014, NorRock filed its proof of claim on March 5, 2014 against IGW Industrial, the general partner, IGW Industrial GP Inc., and 825. NorRock claimed the break fee of $500,000, which it alleged was owed under section 13.1 of the Agreement.

[27] The Monitor responded with a Notice of Revision or Disallowance dated May 9, 2014, stating in part that IGW Industrial did not terminate the Agreement so as to trigger the obligation to pay the break fee.

[28] On May 27, 2014, NorRock filed a Notice of Dispute of Revision or Disallowance. In that Notice, NorRock advanced arguments that were not put forward on this application (ie. that IGW Industrial had "frustrated" the Agreement and intentionally breached the Agreement by the *CCAA* filing). I agree that it is unfortunate that NorRock's arguments have been somewhat of a moving target. In any event, as paragraph 36 of the Claims Process Order dated January 23, 2014 provides that the adjudication of the claim is to be done on a *de novo* basis, no particular issues arise in that respect.

[29] The only evidence on this application, save for the filed *CCAA* materials, including reports of the Monitor, was the affidavit of Jacqueline Boddaert #1, the CEO of ANB, sworn November 3, 2016.

DISCUSSION AND ANALYSIS

[30] ANB argues that, prior to the Closing/Outside Date, IGW Industrial terminated the Agreement by repudiating the Agreement, and this repudiation was accepted by ANB. ANB argues that such repudiation triggers the right to payment of the break fee pursuant to section 13.1 of the Agreement.

[31] ANB argues that IGW Industrial repudiated the Agreement in two separate and distinct ways: firstly, by express notice in October 2013 and secondly, impliedly by conduct which took place in November 2013.

[32] The relevant law is not in dispute.

[33] In *McCallum et al. v. Zivojinovic* (1977), 16 O.R. (2d) 721 (C.A.), at 723, the court discusses the manner in which renunciation or repudiation may take place:

> The renunciation of a contract may be express or implied. A party to a contract may state before the time for performance that he will not, or cannot, perform his obligations. This is tantamount to an express renunciation. On the other hand a renunciation will be implied if the conduct of a party is such as to lead a reasonable person to the conclusion that he will not perform, or will not be able to perform, when the time for performance arises: *Chitty on Contracts*, 23rd ed., vol. 1, para. 1342, at p. 626; 9 *Hals.*, 4th ed., para. 548, at p. 376. ...

[34] Even when a person has indicated that he will not or cannot perform his obligations, this does not automatically result in termination of the contract. The innocent party has the option to accept the repudiation and elect to treat the contract as terminated. If not, then the contract remains effective and both parties remain subject to the provisions in that contract.

[35] In *Dosanjh v. Liang*, 2015 BCCA 18, the court adopted the trial judge's summary of the rights of a party to accept a repudiation of a contract:

[33] The trial judge summarized the general law with respect to a party's right to accept a repudiation of a contract at para. 50 of her judgment:

> The consequences of a repudiation, whether by anticipatory breach or breach of a fundamental term, are well established. They are referred to in *Sethna v. 350 Kingsway Development Ltd.*, 2011 BCCA 434, at para. 24, and *Homestar Industrial Properties Ltd. v. Philps* (1992), 72 B.C.L.R. (2d) 69 (C.A.), at para. 13, and may be summarized as follows:
>
> - A party to a contract has two alternatives if the other party repudiates the contract: the innocent party may accept the repudiation or affirm the contract.
> - If the innocent party accepts the repudiation, the contract is at an end, both parties are relieved of their obligations under it, and the innocent party may sue for damages immediately without waiting for the time that the contract should have been performed.
> - If the innocent party affirms the contract, the contract remains alive in all respects for both parties, and the risk exists that the party beginning as the innocent party will subsequently commit a breach of its own.
> - If the innocent party wishes to accept the repudiation, he or she must make his or her election known.
> - Once made, the election is irrevocable.

[36] In *Gulston v. Aldred*, 2011 BCCA 147, the court reinforced the notion that the election must be made promptly:

> [50] Where there is a breach of a fundamental term, the innocent party has two options. As this Court stated in *Morrison-Knudsen Co. Inc. v. British Columbia Hydro and Power Authority*, (1978) 85 D.L.R (3d) 186 at para. 130:
>
> > … When faced with a fundamental breach the innocent party is put to an election. He may elect to affirm the contract and to hold the other party to the performance of his obligations and sue for damages as compensation for the breach. He may, on the other hand, elect to treat the breach as a fundamental breach and accept it as such. Thus he would terminate the contract and thereafter be relieved of any further duty to perform and he could sue at once for damages or *quantum meruit* for performance to that point. It is essential that such election, an election between inconsistent rights, be made promptly and communicated to the guilty party. Once made, the election is binding and cannot be changed.
> >
> > [Emphasis in original.]

[37] It has been stated that the timeliness of the communication requires that the election be made within a reasonable time: *Brown v. Belleville (City)*, 2013 ONCA 148 at para. 45; *Dosanjh* at para. 37.

[38] As indicated in *Gulston*, the election to disaffirm a contract must be clearly and unequivocally made to the repudiating party. That communication can be accomplished directly, by either oral or written words, or may be inferred from the conduct of the innocent party in the particular circumstances of the case: *Brown* at paras. 45-48. The Court in *A & G Investment Inc. v. 0915630 B.C. Ltd.*, 2014 BCCA 425 stated:

> [38] An election between inconsistent rights must, however, be made promptly and communicated to the other side. Parties cannot adopt a "wait-and-see" approach to fundamental breach, as their election simultaneously determines the position of the counterparty to the contract. Either the contract is not repudiated and the rights and obligations under it still exist, or the contract is rescinded because of an accepted repudiation and then very different rights come into being in respect of a cause of action. In either case, parties must have prompt notice of their position. …

[39] These cases make plain that the law requires an irrevocable election by the innocent party, an election that is effectively communicated in a timely way to the repudiating party in order to determine the rights and obligations under the contract.

(1) Was there termination by Notice?

[40] ANB contends that Adam Gant, IGW Industrial's CEO, expressly gave notice of IGW Industrial's intention not to complete the transaction in October 2013, after the *CCAA* filing. ANB also contends that this was done with the consent and advice of the Monitor. As such, ANB alleges that IGW Industrial, with the consent of the Monitor, terminated the Agreement no later than October 31, 2013, prior to the Outside Date.

[41] Shortly after the *CCAA* filing on October 18, 2013, NorRock became aware of that fact. The details as to how that occurred are not in evidence. In any event, the Initial Order would have been posted on the Monitor's website, as required by the Initial Order (as would all of the Monitor's reports referenced below).

[42] Ms. Boddaert states that on October 22, 2013, she was advised by NorRock's counsel that:

> … TSXV would not likely provide approval for a transaction where the new control person was subject to insolvency proceedings and that, therefore, it was unlikely that the Transaction with IGW Industrial and 825 being subject to CCAA proceedings, would receive TSXV approval.

[43] The only evidence relied upon by ANB as the basis upon which IGW Industrial gave express notice of its repudiation of the Agreement is found in Ms. Boddaert's affidavit, as follows:

> 20. During the period October 18, 2013 to October 31, 2013, I was informed by Adam Gant, the CEO of the IGW Industrial, that the Monitor did not intend to complete the Transaction because of the non-cash consideration to be paid for the LaSalle Property; and the Monitor preferred to sell the LaSalle Property in a cash transaction. On hearing that the Monitor did not want to proceed with the Transaction I advised our counsel Harris + Harris LLP and asked that they obtain confirmation from counsel to IGW Industrial and the other League entities including in the CCAA filing.

[44] This statement makes clear that NorRock was expressly aware that the insolvency proceedings *could* have an effect on the ability of IGW Industrial to complete the transaction and its obligations to abide by the Agreement and that the Monitor's views would be a key factor in that regard.

[45] The first issue to be addressed is whether IGW Industrial could validly repudiate the Agreement in the circumstances alleged by Ms. Boddaert. In my view, the answer to that question is "No".

[46] It is manifestly the case that IGW Industrial did not give notice to NorRock of its intention to disclaim the Agreement, as required by the *CCAA*, s. 32. Section 32 requires that the prescribed form be used to formally give such notice. No such form was ever prepared and provided to NorRock.

[47] In addition, at no time did the Monitor consent to any disclaimer of the Agreement, including signing the prescribed form, as required by s. 32, or otherwise. Whatever Mr. Gant may have advised Ms. Boddaert, the Monitor never did so and it does not appear that NorRock ever sought confirmation directly from the Monitor.

[48] NorRock was aware of the *CCAA* filing almost immediately and would have known, or ought to have known, that the Agreement was not disclaimed. The Initial Order, posted on the Monitor's website, set out the process for disclaiming contracts, including the statutory requirements in s. 32 of the *CCAA*. NorRock also did not receive direct communication from the Monitor that it had consented to any repudiation on the part of IGW Industrial. NorRock is then taken to have express or implied knowledge that the statutory procedures had not been followed by IGW Industrial in order to effectively disclaim the contract, leaving the Agreement in force.

[49] These *CCAA* provisions are not inconsequential in the face of this type of proceedings. At this point, the matter is no longer between the debtor company and a counterparty. There are other stakeholders involved and the statutory provisions, and the provisions of court orders such as the Initial Order, are meant to protect the stakeholder group as a whole, while also allowing a certain amount of flexibility for the debtor company. A disclaimer of a contract has consequences not only to the debtor company, but the estate generally. Such an action can substantially increase the debt being faced by the estate or divest the debtor of a substantial benefit that might be realized for the benefit of the creditors. It is in that context that the *CCAA* requires that certain procedures be followed by the debtor company, with the necessary oversight by the Court's officer, the Monitor, as to whether any disclaimer will be approved or not.

[50] Implicitly, NorRock recognizes that it knew or should have known of the s. 32 process to disclaim any contract. However, NorRock argues that the s. 32 requirement is a red herring. It argues that a debtor company may deem it unnecessary or impractical to invoke the s. 32 disclaimer process. NorRock says that whether or not such a process is invoked is not determinative as to whether a debtor company has in fact disclaimed a contract. This argument is couched in terms of a debtor company having the ability to deal with what NorRock describes as "less important agreements" via a less cumbersome procedure.

[51] I do not agree that the debtor company can proceed without the required oversight by the Monitor, which is the means by which an independent eye is cast upon any such proposed action by the debtor company. As IGW Industrial argues, s. 32 does not itself admit of any exceptions. Further, even based on NorRock's argument, one can hardly describe IGW Industrial's obligations under the Agreement as unimportant, particularly given the magnitude of the value of the LaSalle Property.

[52] Accordingly, any comments by Mr. Gant to Ms. Boddaert did not result in any valid repudiation of the Agreement under the *CCAA*.

[53] Further, leaving the s. 32 process aside, the difficulty with Ms. Boddaert's evidence is that at no time does she assert that Mr. Gant advised her that IGW Industrial had no intention of completing the transaction under the Agreement. The only reference in her evidence is to the *Monitor's* intentions in respect of the transaction. ANB contends that this evidence establishes that the Monitor agreed to a repudiation and directed IGW Industrial to proceed in that fashion. However, even accepting Mr. Gant's suggestion that the Monitor did not intend to approve the completion of the transaction, this would not have prevented IGW Industrial from seeking a court order to do so under the *CCAA*, s. 32(3).

[54] Accordingly, I see no basis upon which ANB can argue that the October 2013 discussions between Ms. Boddaert and Mr. Gant constitute express notice by IGW Industrial of its repudiation of the Agreement.

[55] This conclusion is supported by the fact that NorRock later sought "confirmation" from IGW Industrial as to its ability or willingness to complete the transaction. That took the form of a letter dated October 31, 2013 from Harris + Harris LLP, NorRock's counsel, to IGW Industrial's counsel. That letter is instructive on both the issue of the alleged prior repudiation (as asserted by NorRock) and whether this letter represented acceptance of IGW Industrial's repudiation (also as asserted by NorRock).

[56] Relevant portions of the October 31, 2013 letter from Harris + Harris LLP read:

> … We now understand from discussions between our respective clients that [the Monitor] does not want to complete the Transaction as planned because of the non-cash consideration to be paid to [IGW Industrial]. We have been advised indirectly via NorRock that the Monitor prefers to sell the Property in a cash sale Transaction.
>
> It is unfortunate that [IGW Industrial] is now under CCAA protection and does not wish to close the Transaction …
>
> Even if the Monitor were convinced to proceed with the Transaction, we suspect [IGW Industrial] would have challenges to completing the Transaction, since the [TSXV] will, in these circumstances, not likely grant approval for [IGW Industrial] (as party to the CCAA proceedings) to become a shareholder of a publicly traded company such as NorRock; until after the CCAA process has been completed. Specifically, the fact that [IGW industrial] is understood CCAA protection likely means that the TSXV will not grant approval for the Transaction, as the TSXV will not permit an insolvent Vendor to become an insider of NorRock and hold a large block of NorRock's shares. A possibility would be to wait until the CCAA process has been completed and then obtain the TSXV approval; however, perhaps this is too lengthy a time period for the Monitor. We might also apply to the court to exclude [IGW Industrial] from the CCAA proceedings process and distribute the securities of NorRock issued on completion of the Transaction to all of the limited partners of [IGW Industrial].
>
> If, as it appears, the Monitor wishes to terminate the Purchase Agreement (and in the alternative, the Transaction will likely be frustrated as a result of League's (and the related parties' conduct)), the issue really will then come down to the break fee provided for in the Purchase Agreement. … My client has incurred extraordinary costs and expenses in connection with the Transaction and now, by not completing the Transaction, my client will suffer significant additional damages as well – all of these far exceeding the break fee.
>
> Our understanding is that while the Vendor itself is a solvent company, it does not have sufficient cash assets to immediately pay the break fee, nor is it likely to be able to obtain such proceeds from League Assets Corp. at this time. Consequently, in an effort to resolve this matter expeditiously and with some degree of certainty; as well as allowing NorRock to stop incurring expenses and damages, we are prepared to recommend that NorRock accept a direction and undertaking from [IGW industrial] and the Monitor; to have the break fee paid from the proceeds received on a disposition/sale of the Property; provided that same happens on or before January 31, 2014.
>
> …
>
> We appreciate your cooperation and timely attention to this matter so that NorRock may move forward with the alternate reactivation transaction in place of the previously contemplated Transaction involving [IGW industrial].

[57] In my view, it is inconsistent for Ms. Boddaert to refer to this letter as being both a communication to obtain "confirmation" as to IGW Industrial's earlier indicated intention not to proceed with the transaction *and* a communication by NorRock to IGW Industrial of NorRock's acceptance of IGW Industrial's prior repudiation.

[58] If nothing else, the author of this letter appears to have implicitly recognized the need for IGW Industrial to obtain the Monitor's approval of any disclaimer under the *CCAA*, s. 32.

[59] Further, even if I had accepted that Mr. Gant's comments did result in NorRock being advised of IGW Industrial's intention not to complete the transaction, I do not consider this letter to be a clear and unequivocal indication of NorRock's acceptance of the repudiation per *Gulston*. In substance, NorRock's counsel was: trying to engage in a discussion about the difficulties in proceeding with the transaction given the *CCAA* filing; speculating about the "likely" response of the TSXV; commenting on whether the Monitor could possibly be convinced to approve the transaction; and, asking whether other options could possibly be explored in order to complete the transaction (such as removing IGW Industrial from the *CCAA* proceedings). The reference to the break fee in this letter is made in the context of resolving the uncertainty that both IGW Industrial and NorRock faced in the situation.

[60] Taken as a whole, there is nothing in the Harris + Harris LLP letter that indicates an acceptance by NorRock that the Agreement was terminated as of October 31 and the transaction was at an end by reason of IGW Industrial's unwillingness or inability to proceed with it, such that the break fee was payable.

[61] Accordingly, I agree with IGW Industrial and the Monitor that the Agreement, as an executory contract, remained in full force and effect as of October 31, 2013.

(2) Was there termination by Conduct?

[62] In the alternative, ANB contends that the conduct of IGW Industrial and the Monitor, subsequent to October 31, 2013 and throughout November 2013, communicated to NorRock that IGW Industrial had no intention of completing the

transaction under the Agreement. As such, ANB alleges again that IGW Industrial, with the consent of the Monitor, terminated the Agreement prior to the Outside Date.

[63] At this stage, the circumstances faced by the petitioners after the filing of the *CCAA* proceedings are very relevant.

[64] In *Canada (Minister of Indian Affairs & Northern Development) v. Curragh Inc.* (1994), 114 D.L.R. (4th) 176 (Ont. S.C.J.) at 185, Justice Farley made an oft-quoted statement about the condition of insolvency:

> … It should be recognized that where one is dealing with an insolvency situation one is not dealing with matters which are neatly organised and operating under predictable discipline. Rather the condition of insolvency usually carries its own internal seeds of chaos, unpredictability and instability. …

[65] The words "chaos, unpredictability and instability" certainly applied to the petitioners at the time of the *CCAA* filing and that became increasingly so after the filing.

[66] At the time of the filing, the petitioners' business operations involved over a hundred different corporations, limited partnerships and real estate investment trusts. There were various real estate projects underway across Canada, which were mostly failures. Most, if not all, of the projects were encumbered by secured debt. There was substantial unsecured debt. Thousands of individual investors were involved who were owed millions of dollars.

[67] I described the substantial issues facing the petitioners in my earlier reasons when I approved interim financing and appointed representative counsel for the investors on October 25, 2013: *League Assets Corp. (Re)*, 2013 BCSC 2043. In addition, the course of events after the *CCAA* filing and into November 2013 is described in the Monitor's Fourth and Sixth reports.

[68] These *CCAA* proceedings were extremely contentious at the beginning. Despite the *CCAA* filing on October 18, many of the secured creditors were clamouring to convert the proceedings to a receivership; alternatively, they sought a

court order to exempt their properties from the stay so that they could commence foreclosure proceedings. Conversely, the petitioners were still of the view that they had a reasonable prospect of continuing with the restructuring towards putting a plan to the stakeholders and preserving at least some portion of the business operations. They considered that if the plan was to succeed, they needed many of the real estate projects to remain intact.

[69] In these early days, it was unclear which stakeholders were “in the money” and that was particularly so in respect of the investor group.

[70] In late October 2013, it was shaping up to be a showdown at the comeback hearing to determine if there was a nascent plan, sufficient to continue the stay and the *CCAA* proceedings, or whether any plan was likely to fail: see *Azure Dynamics Corporation (Re)*, 2012 BCSC 781.

[71] In the face of this chaos, the Monitor participated in numerous discussions with the petitioners, counsel for certain secured lenders, representative counsel and other stakeholders. The Monitor’s objective was to determine whether there was a consensual path forward that was in the best interest of all of the stakeholders.

[72] In the period of time leading up to the comeback hearing on November 18, 2013, it was not at all clear what would happen to the *CCAA* proceedings and the properties held by the petitioners. One of the major concerns raised was whether allowing a receivership would result in a loss of value, by increasing recovery costs and entering into a forced liquidation approach, to the detriment of many stakeholders. With ongoing negotiations underway, the comeback hearing was adjourned to November 22, 2013.

[73] After difficult negotiations, various stakeholders reached an agreement on a path forward that would see the petitioners remain subject to the *CCAA* proceedings. As such, on November 22, 2013, this Court granted the Process Order, which, amongst other things, expanded the Monitor's powers and removed Mr. Gant from operational, executive and management responsibilities. The Process Order also

provided that the Monitor would assist the petitioners in identifying, negotiating and implementing any reasonable refinancing and restructuring opportunities.

[74] The Process Order allowed for an orderly sale process for certain properties of the petitioners while maintaining the petitioners' ability to put forward a restructuring transaction. It was in this context that the Process Order authorized and empowered the Monitor to market and list certain of the petitioners' properties, but only effective December 19, 2013. The listed properties included the LaSalle Property.

[75] Given the possibility of the petitioners pursuing refinancing and restructuring opportunities, the Process Order permitted the petitioners to, on or before November 29, 2013, advise of properties that they did not wish to be marketed or listed for sale (the "Excluded Properties") accompanied by a written explanation for the removal.

[76] On November 29, the petitioners did, in fact, advise the Monitor that they wished to exclude the LaSalle Property. The stated reason for doing so was:

> Reasons for exclusion: this property produced positive cashflow on an annualized basis after debt service based on stable leases, and has favourable financing available only to the current owner. The property has potential for rental uplift. The Petitioners believe this property will be an important component of a successful reorganization on either a consolidated or standalone basis.

[77] Accordingly, the LaSalle Property was not listed for sale by the Monitor in accordance with the Process Order.

[78] ANB takes the position that the Court's empowering of the Monitor to list the LaSalle Property under the Process Order, and IGW Industrial's later exclusion of the LaSalle Property and the stated reasons in doing so, can reasonably be interpreted as an indication by IGW Industrial that it did not intend to complete the transaction. ANB argues that this was a repudiation of the Agreement by IGW Industrial so as to terminate the Agreement.

[79] ANB also argues that these steps confirmed that IGW Industrial was either seeking to sell the LaSalle Property to a new purchaser, or that it intended to retain the LaSalle Property for its own benefit.

[80] I disagree that the granting of the Process Order and the later exclusion of the LaSalle Property reasonably leads to the conclusion that IGW Industrial had no intention of completing the transaction under the Agreement. As I have already mentioned, the Process Order was granted to bring some stability and certainty to a chaotic environment and allow the petitioners to consider their next steps in terms of a possible restructuring. I see nothing arising from the Process Order which indicates any intention on the part of IGW Industrial to repudiate or disclaim the Agreement. At best, it allowed some breathing room for IGW Industrial to consider its entire affairs (before any listing of properties by the Monitor on December 19), which would, of necessity, have included a consideration of its obligations under the Agreement.

[81] In addition, the later exclusion of the LaSalle Property does not, in itself, indicate any intention on the part of IGW Industrial to repudiate the Agreement. I agree that it is strange that there was no mention of the Agreement in the reasons for exclusion of the LaSalle Property. One could speculate as to why the reasons were framed in the way they were. Even so, there is no mention of selling the LaSalle Property other than to NorRock; nor is there any indication that IGW Industrial wished to retain the LaSalle Property in the future without honouring its obligations under the Agreement. Nothing can be conclusively determined as to IGW Industrial's intentions from the stated reasons themselves.

[82] I conclude that there was nothing in the actions taken by IGW Industrial through to the end of November 2013 that could reasonably be interpreted as indicating an intention to disclaim or repudiate the Agreement and thereby terminate it.

[83] I would again point out that such actions did not satisfy the requirements of the s. 32 process. It is worthwhile pointing out that the Monitor's Fourth report dated

November 18, 2013 expressly referred to the petitioners following the s. 32 disclaimer process in relation to other executory contracts. This should have stood as a reminder to NorRock of that process.

[84] Lastly, NorRock's argument that repudiation is a "reasonable" interpretation of the Process Order and IGW Industrial's exclusion of the LaSalle Property, must be considered in light of NorRock's failure to communicate at all with IGW Industrial and the Monitor during the November period. This leads to the final difficulty with any alleged repudiation by IGW Industrial, namely, the requirement that NorRock clearly and unequivocally accept that repudiation.

[85] ANB points back to the Harris + Harris LLP October 31, 2013 letter as evidence that it "accepted" IGW Industrial's repudiation conduct in November 2013. With respect, I see little logic in such an argument, even accepting that this letter was a valid acceptance of a repudiation (which I do not, as discussed above). I find it difficult to conceive that a repudiation in November 2013 could be accepted by reference back to an earlier communication and with no indication by NorRock that it intended to rely on that earlier communication. No authority was cited to me for such a proposition.

[86] As such, as of the end of November 2013, the Agreement remained in full force and effect.

CONCLUSION

[87] In conclusion, I find that IGW Industrial did not terminate the Agreement during the *CCAA* proceedings in October/November 2013. Accordingly, the Agreement remained in full force and effect and subject to fulfillment of the Vendor's and Purchaser's Conditions. NorRock did not obtain the Regulatory Approvals and accordingly, those Conditions were not fulfilled by the Outside Date of December 31, 2013. The Agreement was therefore terminated for that reason.

[88] The break fee is not payable by IGW Industrial, as the termination of the Agreement arose solely by reason of the non-fulfillment of the Conditions, including the Vendor's Conditions. ANB's claim is dismissed.

"Fitzpatrick J."

TAB 2

CANADA

CONSOLIDATION

CODIFICATION

Companies' Creditors Arrangement Act

Loi sur les arrangements avec les créanciers des compagnies

R.S.C., 1985, c. C-36

L.R.C. (1985), ch. C-36

Current to June 3, 2021

Last amended on November 1, 2019

À jour au 3 juin 2021

Dernière modification le 1 novembre 2019

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PART II

Jurisdiction of Courts

Jurisdiction of court to receive applications

9 (1) Any application under this Act may be made to the court that has jurisdiction in the province within which the head office or chief place of business of the company in Canada is situated, or, if the company has no place of business in Canada, in any province within which any assets of the company are situated.

Single judge may exercise powers, subject to appeal

(2) The powers conferred by this Act on a court may, subject to appeal as provided for in this Act, be exercised by a single judge thereof, and those powers may be exercised in chambers during term or in vacation.

R.S., c. C-25, s. 9.

Form of applications

10 (1) Applications under this Act shall be made by petition or by way of originating summons or notice of motion in accordance with the practice of the court in which the application is made.

Documents that must accompany initial application

(2) An initial application must be accompanied by

(a) a statement indicating, on a weekly basis, the projected cash flow of the debtor company;

(b) a report containing the prescribed representations of the debtor company regarding the preparation of the cash-flow statement; and

(c) copies of all financial statements, audited or unaudited, prepared during the year before the application or, if no such statements were prepared in that year, a copy of the most recent such statement.

Publication ban

(3) The court may make an order prohibiting the release to the public of any cash-flow statement, or any part of a cash-flow statement, if it is satisfied that the release would unduly prejudice the debtor company and the making of the order would not unduly prejudice the company's creditors, but the court may, in the order, direct that the cash-flow statement or any part of it be made

PARTIE II

Juridiction des tribunaux

Le tribunal a juridiction pour recevoir des demandes

9 (1) Toute demande prévue par la présente loi peut être faite au tribunal ayant juridiction dans la province où est situé le siège social ou le principal bureau d'affaires de la compagnie au Canada, ou, si la compagnie n'a pas de bureau d'affaires au Canada, dans la province où est situé quelque actif de la compagnie.

Un seul juge peut exercer les pouvoirs, sous réserve d'appel

(2) Les pouvoirs conférés au tribunal par la présente loi peuvent être exercés par un seul de ses juges, sous réserve de l'appel prévu par la présente loi. Ces pouvoirs peuvent être exercés en chambre, soit durant une session du tribunal, soit pendant les vacances judiciaires.

S.R., ch. C-25, art. 9.

Forme des demandes

10 (1) Les demandes prévues par la présente loi peuvent être formulées par requête ou par voie d'assignation introductive d'instance ou d'avis de motion conformément à la pratique du tribunal auquel la demande est présentée.

Documents accompagnant la demande initiale

(2) La demande initiale doit être accompagnée :

a) d'un état portant, projections à l'appui, sur l'évolution hebdomadaire de l'encaisse de la compagnie débitrice;

b) d'un rapport contenant les observations réglementaires de la compagnie débitrice relativement à l'établissement de cet état;

c) d'une copie des états financiers, vérifiés ou non, établis au cours de l'année précédant la demande ou, à défaut, d'une copie des états financiers les plus récents.

Interdiction de mettre l'état à la disposition du public

(3) Le tribunal peut, par ordonnance, interdire la communication au public de tout ou partie de l'état de l'évolution de l'encaisse de la compagnie débitrice s'il est convaincu que sa communication causerait un préjudice indu à celle-ci et que sa non-communication ne causerait pas de préjudice indu à ses créanciers. Il peut toutefois préciser dans l'ordonnance que tout ou partie de cet état

18.2 [Repealed, 2005, c. 47, s. 131]

18.3 [Repealed, 2005, c. 47, s. 131]

18.4 [Repealed, 2005, c. 47, s. 131]

18.5 [Repealed, 2005, c. 47, s. 131]

18.2 [Abrogé, 2005, ch. 47, art. 131]

18.3 [Abrogé, 2005, ch. 47, art. 131]

18.4 [Abrogé, 2005, ch. 47, art. 131]

18.5 [Abrogé, 2005, ch. 47, art. 131]

PART III

General

Duty of Good Faith

Good faith

18.6 (1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.

Good faith — powers of court

(2) If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the court may make any order that it considers appropriate in the circumstances.

1997, c. 12, s. 125; 2005, c. 47, s. 131; 2019, c. 29, s. 140.

Claims

Claims that may be dealt with by a compromise or arrangement

19 (1) Subject to subsection (2), the only claims that may be dealt with by a compromise or arrangement in respect of a debtor company are

(a) claims that relate to debts or liabilities, present or future, to which the company is subject on the earlier of

(i) the day on which proceedings commenced under this Act, and

(ii) if the company filed a notice of intention under section 50.4 of the *Bankruptcy and Insolvency Act* or commenced proceedings under this Act with the consent of inspectors referred to in section 116 of the *Bankruptcy and Insolvency Act*, the date of the initial bankruptcy event within the meaning of section 2 of that Act; and

(b) claims that relate to debts or liabilities, present or future, to which the company may become subject before the compromise or arrangement is sanctioned by reason of any obligation incurred by the company

PARTIE III

Dispositions générales

Obligation d'agir de bonne foi

Bonne foi

18.6 (1) Tout intéressé est tenu d'agir de bonne foi dans le cadre d'une procédure intentée au titre de la présente loi.

Bonne foi — pouvoirs du tribunal

(2) S'il est convaincu que l'intéressé n'agit pas de bonne foi, le tribunal peut, à la demande de tout intéressé, rendre toute ordonnance qu'il estime indiquée.

1997, ch. 12, art. 125; 2005, ch. 47, art. 131; 2019, ch. 29, art. 140.

Réclamations

Réclamations considérées dans le cadre des transactions ou arrangements

19 (1) Les seules réclamations qui peuvent être considérées dans le cadre d'une transaction ou d'un arrangement visant une compagnie débitrice sont :

a) celles se rapportant aux dettes et obligations, présentes ou futures, auxquelles la compagnie est assujettie à celle des dates ci-après qui est antérieure à l'autre :

(i) la date à laquelle une procédure a été intentée sous le régime de la présente loi à l'égard de la compagnie,

(ii) la date d'ouverture de la faillite, au sens de l'article 2 de la *Loi sur la faillite et l'insolvabilité*, si elle a déposé un avis d'intention sous le régime de l'article 50.4 de cette loi ou qu'elle a intenté une procédure sous le régime de la présente loi avec le consentement des inspecteurs visés à l'article 116 de la *Loi sur la faillite et l'insolvabilité*;

b) celles se rapportant aux dettes et obligations, présentes ou futures, auxquelles elle peut devenir

Decision

(8) The decision of the Superintendent of Bankruptcy after the hearing, together with the reasons for the decision, must be given in writing to the monitor not later than three months after the conclusion of the hearing, and is public.

Review by Federal Court

(9) A decision of the Superintendent of Bankruptcy given under subsection (8) is deemed to be a decision of a federal board, commission or other tribunal that may be reviewed and set aside under the *Federal Courts Act*.

2005, c. 47, s. 131; 2007, c. 36, s. 75.

Delegation

31 (1) The Superintendent of Bankruptcy may, in writing, authorize any person to exercise or perform, subject to any terms and conditions that he or she may specify in the authorization, any of the powers, duties or functions of the Superintendent of Bankruptcy under sections 29 and 30.

Notification to monitor

(2) If the Superintendent of Bankruptcy delegates in accordance with subsection (1), the Superintendent or the delegate must give notice of the delegation in the prescribed manner to any monitor who may be affected by the delegation.

2005, c. 47, s. 131.

Agreements

Disclaimer or resiliation of agreements

32 (1) Subject to subsections (2) and (3), a debtor company may — on notice given in the prescribed form and manner to the other parties to the agreement and the monitor — disclaim or resiliate any agreement to which the company is a party on the day on which proceedings commence under this Act. The company may not give notice unless the monitor approves the proposed disclaimer or resiliation.

Court may prohibit disclaimer or resiliation

(2) Within 15 days after the day on which the company gives notice under subsection (1), a party to the agreement may, on notice to the other parties to the agreement and the monitor, apply to a court for an order that the agreement is not to be disclaimed or resiliated.

Court-ordered disclaimer or resiliation

(3) If the monitor does not approve the proposed disclaimer or resiliation, the company may, on notice to the other parties to the agreement and the monitor, apply to

Décision

(8) La décision du surintendant des faillites est rendue par écrit, motivée et remise au contrôleur dans les trois mois suivant la clôture de l'audition, et elle est publique.

Examen de la Cour fédérale

(9) La décision du surintendant, rendue et remise conformément au paragraphe (8), est assimilée à celle d'un office fédéral et est soumise au pouvoir d'examen et d'annulation prévu par la *Loi sur les Cours fédérales*.

2005, ch. 47, art. 131; 2007, ch. 36, art. 75.

Pouvoir de délégation

31 (1) Le surintendant des faillites peut, par écrit, selon les modalités qu'il précise, déléguer les attributions que lui confèrent les articles 29 et 30.

Notification

(2) En cas de délégation, le surintendant des faillites ou le délégué en avise, de la manière réglementaire, tout contrôleur qui pourrait être touché par cette mesure.

2005, ch. 47, art. 131.

Contrats et conventions collectives

Résiliation de contrats

32 (1) Sous réserve des paragraphes (2) et (3), la compagnie débitrice peut — sur préavis donné en la forme et de la manière réglementaires aux autres parties au contrat et au contrôleur et après avoir obtenu l'acquiescement de celui-ci relativement au projet de résiliation — résilier tout contrat auquel elle est partie à la date à laquelle une procédure a été intentée sous le régime de la présente loi.

Contestation

(2) Dans les quinze jours suivant la date à laquelle la compagnie donne le préavis mentionné au paragraphe (1), toute partie au contrat peut, sur préavis aux autres parties au contrat et au contrôleur, demander au tribunal d'ordonner que le contrat ne soit pas résilié.

Absence d'acquiescement du contrôleur

(3) Si le contrôleur n'acquiesce pas au projet de résiliation, la compagnie peut, sur préavis aux autres parties au

a court for an order that the agreement be disclaimed or resiliated.

Factors to be considered

(4) In deciding whether to make the order, the court is to consider, among other things,

(a) whether the monitor approved the proposed disclaimer or resiliation;

(b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and

(c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

Date of disclaimer or resiliation

(5) An agreement is disclaimed or resiliated

(a) if no application is made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1);

(b) if the court dismisses the application made under subsection (2), on the day that is 30 days after the day on which the company gives notice under subsection (1) or on any later day fixed by the court; or

(c) if the court orders that the agreement is disclaimed or resiliated under subsection (3), on the day that is 30 days after the day on which the company gives notice or on any later day fixed by the court.

Intellectual property

(6) If the company has granted a right to use intellectual property to a party to an agreement, the disclaimer or resiliation does not affect the party's right to use the intellectual property — including the party's right to enforce an exclusive use — during the term of the agreement, including any period for which the party extends the agreement as of right, as long as the party continues to perform its obligations under the agreement in relation to the use of the intellectual property.

Loss related to disclaimer or resiliation

(7) If an agreement is disclaimed or resiliated, a party to the agreement who suffers a loss in relation to the disclaimer or resiliation is considered to have a provable claim.

contrat et au contrôleur, demander au tribunal d'ordonner la résiliation du contrat.

Facteurs à prendre en considération

(4) Pour décider s'il rend l'ordonnance, le tribunal prend en considération, entre autres, les facteurs suivants :

a) l'acquiescement du contrôleur au projet de résiliation, le cas échéant;

b) la question de savoir si la résiliation favorisera la conclusion d'une transaction ou d'un arrangement viable à l'égard de la compagnie;

c) le risque que la résiliation puisse vraisemblablement causer de sérieuses difficultés financières à une partie au contrat.

Résiliation

(5) Le contrat est résilié :

a) trente jours après la date à laquelle la compagnie donne le préavis mentionné au paragraphe (1), si aucune demande n'est présentée en vertu du paragraphe (2);

b) trente jours après la date à laquelle la compagnie donne le préavis mentionné au paragraphe (1) ou à la date postérieure fixée par le tribunal, si ce dernier rejette la demande présentée en vertu du paragraphe (2);

c) trente jours après la date à laquelle la compagnie donne le préavis mentionné au paragraphe (3) ou à la date postérieure fixée par le tribunal, si ce dernier ordonne la résiliation du contrat en vertu de ce paragraphe.

Propriété intellectuelle

(6) Si la compagnie a autorisé par contrat une personne à utiliser un droit de propriété intellectuelle, la résiliation n'empêche pas la personne de l'utiliser ni d'en faire respecter l'utilisation exclusive, à condition qu'elle respecte ses obligations contractuelles à l'égard de l'utilisation de ce droit, et ce pour la période prévue au contrat et pour toute période additionnelle dont elle peut et décide de se prévaloir de son propre gré.

Pertes découlant de la résiliation

(7) En cas de résiliation du contrat, toute partie à celui-ci qui subit des pertes découlant de la résiliation est réputée avoir une réclamation prouvable.

TAB 3

Aveos Fleet Performance Inc./Aveos Fleet performance aéronautique inc. (Arrangement relatif à)

Jugements du Québec

Quebec Superior Court

District of Montréal

The Honourable Mark Schrager, J.S.C.

Heard: September 28, October 18, 19, 30, 2012.

Judgment: November 20, 2012.

No.: 500-11-042345-120

[2012] Q.J. No. 18503 | 2012 QCCS 6796 | 2013EXP-453 | J.E. 2013-232 | EYB 2012-216879 | 2 C.B.R. (6th) 222 | 2012 CarswellQue 14439

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985 c. C-36: AVEOS FLEET PERFORMANCE INC./AVEOS FLEET PERFORMANCE AÉRONAUTIQUE INC., Insolvent Debtor/Petitioner and AERO TECHNICAL US, INC., Insolvent Debtor and FTI CONSULTING CANADA INC., Monitor and NORTHGATEARINSO CANADA INC., Petitioner and CREDIT SUISSE AG CAYMAN ISLANDS BRANCH, Secured creditor

(72 paras.)

Résumé

Bankruptcy and insolvency law — Property of bankrupt — Goods — Resiliation, revendication or repossession — The equitable treatment of creditors demands that claims for contractual damages arising from the termination of contracts after filing under the C.C.A.A. be treated on a par with other provable claims — Moreover, the parties to a contract cannot exclude in advance the application of the C.C.A.A. — Motion to strike notice to resiliate an agreement dismissed.

Bankruptcy and insolvency law — Companies' Creditors Arrangement Act (CCAA) matters — Compromises and arrangements — Monitors — Powers, duties and functions — The shutdown of Aveos' normal operations and the implementation of a sales process does not, in itself, eliminate the application of s. 32 C.C.A.A. as argued by NGA — If Aveos could not rely on s. 32 C.C.A.A. and was obliged to rely on the cancellation for convenience clause in the GMSA, the penalty would constitute a provable claim payable under an eventual plan of arrangement — Accordingly, this claim by NGA for the cancellation indemnity would not have the status of a "post-filing claim" payable prior to the claims of other creditors — Motion to strike notice to resiliate an agreement dismissed.

Northgatearinso Canada Inc. (NGA) seeks to strike the notice that was sent by Aveos Fleet Performance Inc. (Aveos) to resiliate an agreement entered into by the parties. With the view to completely outsource its human resources and payroll system, Aveos signed with NGA a Global Master Services Agreement (GMSA) in January 2011. By the time of its Companies' Creditors Arrangement Act (C.C.A.A.) filing in March 2012, Aveos had lost confidence in NGA and its system. Aveos sought cancellation of the GMSA not only under s. 32 C.C.A.A. but also sought resiliation for cause pursuant to the law of contracts based on NGA's alleged faulty execution of its obligations. The Monitor concluded that cancelling the GMSA would enhance the prospect of filing an arrangement. The sale or assignment of the GMSA as part of a sale of assets was not an alternative in the view of the Monitor, even absent all the problems experienced by Aveos with the system. NGA submits that since the GMSA contains a mechanism to cancel where cancellation for cause under the common law of contracts is not available, then s. 32

C.C.A.A. cannot apply.

HELD: Motion dismissed.

The shutdown of Aveos' normal operations and the implementation of a sales process does not, in itself, eliminate the application of s. 32 C.C.A.A. as argued by NGA. If Aveos could not rely on s. 32 C.C.A.A. and was obliged to rely on the cancellation for convenience clause in the GMSA, the penalty would constitute a provable claim payable under an eventual plan of arrangement. Accordingly, this claim by NGA for the cancellation indemnity would not have the status of a "post-filing claim" payable prior to the claims of other creditors. Pre-filing creditors cannot under the guise of making a post-filing claim, obtain a preference over other creditors. The equitable treatment of creditors demands that claims for contractual damages arising from the termination of contracts after filing under the C.C.A.A. be treated on a par with other provable claims. Moreover, the parties cannot write out part of the C.C.A.A. from contracts. This is against public policy. Parties to a contract cannot exclude in advance the application of the C.C.A.A.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, *R.S.C. 1985, c. B-3, s. 121*

Civil Code of Quebec, art. 2091

Companies' Creditors Arrangement Act, *R.S.C. 1985, c. C-25, s. 2*, s. 8, s. 19, s. 32, s. 32(1)(b), s. 32(4), s. 32(4)(a), s. 32(4)(b), s. 36, s. 37(4)(c)

Counsel

Mtre. Martin Poulin, Attorney for Aveos Fleet Performance inc./Aveos Fleet Performance Aéronautique Inc., Aéro Technical US Inc., Insolvent Debtor/Petitioner.

Mtre. Geneviève Cloutier, Attorney for Northegatearinso Canada Inc.

Mtre. Bernard Bouchard, Mtre. Caroline Dion, Attorneys for Canadian Counsel for Credit, Suisse AG, Cayman Islands Branch.

Mtre. Sylvain Rigaud, Attorney for FTI Consulting Canada Inc., Monitor.

JUDGMENT

INTRODUCTION

1 Aveos Fleet Performance Inc. ("Aveos") is subject to an order under the *Companies' Creditors Arrangement Act* ("C.C.A.A.")[1] It has sold or seeks to sell all of its assets and is not operating its business. Can it invoke Section 32 C.C.A.A. to cancel an executory contract? This is the principal issue before this Court.

FACTS

2 Aveos and its related entity, Aero Technical US, Inc. (collectively, the "debtors") applied for and this Court issued an initial order under the C.C.A.A. on March 19, 2012. A stay was issued until April 5, 2012, at that time and has

subsequently been extended. F.T.I. Consulting Canada Inc. was named monitor. The record of the Court and particularly the orders and reasons of the undersigned indicate that in the hours following the initial order, the entire board of directors (but one) of Aveos resigned. Most of the remaining employees (i.e. those who had not been laid off prior to the C.C.A.A. filing) were laid off immediately following the initial order and the day-to-day operations of Aveos were shut down.

3 The remaining director signed the affidavit in support of a Motion Seeking the Appointment of a Chief Restructuring Officer ("C.R.O."), in virtue of which Mr. Jonathan Solursh of the firm R.e.I. Consulting Group, an independent consultant, was named C.R.O. and has acted in such capacity since then. The remaining director resigned following such appointment.

4 Much time and effort were spent in the month following the filing with the emergency situations of a company not having sufficient cash to operate in the normal course, being in possession of property claimed by third parties and having 2800 former or present employees owed millions of dollars in the aggregate. Nevertheless, the C.R.O. quickly concluded with the support of the Monitor that Aveos had to be sold.

5 On April 29, 2012, this Court issued an order approving the "Divestiture Process" put forward by the C.R.O. in virtue of which Aveos was offered for sale. The C.R.O. determined that Aveos' three (3) divisions (i.e. engines, components and air frames) should be marketed with a view to separate sales as it was unlikely that anyone would purchase all three (3) divisions. The C.R.O. believed that the value could be maximized by seeking to split Aveos into three (3) enterprises although there was no impediment to any one person acquiring all three (3) divisions. It was certainly hoped that all three (3) divisions would be sold on a going concern basis and would recommence operations and this in the interest of all stakeholders.

6 As the Court record indicates, at no time did any party bring a motion to end the stay period with a view to petitioning Aveos into bankruptcy.

7 The C.R.O. and Monitor have reported on an ongoing basis and also gave evidence in the present matter before the undersigned. The Divestiture Process has given rise to over 10 transactions. Unfortunately, only one sale (for the components division) has been made on a going concern basis where approximately 200 jobs should be conserved. However, and significantly, although the process of seeking bids has ended, the C.R.O. and the Monitor testified before the undersigned that a "latecomer" has appeared, and is performing a due diligence investigation with a view to making an offer to acquire the engine maintenance division of Aveos. The engine maintenance equipment remains in the hands of a liquidator but the scheduled auction has now been postponed. The interested party is in the same type of business, so that the tax losses of Aveos may have value as part of the transaction and this could potentially lead to the filing of a plan of arrangement with some benefit for unsecured creditors. Though the engine maintenance contract with Air Canada was sold as part of the Divestiture Process, it represented approximately 55 % of the engine maintenance business. Accordingly, there is a potential value in the business enterprise beyond the liquidation value of the tangible assets.

8 Against this status update of the C.C.A.A. file is the dispute between Aveos and the present Petitioner, Northgatearinso Canada Inc. ("N.G.A.").

9 Aveos was created as a result of the C.C.A.A. restructuring of Air Canada. It was the former maintenance department of Air Canada. Initially, it depended on Air Canada's support for payroll and human resources. As part of the process of separating Aveos from Air Canada, Aveos sought to outsource its human resources and payroll departments. To this end, a process to select a service provider was put in place. The goal of Aveos was to have a completely outsourced human resources and payroll system that would include computer access for employees through a portal where they could access their files and view their status (e.g. benefit accruals) and even input information (e.g. change beneficiaries in insurance plans). The service would include a call center to handle employee questions.

10 The establishment of the system had many challenges and complicating factors, such as the fact that some Aveos' personnel were Air Canada's employees that had been seconded to Aveos.

11 Originally, an operating system completely independent from Air Canada and its services providers was targeted for autumn 2010. This date was extended due to extraneous considerations to July 14, 2011, which was fortunate given all of the developmental problems experienced as will be addressed below.

12 The "Global Master Services Agreement" ("G.M.S.A.") with N.G.A. was signed between Aveos and N.G.A. in January 2011. By the time of the C.C.A.A. filing in March 2012 not all outstanding operational issues had been resolved. The relationship was fraught with frustration on both sides. Aveos felt that N.G.A. took too long to install systems and was unable to provide certain services altogether. Costs ran over those stipulated in the G.M.S.A. for services not covered under the agreement. All of this caused Aveos to lose confidence in N.G.A.

13 N.G.A. was frustrated by the ongoing changes in Aveos management personnel charged with the implementation of the system, so that from N.G.A.'s point of view, once it finally "educated" one member of the Aveos team he she was replaced so that Aveos throughout did not fully understand what the system was designed to do, and by extension, what the system could not do.

14 Aveos felt that N.G.A. as the expert should tell it not merely what was needed, but what was missing in the system to address Aveos' needs. Instead, the Aveos' personnel in charge learned piecemeal that features that they wanted or needed were not available or at least not included in the contract price. This situation was severe enough to cause Aveos to engage the services of Deloitte at the beginning of 2012 as a consultant to help Aveos resolve the continuing issues arising during implementation of the services to be provided by N.G.A. under the G.M.S.A.

15 N.G.A. felt not only did Aveos fail to understand the system, but it provided incomplete or incorrect data to N.G.A. for input and thus further complicated matters.

16 The problems with N.G.A. were such that Aveos has sought cancellation of the G.M.S.A. not only under Section 32 C.C.A.A. but also Aveos seeks resiliation for cause pursuant to the law of contracts generally based on N.G.A.'s alleged faulty execution of its obligations.

17 The level of frustration existing between N.G.A. and Aveos continued after the C.C.A.A. filing. The lay-offs and the shut down of day-to-day operations required services not contemplated by the G.M.S.A. Obtaining such services in a timely manner from N.G.A. was the subject of ongoing extensive and tense negotiations over a period of approximately one month. Aveos was now represented by the C.R.O. and his staff with the support of the Monitor.

18 Before the undersigned, the representative of the Monitor diplomatically described the situation between N.G.A. and Aveos prior to the C.C.A.A. filing as a "failed business relationship". Unfortunately, the situation did not improve during the post-filing period.

19 Upon learning of the initial filing under the C.C.A.A., N.G.A. communicated with Aveos. The thrust of N.G.A.'s written and verbal communications were either a refusal to continue services under the existing contract and seeking assurance of payment going forward (according to Aveos) or a request as to what would be required given the change of operations and personnel as described above (according to N.G.A). There followed a series of exchanges including numerous conference calls which gave rise, in succession, to three Memoranda of Understanding dated March 26, April 10 and April 13, 2012 which outlined the services to be provided by N.G.A. to Aveos and the pricing in respect thereof.

20 Aveos had payroll needs because 120 employees had been recalled. Also payroll periods which fell on both sides of the C.C.A.A. filing date required special attention. Certain "claw-back" amounts previously set off against

amounts due to employees had to be paid post-filing. Records of employment had to be issued in order for employees to be able to claim benefits from the government unemployment insurance program.

21 Other ongoing services under the G.M.S.A. were obviously not required as Aveos' operations were not continuing as had been the case prior to the C.C.A.A. filing.

22 From N.G.A.'s point of view, the demands being made by Aveos were exorbitant mainly because the time delays were extremely aggressive. Many of the services requested were not what the system was designed to do. For example, records of employment resulting from mass layoffs were not designed into the system, nor were reversing deductions from past pay periods and ledgering these reversals in the former pay period already closed for purposes of data entry. The system had to be (re-)designed to accommodate these needs.

23 From the C.R.O's point of view, N.G.A.'s performance failures experienced by Aveos pre-filing now continued into the post-filing period. N.G.A.'s difficulty to meet tight time deadlines imposed by the C.C.A.A. circumstances and the exorbitant pricing made it such that Aveos, through the C.R.O., sought and engaged an alternate payroll service provider as of May 1st, 2012. The price for a one-year contract albeit encompassing far less extensive services than those under the G.M.S.A., is one-half of N.G.A.'s monthly fee. Indeed, the representative of the C.R.O. testified that the exorbitant pricing under the three (3) Memoranda of Agreement was only accepted because there was no alternative at that time. As such, $240,000.00 was paid by Aveos to N.G.A. for the 4-week period between the end of March and the end of April 2012.

24 In one instance, where the payroll included the reversal of amounts previously set off, N.G.A. could not produce the work product at all or at least on time such that the C.R.O. organized staff to produce 800 pay cheques manually. Moreover, the data in question was entered into the database by N.G.A. in the current as opposed to the old, pre-filing period in consideration of which the payments were being made. This caused Services Canada to question whether the employees were indeed eligible for Unemployment Insurance ("UIC") benefits. Apparently, much energy was expended in order to correct this situation and the results were additional delays for employees to receive their UIC benefits.

25 Effective May 1st, 2012, Aveos gave notice to N.G.A. that it was cancelling the G.M.S.A. and the three (3) Memoranda of Agreement for faulty performances both pre and post-filing. Alternatively, Aveos took the position that it was cancelling and repudiating the agreements pursuant to its rights to do so under Section 32 C.C.A.A. N.G.A. claims $501,381.00 which is the indemnity provided by the G.M.S.A. where cancellation is for "convenience", i.e. without cause. N.G.A. also claims the sum of $91,377.00 for unpaid services rendered under the three (3) Memoranda of Agreement.

26 Crédit Suisse, the secured creditor, has taken the position that whatever sums might be due to N.G.A., they fall within the definition of "claim" in Sections 2 and 19 C.C.A.A. and are not post-filing claims as postulated by N.G.A. Thus, any payment would be subordinate to the rights of Crédit Suisse.

ISSUES

27 Is Section 32 C.C.A.A. available to Aveos as a means to resiliate or cancel the G.M.S.A.?

28 Aside from Section 32 C.C.A.A., does Aveos have the right to resiliate the G.M.S.A. because of the alleged faulty execution by N.G.A. of its obligations there under?

29 Does N.G.A. have the right to claim the cancellation indemnity of $501,381.00 foreseen by the G.M.S.A.? If so, is the amount due immediately by Aveos as a claim arising after the C.C.A.A. filing, and as such not subject to the stay of proceedings? In the alternative, is the amount due but subject to be treated as a (pre-filing) ordinary or unsecured claim to be dealt with under an arrangement, if any, or a bankruptcy?

30 Is the sum of $91,377.00 due immediately for services rendered by N.G.A. to Aveos after the C.C.A.A. filing?

POSITION OF N.G.A.

31 N.G.A. contends that Section 32 C.C.A.A. does not apply in the circumstances where Aveos ceased to carry on business, is being liquidated and as such will not propose an arrangement to its creditors. N.G.A. argues that Section 32(1)(b) C.C.A.A. does not apply to such a scenario. The purpose of Section 32 C.C.A.A. is to allow a debtor company to rid itself of contractual obligations which are an impediment to an arrangement. Where no arrangement will be filed, Section 32 C.C.A.A. should not apply according to N.G.A.

32 Moreover, since the G.M.S.A. contains a provision allowing for cancellation without cause, such recourse must be used before reverting to a statutory mechanism to seek cancellation of the contract. In other words, according to N.G.A., Aveos must pay the stipulated cancellation penalty of $501,381.00 to achieve cancellation in such manner rather than having recourse to Section 32 C.C.A.A.

33 The resiliation of the G.M.S.A. for faulty execution is not available to Aveos because on the facts of the case, N.G.A. is not at fault having fulfilled its contractual obligations at all relevant times.

34 The $501,381.00 cancellation penalty is not a claim provable within the meaning of the C.C.A.A., but rather is a post-filing claim. This claim arises from the unilateral cancellation of the G.M.S.A. by Aveos after the C.C.A.A. filing. N.G.A. continued to render services after the filing albeit in a modified manner, at Aveos' request and in order to respond to Aveos' needs in the situation as it unfolded after the C.C.A.A. filing. On or about May 1st, 2012, approximately five (5) weeks after the C.C.A.A. filing, Aveos cancelled the G.M.S.A. and as such the obligation of Aveos to pay the penalty of $501,381.00.00 arose after the filing. Consequently, it is not a provable claim, but rather an amount arising and payable after the C.C.A.A. filing.

35 Similarly, the $91,377.00 representing charges for services rendered after the filing, and at the request of and as agreed with Aveos, are currently due. This is not a claim provable to be dealt with under an arrangement, according to N.G.A. As such, it should be paid by Aveos immediately, as were the other amounts for services rendered after the C.C.A.A. filing, the whole as pleaded by N.G.A.

DISCUSSION

36 Section 32 C.C.A.A. provides a mechanism for a debtor company to "disclaim or resiliate" agreements to which it is a party at the time of the initial C.C.A.A. filing. This disclaimer is achieved by notice given by the debtor to the co-contracting party.

37 The debtor company's notice to disclaim may be contested by the other party to the contract as N.G.A. has done in the present case. It then falls upon the Court to make (or not) an order of disclaimer:

38 Section 32(4) C.C.A.A. provides as follows:

> "Factors to be considered
>
> In deciding whether to make the order, the court is to consider, among other things,
>
> a) whether the monitor approved the proposed disclaimer or resiliation;
>
> b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement."

39 On the face of the drafting of Section 32(4) C.C.A.A., the matters listed are not an exhaustive enumeration of

the matters that this Court may consider in deciding whether to approve the cancellation of a contract where the notice is contested.

40 Section 37(4)(c) C.C.A.A. is not in issue in these proceedings because N.G.A. did not allege nor prove any financial hardship arising from the G.M.S.A. There is the obvious lack of revenue stream when the contract is cancelled (approximately $80,000.00 per month), but it was not contended that the loss of this, *per se* constituted, in this particular case, the "financial hardship" to which subparagraph (c) refers.

41 Section 32(4)(b) C.C.A.A. addresses the issue of whether the cancellation of the contract would "enhance the prospects of a viable" arrangement being made.

42 The Monitor filed a report and its representative, Ms. Toni Vanderlaan, testified before the undersigned.

43 The Monitor confirmed that it had approved the proposed cancellation of the G.M.S.A. as foreseen by Section 32(4)(a) C.C.A.A. In so doing, the Monitor considered the cost of continuing the G.M.S.A., which as indicated above represents approximately $80,000.00 per month prior to the C.C.A.A. filing. The alternate provider engaged by Aveos after May 1st (Ceridian), was considerably cheaper at $40,000.00 per year albeit that the scope of the service under the G.M.S.A. provided by N.G.A. was much broader than those provided by Ceridian. In any event, the Monitor determined that the G.M.S.A. was far too expensive given the cash position of Aveos and its payroll and human resources needs in any scenario post C.C.A.A. filing.

44 In addition to cost, the Monitor concluded that cancelling the G.M.S.A. would enhance the prospect of filing an arrangement. The Monitor underlined that not merely was the G.M.S.A. expensive, but it was undesirable. As stated above, Ms. Vanderlaan summarized the relations between N.G.A. and Aveos at the time of the C.C.A.A. filing as a "failed business relationship". It is clear to the Court that the systems provided by N.G.A. either did not do what they were supposed to do or if they did do what they were supposed to do, then there was a breakdown in communication between N.G.A. as service provider and Aveos as consumer as to what the requirements of Aveos were.

45 The representative of N.G.A., Mr. Latulippe, referred on a number of occasions to the fact that the representatives of Aveos responsible for the negotiation and implementation of the G.M.S.A. with N.G.A. did not properly understand what the system was designed to do. This may have been so, but it became evident during the hearing before the undersigned that N.G.A. was lacking in its ability both before and after the C.C.A.A. filing to understand its client's needs and to address them adequately or where that was not possible to explain such inability in a timely and comprehensible fashion. It was therefore not conceivable that Aveos could use the G.M.S.A. going forward because of all of the problems associated with it.

46 Moreover, the system described in the G.M.S.A. was designed for a company with approximately 3,000 employees. After the C.C.A.A. filing, Aveos only had a fraction of that number on a descending basis. Since the Divestiture Process was based on the premise that no one acquirerer would seek to purchase all three (3) divisions of Aveos, then any possible purchasers would not want the contract based purely on the number of employees. Aside from such consideration, the system did not work very well and the likelihood was that any acquirerer would be an operator in the industry and already have its own payroll and human resources systems in place. The sale or assignment of the G.M.S.A. as part of a sale of assets was not an alternative in the view of the Monitor even absent all the problems experienced by Aveos with the system. Thus, in any possible scenario, the G.M.S.A. was of no use to Aveos and could not enhance, in any scenario, the making of an arrangement.

47 However, and as stated above, N.G.A. contends that cancellation under Section 32 C.C.A.A. is not available because Section 32(4)(b) C.C.A.A. does not apply. According to N.G.A., there is no discussion to be had about the prospect of an arrangement since early on in the C.C.A.A. process, Aveos shut down its normal operations and went into liquidation mode. Thus, no plan of arrangement will be made, so that an essential element for the application of Section 32 C.C.A.A. is not met according to N.G.A.

48 The text of Section 32(4)(b) C.C.A.A. does not impose as a condition for resiliation that there be a plan of arrangement or even the certainty that there will be a plan of arrangement filed. Rather 32(4)(b) C.C.A.A. requires that the cancellation of the G.M.S.A. enhance the prospects of a viable arrangement. It is clear from the Monitor's analysis referred to above that the cancellation would rid Aveos of an expensive contract for a system which never functioned in a completely satisfactory manner, and that under the best of circumstances was inappropriate for a company with less than 2,800 employees, and where the relationship with the service provider (both pre and post C.C.A.A. filing) had failed. Viewed in this way, the disclaimer could only enhance the possibility of an arrangement.

49 It is accepted by the case law that the disclaimer need not be essential but merely advantageous to a plan[2]. There need not be any certainty that there will be a plan of arrangement but just that cancellation of the contract in question would be beneficial to the making of a plan.

50 Section 32 C.C.A.A. applies even where there is a sales process in place as is the situation with Aveos[3]. Prior to Section 36 C.C.A.A. coming into force in 2009, it was broadly accepted that liquidating while under C.C.A.A. protection was not contrary to the Act.[4] Now, Section 36 C.C.A.A. explicitly provides for sales out of the ordinary course of business, with Court approval.

51 A sales process, particularly when assets are offered on a going concern basis together with intangible property (e.g. customer contracts) can lead to a result where one or several operating business entities similar to those operated by the debtor pre C.C.A.A. filing, continues after the C.C.A.A. process is completed. The ability to file an arrangement can largely be a function of the sales proceeds received and the amounts available to different stakeholders, particularly secured creditors. The point is that the existence of a sales process or "liquidation" does not *per se* mean that an arrangement is not a possibility. The fact that Aveos ceased operations was a function of cash (or the lack thereof), but the sales process was specifically designed to enhance the possibility of going-concern sales. Indeed, the timetable was short, specifically so as to limit the deterioration of critical mass of such things as customer base and labour pool. Despite the fact that only one division (components) of Aveos was sold on a going concern basis through the process, the C.R.O. testified at the hearing that a new prospective purchaser had come forward to possibly purchase the engine maintenance center together with tax losses arising from Aveos' operations. This could result in a plan of arrangement being filed with benefit for unsecured creditors.

52 Accordingly, in the view of this Court, the shutdown of Aveos' normal operations and the implementation of a sales process does not in itself, eliminate the application of Section 32 C.C.A.A. as argued by N.G.A.

53 As indicated above, the undersigned has considered the evidence of the C.R.O. with respect to the late bidder. C.C.A.A. issues generally must be decided in "real time" if for no other reason so as to achieve the broad remedial purpose of the legislation[5] of providing a means for financially-strapped enterprises to correct problems and continue in business. This is all the more so in a process such as the Aveos Divestiture Process where the parties' business judgment dictates that the debtor be offered for sale but the parties do not know ahead of time what the outcome of such process will be. The situation evolves constantly and rapidly. The Court's decisions along the way cannot be frozen in time lest those decisions be unrealistic and unhelpful to the process. In any event, even if the undersigned only considered the facts as they were at the date of the notice to disclaim the G.M.S.A. as urged by N.G.A., the undersigned would still be of the opinion that Section 32 C.C.A.A. is available to Aveos for the reasons given above pertaining to the interpretation of Section 32 C.C.A.A.

54 N.G.A. also submitted that since the G.M.S.A. contains a mechanism to cancel where cancellation for cause under the common law of contracts is not available, then Section 32 C.C.A.A. cannot apply. The argument put forward by N.G.A. is based on the decision in the matter of Hart Stores[6] where Mongeon, J.S.C. held that Section 32 C.C.A.A. did not apply to the cancellation or termination of verbal contracts of employment having no fixed term.

55 The reasoning in that case was that the mechanism in Section 32 C.C.A.A. was inappropriate to cancel a verbal contract of indeterminate term where the law (Article 2091 of the Civil Code of Québec) provided a mechanism for

unilateral cancellation. In this Court's opinion that reasoning does not apply to a written service agreement of determinate term such as the G.M.S.A.

56 Moreover taken to its logical conclusion, the argument is not really of any help to N.G.A. for the following reason. If Aveos could not rely on Section 32 C.C.A.A. and was obliged to rely on the cancellation for convenience clause in the G.M.S.A., the penalty of $501,381.00 would nonetheless constitute a provable claim payable under an eventual plan of arrangement or bankruptcy.

57 "Claim" is defined in Section 2 of the C.C.A.A. by reference to the *Bankruptcy and Insolvency Act* ("B.I.A.")[7]. Section 19 C.C.A.A. introduced in the 2007 amendments which came into force in 2009, includes in claims that can be dealt with under a plan of arrangement the following:

> "19.(1)(*b*) claims that relate to debts or liabilities, present or future, to which the company may become subject before the compromise or arrangement is sanctioned by reason of any obligation incurred by the company before the earlier of the days referred to in subparagraphs (*a*)(i) and (ii)."
>
> This is precisely the situation with the cancellation indemnity claimed by N.G.A. in this case. Though Aveos may have triggered the cancellation penalty after the C.C.A.A. filing, the obligation stems from a contract to which it was bound pre-C.C.A.A. filing.

58 The claim for the cancellation penalty would also be a claim provable in a bankruptcy (see Section 2 and Section 121 of the *B.I.A.* which are substantially similar to Section 19 C.C.A.A.).

59 Accordingly, in any and all scenarios, the $501,381.00 claimed by N.G.A. for the cancellation indemnity would be a claim provable and would not have the status of a "post-filing claim" payable immediately, i.e. prior to the claims of other creditors.

60 The Courts have said on numerous occasions that pre-filing creditors cannot under the guise of making a post-filing claim, obtain a preference over other creditors.[8] This applies even to employees for severance claims arising from termination of employment after the C.C.A.A. filing[9]. The equitable treatment of creditors' demands that claims for contractual damages arising from the termination of contracts after filing under the C.C.A.A. be treated on a par with other provable claims[10].

61 Consequently, N.G.A.'s argument based on the cancellation of the G.M.S.A. without cause after the C.C.A.A. filing date is not helpful to N.G.A., since even if correct, the argument would give rise to a claim provable only.

62 Moreover, the parties cannot write out part of the C.C.A.A. from contracts.[11] This is against public policy. Parties to a contract cannot exclude in advance the application of the C.C.A.A. It would be offensive to the wording of Section 32 and the C.C.A.A. in general if Section 32 C.C.A.A. could not achieve its purpose as a result of the drafting of the contract which the debtor sought to cancel. This would defeat the rehabilitative purpose of the C.C.A.A. and thus would be contrary to the public policy of the C.C.A.A.

63 Consequently, Section 32 C.C.A.A. is available to Aveos in order to cancel the G.M.S.A. The appropriate order will issue.

64 Because of the manner in which the Court has answered the first issue set forth hereinabove (i.e. the application of Section 32 C.C.A.A.) it is not necessary to analyse whether Aveos could cancel the G.M.S.A. for cause because of alleged faulty execution by N.G.A. in virtue of the law of contracts generally.

65 Regarding the $501,381.00 cancellation indemnity, the following should be added. Section 32(7) C.C.A.A. provides that any loss suffered in relation to the disclaimer is a provable claim. The Court renders no judgment on whether the amount of any such claim is $501,381.00 or any other amount in the circumstances. That will have to be determined at a later date, if necessary.

66 The final issue requiring determination is the matter of N.G.A.'s claim for $91,377.00 for system maintenance. This amount represents the fee of $10,153.00 per week stipulated in the memorandum of understanding of April 13th. Such an amount was paid for the period up to the end of April 2012. The $91,377.00 represents $10,153.00 per week for the 9-week period commencing April 30, 2012, i.e. the expiry of the term of the last memorandum of understanding.

67 N.G.A. needed the data maintained in the system to complete the records of employment ("R.O.E.") for each of the employees. It had contracted to make "best efforts" to complete those R.O.E.s by April 28, 2012. Mr. Latulippe, N.G.A.'s representative, testified that N.G.A. completed all of the R.O.Es by April 28th, except for 50 which were problematic and could not be completed until the end of June. Accordingly, N.G.A. required the data to be maintained until that time. He conceded that there was no explicit agreement in place after April 30, 2012 for Aveos to pay such weekly system maintenance fee.

68 Even though N.G.A. only contracted to make best efforts to complete the R.O.E.s before April 28th, if N.G.A. needed to maintain the data in the system after April 28th, it was not justified, without Aveos' consent, to charge the $10,153.00 per week to maintain the data in the system. The "best efforts" clause may have attenuated N.G.A.'S obligation to complete by April 28th but did not impose an obligation on Aveos after that date without its consent. It had been agreed after the C.C.A.A. filing that the services to be provided by N.G.A. and paid for by Aveos were set forth in the memoranda of understanding. There was no obligation to pay for system maintenance after April 28th.

69 The Court adds that the fact that the cancellation of the G.M.S.A. takes effect according to Section 32(5) C.C.A.A. on the 30th day following Aveos' notice of May 7, 2012 does not entitle N.G.A. to charge for services under the M.G.S.A. not provided nor for services not agreed to under the memoranda of understanding. Accordingly, the claim for $91,377.00 will be denied.

FOR ALL OF THE FOREGOING REASONS, THE COURT:

70 DISMISSES Northgatearinso Canada Inc.'s "Amended Motion to Strike *De Bene Esse* Notice by Debtor Company to Disclaim or Resiliate an Agreement and for Payment of Post-filing Obligations", dated July 9, 2012;

71 DECLARES and **ORDERS** resiliated as of June 6, 2012 the following agreement, namely: "Global Master Services Agreement" between Aveos Fleet Performance Inc. and Northgatearinso Canada Inc. dated June 30, 2010 as amended from time to time including, *inter alia*, by subsequent Memoranda of Agreement".

72 THE WHOLE with costs against Northgatearinso Canada Inc.

MARK SCHRAGER, J.S.C.

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1 *R.S.C. 1985, c. C-25*.

2 *Timminco Limited (Re)*, *2012 ONSC 4471* at par. 52 to 57; *Boutique Jacob inc. (Arrangement relatif à)* *2011 QCCS 276* at par. 38 to 41 and 46; *Homburg Invest inc. (Re)*, *2011 QCCS 6376* at par. 103-106; *9145-7978 Québec inc. (arrangement relatif à)*, *2007 QCCA 768* at par. 26 to 29.

3 *Timminco Limited* (Re), op. cit., at par. 52-27

4 *Sproule vs. Nortel Networks Corporation, 2009 ONCA 833; First Leaside Wealth Management Inc. (Re) 2012 ONSC 1299*; *PCAS Patient Care Automation Services Inc. (Re) 2012 ONSC 3367*; *Brainhunter Inc. (Re) (2009) 62 C.B.R. (5th) 41* (ONSC); *Anvil Range Mining Corp. (Re)*, *(2002) 34 C.B.R. (4th) 157* (ONCA).

5 *Century Services Inc. vs. Canada (Attorney General) [2010] 3 S.C.R. 379*.

6 Re *Hart Stores Inc.*, *2012 QCCS 1094*.

7 R.S.C. c. B.-3.

8 *Pine Valley Mining Corporation (Re)* *2008 BCSC 368* para. 37-42; *Canwest Global Communications Corp. (Re)* *2010 ONSC 1746*, para. 29-31, 33-35.

9 *Canwest Global Communications Corp. (Re)* op. cit.

10 *Timminco Limited (Re)*, op. cit., para. 44.

11 Section 8 C.C.A.A.

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TAB 4

Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.

British Columbia Judgments

British Columbia Court of Appeal

Vancouver, British Columbia

Newbury, Hall and Levine JJ.A.

Heard: April 28 - 29, 2003.

Judgment: June 9, 2003.

Vancouver Registry No. CA030149

[2003] B.C.J. No. 1335 | 2003 BCCA 344 | 184 B.C.A.C. 54 | 13 B.C.L.R. (4th) 236 | 43 C.B.R. (4th) 187 | 123 A.C.W.S. (3d) 73 | 2003 CarswellBC 1399

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended Between Skeena Cellulose Inc., Orenda Forest Products Ltd., Orenda Logging Ltd. and 9753 Acquisition Corp., respondents (petitioners), and Clear Creek Contracting Ltd. and Jasak Logging Ltd., appellants (applicants), and The Truck Loggers' Association, intervenor

(67 paras.)

Counsel

J.S. Forstrom, for the appellants. M.I. Buttery and S.A. Dubo, for the respondents. M. MacLean and J.I. McLean, for the intervenor, Truck Loggers' Association.

The judgment of the Court was delivered by

NEWBURY J.A.

1 This appeal turns on the interaction of two statutory regimes - the scheme of "replaceable" or "evergreen" logging contracts established by the Province under the Forest Act, *R.S.B.C. 1996, c. 157*, and the scheme of judicial stays and creditors' compromises available under the Companies' Creditors Arrangement Act, *R.S.C. 1985, c. C-36* as amended (the "CCAA"), to insolvent corporations whose indebtedness exceeds $5,000,000.

2 Both schemes are said to involve considerations of fairness and equity. In the case of the Forest Act, a detailed series of "contractual" terms is required to be incorporated in agreements between the holders of harvesting licences granted by the Crown, and the contractors they in turn retain to carry out the logging. Most aspects of the relationship are either provided for in the mandatory terms or must be resolved by arbitration, the principles and procedures of which are also regulated by the Act. Most importantly, a licence holder must agree that when such an agreement expires, it will be renewed (or in the statutory terminology, "replaced") on terms substantially the same as those of the expired contract, assuming the contractor has performed its obligations thereunder. In this way, the legislation seeks to provide contractors with a degree of "security" analogous to the security of tenure implicit in a Crown harvesting licence, and to achieve greater fairness between the licence holder and its contractors.

3 In the case of the CCAA, the fairness analysis required to be carried out by the court generally refers to fairness as between classes of creditors. That analysis is tempered by the starker realities of whether the proposal before

the court offers a chance of survival to the debtor corporation and whether it will be acceptable to the requisite majority of creditors. Unlike the detailed provisions of the Forest Act and regulations thereto, the CCAA is a brief set of "broad-brush" provisions that leave wide avenues of discretion to be exercised by courts in circumstances that may not permit the fine weighing of individual interests. As observed in Re Keddy Motor Inns Ltd. *(1992) 13 C.B.R. (3d) 245* (N.S.S.C., App. Div.) at 258, the legislation contemplates "rough-and-tumble negotiations between debtor companies desperately seeking a chance to survive and creditors willing to keep them afloat but on the best terms they can get."

4 The substantive question raised by this appeal is to what extent considerations of fairness between individual logging contractors who have replaceable contracts with a corporation in CCAA proceedings, should figure in the "rough-and-tumble" considerations applicable to a large corporate insolvency. Looked at another way, does the desirability of staving off a bankruptcy which could have disastrous consequences for many individuals, local governments and communities, supplant considerations of fairness between the holders of replaceable logging contracts to which the debtor corporation is a party?

FACTUAL BACKGROUND

5 The insolvent corporation in this case is Skeena Cellulose Inc. ("Skeena"). At all material times, it owned and operated a pulp mill and three sawmills, and held related forest tenures, mainly in north-western British Columbia. It was a large employer in that region and was one of the major manufacturers of bleached softwood kraft pulp in North America.

6 Skeena has experienced financial difficulties for many years. It underwent a financial restructuring under the CCAA in 1997. Although many of the positive results hoped for from that arrangement improved Skeena's long-term prospects, it appears that various other factors prevented full recovery. In August 2001, the Toronto-Dominion Bank demanded payment of more than $350,000,000 from Skeena and its subsidiaries, froze their operating lines and began to refuse to honour their cheques, including payroll cheques. Other creditors followed suit, and on September 5, 2001, Skeena and its subsidiaries petitioned the Supreme Court of British Columbia for a stay of proceedings under the CCAA.

7 The petition alleged, and it is not disputed, that Skeena owed over $409,000,000 (exclusive of interest) mainly to the Toronto-Dominion Bank and to corporations owned by the Province, which also held over 70 percent of its common shares. This debt was represented by bonds issued under a trust deed secured by charges on all of Skeena's assets, present and future. The petition stated that Skeena and its subsidiaries were insolvent and described the impact their bankruptcy could have on the provincial economy:

> 50. If the Petitioners were to totally cease operations or go into liquidation, the direct loss of jobs in British Columbia would be enormous, including the approximately 1,050 existing Skeena employees and, at least 1,000 employees of logging contractors, road building and silviculture contractors. It would also directly and indirectly impact service industries and business which rely on Skeena for a source of revenue. By the Petitioners' estimate, as many as 7,000 additional jobs in British Columbia would be affected.
>
> 51. A liquidation of the Petitioners would be particularly devastating to the communities of Terrace, South Hazelton, and Prince Rupert. Skeena is the largest employer in those communities, and many hundreds of families depend on Skeena for their livelihoods in those communities.
>
> 52. The loss of this number of jobs would also, of course, have a generally damaging effect on the British Columbia economy, given the spillover effect of lost wages and lost purchases.
>
> 53. Skeena is currently in good standing under its collective agreements and other employment relationships. However, if some or all of the employees would be terminated, severance claims, including payments for group termination under the Employment Standards Act, could be significant.

8 Chief Justice Brenner, who I understand heard most if not all the applications in this matter in Supreme Court, granted an initial order ex parte on September 5, 2001, staying proceedings against Skeena and its subsidiaries for 30 days and appointing Arthur Andersen Inc. as Monitor. On October 5, he granted a "Come-back Order" which extended the stay and contemplated that the petitioners would file a formal plan of compromise or arrangement (entitled the "Reorganization Plan") with their creditors on or before November 5; that they would file a formal plan of arrangement (entitled the "Plan of Arrangement") with their shareholders under the Canada Business Corporations Act, *R.S.C. 1985, c. C-44*; and that meetings of their creditors would be called to vote on the Reorganization Plan. Under the heading "Post-Filing Operations", the Order stated:

> 11. The Petitioners shall remain in possession of the Assets and shall continue to carry on business in the ordinary course provided that they shall have the right with the approval of the Monitor, or this Court, to proceed with an orderly disposition of such of the Assets as they deem appropriate, either with the consent of any creditor holding security against such Assets or pursuant to an Order of this Court, in order to facilitate the downsizing and consolidation of their business and operations (the "Downsizing").
>
> 12. To facilitate the Downsizing, the Petitioners may:
>
> (a) terminate the employment of such of the Petitioners' employees or temporarily lay off such of the Petitioners' employees as they deem appropriate;
>
> (b) terminate such of the Petitioners' supplier or service arrangements or agreements as they deem appropriate;
>
> (c) abandon such leases, tenures, contracts, rights, authorizations, franchises, dealerships, permits, approvals, uses or consents as are deemed to be unnecessary for the Petitioners' business; . . .
>
> all without interference of any kind from third parties, including landlords and notwithstanding the provisions of any lease, other instrument or law affecting or limiting the rights of the Petitioners to remove or divest Assets from leased premises, and that any liabilities of the Petitioners arising as a result thereof shall be claims provable in these proceedings in the same manner as all creditor claims existing as at the Filing Date and provided that:
>
> (f) the Monitor shall have submitted to the Court a report of any proposed termination of any Forest Act Replacement Contract under the foregoing sub-paragraph (b) at least 21 days before such plan is implemented;
>
> (g) the implementation of any of the plans and procedures contemplated by the foregoing sub-paragraphs (a)-(d) including any termination or partial termination of any contract, shall be without prejudice to the claims of any counter party to such contract to file a proof of claim in such manner as may be provided for in the Reorganization Plan;
>
> (h) the Petitioners shall provide 3 days' written notice of any termination of any executory agreements under the foregoing sub-paragraphs (b) or (c); and
>
> (i) the counter party or parties to any agreements proposed by the Petitioners to be terminated in accordance with the foregoing, including the counter party or parties to any Forest Act Replacement Contracts, may during the applicable 3 day notice period, in the case of executory contracts, or within 21 days of the filing of the Monitor's report, in the case of the Forest Act Replacement Contracts, apply to the Court in this proceeding to show cause why such agreement or agreements should not be terminated or for such directions as to the termination of such agreements as may be appropriate. [Emphasis added.]

9 The deadline for the filing of the Reorganization Plan was extended by the Court on several occasions while solutions to Skeena's difficulties were sought and potential purchasers were pursued. Finally, on February 28,

2002, a Plan was filed which proposed that an outside buyer, NWBC Timber & Pulp Ltd. ("NWBC"), would acquire the interests of the secured lenders for $8,000,000. Of this, $2,000,000 would be paid to the Monitor for distribution to the unsecured creditors, so that the secured creditors would receive $6,000,000 on debt in excess of $400,000,000. The claims of governmental bodies for property taxes would be compromised, and the holders of existing common shares would surrender them for no consideration. Skeena would then issue new common shares to NWBC. The Plan was of course subject to many conditions, including approval by the specified classes of creditors and shareholders and the passing of applicable appeal periods in respect of the Court's order. After some amendments, the Plan was approved by the Court on April 4, 2002. Once the conditions contained in the Order were met, NWBC completed its purchase of the shares and secured debt of Skeena in early May.

The Appellants' Logging Contracts

10 The appellants or their predecessors had been performing logging services under contract with Skeena or its predecessors since the 1960s. In 1991, their contracts became "replaceable logging contracts" under new provisions of the Forest Act. At the time Skeena's financial difficulties became manifest in 2001, the corporation had five such contracts. All five were due to expire on December 31, 2001, and Skeena was required to offer replacement contracts to the contractors thereunder no later than September 30 of that year.

11 Skeena did not offer replacement contracts to the appellants, but did renew those of its three other logging contractors. Mr. Veniez, the president and chief executive officer of NWBC and Skeena following the Reorganization, explained this decision by reference, at least in part, to the fact that whereas the Forest Act scheme requires a licence holder to cut at least 50 percent of its allowable annual cut ("AAC") through replaceable contracts, Skeena had entered into such contracts for approximately 65 percent of its AAC. Moreover, the change in control of Skeena contemplated by the Reorganization would result in a five percent reduction of its AAC, absent a ruling to the contrary by the Ministry of Forests. Mr. Veniez deposed in these proceedings that:

> 17. As part of its efforts to ensure the economic viability of Skeena, NWBC determined, in consultation with Skeena management at the time, that it would be desirable to reduce the amount of timber required to be harvested under replaceable contracts to the current statutory minimum of 50% of Skeena's AAC.
>
> 18. Because NWBC's acquisition of Skeena represents a change of control, I knew that Skeena's Terrace Woodlands' AAC would be reduced by 5% to approximately 878,000 m3. Therefore, in consultation with Skeena management, I determined that it would be appropriate to reduce the volume of timber allocated to evergreen contractors to 439,000 m3, representing a reduction of approximately 160,000 m3.
>
> 19. I was advised by Skeena management that, until the terminations of Clear Creek and Jasak, Skeena's five evergreen contractors held the following volumes:

Contractors	Volume
Don Hull & Sons	166,239 m3
K'Shian Logging	166,239 m3
Main Logging	99,828 m3
Clear Creek	83,331 m3
Jasak	83,331 m3

20. In consultation with Skeena management and the Province, NWBC determined that it would be appropriate to terminate the Clear Creek and Jasak contracts, representing a reduction of "evergreen" volume of approximately 166,662 m3.

21. I recognize that by terminating these two contracts, Skeena will be slightly below the 50% allowable minimum under the Contract Regulation, but it is Skeena's intention to re-tender the approximately 6,000 m[3] difference in the form of new evergreen contract. The approximately 160,000 m3 balance will be tendered on the open market (as opposed to have to negotiate rates with its existing evergreen contractors). I expect that this tendering process will result in substantial savings to Skeena and significantly reduce its delivered wood costs for this 160,000 m3. (If the cost differential is $3.90/m3, the savings could be as much as $624,000 per year).

22. Moreover, a tendering process for this volume of wood will help to establish more accurate fair market values for both evergreen and non-evergreen contracts (in this regard, I am advised by Mr. Curtis that historically it has been difficult to establish these values in light of the predominance of evergreen contracts).

23. In deciding to terminate certain of Skeena's evergreen contracts, I reasoned that this would better allow Skeena to reorganise the size (volume) and equipment configurations for its different contracts. (Skeena does have the right to insist that its current evergreen contractors log by whatever methods Skeena stipulates, but historically it has been more cost-efficient for Skeena to introduce new logging methods via an open tendering process than by introducing changes to existing replaceable contracts).

24. Finally, I was advised by Skeena management that Clear Creek and Jasak had, historically, been more expensive than the three other evergreen contractors listed above. That is, through a combination of the rates charged by those two contractors, and their relative efficiency, the cost to Skeena of logs produced by Clear Creek and Jasak was greater than for the other three evergreen contractors above.

25. With the foregoing considerations in mind, I, on behalf of NWBC, advised Skeena's management at the time that NWBC would require, as a condition of going forward with the acquisition of Skeena, that Skeena take steps within the context of the CCAA proceedings to terminate the Clear Creek and Jasak contracts.

26. By asking Skeena to terminate those contracts, NWBC was in no way motivated to frustrate the objectives of the Forest Act. On the contrary, for the reasons set out above, NWBC perceives these terminations to be an important aspect of what I hope and fully expect will be a successful reorganization of Skeena. [Emphasis added.]

12 On or about March 1, 2002, each of the appellants received a letter from Skeena purporting to terminate its replaceable contract, effective immediately. Neither the Court nor the appellants had received prior notification from Skeena or the Monitor - even though under the terms of the Come-back Order, the Monitor was required to submit to the Court "a report of any proposed termination of any Forest Act Replacement Contract . . . at least 21 days before such plan is implemented" and even though within 21 days of the filing of the Monitor's report, the parties to such contracts were to be entitled to apply to the Court to "show cause why such agreement or agreements should not be terminated or for such directions as to the termination of such agreements as may be appropriate." Two weeks later, in its Eleventh Report to the Court, the Monitor referred to the terminations as faits accomplis:

> We have been advised that the petitioner has terminated replaceable logging contracts with Jasak Logging Ltd. and Clear Creek Contracting Ltd. in accordance with the Order. Copies of the letters of termination to each of the contractors dated March 4, 2002 and March 1, 2002, respectively are attached.
>
> These replaceable logging contracts have been terminated in accordance with the terms of the Purchase Agreement between NWBC Timber & Pulp Ltd., 552513 British Columbia Ltd. and Skeena Cellulose Inc. dated February 20, 2002.

13 It is not clear to me what "plan" was being referred to in subpara. 12(f) of the Come-back Order quoted above, nor whether it was necessary to "terminate" contracts that had not been renewed. On appeal, however, Skeena acknowledged that the Monitor's report had been filed two weeks after the termination letters were issued and that the "creditors' meeting to vote on the Plan took place before the 21-day time period referred to in the Come-back Order had expired." Thus counsel did not take issue with the Chief Justice's conclusion that Skeena had not complied strictly with the Come-back Order.

14 Upon receiving the letters of termination, the appellants' solicitors wrote to the Monitor's solicitors objecting that that the Come-back Order had not been complied with. They explained:

> Our clients are in a position where they cannot file proofs of claim on March 25 as their contracts are not terminated yet and they do not know if the contracts will be terminated and, if there is a termination, what class of creditor they will be. Due to the failure to deal with this matter in a timely fashion, it appears that the parties have no choice but to postpone the deadline for filing claims to the middle of April with a vote of creditors to take place in early May.

The appellants asked the Monitor for information as to how the termination would result in lower costs to Skeena and requested a copy of the contract of purchase between Skeena and NWBC. The Monitor declined to provide a copy of this agreement on the basis that it was confidential. The agreement was never adduced into evidence.

15 In further correspondence, Skeena characterized its earlier letters to the appellants as having "served to clarify that the previously expired contract with Jasak and Clear Creek would not be reinstated." (My emphasis.) Again, however, since that characterization of the letters was not pursued by counsel in this court or the court below, I will proceed on the footing that the contracts were terminated, as opposed to not having been renewed. (In law, the distinction in this case may be insignificant.) The appellants were told that if they wished to vote on Skeena's Reorganization Plan, they would have to file proofs of claim by March 22. At the same time, Skeena told the appellants it was prepared to discuss future arrangements with them "for the continuation of their services to Skeena."

16 By March 22, the appellants did file conditional proofs of claim in the CCAA proceeding, claiming indebtedness in the amount of $2,925,315.14 in the case of Jasak Logging Ltd., and $2,896,680 in the case of Clear Creek Contracting Ltd. (Mr. Forstrom advised us that these amounts represented the present value of the income stream which the appellants stood to earn under their contracts over the next 50 years or so. I understand that apart from these 'future' losses, nothing was owing by Skeena to the appellants under their expired contracts.) The Monitor disallowed a portion of each claim and instead allowed a claim of $172,430.47 to Jasak and $166,670 to Clear Creek. The appellants notified the Monitor that they disagreed with its position.

17 On March 28, Jasak and Clear Creek filed a motion in Supreme Court seeking an order restraining Skeena from terminating their contracts and declaring them "in full force and effect and are binding upon the parties thereto". Alternatively, they sought the summary determination of the value of their respective claims as creditors in Skeena's plan of arrangement. However, before the motion could be heard, the meeting of Skeena's creditors took place and the Reorganization Plan was approved by the requisite numbers of each class. The appellants did not attend or vote at the meeting. On April 4, 2002 Skeena applied for and obtained court approval of the Plan. As earlier mentioned, NWBC closed its purchase of the shares of Skeena in accordance with the Reorganization Plan in early May. We are told that it has not yet resumed its logging operations.

18 The appellants' motion to have the termination of their contracts declared invalid was heard in Chambers on June 17 and was dismissed by the Chief Justice on September 4, 2002. His reasons are now reported at *(2002) 5 B.C.L.R. (4th) 193*.

19 After reciting the facts before him, the Chief Justice briefly summarized the purpose of the replaceable contract scheme and the nature of replaceable contracts. He noted that in Skeena's CCAA proceeding in 1997, Thackray J.

(as he then was) had determined that the Court had the authority under the CCAA to allow Skeena to terminate replaceable logging contracts notwithstanding their unusual 'statutory' aspects. (See In the Matter of the Companies' Creditors Arrangement Act and In the Matter of Repap British Columbia Inc. et al., B.C.S.C., Vancouver Registry A970588, dated June 11, 1997.) Thackray J. had observed:

> I do not accept that allowing the petitioner to terminate renewable contracts is a striking down of the Provincial legislation. I mentioned several times to Mr. Ross that I could and do go so far as to find that there is legislat[ive] involvement in replaceable contracts under the Forest Act. However, I cannot accede to the position taken by Mr. Ross that these contracts attain some classification that makes them almost statutory contracts and thereby subject to some different rule of the law than general commercial contracts. There is no doubt that the parties are governed by the regulation and that the regulations forming part of the contract will govern many events by parties to the contracts. However the issue here is whether or not the contract is subject to the particular order that I gave under the Companies' Creditors Arrangement Act. I am of the opinion that it is subject to the order which I gave and that this Court had the jurisdiction to give that order. [para. 7]

20 The Chief Justice then turned to the questions of whether on this occasion, Skeena had complied with the "procedures and conditions" stipulated in the Come-back Order and whether the termination conformed to the "broader principles of economic necessity and fairness" underlying the Court's discretionary authority under the CCAA. In connection with the first question, he noted that the Come-back Order had authorized the termination of arrangements and agreements by Skeena only for the purpose of facilitating the "downsizing and consolidation of their business and operations (the 'Downsizing')". He noted the appellants' submission that although Skeena claimed to be "downsizing" its operations, it had maintained its timber harvesting rights and was planning to continue to harvest timber from them, presumably to the extent it always had in the past. On the other hand, there was the fact that the change in control of Skeena would result in a five percent reduction of Skeena's AAC, which Skeena proposed to reflect in a reduction in volume of timber allocated to "evergreen" contractors by approximately 160,000 cubic metres. The Chief Justice concluded that this reduction qualified as "Downsizing" for purposes of the Come-back Order. This conclusion was not specifically challenged on appeal.

21 In response to the appellants' objection that Skeena had terminated their contracts without first filing a report of the Monitor, the Chief Justice agreed that the letters of termination had been "issued untimely". He concluded, however, that since the appellants had had "clear and unequivocal notice", prior to the creditors' meeting, of Skeena's intention to terminate their contracts and to treat their claims as compromised under the Plan, they had not been prejudiced by the lack of strict compliance. (para. 41.)

22 The remaining question framed by the Chief Justice was whether Skeena's termination of two of its five replaceable logging contracts constituted an "inappropriate differentiation of treatment between the applicants and other [Skeena] creditors." (para. 42.) He noted that one of the unfortunate results of insolvency restructurings is that some persons suffer hardship. In this case, Skeena had had to terminate the employment of many individuals, its unsecured and secured creditors stood to recoup only a small fraction of their claims, and the Court had already dismissed an application brought by the Pulp, Paper and Research Institute of Canada similar to that brought by the appellants. The Court noted the comments of LoVecchio J. in Re Blue Range Resource Corp. *[1999] A.J. No. 788* (Alta Q.B.), to the effect that an order authorizing the termination of a contract is appropriate in a restructuring since, like others dealing with the insolvent corporation, the contracting party will have its claim for damages. But that claim should not be elevated above those of other contracting parties; as LoVecchio J. had stated:

> A unilateral termination, as in any case of breach, may or may not give rise to a legitimate claim in damages. Although the Order contemplates and to a certain extent permits unilateral termination, nothing in section 16.e or in any other part of the Order would suggest that Blue Range is to be relieved of this consequence; indeed Blue Range's liability for damages seems to have been assumed by Duke and Engage in their set-off argument. The application amounts to a request for an order of specific performance or an injunction which ought not to be available indirectly. In my view, an order authorizing the termination

> of contracts is appropriate in a restructuring, particularly given that it does not affect the creditors' rights to claim for damages.
>
> The Applicants are needless to say not happy about having to look to a frail and struggling company for a potentially significant damages claim. They will be relegated to the ranks of unsecured judgment creditors and may not, indeed likely will not, have their judgments satisfied in full. While I sympathise with the Applicants' positions, they ought not to, in the name of equity, the guide in CCAA proceedings, be able to elevate their claim for damages above the claims of all the other unsecured creditors through this route. [paras. 37-8]

23 Similarly in this case, the Chief Justice concluded that the applicants before him were "seeking to be put in a position superior to [Skeena's] other creditors." (para. 50.) In the result, since Thackray J. had already ruled that replaceable contracts could be terminated as part of a CCAA reorganization, and the appellants had had "full knowledge prior to the creditors' meetings that they would have claims under the Plan if their contracts were to be terminated", the Chief Justice saw no reason why the appellants should "in effect, be placed in a better position than other creditors." (para. 53.)

24 On appeal, the appellants challenged both the Court's ruling on the question of notice and its substantive ruling that the Come-back Order validly permitted Skeena to terminate the appellants' "evergreen" contracts. Since Mr. Forstrom, counsel for the appellants, focussed on the second argument in his oral submissions in this court - and rightly so in my view - I will deal with it first. It is linked to the argument made by the intervenor, the Truck Loggers' Association, which challenges the court's constitutional and statutory jurisdiction to "permit" Skeena to terminate any replaceable logging contracts, contrary to what Mr. Maclean says is the intention of the Forest Act. Mr. Maclean submits that this legislation must prevail over what he characterized as the exercise of the court's "inherent jurisdiction" under the CCAA when the court approves an arrangement which includes the termination of a lease or other contract.

25 It may be useful at this point to review in greater depth the unusual scheme of replaceable contracts imposed by the Forest Act, and then to review the CCAA and the "inherent" or 'supervisory' jurisdiction exercised by the courts thereunder.

The Forest Act Scheme

26 The Province first introduced a regime of statutorily-mandated logging contracts in 1991. The initial legislation was revised somewhat in 1996 when the present Regulation 22/96 to the Forest Act was enacted. Speaking in the Legislative Assembly in June 1991, the then Minister of Forests stated that the purposes of the legislation were to "address logging-contractor security in British Columbia", to "improve the balance in . . . contractual relationships" between holders of timber rights and logging contractors, and to provide a quick and inexpensive system for resolving disputes between them. The Minister drew an analogy between the desire of long-term licence holders for security of tenure from the Crown, and the needs of logging contractors and subcontractors, who also make large capital investments in logging equipment, for similar security vis-à-vis the licence holders. Accordingly, the Forest Amendment Act, 1991, c. 11, permitted the imposition of a series of requirements on the holders of certain classes of timber licences with respect to logging contracts already in existence, and logging contracts entered into thereafter.

27 Most of the provisions relevant to this appeal are contained in Regulation 22/96. Part 2, headed "Written Contracts and Subcontracts Required", states that persons entering into a timber harvesting contract or subcontract must do so in writing. If the terms of a contract do not comply with the Regulation, the parties are required to make reasonable efforts to cause the contract to do so. Every "replaceable contract" (defined in s. 152 of the Act) must provide that the contractor's interest thereunder is assignable, subject to the consent of the licence holder, which consent may not be unreasonably withheld. As well, every contract must provide that all disputes between the parties in connection with the contract "will be referred to mediation and, if not resolved by the parties through mediation, will be referred to arbitration." (The Regulation leaves unsaid the apparent intention that neither party will

have recourse to courts of law to resolve such disputes.) The Commercial Arbitration Act, *R.S.B.C. 1996, c. 55*, applies to such arbitrations, but there are also detailed rules in Regulation 22/96 for the mediation and arbitration proceedings and for the keeping of a publicly available "Register of Timber Harvesting Contract and Subcontract Arbitration Awards" by the Ministry of Forests.

28 Part 5 of the Regulation is headed "Replaceability of Contracts and Subcontracts". It requires that the holders of Crown licences carry out specified proportions of their timber harvesting operations by means of replaceable contracts. Different requirements apply to different classes of licence and to operations in the Coastal and Interior regions respectively. As I noted earlier, since Skeena operates in the Coastal region, it is required to harvest at least 50 percent of its timber by means of replaceable contracts.

29 Sections 13-15 of the Regulation deal with the commencement and expiration of replaceable contracts in the following terms:

> 13 (1) A replaceable contract must provide that
>
> (a) if the contractor has satisfactorily performed its obligations under the contract, and conditional on the contractor continuing to satisfactorily perform the existing contract, the licence holder must offer a replacement contract to the contractor, and
>
> (b) the replacement contract must
>
> (i) be offered 3 months or more before the expiry of the contract being replaced,
>
> (ii) provide that it commences on or before the expiry of the contract being replaced,
>
> (iii) provide for payment to the contractor of amounts in respect of timber harvesting services as agreed to by the parties or, failing agreement, as determined under section 25, and
>
> (iv) otherwise be on substantially the same terms and conditions as the contract it replaces.
>
> (2) If a replaceable contract does not provide for an expiry date, the contract expires on the second anniversary of the date on which the contract commenced.
>
> 14 (1) A replaceable contract must provide that, upon reasonable notice to the contractor, the licence holder may require, for bona fide business and operational reasons, that the contractor
>
> (a) use different timber harvesting methods, technology or silvicultural systems,
>
> (b) move into a new operating area, or
>
> (c) undertake any other operating change necessary to comply with a direction made by a government agency or lawful obligation imposed by any federal, provincial or municipal government.
>
> (2) A replaceable contract must provide that if a requirement made pursuant to subsection (1) results in a substantial change in the timber harvesting services provided by the contractor, the contractor may, within 60 days of receiving notice under subsection (1), elect by notice in

writing to the licence holder to terminate the replaceable contract without incurring any liability to the licence holder.

(3) A replaceable contract must provide that, if a requirement is made pursuant to subsection (1) and the contractor does not elect to terminate the replaceable contract as provided for in subsection (2), either party may, within 90 days of the contractor receiving notice under subsection (1), request a review of the rate then in effect.

(4) If, after any changes in timber harvesting services required by the licence holder under subsection (1), the parties are unable to agree upon the rate to be paid for timber harvesting services, a rate dispute is deemed to exist.

15 A replaceable contract must provide that the contract terminates, to the extent that it relates to the licence, upon the cancellation, expiry or surrender of a licence under which the timber harvesting services provided by the contractor are carried out. [Emphasis added.]

30 The Regulation stipulates that if a dispute arises regarding the amount of work to be specified in a replaceable contract, the matter may be referred to arbitration under s. 24. The same is true of any dispute regarding the rates chargeable by the contractor for its work. The arbitrator must determine a rate that is reasonable and competitive by industry standards and which "would permit a contractor operating in a manner that is reasonably efficient in the circumstances in terms of costs and productivity to earn a reasonable profit."

31 Division 5 of the Regulation deals with reductions in work under a replaceable contract due to a reduction in AAC. If the Crown reduces the AAC under a harvesting licence, the holder "must apportion the effect of the reduction in AAC . . . proportionately among (i) all contractors holding replaceable contracts, and (ii) any company operations in respect of the licence." (s. 28(2)(d).) Alternatively, the holder may make a proposal either to reduce the AAC covered by one or more of its replaceable contracts or to terminate one or more such contracts. If the proposal is objected to by one or more of the affected contractors, a "dispute is deemed to exist" between the licence holder and the contractor(s). If not settled by mediation, this dispute must also be arbitrated in accordance with s. 32, which states in part:

(g) an arbitrator must resolve the dispute in the manner that the arbitrator believes most fairly takes into account each of the AAC reduction criteria; [and]

(h) for greater certainty, in making a decision with respect to the dispute

(i) an arbitrator is not restricted to choosing between any of the various AAC reduction proposals made by the parties to the arbitration, and

(ii) an arbitrator may make an award that includes the termination of one or more of the replaceable contracts, or reduces the amount of work available to any contractor or company operation in a manner that is not proportionate to the reduction in AAC. [Emphasis added.]

The Regulation defines the term "AAC reduction criteria" to mean each of the following factors:

(a) the amount of work specified in each replaceable contract to which the proposal relates;

(b) the relative seniority of each contractor with a replaceable contract;

(c) the economic impact of the proposal on the timber harvesting operations carried out under that licence by each contractor with a replaceable contract;

(d) the impact of the proposal on employment;

(e) the economic impact of the proposal on the licence holder; [and]

(f) the impact of the proposal on community stability; . . .

32 As Mr. Forstrom points out, then, the statutorily-mandated terms of replaceable logging contracts "tie" them in a sense to Crown licences themselves. A licence holder must carry out a specified percentage of its logging through contractors under replaceable contracts. If the AAC under the licence is reduced, the work committed to by the licence holder in its replaceable contracts may also be reduced. If the licence is cancelled or surrendered, any replaceable contract referable thereto also terminates. Mr. Forstrom and Mr. Maclean go further, however, and argue that the "tie" confers a "special status" on the contractor and that the status must be recognized in the event of a breach of the obligation to renew or continue the contract, and must be reflected in any CCAA arrangement. I will return below to these arguments.

The CCAA

33 Unlike the Forest Act and Regulation, the CCAA is very brief. It operates substantially through judge-made law interpreting and applying its 22 sections. For purposes of this appeal, the key ones are the following:

> 4. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.
>
> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.
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> * * *
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> 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
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> (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and
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> (b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the Bankruptcy and Insolvency Act or is in the course of being wound up under the Winding-up and Restructuring Act, on the trustee in bankruptcy or liquidator and contributories of the company.
>
> * * *
>
> 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.
>
> (2) An application made for the first time under this section in respect of a company, in this section referred to as an "initial application", shall be accompanied by a statement indicating the projected cash flow of the

company and copies of all financial statements, audited or unaudited, prepared during the year prior to the application, or where no such statements were prepared in the prior year, a copy of the most recent such statement.

(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);

(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.

(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.

. . .

(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 satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

34 There is now a large body of judge-made law which "fills the gaps" between these provisions. Most notably, courts appear to have given full effect to the "broad public policy objectives" of the Act, which in the phrase of a venerable article on the topic (Stanley E. Edwards, "Reorganizations under the Companies' Creditors Arrangement Act", (1947) 25 Can. Bar Rev. 587) are to "keep the company going despite insolvency" for the benefit of creditors, shareholders and others who depend on the debtor's continued viability for their economic success. As the author commented:

> Hon. C.H. Cahan when he introduced the bill into the House of Commons indicated that it was designed to permit a corporation through reorganization to continue its business, and thereby to prevent its organization being disrupted and its goodwill lost. It may be that the main value of the assets of a company is derived from their being fitted together into one system and that individually they are worth little. The trade connections associated with the system and held by the management may also be valuable. In the case of a large company it is probable that no buyer can be found who would be able and willing to buy the enterprise as a whole and pay its going concern value. The alternative to reorganization then is often the sale of the property piecemeal for an amount which would yield little satisfaction to the creditors and none at all to the shareholders.
>
> Reorganization may give to those who have a financial stake in the company an opportunity to salvage its intangible assets. To accomplish this they must ordinarily give up some of their nominal rights, in order to keep the enterprise going until business is better or defects in the management can be remedied. This

> object may be furthered by providing in the reorganization plan for such matters as a shift in control of the company or reduction of the fixed charges to such a degree as to make it possible to raise new money through new issues of bonds or shares. It may therefore be in the interest of all parties concerned to give up their claims against an insolvent company in exchange for new securities of lower nominal amount and later maturity date.
>
> Public Interest
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> Another reason which is usually operative in favour of reorganization is the interest of the public in the continuation of the enterprise, particularly if the company supplies commodities or services that are necessary or desirable to large numbers of consumers, or if it employs large numbers of workers who would be thrown out of employment by its liquidation. This public interest may be reflected in the decisions of the creditors and shareholders of the company and is undoubtedly a factor which a court would wish to consider in deciding whether to sanction an arrangement under the C.C.A.A. [at 592-3]

(See also Duff, C.J.C. in Reference re Companies' Creditors Arrangement Act (Canada) *[1934] S.C.R. 659*.)

35 In accordance with these objectives, Canadian courts have adopted a "standard of liberal construction" that serves the interests of a "broad constituency of investors, creditors and employees" and reflects "diverse societal interests." (See Re Smoky River Coal Ltd. *(1999) 175 D.L.R. (4th) 703* (Alta. C.A.), at 721-2.) In Chef Ready Foods Ltd. v. Hongkong Bank of Canada *(1990) 51 B.C.L.R. (2d) 84* (B.C.C.A.), for example, this court held that security granted under s. 178 of the Bank Act was not exempt from the CCAA provisions applicable to "security" and secured creditors, since otherwise a single creditor (in that case, a bank) could frustrate the objectives of the statute. Gibbs J.A. observed:

> 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.
>
> There is nothing in the C.C.A.A. which exempts any creditors of a debtor company from its provisions. The all encompassing scope of the Act qua creditors is even underscored by s. 8 which negates any contracting out provisions in a security instrument. And Chef Ready emphasizes the obvious, that if it had been intended that s. 178 security or the holders of s. 178 security be exempt from the C.C.A.A. it would have been a simple matter to say so. [at 88-9]

36 In connection with other "priority" issues - the power to grant priority to persons advancing debtor-in-possession ("DIP") financing and to the Monitor for the payment of its fees and disbursements before the payment of secured creditors - this court has called in aid Equity's ability to adapt to changing circumstances in order to achieve the objectives of the statute. In Re United Used Auto & Truck Parts Ltd. *(2000) 16 C.B.R. (4th) 141* (B.C.C.A.), this court declined to follow an earlier case in which the Ontario Court of Appeal had ruled that the receiver of a partnership had no authority to subordinate the interests of secured creditors to liability for the receiver's disbursements, unless one of three exceptions applied. (See Robert F. Kowal Investments Ltd. v. Deeder Electric Ltd. *(1975) 21 C.B.R. (N.S.) 201*.) Mackenzie J.A. commented:

> Houlden J.A. stated that these three exceptions were not exhaustive. Nonetheless the Kowal statement of exceptions has been influential in subsequent cases and they were applied by this Court in Lochson

> Holdings Ltd. v. Eaton Mechanical Inc. *(1984), 55 B.C.L.R. 54* (C.A.). But as Macdonald J. observed in Westar Mining, supra at 93-94, different considerations apply under the CCAA. The court is concerned with the survival of the debtor company long enough to present a plan of reorganization. That is a broader interest than that of creditors alone. The jurisdiction must expand from the Kowal exceptions to serve that broader interest.
>
> Thus the receivers' jurisdiction and the monitors' jurisdiction are analogous to the extent that they are both rooted in equity but they diverge to the extent that the monitors' jurisdiction serves a broader statutory objective under the CCAA. In my opinion the jurisdiction under the CCAA cannot be restricted to the Kowal exceptions. [paras. 21-22; emphasis added.]

In conclusion, he stated:

> In my opinion, an equitable jurisdiction is available to support the monitor which is sufficiently flexible to be adapted to the monitor's role under the CCAA. It is a time honoured function of equity to adapt to new exigencies. At the same time it should not be overlooked that costs of administration and DIP financing can erode the security of creditors and CCAA orders should only be made if there is a reasonable prospect of a successful restructuring. That determination is largely a matter of judgement for the judge at first instance and appellate courts normally will be slow to interfere with an exercise of discretion.
>
> In my opinion, super-priority for DIP financing rests on the same jurisdictional foundation in equity. Priority for the reasonable restructuring fees and disbursements could have been allowed as part of DIP financing. It is immaterial that they have been allowed here as part of the administration charge. [paras. 30-31; emphasis added.]

(I understand that leave to appeal United Used Auto was granted by the Supreme Court of Canada, but that the case settled before the appeal was heard, *[2000] S.C.C.A. No. 142*.)

37 In the exercise of their 'broad discretion' under the CCAA, it has now become common for courts to sanction the indefinite, or even permanent, affecting of contractual rights. Most notably, in Re Dylex Ltd. *(1995) 31 C.B.R. (3d) 106* (Ont. Ct. (Gen. Div.)), Farley J. followed several other cases in holding that in "filling in the gaps" of the CCAA, a court may sanction a plan of arrangement that includes the termination of leases to which the debtor is a party. (See also the cases cited in Dylex, at para. 8; Re T. Eaton Co. *(1999) 14 C.B.R. (4th) 288* (Ont. S.C.), at 293-4; Smoky River Coal; supra, and Re Armbro Enterprises Inc. *(1993) 22 C.B.R. (3d) 80* (Ont. Ct. (Gen. Div.)), at para. 13.) In the latter case, R.A. Blair J. said he saw nothing in principle that precluded a court from "interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices." In its recent judgment in Syndicat national de l'amiante d'Asbestos inc. v. Jeffrey Mines Ltd *[2003] Q.J. No. 264*, the Quebec Court of Appeal observed that "A review of the jurisprudence shows that the debtor's right to cancel contracts prejudicial to it can be provided for in an order to stay proceedings under s. 11." (para. 74.)

38 But in approving and implementing compromises and arrangements under the statute, courts are concerned with more than the efficacy of the plans before them and their acceptability to creditors. Courts also strive to ensure fairness as between the unsecured, secured and preferred creditors of the corporation and as between the debtor and its creditors generally. In the article from which I have already quoted, Stanley Edwards also wrote:

> In addition to being feasible, a reorganization plan should be fair and equitable as between the parties. In order to make the Act workable it has been necessary to permit a majority of each class, with court approval, to bind the minority to the terms of an arrangement. This provision is justified as a precaution that minorities should not be permitted to block or unduly delay the reorganization for reasons that are not common to other members of the same class of creditors or shareholders, or are contrary to the public interest. If small groups are placed in too strong a position they become capable of acquiring a nuisance value which will make it necessary for the reorganizers to buy them off at a high price in order to effectuate

> the plan successfully. However, care should be taken that this statutory power of binding minorities should not be utilized to confiscate the legitimate claims of those minorities or of any class of creditors or shareholders. [at 595; emphasis added.]

39 This theme has been repeated and refined in various cases over the years as CCAA courts have struggled with increasingly complex forms of debt and security and with increasingly complicated plans of arrangement. In current terms, the principle of equity is expressed as a concern to see that a plan of arrangement is fair and reasonable and represents an attempt to "balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights". (Per Farley J. in Re Sammi Atlas Inc. *(1998) 3 C.B.R. (4th) 171* (Ont. Ct. (Gen. Div.)), at 173.) Elsewhere, it has been said that one measure of what is "fair and reasonable" is the "extent to which the proposed Plan treats creditors equally in their opportunities to recover, consistent with their security rights, and whether it does so in a non-intrusive and as non-prejudicial a manner as possible." (Per Blair J. in Olympia & York Developments Ltd. *(1993) 12 O.R. (3d) 500*, at 513.) At the same time, fairness and reasonableness are not "abstract notions, but must be measured against the available commercial alternative." Thus in Re Canadian Airlines Corp. *[2000] A.J. No. 771*, *[2000] 10 W.W.R. 269* (Alta. Q.B.), the Court summarized the interaction between the objectives of a CCAA arrangement and the principles of fairness and reasonableness as follows:

> In determining whether to sanction a plan of arrangement under the CCAA, the court is guided by two fundamental concepts: "fairness" and "reasonableness". While these concepts are always at the heart of the court's exercise of its discretion, their meanings are necessarily shaped by the unique circumstances of each case, within the context of the Act and accordingly can be difficult to distill and challenging to apply. Blair J. described these concepts in Olympia and York Dev. Ltd. v. Royal Trust Co., supra, at page 9:
>
> > "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction - although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise an exercise in equity - and "reasonableness" is what lends objectivity to the process.
>
> The legislation, while conferring broad discretion on the court, offers little guidance. However, the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and, in many instances, a much broader constituency of affected persons. Parliament has recognized that reorganization, if commercially feasible, is in most cases preferable, economically and socially, to liquidation: Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd., *[1989] 2 W.W.R. 566* at 574 (Alta. Q.B.); Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada, *[1989] 3 W.W.R. 363* at 368 (B.C.C.A.).
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> The sanction of the court of a creditor-approved plan is not to be considered as a rubber stamp process. Although the majority vote that brings the plan to a sanction hearing plays a significant role in the court's assessment, the court will consider other matters as are appropriate in light of its discretion. In the unique circumstances of this case, it is appropriate to consider a number of additional matters:
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> a. The composition of the unsecured vote;
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> b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;
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> c. Alternatives available to the Plan and bankruptcy;
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> d. Oppression;
>
> e. Unfairness to Shareholders of [the debtor]; and
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> f. The public interest. [paras. 94-96]

40 Of course, there are also statutory and constitutional limitations on the court's exercise of its authority under the CCAA. The Supreme Court of Canada's decision in Baxter Student Housing Ltd. v. College Housing Cooperative Ltd. *[1976] 2 S.C.R. 475* confirmed that it is beyond the authority of a CCAA court to provide for a priority that runs

contrary to the express terms of a statute (in that case, the Mechanics Lien Act of Manitoba.) Thus in Baxter, the fact that the provincial legislation created a lien having priority over "all judgments, executions, assignments, attachments, garnishments and receiving orders", precluded an order granting CMHC priority for new advances over and above all prior registered liens. Dickson J. (as he then was) stated for the Court:

> . . . the inherent jurisdiction of the Court of Queen's Bench is not such as to empower a judge of that Court to make an order negating the unambiguous expression of the legislative will. The effect of the order made in this case was to alter the statutory priorities which a Court simply cannot do. [at 480; emphasis added.]

41 Baxter continues to be applied today: see Re Royal Oak Mines Inc. *(1999) 7 C.B.R. (4th) 293* (Ont. Ct. (Gen. Div.)) and Re Westar Mining Ltd. *(1992) 70 B.C.L.R. (2d) 6* (B.C.S.C.). However, the Court in United Used Auto distinguished Baxter on the basis that the former did not involve an express statutory priority that could not be overcome by the Court's equitable jurisdiction. Mackenzie J.A. noted that the receiver's jurisdiction originates in the "equitable jurisdiction of the Court of Chancery and [that] while that jurisdiction cannot be exercised contrary to a statute, nothing precludes its exercise to supplement a statute and effect a statutory object." (para. 18.)

42 It may be unnecessary to add that in cases of direct or express conflict between the CCAA itself and a provincial statute, the doctrine of paramountcy would apply and the federal statute would prevail. The only case brought to our attention which, on its face at least, applied the doctrine of paramountcy in the CCAA context was Re Sulphur Corp. of Canada Ltd. *[2002] A.J. No. 918* (Alta. Q.B.). In addressing the question of whether the Court had the authority to permit DIP financing ranking in priority to liens registered under the Builders' Lien Act of British Columbia, LoVecchio J. distinguished Baxter and Royal Oak, supra, on the basis that the discretion to grant priority for DIP financing was grounded in s. 11 of the CCAA rather than purely in the court's inherent jurisdiction. (This, at least, is what I draw from the Court's comments at paras. 35-37.) Seeing the case before him as involving a conflict between a federal statute and a provincial statute, LoVecchio J. ruled that the former prevailed and that in exercising its jurisdiction under the CCAA, the Court could grant priority for DIP financing. (See also Pacific National Lease Holding Corp. v. Sun Life Trust Co. *(1995) 10 B.C.L.R. (3d) 62* (B.C.C.A.).)

The Issues in this Case

43 Against this background, I turn at last to the substantive questions raised by the intervenor and the appellants respectively - did the Chambers judge have the jurisdiction to include in the Come-back Order provisions which contemplated the termination of any replaceable logging contracts; and if so, did he err by failing to consider whether the appellants would be treated fairly in relation to Skeena's other replaceable contractors or by failing to consider whether the termination of the appellants' contracts was, in their words, "a necessary or justifiable part of [Skeena's] reorganization plan at all"?

Jurisdiction

44 On behalf of the Truck Loggers' Association, Mr. Maclean contended that the Chambers judge had strayed outside his jurisdiction because nothing in s. 11 of the CCAA (which permits the granting of a stay) extends to the termination of a contract. On this view, any authority to sanction a termination must originate not in the statute, but in the Court's inherent jurisdiction. Based on the authority of Baxter, Royal Oak and Westar, the intervenor submits that the court's inherent jurisdiction cannot be used to override legislation such as the Forest Act and Regulation 22/96.

45 It is true that in "filling in the gaps" or "putting flesh on the bones" of the CCAA - for example, by approving arrangements which contemplate the termination of binding contracts or leases - courts have often purported to rely on their "inherent jurisdiction". Farley J. did so in Dylex, for example, at para. 8, and in Royal Oak, supra, at para. 4, the latter in connection with the granting of a "superpriority"; and Macdonald J. did so in Westar, supra, at 8 and 13. The court's use of the term "inherent jurisdiction" is certainly understandable in connection with a statute that confers broad jurisdiction with few specific limitations. But if one examines the strict meaning of "inherent jurisdiction", it appears that in many of the cases discussed above, the courts have been exercising a discretion

given by the CCAA rather than their inherent jurisdiction. In his seminal article, "The Inherent Jurisdiction of the Court", (1970) 23 Current Legal Problems, Sir J.H. Jacob, Q.C., writes that the inherent jurisdiction of a superior court of law is "that which enables it to fulfill itself as a court of law." The author explains:

> On what basis did the superior courts exercise their powers to punish for contempt and to prevent abuse of process by summary proceedings instead of by the ordinary course of trial and verdict? The answer is, that the jurisdiction to exercise these powers was derived, not from any statute or rule of law, but from the very nature of the court as a superior court of law, and for this reason such jurisdiction has been called "inherent". This description has been criticized as being "metaphysical," but I think nevertheless it is apt to describe the quality of this jurisdiction. For the essential character of a superior court of law necessarily involves that it should be invested with the power to maintain its authority and to prevent its process being obstructed and abused. Such a power is intrinsic in a superior court; it is its very life-blood, its very essence, its immanent attribute. Without such a power, the court would have form but would lack substance. . . . The juridical basis of this jurisdiction is therefore the authority of the judiciary to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner. [at 27-28; emphasis added]

The author also notes that unlike inherent jurisdiction, the source of statutory jurisdiction "is of course the statute itself, which will define the limits within which such jurisdiction is to be exercised, whereas the source of inherent jurisdiction of the court is derived from its nature as a court of law, so that the limits of such jurisdiction are not easy to define, and indeed appear to elude definition." (at 24.)

46 Applying this distinction to the issue at hand, I think the preferable view is that when a court approves a plan of arrangement under the CCAA which contemplates that one or more binding contracts will be terminated by the debtor corporation, 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. (As to the meaning of "discretion" in this context, see S. Waddams, "Judicial Discretion", (2001) 1 Cmnwth. L.J. 59.) 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, rather than the integrity of their own process.

47 In saying this, I leave to one side the jurisdiction of the court to make special provision for the payment of the fees and expenses of a monitor appointed under the CCAA. The monitor's functions are of course analogous to those of a receiver - traditionally a creature of Equity. I suspect that this particular power may be properly described as both an equitable jurisdiction and a statutory discretion. As this court said in United Used Auto, nothing precludes the exercise of the equitable jurisdiction of the Court of Chancery to "supplement a statute and effect a statutory object." (para. 18.) In any event, the distinction between these two sources of authority is one that, in my mind at least, 'eludes definition'.

48 Returning, then, to the intervenor's argument, the first question posed by it must in my view be revised to whether the Chief Justice erred in purporting to exercise the statutory discretion given by the CCAA in a manner that conflicts with the Forest Act. But the second branch of the question also incorporates an assumption that is problematic. Can it be said that the Come-back Order conflicts with the Forest Act or the scheme created thereby? It is true that the Act and Regulation contemplate a perpetual series of contracts (provided the contractor fulfils its obligations thereunder) and contemplate the termination of a replaceable contract only in the event of a reduction in AAC or the expiration or surrender of the licence. But nothing in the legislation to which we were referred purports to invalidate a termination of a replaceable logging contract by the licence holder or to require that a court make an order for specific performance in the event of such a termination. (In a CCAA context, such an order would be very unlikely, as well as futile.) The licence holder will of course be liable in damages for breach of contract, giving rise to a "claim" against the debtor corporation under the CCAA. The licence holder may also be in breach of one or more of its obligations under the Act; but ultimately, a logging contract is still a "contract" at law, notwithstanding that many of its terms are dictated by the legislation for the protection and security of the contractor.

49 Thus I disagree with the intervenor's assertion that the effect of the Come-back Order was to "eliminate" the licence holder's "statutory obligation under the Forest Act to replace the contract and to eliminate the other conditions that are required by the Regulation to be included in the contract." In fact, the renewal of the appellants' contracts was not required by the Act per se; what the Act required was that each of their contracts contain a clause requiring renewal. It was those contractual terms which were breached. The licence holder's obligations, mandated by the scheme, were not "eliminated" by the Come-back Order or even by Skeena: having been breached, the obligations are recognized as giving rise to claims against the corporation either for specific performance or for damages.

50 It follows in my view that in approving an arrangement in which the debtor corporation terminates a replaceable logging contract, a CCAA court is not overriding "provincial legislation" as the intervenor contends. Nor is the court "overriding" the terms of the contract: it is merely exercising the discretion given to it by the statute to approve a plan of arrangement. The breach of contract is recognized as a matter of fact by the court, but is not "permitted" in the sense that the licence holder is somehow immunized from the usual consequences of its breach at law or in Equity. Finally, even if the Forest Act or Regulation did prohibit the termination of replaceable contracts, the federal government's powers with respect to bankruptcy and insolvency would become applicable once the CCAA was invoked and the doctrine of paramountcy would operate to resolve any direct conflict.

The Exercise of the Court's Discretion

51 The appellants and the intervenor argued that even if the Court did have the authority to grant the Come-back Order on the terms it did, the Chief Justice erred in failing to exercise his discretion so as to achieve "fairness" between the appellants and Skeena's three other logging contractors, whose contracts were, in theory at least, unaffected by the Reorganization Plan. As I mentioned earlier, both the appellants and the intervenor contend that contractors under replaceable contracts have "special status" as persons entitled to share in the benefits of a Crown resource (timber) and that the Forest Act scheme is predicated on fairness between them, and between them and the holders of Crown licences. They note that the Chief Justice referred in his "fairness" analysis only to the question of whether the Order differentiated inappropriately "between the applicants and other [Skeena] creditors" and made no reference to fairness as between the appellants and the other three contractors or as between the appellants and Skeena itself. In Mr. Forstrom's submission, it is unfair that his clients should suffer the loss of their very significant income streams under the replaceable contracts when the other three contractors will suffer no such loss, and when the licence holder itself suffers only the loss of five percent of its AAC under the Forest Act. (In fact, it is possible the Minister may revoke that reduction upon application by Skeena under s. 56.1 of the Act.) In essence, the argument of the appellants is "Why us?"

52 It is trite law that the scope of review open to an appellate court in respect of the exercise of discretion of a CCAA court (or any other court) is narrow. In Re Pacific National Lease Holding Corp. *(1992) 72 B.C.L.R. (2d) 368*, Macfarlane J.A. (in Chambers) observed that this court should exercise its powers "sparingly" when asked to intervene in this context. In his words:

> In supervising a proceeding under the C.C.A.A. orders are made, and orders are varied as changing circumstances require. . . . In that context appellate proceedings may well upset the balance, and delay or frustrate the process under the C.C.A.A. [para. 32]

Macfarlane J.A.'s comments were echoed by the Alberta Court of Appeal in Smoky River Coal, supra, where Hunt J.A. noted at para. 61 that ". . . Parliament, mindful that CCAA cases often require quick decision-making, intended that most decisions be made by the supervising judge. This supports the view that those decisions should be interfered with only in clear cases."

53 Another principle informing the court's task flows from the fact that a plan of arrangement approved by the court is not the plan of the court. It is a compromise arrived at by the debtor company and the requisite number of its creditors. The court should not readily interfere with their business decision, especially where the plan has been

approved by a high percentage of creditors. As observed by Blair J. in Re Olympia & York, supra, "[I]t is not my function to second guess the business people with respect to the 'business' aspects of the Plan, descending into the negotiating arena and substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas." (at 510.) (See also Re Sammi Atlas Inc., supra, at para. 5, and Re Northland Properties Ltd. *(1989) 73 C.B.R. (N.S.) 195* (B.C.C.A.), at 205, per McEachern C.J.B.C.)

54 In this case, the chief executive officer of NWBC and Skeena provided the Chambers judge below with an explanation as to why they chose to reduce the volume of timber allocated to Skeena's evergreen contractors, and why they chose to terminate the contracts of the appellants rather than to terminate all five contracts or reduce the work allocated to all five. I have already mentioned Mr. Veniez's affidavit evidence (see para. 11 above) that the cost to Skeena of logs produced by each of the appellants was greater than those produced by the other three contractors and that NWBC made it a "condition of going forward with the acquisition of Skeena, that Skeena take steps within the context of the CCAA proceedings to terminate the Clear Creek and Jasak contracts."

55 In this court, Mr. Forstrom asked us to discount Mr. Veniez's evidence, contending that since the appellants' objections to the Come-Back Order had been known to NWBC when it completed its purchase of the Skeena shares, NWBC must be taken to have effectively "waived" this condition. I am not persuaded that such an inference necessarily follows from NWBC's completion of the Plan. At that time, the Come-back Order clearly authorized the termination of replaceable logging contracts, and the validity of a similar order had been upheld by Thackray J. in 1997. It may be that in deciding to proceed, NWBC undertook a risk that the appellants would be successful either before the Chief Justice or on appeal, but we have no evidence as to what concessions NWBC may have obtained to protect against that risk.

56 As for the argument that the appellants' contracts were no less costly to Skeena than those of the other three contractors (since the rates chargeable under all five contracts were subject to arbitration), Mr. Veniez deposed:

> 13. I acknowledge that the Contract Regulation dictates that any rates determined according to this process must be determined according to what a licence-holder and a contractor acting reasonably in similar circumstances would agree is a rate that is competitive by industry standards. However, this provides little comfort to licence-holders such as Skeena, because ultimately rates under the Contract Regulation are determined on a cost-plus reasonable profit for replaceable contractors basis which, in my view, acts as a significant disincentive for replaceable contractors to be cost effective on an ongoing basis.
>
> 14. On the contrary, the Contract Regulation in my view creates a legislated disincentive for evergreen contractors to control their cost structures, because volumes under these contracts are guaranteed. This results in high costs being passed on to Skeena.
>
> 15. Prior to NWBC's acquisition of Skeena, and the termination of the replaceable contract that has given rise to this application, I was advised that Skeena, on average, paid approximately 10% more for work done under replaceable contracts than work done pursuant to contracts issued after a competitive bid process. Indeed, I am advised by Derrick Curtis, Skeena's Terrace Woodland's Manager, that in March 2001 Skeena put out to tender a harvesting contract (Setting S83303), consisting of roughly 20,000 m3, and received tenders from both evergreen and non-evergreen contractors. The latter offered significantly lower rates ($23.95/m3 vs. $27.85/m3, a difference of $3.90/m3), resulting in a 14% reduction in costs to Skeena. [Emphasis added.]

57 There was, then, a "business case" for the actions taken by Skeena and NWBC vis-à-vis the appellants. Clear Creek and Jasak did not apply to cross-examine Mr. Veniez on this evidence, and did not bring anything to our attention which would cast doubt on his statements. In these circumstances, the Chambers judge was entitled to take seriously the assertion that the termination of the appellants' contracts would save Skeena a considerable sum per year and that that fact was important to the only purchaser willing to make an offer acceptable to the requisite number of creditors. In the terminology used by Mr. Forstrom, there was a "causal link" between the terminations

and the chances of success of the Reorganization Plan. For this reason, I do not agree with his submission that Dylex is different in principle from the case at bar: the appellants' contracts in particular were said to be too costly for Skeena to continue operating under them, in the same way the terminated leases were said to be too costly for Dylex to continue leasing under them. And, weighing Dylex's precarious financial position against that of the landlord (which was described as "less than robust"), the Court 'gave the nod' to the insolvent corporation, rejecting the proposition that Dylex should have to prove that without the three proposed closures (of leases), its proposal would not be viable. (supra, para. 10.)

58 In this case, the appellants deposed that the evergreen contracts were important to them, particularly for financing purposes. Mr. Rigsby, the controller of Clear Creek, for example, deposed:

> 26. Clear Creek requires its Replaceable Contract in order to obtain financing for capital costs. Lending institutions require that Clear Creek has a replaceable contract when considering lending money to, or financing equipment for, Clear Creek. Within the logging industry, it is very difficult to obtain financing without the security of a replaceable contract.
>
> * * *
>
> 30. Clear Creek remains capable of properly capitalising itself, and maintaining its own equipment and other capital investments in good working order, provided that it has a replaceable contract. If Clear Creek's replaceable contract remains in place, Clear Creek will be able to provide competitive, cost-effective, and efficient services and rates to [Skeena] . . . .

59 This evidence brings us squarely to the question of fairness. As already noted, for purposes of the CCAA, the court must be satisfied that the arrangement proposed is "fair, reasonable and equitable." Courts have made it clear that "equity" is not necessarily "equality"; in the words of Farley J. in Re Sammi Atlas Inc.:

> A Plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment. One must look at the creditors as a whole (i.e. generally) and to the objecting creditors (specifically) and see if rights are compromised in an attempt to balance interests (and have the pain of the compromise equitably shared) as opposed to a confiscation of rights . . . . [para. 4]

60 I have no difficulty in accepting the appellants' argument that fairness as between them and the other three evergreen contractors and as between the appellants and Skeena was a legitimate consideration in the analysis in this case. (Indeed, I believe the Chief Justice considered this aspect of fairness, even though he did not mention it specifically in this part of his Reasons.) The appellants are obviously part of the "broad constituency" served by the CCAA. But the key to the fairness analysis, in my view, lies in the very breadth of that constituency and wide range of interests that may be properly asserted by individuals, corporations, government entities and communities. Here, it seems to me, is where the flaw in the appellants' case lies: essentially, they wish to limit the scope of the inquiry to fairness as between five evergreen contractors or as between themselves and Skeena, whereas the case-law decided under the CCAA, and its general purposes discussed above, require that the views and interests of the "broad constituency" be considered. In the case at bar, the Court was concerned with the deferral and settlement of more than $400,000,000 in debt, failing which hundreds of Skeena's employees and hundreds of employees of logging and other contractors stood to lose their livelihoods. The only plan suggested at the end of the extended negotiation period to save Skeena from bankruptcy was NWBC's acquisition of its common shares for no consideration and the acceptance by its creditors of very little on the dollar for their claims. As the Chief Justice noted, many individuals and corporations, as well as the Province, incurred major losses under the Plan. Each of them might also ask "Why me?" However, as he also noted, that is a frequent and unfortunate fact of life in CCAA cases, where the only "upside" is the possibility that bankruptcy and even greater losses will be averted.

61 As has been seen, the purchaser required as a condition of proceeding with the Reorganization Plan that the

appellants' contracts be terminated. In the absence of evidence that Skeena or the purchaser was motivated by anything other than a desire to improve the debtor corporation's financial prospects for survival post-arrangement, it cannot in my view be said that the Chambers judge erred in ruling that the termination of the appellants' replaceable contracts was a valid part of the Reorganization Plan in this case.

Procedural Question

62 The second ground of appeal advanced by the appellants was that since Skeena had failed to comply strictly with the requirements of the Come-back Order in relation to the termination of their contracts, the terminations were null and void. In response to the Chief Justice's conclusion that the appellants had not been prejudiced by the failure to give timely notice, the appellants submitted that the terminations could not have been effective until 21 days after they received the Monitor's Eleventh Report. In the meantime, the creditors' meeting took place. The appellants contend that since there was uncertainty as to whether their contracts had been validly terminated or would be terminated, it was unclear whether they were entitled to vote at the meeting. Accordingly, they submit that they:

> . . . were effectively disenfranchised in the CCAA proceeding. The Come-Back Order contemplates that the effectiveness of any proposed termination of a replaceable logging contract will be determined in a timely way, before the Plan of reorganisation is submitted to the creditors for approval. By failing to give proper notice, [Skeena] created uncertainty about both when and if the Appellants' contracts would be terminated. The Appellants were only entitled to vote in relation to the Plan if they acknowledged that the termination of their contracts was effective when the initial (and clearly invalid) notice was given on March 1, 2002.
>
> This placed the Appellants on the horns of a dilemma. Had the Appellants exercised the right to vote on April 2,2002, based on the premise that their contracts had been terminated, they would be guilty of approbation and reprobation in relation to their position that no valid notice of termination had yet been given and that their contracts remains in force. [Skeena] structured the approval process in such a way that the Appellants would effectively be required to waive their right to proper notice of termination under the Come-Back Order in order to vote on the Plan.

63 In response, Skeena emphasizes that the appellants did file proofs of claim with the Monitor prior to the creditors' meeting. Skeena says the Chief Justice was correct in concluding that the appellants were not prejudiced in fact, since if it is ultimately determined that the replaceable logging contracts were not validly terminated, the appellants will be free to withdraw their proofs of claim; and if the contracts were validly terminated, the appellants will share pro rata under the Plan with Skeena's other unsecured creditors once the amounts of all claims have been finally determined.

64 As for the proposition that the appellants could not both reprobate and approbate, Skeena notes that "conditional voting" was permitted by the Monitor in light of the time pressures attendant upon the approval of the Plan. These led the Monitor to allow voting even by those claimants whose claims it had disallowed. The Monitor noted their particular ballots as "objected to" in case the votes cast by them ultimately had an impact on the outcome of the vote for the applicable class. Mr. Zuk, the chair and claims officer for the meeting, deposed that even if all of the disallowed claims were reversed and the appellants' votes were counted, the result would not have been affected. This statement was not challenged by the appellants.

65 In these circumstances, I cannot agree with the appellants that the delay in their receipt of notice of the terminations of their contracts and the delay in the processing of their proofs of claim were prejudicial to them. It is certainly unfortunate that these delays occurred, but there is no evidence (as opposed to speculation) that the delays were the result of bad faith or deliberate omission. On the other hand, the appellants could have had little doubt that they faced major difficulties once the initial CCAA order was granted (September 5, 2001) and once the "replacement" deadline of September 30 passed. Ultimately, the effect of the delay in their receipt of formal notice made no difference to the appellants' position and did not influence the approval of the Reorganization Plan one way or the other, especially given the small amount allowed by the Monitor in respect of the appellants' claims in

relation to Skeena's indebtedness. The appellants chose not to attend the meeting and not to vote, even on a conditional basis. In these circumstances, the Chief Justice correctly recognized that, as stated by Rowles J.A. for the Court in Cam-Net Communications v. Vancouver Telephone Co. *(1999) 71 B.C.L.R. (3d) 226*, a supervising court under the CCAA must be alert to the incentive for creditors to "avoid the reorganization compromise" and must "scrutinize carefully any action by a creditor which would have the effect of giving it an advantage over the general body of creditors." (para. 20.)

66 Moreover, the arguments which the appellants would have made at the show cause hearing have now been made in the Supreme Court and in this court. If my analysis is correct, they would have failed even if the Court's approval of the Reorganization Plan had been delayed in accordance with the apparent intent of the Come-back Order.

67 I cannot say the Chief Justice was wrong in concluding that Skeena's failure to give timely notice was anything other than a procedural error without prejudicial consequences. I would dismiss this ground of appeal, as well as the substantive grounds, for the reasons I have given.

NEWBURY J.A.
HALL J.A.:— I agree.
LEVINE J.A.:— I agree.

End of Document

TAB 5

Clover On Yonge Inc. (Re)

Ontario Judgments

Ontario Superior Court of Justice

Commercial List

M. Koehnen J.

Heard: July 22, 2020.

Judgment: July 27, 2020.

Court File No.: CV-20-00642928-00CL

[2020] O.J. No. 3641 | 2020 ONSC 5444

RE: 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 the Clover on Yonge Inc. and the Clover on Yonge Limited Partnership, Applicants

(48 paras.)

Case Summary

Bankruptcy and Insolvency Law — Proceedings-- Practice and procedure — Discovery — Motion for production of documents allowed in part — Condominium project involved in CCAA proceedings scheduled motion to disclaim agreements of purchase and sale for units — Purchasers sought production of unredacted appraisal report obtained by developer — Production of unredacted appraisal report accompanied by non-disclosure agreement was fair price for developer to pay for right to argue disclaimer of numerous contracts — Companies' Creditors Arrangement Act, s. 32(4).

Motion for the production of documents. The motion arose in the context of Companies' Creditors Arrangement Act proceeding with respect to a condominium project known as The Clover on Yonge (Clover). Clover had scheduled a motion to disclaim the agreements of purchase and sale that it had entered into with approximately 496 purchasers. Clover said it was economically unfeasible to complete the project with the pricing contained in the purchase agreements because construction prices had increased dramatically since the contracts were entered into in 2015. Clover commissioned a cost report and an appraisal report from Altus Group. Counsel for the unit purchasers have received a complete copy of the cost report and a redacted copy of the appraisal report. The purchasers sought production of an unredacted appraisal report. In addition, Maria Athanasoulis sought production of only the cost report and a number of real estate brokers seek production of both the cost and appraisal reports. Clover resisted production, submitting that the redacted portions of the appraisal report contain sensitive information which would be detrimental to Clover if it became public.

HELD: Motion allowed in part.

Production of the unredacted appraisal report accompanied by a non-disclosure agreement was a fair price for Clover to pay for the right to argue disclaimer of 496 contracts. Clover did not give the purchasers adequate time to commission their own appraisal, after giving those purchasers a false sense of security that they would receive the appraisal report. The appraisal information on the disclaimer motion would assist in determining whether disclaimer would enhance the chance of a compromise and whether it caused significant financial hardship to any party to the agreement. The unredacted appraisal report was to be disclosed to counsel for the purchasers, their expert and their two-person steering committee. Athanasoulis was the former president of the holding company that owned Clover. She was a contingent creditor and a potential purchaser of Clover in any sale of the property and a party without an economic interest in the disclaimer issue. She was not entitled to the cost report. The real estate agents

demonstrated no need for the reports.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, *R.S.C. 1985, c. C-36, s. 32*(4)

Rules of Civil Procedure,

Counsel

David Gruber for the CCAA Applicants and Concord Land Developments Limited.

Steven Graff and Jeremy Nemers for the CCAA Applicants.

Geoff R. Hall, Heather L. Meredith and Alexander Steele for the Monitor, PWC.

Matthew P. Gottlieb, Andrew J. Winton and Zain Naqi for a group of unit purchasers.

Kenneth Kraft for a group of unit purchasers.

Karen Groulx for Altus Group Limited.

Aaron Grossman for certain brokers.

Mark Dunn for Maria Athanasoulis.

Jonathan Rosenstein for Aviva Insurance Company of Canada.

Fred Tayar for OTB Capital Inc.

Nick Stanoulis for Stancorp Properties Inc. and certain unit purchasers.

Christopher Henderson for the City of Toronto.

ENDORSEMENT

M. KOEHNEN J.

1 This motion arises in the context of a *CCAA* proceeding involving a condominium project known as The Clover on Yonge. I will refer to the project in these reasons as either Clover or the debtor. Clover has approximately 522 residential units plus commercial and parking units and is in the course of being built on Yonge St. in Toronto. Clover has scheduled a motion to disclaim the agreements of purchase and sale that it had entered into with approximately 496 purchasers. Clover says it is economically unfeasible to complete the project with the pricing contained in the purchase agreements because construction prices have increased dramatically since the contracts were entered into in 2015.

2 Clover commissioned a cost report and an appraisal report, from Altus Group, a consultant, quantity surveyor and appraiser specializing in real estate.

3 Counsel for the unit purchasers have received a complete copy of the cost report and a redacted copy of the appraisal report. On this motion, the purchasers seek production of an unredacted appraisal report. In addition, Maria Athanasoulis seeks production of only the cost report and a number of real estate brokers seek production of both the cost and appraisal reports.

4 Clover resists further production to any of the moving parties. It submits that the redacted portions of the appraisal report contain sensitive information which would be detrimental to the debtor if it became public, particularly if the *CCAA* plan fails and the project has to be sold. In those circumstances, dissemination of the information contained in the appraisal report would be prejudicial to the ability to sell the project. Counsel for the purchasers have signed non-disclosure agreements in respect of the cost report and are prepared to do the same for the appraisal report. The non-disclosure agreements restrict the availability of the reports to counsel, experts and a two-person steering committee. The debtor nevertheless is of the view that there is too much risk involved in the production of the unredacted appraisal report. The Monitor shares this view.

5 For the reasons set out below, I grant the purchasers' motion for production of the unredacted appraisal report and dismiss the motions of Ms. Athanasoulis and the brokers for production of the cost and appraisal reports. **A. The Purchasers' Motion**

6 The purchasers point out that the debtor's deponent, Mr. McCracken, referred to the Altus reports in his affidavit supporting the disclaimer motion as a result of which they say production of the report must be ordered. The purchasers rely on rule 30.04 (2) which provides:

> (2) A request to inspect documents may also be used to obtain the inspection of any document in another party's possession, control or power that is referred to in the originating process, pleadings or an affidavit served by the other party.

7 The purchasers submit that this is a mandatory provision that applies in all circumstances without exception. In support of this proposition they rely on language of D.M. Brown J. (as he then was) in *Timminco v. Asensio*, *(2009), 95 O.R. (3d) 547* (Sup. Ct.) at para. 28, where he noted that a request to inspect must lead to "immediate and mandatory" production. There are no "[c]arve-outs" for "certain types of documents." Indeed, "[e]ven where a party has referred to an otherwise privileged document in its pleading, it must be produced if inspection is requested."

8 Nordheimer J. (as he then was) articulated similar views in *R. v. Vijaya*, *2014 ONSC 1653* at para. 35:

> It is a basic principle that a party who files an affidavit as evidence in a proceeding is obliged to produce any material referred to in that affidavit at the request of any other interested party. Normally, any such material should properly be marked as an exhibit to the affidavit, and therefore be automatically available to any other interested party, but the failure to mark the material as an exhibit does not shield it from production. The entitlement to see such material is codified for civil proceedings in rule 30.04 (2)...

9 The debtor and the Monitor submit that those cases did not involve *CCAA* applications and that a judge within the context of a *CCAA* proceeding has more discretion than the language of *Timminco* and *Vijaya* suggest. I am inclined to agree with the debtor and the Monitor in this regard. It strikes me that a federal statute that permits a court to disclaim contracts based on discretionary considerations and to develop a process for the resolution of litigious disputes within the *CCAA* proceeding that departs significantly from the *Rules of Civil Procedure*, also affords the court the discretion to depart from other "mandatory" provisions of the rules such as rule 30.04 (2).

10 The question then becomes whether I should exercise my discretion in favour of production or maintain the more limited production that the debtor and the Monitor advocate.

11 Although I have found that I have the ability to exercise discretion and am not absolutely bound by rule 30.04

(2), the rule remains a relevant factor in the exercise of my discretion. One factor relevant to the exercise of discretion is to consider the way in which a party has used the contested document in its affidavit. A passing, incidental reference to a document may lead a court to exercise its discretion against production. Reliance on the document for a material issue before the court may incline the court towards production. Reference to the Altus appraisal in the debtor's materials tends more in the latter direction.

12 In Mr. McCracken's affidavit sworn July 8, 2020, he deposes in paragraph 8 that the project cannot be built with the original contracts in place "because the available revenue would be insufficient to repay the financing required; but it would be a viable project if the Pre-Sale Contracts were not in place." He goes on in paragraph 19 to state that if the original purchase agreements remain in place, the developer would need to generate approximately $2,125 per square foot from the unsold commercial units and parking units just to break even which, in his view, is impossible.

13 Mr. McCracken goes on in paragraph 45 of his affidavit to say:

> Altus Group is in the process of preparing an appraisal report providing their view of the anticipated market revenues of the various components of the Clover project, and which I anticipate will be generally in line with Concord's[1] view. I understand it will become available to counsel for unit purchasers and their steering committees who have entered into non-disclosure agreements with the Monitor."

14 A number of factors emerge from Mr. McCracken's affidavit. First, Mr. McCracken deposes that the revenues from the project make it unfeasible without disclaiming the original contracts. He supported that view by invoking the authority of the Altus appraisal. Thus, the Altus appraisal was not referred to inadvertently or incidentally, but as a means of according legitimacy to Mr. McCracken's views about revenue. It would be unfair to permit a party to influence the court by referring to independent expertise but then decline to produce that expertise.

15 Second, Mr. McCracken stated in his report that the appraisal report would be available to counsel for the unit purchasers and their steering committees. That affidavit was used in a hearing at which parties made submissions on the process to be followed for the disclaimer motion and I made rulings in that regard. The strategies that parties pursue in respect of a disclaimer motion could reasonably be expected to be influenced by the commitments that an opposite party makes. It would be unfair to have a party and the court be influenced by a statement of the sort Mr. McCracken makes in his affidavit only to have him resile from that commitment later. While it became clear on the scheduling motion that the debtor would not disclose the unredacted appraisal report without a court order, that hearing occurred on July 17, 2020. Mr. McCracken's affidavit was delivered to counsel for the purchasers shortly after July 8, 2020. This is a real-time litigation. As set out in greater detail below, the debtor seeks a speedy determination of the disclaimer motion and of its proposed plan. In those circumstances, for the purchasers to be under a misunderstanding about whether they would get the appraisal for even a few days, can seriously prejudice their ability to mount an effective case.

16 Third, the disclaimer motion has been scheduled for August 20, 2020. Even that date is several weeks later than the debtor had asked for. The debtor and its new owner, Concord, have been aware of the disclaimer issue since at least February 2020. It has taken them until late June or July to complete the Altus report. It submits, however, that the purchasers do not need production of the Altus appraisal because they can obtain their own appraisal. The unfairness in this approach is manifest. Although Concord is one of the most sophisticated development companies in the world and has had six months to prepare an appraisal, it suggests that a disparate group of 496 purchasers be given approximately one month to do the same.

17 Fourth, the debtor seeks the protection of the court. In doing so it obtains substantial advantages. It has prevented creditors from commencing lawsuits against it, it has prevented creditors from assigning it into bankruptcy, all with the object of restructuring in the hope of creating a profitable enterprise out of what it says is now an insolvent one. As part of that process, the debtor wants to disclaim the contracts that it entered into with 496 purchasers without facing any liability.

18 It strikes me that production of the unredacted appraisal report accompanied by a non-disclosure agreement is a fair price for the debtor to pay for: (i) the right to argue disclaimer of 496 contracts; (ii) on a real-time basis; (iii) that does not give the purchasers adequate time to commission their own appraisal; (iv) after giving those purchasers a false sense of security that they would receive the appraisal report. There is a price to pay for the extraordinary benefits that the debtor seeks. Here the price is merely transparency.

19 The debtor and the Monitor submit that the issue of producing the appraisal does not require the court to balance the interests as I have done above because the appraisal is not relevant to the disclaimer motion. The debtor notes that, if it is successful on the disclaimer motion, it will offer the units back to the original purchasers on a cost plus formula. It is for that reason that they have produced the unredacted Altus cost report to the purchasers. Clover and the Monitor submit, that the cost report gives the purchasers sufficient information with which to make decisions.

20 Section 32 (4) sets out the factors the court should consider when determining whether to disclaim contracts and provides:

> (4) In deciding whether to make the order, the court is to consider, among other things,
>
> (a) whether the Monitor approved the proposed disclaimer or resiliation;
>
> (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

21 It strikes me that, at a minimum, the appraisal is relevant to the factors (b) and (c). It may well also irrelevant to any other relevant factors that the court is permitted to consider by virtue of the reference to "among other things" in the opening passage of section 32 (4).

22 When I asked counsel for the Monitor whether production of the appraisal report would not enhance the prospects of a viable arrangement by providing both parties with information that might enable them to reach a mutually acceptable compromise, he responded that this was not the issue on the disclaimer motion. The Monitor submits that the disclaimer motion is a threshold issue which is conceptually distinct from the negotiation or approval of a plan.

23 While I agree with that in theory, the distinction here is somewhat artificial. Disclaimer cannot necessarily be decided in a vacuum. It strikes me that both the purchasers and the court need to know what range of alternatives is available to decide whether to agree to or permit disclaimer; especially when the debtor proposes to seek plan approval within weeks of the disclaimer motion.

24 A more extreme example helps make the point. If the value of the property in a *CCAA* sale generated enough profit to pay the unitholders their full damages on the sale, that might lead a court to reject disclaimer because there was no particular benefit associated with it. If, however, sale without disclaimer left nothing for unit purchasers then disclaimer might be more acceptable because it does not put the unit purchasers into any worse position than they would otherwise be in. The commercial reality may be considerably muddier than those two extremes. The two ends of the spectrum do, however, at least demonstrate conceptually why appraisal information is relevant even on the disclaimer motion.

25 Having appraisal information on the disclaimer motion will assist in determining whether disclaimer will enhance the chance of a compromise and whether it causes significant financial hardship to any party to the agreement.

26 The debtor and the Monitor note that the Altus reports were commissioned to help obtain financing and help the

sales process, if needed. While that may be, Mr. McCracken appeared to recognize its relevance to the purchasers when he stated that it would be disclosed to them.

27 A further dynamic applies in this case. As noted earlier, the debtor was acquired by Concord in the course of this proceeding. In that light, this is not a situation of the debtor stakeholder having been victimized by economic circumstances beyond its control, but rather where the true stakeholder within the debtor is an entity that came into the situation with eyes wide open in the hope of making a profit with the benefit of the court protection that the *CCAA* affords. The disclaimer involves, as counsel for the purchasers put it, a transfer of wealth from the purchasers to Concord. There is nothing inherently wrong with that. If the project truly is economically unfeasible on its original pricing, Concord is entitled to a reasonable profit on its investment. That might be the only way to permit the purchasers to retain their units. At the same time, however, if a developer wants the court's assistance in facilitating a wealth transfer to itself, the court should have the benefit of full information associated with that wealth transfer.

28 Neither the Monitor nor the debtor submit that the purchasers would have some unfair advantage if they obtain the appraisal. Rather, their concern is that if recipients of redacted appraisal information inadvertently leaked it, creditors could suffer significant prejudice if the contracts were not disclaimed and the project had to be sold or if certain units had to be re-sold if their original purchasers did not participate in with whatever compromise may be negotiated. Those are valid concerns. It strikes me, however, that they can be addressed through appropriate non-disclosure mechanisms. By way of example, the debtor and Monitor have already agreed to disclose the cost report to purchasers with non-disclosure mechanisms that limit access to counsel, experts and a two-person steering committee. The purchasers agree that the appraisal report should be subject to the same type of restrictions. Neither the Monitor nor the debtor have identified any particular risks of doing so other than the general proposition that risk of disclosure increases as more people receive the information.

29 Ms. Groulx stated on behalf of Altus, that the appraisal was prepared for a specific purpose and for a specific party. Altus is concerned about being exposed to liability if others use the report. That too is a fair concern. It can however be addressed by a provision in the production order to the effect that giving the purchasers access to the appraisal does not give them any right of action against Altus. Any use of the appraisal by any party for any purpose other than as originally contemplated when Altus was retained should not give rise to any liability against Altus

30 For the reasons set out above I order that the Altus appraisal report be disclosed to counsel for the purchasers, their expert and their two-person steering committee in unredacted form. No such recipient is to communicate any of the contents of the appraisal report to anyone other than an authorized recipient of the appraisal report.

B. The Claim of Maria Athanasoulis

31 Maria Athanasoulis is the former president of Cresford. She has a claim against Cresford and others for wrongful dismissal of $1,000,000. In addition she claims that she was entitled to 20% of the profits of the project.

32 Ms. Athanasoulis seeks production of the Altus cost report that has already been delivered to counsel for the purchasers. She does not seek production of the appraisal because she agrees that she may be part of a purchaser group who may be interested in acquiring the project if the *CCAA* proceeding is not successful.

33 Ms. Athanasoulis submits that she needs the cost report to help evaluate the debtor's proposed plan. At this point, the debtor envisages presenting a plan that would offer unit purchasers new contracts, would pay out all secured debt, would pay out all trade creditors and leave remaining unsecured creditors with a dividend of 3% of their claim amount.

34 Ms. Athanasoulis is in a different equitable position than the purchasers. Clover never agreed to share either of the reports with her. She has only a potential claim as a judgment creditor. Her claim has not been adjudicated. She is not a unit purchaser and has no particular interest in whether the purchase contracts are or are not disclaimed.

35 Ms. Athanasoulis is the former President and Chief Operating Officer of Cresford, the holding company with overall control of Clover before Concord acquired it. She is clearly a sophisticated individual with inside knowledge about the project.

36 Paragraph 61 of her statement of claim states:

> By the fall of 2018, Ms. Athanasoulis, and the rest of Cresford's senior management team, advised Mr. Casey that Clover would require an additional $50 million to complete construction. Though this additional funding requirement would mean that no profit would be earned on this project, all lenders, trades and costs would be paid in full and Cresford could continue as a going concern with a solid reputation. Cresford funded some of the Clover obligations using fees earned on other projects, but a shortfall of $37 million remains.

37 In other words, she admits the project was losing money. As a result, as of the time she left Cresford her 20% profit share would have had no value.

38 In addition, her wrongful dismissal claim of $1,000,000 is subject to some ambiguity. Ms. Athanasoulis admits in her statement of claim that she was not paid out of the Clover entities but from another corporation that formally employed Cresford employees. There are 13 corporate parties in her statement of claim against which she claims wrongful dismissal. There would appear to be an issue about how her claim should be allocated between Clover and the other defendants.

39 As a result of the foregoing, Ms. Athanasoulis is a contingent creditor and a potential purchaser of the debtor in any sale of the property and a party without an economic interest in the disclaimer issue.

40 Those factors make the cost report significantly less important for Ms. Athanasoulis to have than it is for the purchasers to have the cost and appraisal reports. Given that Ms. Athanasoulis is a potential purchaser of the project, the difficulties posed by her having the Altus cost report are significant. Ms. Athanasoulis admits that it would be improper for her to have the appraisal given that she is a potential bidder in any sale of the project. Giving her the cost report raises similar conflicts.

41 Given the degree of need that Ms. Athanasoulis has for the cost report, the conflict created by giving her the cost report, her limited interest (if any) in the disclaimer motion and the absence of any commitment by Clover to share the report with her, I dismiss her motion for production of the Altus cost report.

C.

D. The Real Estate Brokers

42 The real estate brokers at issue are those who are entitled to commissions under the original purchase agreements. They claim their commissions in the *CCAA* proceeding. If the contracts are disclaimed, they would lose their commissions and also be limited to a 3% dividend under the plan the debtor proposes. The brokers seek both the cost and appraisal reports.

43 They too have a significantly lesser need for the reports than do the unit purchasers.

44 Most significantly, the debtor has already agreed that, if the contracts are disclaimed and the original unit buyers re-purchase them, the brokers will be deemed to be the broker and will earn commissions under the new purchase. That significantly reduces the financial impact of a disclaimer to them. If the contracts are not disclaimed, the brokers would likely lose their right to commission in any event in a subsequent receivership or bankruptcy sale.

45 Even if the contract(s) in respect of which a broker has a commission claim is/are not re-purchased, having cost

and appraisal information from Clover would give that broker an advantage over others and over Clover when the unit is re-sold. That subsequent sale to another purchaser is one in respect of which the purchaser is not entitled to transparency because it is an ordinary, arm's length purchase in respect of which Clover has not obtained any advantage vis a vis the new purchaser through the *CCAA* process.

46 The brokers have articulated no particular reason for needing the reports other than the general proposition that they would be helpful when they are considering their position on the plan. Their claims to the reports are, like those of Ms. Athanasoulis, weaker given that the debtor never promised to produce the reports to them, arguments for and against disclaimer are already being advanced by highly qualified counsel and they stand to earn commissions even if the contracts are disclaimed. As a result, I dismiss the brokers' motion for production of the cost and appraisal reports.

Other Relief

47 The debtor also sought other relief on the hearing which was not contested and in respect of which I signed orders immediately after the hearing. The principal issue involved an increase to the DIP facility. The increase was clearly necessary. It provided funding to take out the previous secured lender. To that extend it does not prime any other stakeholders. The interest rate on the DIP loan is also more favourable to the debtor than the interest rate on the previous loan. To the extent that the DIP funds ongoing construction and does prime other stakeholders, that construction preserves the value of the project and is in all stakeholders' interests. In approving the DIP I am not, however, deciding whether the conditions in the DIP that call for further court rulings or orders have been satisfied. Those will be issues for another day.

Conclusion

48 For the reasons set out above, I grant the purchasers' motion to have access to the unredacted Altus appraisal provided access is restricted to counsel, their expert and the two person steering committee and provided all those who receive access sign a satisfactory non-disclosure agreement. I am available to resolve any disagreements about terms of access or use. I dismiss the motions of Ms. Athanasoulis and the brokers for access to either the cost or appraisal reports.

M. KOEHNEN J.

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1 Concord is the new owner of Clover. Concord acquired Clover in the course of the CCAA proceeding. When doing so it made clear that it would proceed with the CCAA only if it were permitted to disclaim the contracts. If not, it indicated that the CCAA proceeding could not succeed.

End of Document

TAB 6

CITATION: Laurentian University of Sudbury, 2021 ONSC 3272
COURT FILE NO.: CV-21-656040-00CL
DATE: 2021-05-07

SUPERIOR COURT OF JUSTICE - ONTARIO

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

IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF LAURENTIAN UNIVERSITY OF SUDBURY

BEFORE: Chief Justice G.B. Morawetz

COUNSEL: *D.J. Miller, Mitch W. Grossell, Andrew Hanrahan and Derek Harland*, for the Applicant

Ashley Taylor, Elizabeth Pillon and Ben Muller, for the Court-appointed Monitor Ernst & Young Inc

Vern W. DaRe, for the Firm Capital Corporation, the DIP Lender

Susan Philpott, Charles Sinclair and David Sworn, Insolvency Counsel for Laurentian University Faculty Association (LUFA)

Tracey Henry and Danielle Stampley, for Laurentian University Staff Union (LUSU)

Aryo Shalviri and Pamela Huff, for the Royal Bank of Canada

Andrew Hatnay, Demetrios Yiokaris and Sydney Edmonds and Eugene Meehan, Q.C., for Thorneloe University

Dylan Chochla and Stuart Brotman, for the Toronto Dominion Bank

André Claude, for the University of Sudbury

Donia Hashem, for the Canada Foundation for Innovation

Virginie Gauthier, for Lakehead University

George Benchetrit, for the Bank of Montreal

Joseph Bellissimo and Natalie Levine, for Huntington University

Gale Rubenstein and Bradley Wiffen, for the Financial Services Regulatory Authority

Sarah Godwin, for the Canadian Association of University Teachers

David Salter and Peter J. Osborne, for the Board of Governors

Rachel Moses, for Royal Trust

Mark G. Baker and Andre Luzhetskyy, for Laurentian University Students' General Association

Michelle Pottruff, for the Ministry of Colleges and Universities

Charlotte Servant-L'Heureux, for the Assemblée de la francophonie de l'Ontario

Linda Chen, for the Information and Privacy Commissioner of Ontario

HEARD: April 29, 2021

DECISION RELEASED: May 2, 2021

REASONS: May 7, 2021

ENDORSEMENT

[1] On Sunday, May 2, 2021, the following endorsement was released:

> [1] Thorneloe University ("Thorneloe") brings this motion under section 32(2) of the *Companies' Creditors Arrangement Act* ("CCAA") for an order that the following two agreements in the Notice of Disclaimer of Laurentian University of Sudbury ("Laurentian") dated April 1, 2021 are not to be disclaimed or resiliated:
>
> > (a) the Federation Agreement between Laurentian and Thorneloe, dated 1962 (the "Federation Agreement"); and,
> >
> > (b) the Financial Distribution Notice between Laurentian and Thorneloe dated May 1, 2019, amending the Proposed Grant Distribution and Services agreement between Laurentian, the University of Sudbury, Thorneloe University, and Huntington University dated November 10, 1993 (the "Financial Distribution Notice") (collectively, the "Agreements");
>
> and, for an order amending the Loan Amendment Agreement dated April 20, 2021 (the "DIP Amendment Agreement"), to delete the following condition:
>
> > 4. The Disclaimers of the Borrower's Federation Agreements and Financial Distribution Notices with each of Huntington

> University, Thorneloe University and the University of Sudbury (collectively, the "Federated Universities") issued on April 1, 2021 shall become effective, binding and final on May 1, 2021 (the "New Disclaimer Term").

[2] This motion was heard via Zoom on April 29, 2021.

[3] The University of Sudbury also brought a motion pursuant to section 32(2) of the CCAA with respect to a Federation Agreement between Laurentian and the University of Sudbury. This motion was heard via Zoom on April 30, 2021 by Gilmore J.

[4] This endorsement is being released concurrently with the endorsement of Gilmore J.

[5] For reasons to follow, Thorneloe's motion is dismissed.

[2] These are my reasons.

BACKGROUND

[3] In 1960, Thorneloe, Huntington University ("Huntington"), and the University of Sudbury ("U Sudbury") (collectively, the "Federated Universities"), were established by the Anglican, United and Roman Catholic churches, respectively. As religiously affiliated institutions, they were not eligible for government funding. The Province of Ontario passed an *Act to Incorporate Laurentian University of Sudbury*, S.O. 1960, c. 151, and Laurentian was established. On September 10, 1960, U Sudbury and Huntington entered into Federation Agreements with Laurentian and in 1962, Thorneloe entered into a Federation Agreement with Laurentian (collectively, the "Federation Agreements").

[4] The Federated Universities agreed to suspend degree-granting authority (other than Theology, in the case of Thorneloe and Huntington) and effectively operate as a single university. The Federated Universities would teach courses to students for credit at Laurentian. Funding from the provincial government was provided to the Federated Universities, through Laurentian.

[5] The arrangement among the Federated Universities to distribute government grants is set out in the Proposed Grant Distribution and Services Fees Agreement dated November 10, 1993.

[6] The funding arrangement was changed commencing in the 2019 – 2020 academic year, per the Financial Distribution Notice.

[7] Laurentian wants to disclaim the Federation Agreements and the Financial Distribution Notice with respect to Thorneloe and U Sudbury.

[8] As referenced in the Third Report of the Monitor, the Federated Universities do not admit or register their own students, nor do they grant their own degrees (with the exception of Theology

at Huntington and Thorneloe). All Federated University programs and courses are offered through Laurentian, and all students apply for admission to Laurentian. Students who enroll in a program at Laurentian may take elective courses at any or all of the Federated Universities as well as Laurentian. Students enrolled in programs, courses, majors and minors that are administered by the Federated Universities are students of Laurentian, and these courses are credited towards a degree from Laurentian. Laurentian provides certain services to the Federated Universities, however, each of the Federated Universities is separately governed and manages its finances separately from Laurentian and each other.

[9] The Monitor also reported that as all students are students of Laurentian regardless of whether they are enrolled in programs or take courses at one of the Federated Universities, the Federated Universities do not directly bill or collect tuition. Laurentian manages admission. Students are billed tuition by Laurentian. Students then choose courses from a Laurentian course catalogue which includes courses offered through the Federated Universities.

[10] While Laurentian does not receive grant revenue or tuition revenue that is directly intended for the benefit of the Federated Universities, Laurentian and the Federated Universities have certain financial agreements in place pursuant to which Laurentian receives, allocates and distributes a portion of Laurentian's revenue to the Federated Universities in accordance with the funding formula (the "Federated Funding Formula"). Through this Federated Funding Formula, Laurentian compensates the Federated Universities for delivering programs and services to Laurentian students. The key terms of the Federated Funding Formula include the following:

(a) A portion of provincial grants received by Laurentian are distributed to the Federated Universities based on the proportion of students enrolled in the Federated Universities' programs;

(b) A portion of tuition fees received by Laurentian are distributed to the Federated Universities based upon student enrolment and courses offered through the Federated Universities; and

(c) An offsetting charge for service fees charged by Laurentian to the Federated Universities in exchange for Laurentian providing certain support services to the Federated Universities (calculated as 15% of grant and tuition revenues distributed to the Federated Universities).

[11] As of the fall 2020 academic term, there were 417 students enrolled in full-time and part-time programs through the three Federated Universities (271 full-time equivalents). This includes 91 full-time and part-time students of Thorneloe (62.8 full-time equivalents), 108 full-time and part-time students at U Sudbury (69.6 full-time equivalents), and 163 full-time and part-time students at Huntington (103.2 full-time equivalents). The remaining students are enrolled in programs jointly offered by the Federated Universities.

[12] Students who enrolled at Laurentian have had the ability to take elective courses at any or all of the Federated Universities, as well as at Laurentian. The main activity of both U Sudbury

and Thorneloe is to offer elective courses through the Faculty of Arts for students enrolled in the Applicant's programs.

[13] Each of the Federation Agreements contains an aspirational statement which addresses the Federated relationship:

> [B]oth Laurentian University and [the Federated University] declare and express the firm hope and conviction that the relationship between the Universities established by this agreement will be a permanent one… [a]nd to build a great institution of learning which shall forever be bilingual and nondenominational in its character.

[14] Laurentian has Indenture Agreements with each of the Federated Universities, pursuant to which the Federated Universities lease land owned by Laurentian and on which they have constructed their own buildings. Each indenture provides for lease terms of 99 years, with the possibility of further renewal.

[15] The indentures contain termination provisions which allow for the termination of the indenture if the relevant Federated University withdraws from the Federation with the Applicant. No notice of disclaimer was issued by Laurentian in respect of any of the indentures and the indentures are not the subject matter of this motion.

[16] Laurentian takes the position that the main activity of the Federated Universities is offering elective courses that are administered for Laurentian's students. Each time a Laurentian student takes an elective course through the Federated Universities, rather than an elective through Laurentian, that represents lost tuition revenue to Laurentian.

[17] Laurentian takes the position that in fiscal year 2020, as a result of Laurentian students' enrolment in programs and courses through the Federated Universities, Laurentian transferred to the Federated Universities approximately $3.5 million in total grants, $5.3 million in net tuition and $0.3 million in material fees, for a total of $9.1 million. That amount was offset by the administrative services fee of approximately $1.4 million, for a net transfer from Laurentian to the Federated Universities of approximately $7.7 million in fiscal year 2020.

[18] Laurentian has approximately 9,300 undergraduate and graduate students. Laurentian asserts that its Faculty of Arts has the ability and capacity to offer a range of alternative electives to its students, such that there is no need for Laurentian to lose revenue because its students take elective courses offered through the Federated Universities. Since students enrolled in programming offered by the Federated Universities can otherwise be accommodated and enrolled in programs offered by Laurentian, Laurentian asserts that a substantial portion of the grant revenue represents lost revenue for Laurentian. Laurentian and the Monitor concede that Laurentian will not be able to accommodate 100% of the displaced students but anticipate that it will be able to accommodate most of them.

[19] Laurentian also asserts that approximately 70% of its revenues in 2019-2020 is comprised of tuition and grant funding, and, due to the freeze of tuition fees, Laurentian cannot increase

revenue through tuition fees. Thus, the only opportunity for Laurentian to fully utilize the revenue it receives in respect of its students is for them to be enrolled in programs and courses at Laurentian.

[20] Thorneloe presents the facts from its viewpoint. It considers that the funds flow through Laurentian to Thorneloe pursuant to the Financial Distribution Notice. The funds do not belong to Laurentian and the funds do not represent a subsidy. As set out in the Financial Distribution Notice, Laurentian charges Thorneloe an additional 15% of Thorneloe's earned government grants and tuitions.

[21] Thorneloe also points out that it is a small component of the Laurentian Federation, employing a total workforce of 28, including seven full-time faculty members, 12 sessional faculty members, six staff and three casual staff.

[22] Notwithstanding its small size, Thorneloe contends that it has a big impact. In 2019-2020, Thorneloe taught 2861 Laurentian students, representing 297 full-time equivalents ("FTEs"). In 2020-2021, Thorneloe taught slightly fewer (2477) Laurentian students, after it made the decision to close underperforming programs.

[23] Thorneloe also contends that the financial problems of Laurentian are not attributable to Thorneloe or the Federation model.

CCAA PROCEEDINGS

[24] Laurentian obtained an initial stay of proceedings under the CCAA on February 1, 2021. The objective of the CCAA filing was the subject of comment in the affidavit of Dr. Robert Haché, sworn January 30, 2021, filed in support of the initial application. Section VIII covers the "Proposed Restructuring of Laurentian", the "Evaluation of the Federated Universities Model" and the "Restructuring of Program Offerings".

[25] Paragraph 295 of the affidavit reads as follows:

> The Laurentian 2.0 framework seeks to accomplish the foregoing through:
>
> (a) **Restructuring the Academic Model** by streamlining academic programming and delivery through the reduction of number of programs, restructuring academic supports and terminating the agreements and relationship with the Federated Universities; and
>
> (b) **Restructuring the Business Model** by updating business operations, restructuring existing obligations through a compromise in the CCAA and ultimately balancing the budget.

[26] Paragraph 298 reads, in part, as follows:

> [298] More particularly, during this CCAA proceeding, LU ("Laurentian") intends to:
>
> …
>
> (b) re-evaluate the Federated Universities model in such a way that the historic significance of the Federated Universities can be preserved while ensuring that the relationships reflect the current realities of each organization;

[27] Paragraphs 299 – 301 read as follows:

> [299] In 2019, LU provided notice of a change in the funding agreement between LU and each of the Federated Universities. While this amendment was necessary to make the funding arrangements consistent with metrics in respect of tuition and grants from the Province, further work is required. LU estimates that the Federated Universities model costs LU approximately $5 million each year.
>
> [300] Currently, the Federated Universities have duplicate organizational infrastructure, functions and services. Although LU respects the autonomy of the Federated Universities, the Federated Universities also have financial challenges. One successful outcome of this CCAA proceeding may be the remolding of the Federated Universities model in such a way that creates economies of efficiency for LU and the Federated Universities while maintaining the historical significance and identities of the Federated Universities.
>
> [301] This Court-supervised proceeding will assist LU in focusing its discussions and negotiations with leadership of the Federated Universities to arrive at a compromise and solution that is acceptable and, more importantly, ensures the long-term sustainability of LU. If necessary, LU may utilize the proposed mediation to address and resolve the Federated Universities model.

[28] The Honourable Justice Sean Dunphy conducted a judicial mediation to address a number of issues facing Laurentian. Although the contents of any discussions have not been made public, it is apparent that the issues as between Laurentian and the Federated Universities were discussed but were not resolved.

[29] On April 1, 2021, Laurentian gave Notice to Disclaim or Resiliate an Agreement with Thorneloe and with U Sudbury. The notice covered both the Federation Agreements and the Financial Distribution Notice.

[30] The Monitor approved the Notices of Disclaimer.

[31] On April 15, 2021, Thorneloe delivered a Motion Record opposing the Notice of Disclaimer issued to Thorneloe.

[32] U Sudbury also delivered a Motion Record opposing the Notice of Disclaimer. The motion was the subject of a bilingual hearing before Gilmore J.

ISSUE

[33] Thorneloe submits there is one issue to be determined on this motion: should the court prohibit the disclaimer?

ANALYSIS

[34] Section 32 of the CCAA addresses the disclaimer or resiliation of agreements.

[35] The debtor company may, on notice to the other parties to an agreement and the monitor, disclaim or resiliate an agreement to which the company is a party at the commencement of the CCAA proceedings: s. 32(1). The monitor must approve the proposed disclaimer or resiliation. Otherwise, the debtor is required to make an application to the court for an order that the agreement be disclaimed or resiliated: ss. 32(1) and (3). The counterparty has 15 days to make an application to the court opposing the disclaimer or resiliation: s. 32(2). In deciding whether to make the order, the court is to consider, among other things, the factors set out in s. 32(4), which read as follows:

> **Factors to be considered**
>
> (4) In deciding whether to make the order, the court is to consider, among other things,
>
> (a) whether the monitor approved the proposed disclaimer or resiliation;
>
> (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

[36] Thorneloe makes the following arguments in opposition to the disclaimer:

(a) Thorneloe did not cause Laurentian's financial problem;

(b) The disclaimer will result in significant financial hardship for Thorneloe and result in Thorneloe having to make an insolvency filing pursuant to the CCAA or the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3;

(c) Thorneloe is immaterial to Laurentian's financial situation and therefore, the disclaimer would not result in a material improvement to Laurentian's restructuring;

(d) The relationship between Laurentian and Thorneloe is not a commercial relationship to which the disclaimer provisions of the CCAA were intended to apply; and

(e) Laurentian is acting in bad faith contrary to s. 18.6 of the CCAA.

[37] The Monitor approved the disclaimer for reasons set out in the Third Report as follows:

> 169. … [I]t is the Monitor's view that the Notices of Disclaimer will enhance the prospects of a viable compromise or arrangement being made in respect of the Applicant. In fact, it is the Monitor's view that without the Notices of Disclaimer, the Applicant is unlikely to be able to complete a viable plan of compromise or arrangement.
>
> …
>
> 172. While the net estimated savings achieved to date is significant and addresses the Applicant's operational deficit, it is unlikely to be sufficient to cover among other items: (a) the repayment of the DIP Facility (even if refinanced over time) and (b) payment of distributions to creditors pursuant to a plan of compromise or arrangement in connection with the compromise of their claims.
>
> 173. As a not-for-profit, LU is unable to issue equity to creditors. It has no or limited ability to service additional debt beyond the refinancing of the DIP. As set out above, LU has limited opportunity to drive increased revenue. Therefore, LU must, through its restructuring, generate sufficient savings to provide for the ability to make payments over time to its creditors in partial satisfaction of their claims. The savings generated to date through the LUFA Term Sheet, LUSU Term Sheet and non-union employee savings represent a significant component of the required savings, but not the entirety.
>
> 174. The Federated Universities model represents a significant cost to LU. In Fiscal 2020, LU transferred approximately $7.7 million to the Federated Universities as a result of LU students taking programs and courses offered through the Federated Universities. This included the transfer of approximately $3.5 million of grants received by LU, $5.3 million in net tuition collected from LU students and $0.3 million in material fees in respect of Federated Universities courses all offset by a 15% service fee of approximately $1.4 million. …
>
> 175. The Monitor understands that the majority of the funds transferred to the Federated Universities relates to the delivery by the Federated Universities of

> elective courses taken by students enrolled in LU programs as opposed to students enrolled in programs offered through the Federated Universities.
>
> 176. In conducting its review of its academic offerings and operational restructuring model, LU determined that it has the ability and capacity to offer a comprehensive list of programs and courses to LU students from the suite of programs and courses delivered by LU faculty in the absence of continuing the Federated Universities relationship. As a result, LU determined that it could retain the vast majority of the funds transferred to the Federated Universities and continue to support students without incurring those incremental costs.
>
> 177. As a result, LU is of the view that savings estimated in the range of $7.1 to $7.3 million annually can be generated through the disclaimer of the Federated Universities as part of this restructuring.
>
> 178. The Monitor recognizes the potential financial hardship that the Notices of Disclaimer may have for the Federated Universities. However, given the additional savings required for LU to have a reasonable opportunity to put forward a viable plan of compromise or arrangement and effect a successful restructuring, the Monitor is of the view that the disclaimer of the Federated Universities agreements is necessary.

[38] To counter the submissions of Laurentian and the views and recommendations expressed by the Monitor, Thorneloe filed a Report on Financial Impact of Termination of Federated Agreement and Financial Distribution Agreement on Thorneloe University. The Report was prepared by Mr. Allan Nackan, a partner with A. Farber & Partners Inc. Mr. Nackan has been identified as an expert for the purposes of providing his opinion. I am satisfied that Mr. Nackan is an expert in the area of insolvency and restructuring. However, Mr. Nackan acknowledged in cross-examination that he is not an expert in terms of government funding of universities and that he has no prior experience in determining university funding. His lack of industry-specific experience has to be taken into account when considering his report and conclusions.

[39] It is also necessary to acknowledge the expertise of Ernst & Young Inc., the court-appointed Monitor. The Monitor is an officer of the court, with a duty to be neutral and objective: *Bell Canada International Inc. (Re)*, [2003] CarswellOnt No. 4537 (S.C.). The principals of Ernst & Young Inc., including Sharon Hamilton, who signed the Monitor's Third Report, are widely acknowledged as being experts in the field of insolvency and restructuring. Moreover, the Monitor has been involved since the proceedings began and has extensive knowledge of the Applicant's operations and restructuring efforts.

[40] Farber was retained to provide an opinion on whether the termination of the Federated Agreement and the Financial Distribution Notice would result in significant financial hardships to Thorneloe, and whether or not the termination would enhance Laurentian's prospects of a viable compromise or arrangement.

[41] Farber concludes the termination of the Federated Agreement will cause serious financial hardship to Thorneloe as a consequence of which Thorneloe will have to resort to a formal insolvency process.

[42] Farber also concludes that the termination of the Federated Agreement will have an immaterial impact on overall costs reduction in Laurentian's restructuring process and is unlikely to enhance prospects of Laurentian making a viable plan.

[43] In a supplementary report, Farber concludes that:

- Laurentian is not facing an immediate liquidity crisis on May 1, 2021;
- there is no compelling reason that would necessitate termination of the federated arrangement with Thorneloe on May 1, 2021;
- from a financial perspective, Laurentian and the DIP Lender have not provided information to support the need for a Disclaimer Deadline of May 1, 2021.

[44] A consideration of the s. 32(4) factors requires a balancing of interests. The subsection is silent with respect to the relative importance of any one of the factors to be considered and is not restricted to the listed factors. The test does, however, require the court to balance the benefit of the proposed disclaimer for Laurentian against the detrimental impact on Thorneloe. The disclaimer of a contract must be fair, appropriate and reasonable in all the circumstances. Ultimately, it is a discretionary decision to determine whether the disclaimer should be upheld. This discretion is exercised by weighing the competing interests and prejudice to the parties and assessing whether the disclaimer or resiliation is fair and reasonable.

[45] In my view, the considerations in the Third Report of the Monitor reflect a proper balancing of the competing interests of Laurentian and all stakeholders, including Thorneloe. The Third Report discusses the financial challenges facing Laurentian and proposes solutions that could enhance the prospects of a viable plan of compromise or arrangement, while acknowledging the potential financial hardship on the Federated Universities. The Farber Report and the Supplementary Farber Report focuses of the impact of the disclaimer on Thorneloe and the short term DIP Financing requirements. In narrowing its focus, the Farber Report does not take into account that in order to enhance the prospects of a viable plan of compromise or arrangement, it is often necessary to take into account the potential compromises that will have to be made by all stakeholder groups. For this reason, I have concluded that the Third Report of the Monitor has to be given greater weight than the Farber Report and the Supplementary Farber Report.

[46] Laurentian submits that the Courts have identified guiding principles for the analysis:

(a) the recommendation of the Monitor is afforded significant weight in CCAA proceedings (see *Nortel Network Corp. Re*, 2018 ONSC 6257 at para. 27; *Aralez*

Pharmaceuticals Inc., Re, 2018 ONSC 6980 at para. 36; and *Aveos Fleet Performance Inc.*, 2012 QCCS 4074 at para. 50(f);

(b) the disclaimer does not need to be essential to the restructuring, it only need be advantageous and beneficial (see *Timminco Ltd., Re*, 2012 ONSC 4471 at para. 54 ("*Timminco*"); see also *Homberg Invest Inc.*, 2011 QCCS 6376 at para. 103);

(c) the threshold to establish "significant financial hardship" in opposing a disclaimer is high. There must be specific evidence of financial hardship. Mere loss or damage is not sufficient, and it must be likely that the hardship is caused by the disclaimer (see *Target Canada Co. Re*, 2015 ONSC 1028 at para. 26);

(d) the test to establish "significant financial hardship" is subjective and depends on an examination of the individual characteristics and circumstances of the counterparty (see *Timminco* at para. 60); and

(e) the Court should take into consideration the effect that the disclaimer will have on the outcome for all other unsecured creditors and be an equitable result that is dictated by the guiding principles of the CCAA (see *Timminco* at para. 62).

[47] There is no doubt that Laurentian has significant financial challenges. There is also no doubt that, if a successful restructuring is to be achieved, it must be done on an expedited basis. If Laurentian is to successfully restructure its affairs, it is essential that it maintain continuity of operations. The spring term commences May 3, 2021 and extends until the latter part of July 2021. The fall term commences at the beginning of September 2021. If the restructuring is to succeed, Laurentian must be in a position to provide assurances to both its students and faculty that it has a viable plan that will ensure continued operations for both the spring term, the fall term and beyond.

[48] Laurentian, with the assistance of the Monitor, identified a number of areas in which a financial restructuring was required. These include a downsizing of the number of programs being offered by Laurentian and also the necessity to arrive at new, sustainable collective agreements with LUFA and LUSU. These requirements and accommodations are set out in the motion to extend the stay of proceedings.

[49] Laurentian also identified, at the outset of the CCAA proceedings, that it would be necessary to have a fundamental readjustment or realignment with the Federated Universities.

[50] Although Thorneloe is of the view that its relationship with Laurentian has only a minor impact on the financial position of Laurentian, it seems to me that this view is far too narrow in scope. Laurentian has identified that if the disclaimers involving Thorneloe and U Sudbury are upheld, together with the revised agreement with Huntington, this will result in $7.7 million of additional funds remaining with Laurentian on an annual basis. This calculation has been identified by the Monitor and, in my view, represents a real source of annual financial relief for Laurentian.

[51] Thorneloe counters by indicating that it is only one of three Federated Universities; the $7.7 million figure cannot be attributed, in total, to Thorneloe. At first glance, this is an attractive

and persuasive argument. It does not, however, take into account that Huntington, in negotiating its settlement with Laurentian, has included what is known colloquially as a "most favoured nation" clause. Quite simply, if Thorneloe is able to negotiate a better alternative than the agreement negotiated by Huntington, Huntington is in a position to reopen negotiations with Laurentian to obtain similar treatment. Therefore, it seems to me that although there are three Federated Universities involved, their positions are interlinked and interrelated to such a degree that the $7.7 million calculation is relevant to take into account on this motion.

[52] The Notices of Disclaimer are, in my view, central to the Applicant's restructuring. The Disclaimer will result in millions of dollars of additional tuition and grant revenue remaining within Laurentian. As noted in both the affidavit of Dr. Haché and the Monitor's Report, each time a Laurentian student takes an elective course offered through Thorneloe, revenue associated with that course is transferred from Laurentian to Thorneloe. Because the Applicant has the capacity to independently offer students the vast majority of all necessary programs and electives within its existing cost structure, each course taken by a Laurentian student through Thorneloe represents lost revenue for Laurentian.

[53] The Applicant contends that it simply cannot afford to continue its relationship with the Federated Universities. In order to right-size the University, Laurentian cannot continue paying for programs and courses supplied by the Federated Universities that it does not require and are revenue negative for Laurentian.

[54] The Applicant submits that it cannot simply "balance its budget" in order to achieve financial sustainability. It submits that it must generate positive cash flow from operations on an annual basis, prior to the funding of expenses, to achieve financial sustainability. In my view, this submission is consistent with the objective and necessity of achieving long-term sustainability.

[55] Laurentian has also submitted that the savings to be realized from the disclaimer are necessary for the purposes of submitting a viable plan. The Monitor is in agreement with this submission.

[56] Although the savings realized from the disclaimer do not, in isolation, represent a significant amount, in my view, that is not the end of the inquiry. In order to enhance the prospects of a viable plan of reorganization being put forward, it is necessary to assess the totality of what Laurentian is attempting to achieve in this restructuring.

[57] Laurentian suggests that savings have to be realized from a number of sources, including the Federated Universities. Without the total amount of savings being realized, Laurentian submits that it will been unable to put forward the basis of a plan that will be acceptable to its various constituents.

[58] It is necessary to take into account another factor, namely that there is evidence that Laurentian has achieved other milestones in its attempt to put forward a viable plan of reorganization. These include the revised relationships with LUFA and LUSU, the reduction in the number of courses, and the reduction in the number of staff. None of these milestones were realized without significant compromise and hardship being experienced by faculty, students and

the greater Sudbury community. Without such compromises, Laurentian will not be able to survive.

[59] It is also necessary to take into account the position of the DIP Lender. The DIP Lender has put forth a condition for its continued support and for increased financing. That condition is that the Disclaimer with respect to Thorneloe and U Sudbury had to be finalized by May 1, 2021, subject to any reserved decision of the court.

[60] Thorneloe challenges the position of the DIP Lender for two reasons. First, the condition relating to the Disclaimer was not a condition of the original DIP and was inserted only after the Notice of Disclaimer was issued. Second, the analysis performed by Farber indicates that the increased DIP Loan is not required until the latter part of June at the earliest.

[61] There is, in my view, no basis to question the legitimacy of the DIP Lender nor question the conditions that the DIP Lender has put forth with respect to any request to extend the DIP Loan and to increase the amount of the DIP Financing. The DIP Lender is entitled to take into account commercial reality in assessing its options.

[62] The DIP Lender is not a pre-existing lender to Laurentian, nor is there any evidence that the DIP Lender is engaged in a "loan to own strategy". These facts distinguish this DIP Lender from a number of DIP lenders that have been involved in the cases referenced by counsel to Thorneloe, as referenced in Rostom and Fell, "Recent Trends in DIP Financing" (2016) 5-4 IIC Journal; *Essar Steel Algoma (Re)*, Endorsement of Newbould J. dated November 16, 2015; and *Great Basin Gold Ltd. (Re)*, 2012 BCSC 1459.

[63] It is also relevant to remember that this is not a situation where the Court is being asked to approve DIP financing with this DIP Lender. These approvals were granted in February 2021 with no party objecting and with no appeals being filed. It was a competitive process and the DIP Lender was one of eight potential DIP lenders identified at the outset of the proceedings.

[64] Thorneloe also takes issue with respect to the reluctance of a representative of the DIP Lender to be cross-examined or to answer any questions with respect to the DIP Financing.

[65] In response, Laurentian takes the position that the terms for the continued DIP were negotiated as part of a process of achieving a viable long-term plan. Second, although the increased DIP may not be necessary until mid-June, it is a requirement for any extension of the stay to provide a cash flow statement that takes into account the entirety of the Stay Period, and it is necessary to provide the necessary assurances to faculty and students that Laurentian will be able to operate for the next academic term, which commences May 3, 2021 and extends towards the middle to the latter part of July 2021. It is simply not feasible, from its standpoint, to operate without the continued DIP Facility and the certainty that the DIP Facility will be available throughout the entirety of the academic term and the Stay Period.

[66] With respect to the cross-examination of the DIP Lender, I note that no affidavit has been filed in these proceedings by a representative of the DIP Lender. In addition, the DIP Lender is not a pre-existing lender. The DIP Lender is not involved in any of the pre-CCAA DIP contractual

relationships. It is up to the debtor, with the assistance of the Monitor, to negotiate the terms of the DIP Financing. There is no evidence that the DIP Lender has any ulterior motive in negotiating the condition to extend additional financing and to extend the term.

[67] Thorneloe also raises the concern that the Disclaimer will result in significant financial hardship for Thorneloe and result in Thorneloe having to make insolvency filings pursuant to the CCAA or the *Bankruptcy and Insolvency Act*.

[68] There is no doubt that this is a legitimate point being raised by Thorneloe. The impact of the disclaimer on Thorneloe is significant. The consequence of the disclaimer is such that Thorneloe will be unable to operate in its current form. However, Thorneloe was offered alternatives. The form of the Huntington Transition Agreement was offered to Thorneloe but was not accepted. More importantly, it is also necessary to take into account that if Laurentian's restructuring does not succeed and it ceases operations, Thorneloe, as conceded by its counsel, will also be unable to continue operations.

[69] Thorneloe also contests the disclaimers on the basis that the relationship between Laurentian and Thorneloe is not a commercial relationship to which the disclaimer provisions of the CCAA were intended to apply. In my view there is no merit to this submission. The CCAA proceedings were commenced on February 1, 2021. The Initial Order declares that Laurentian is insolvent and is a company to which the CCAA applies. The disclaimer provisions in s. 32 are available to a debtor company. The exceptions set out in s. 32(9) have no application in the circumstances. Laurentian is entitled to utilize the disclaimer provisions in accordance with s. 32.

[70] Thorneloe also takes the position that Laurentian is acting in bad faith contrary to s. 18.6 of the CCAA which provides:

> **Good faith**
>
> **18.6** (1) Any interested person in any proceedings under this Act shall act in good faith with respect to those proceedings.
>
> **Good faith – powers of court**
>
> (2) If the court is satisfied that an interested person fails to act in good faith, on application by an interested person, the court may make any order that it considers appropriate in the circumstances.

[71] In support of this argument, Thorneloe points to Laurentian's attempt to terminate its relationship with Thorneloe, knowing that the disclaimer will result in Thorneloe's insolvency, and to Laurentian's persistence in the face of evidence that termination will not materially assist its restructuring. Thorneloe also submits that Laurentian has consistently and continually wanted to terminate its relationship with Thorneloe and thereby failed to engage in good faith negotiations.

[72] I do not accept that Laurentian has acted in bad faith. Restructurings are not easy and often result in treatment that a party can consider to be extremely harsh. However, that does not

necessarily mean that the other party has not been acting in good faith. In its Third Report, the Monitor makes specific reference to the bad faith argument being raised by Thorneloe. It is significant that the Monitor makes no statement that would suggest in any way that Laurentian has been acting in bad faith. The Monitor ultimately recommends at paragraph 206 of its Third Report that the court grant the relief sought by the Applicant, which includes the disclaimer and also an extension of the stay of proceedings.

[73] Section 11.02(3) of the CCAA addresses the burden of proof on an application for an extension of the stay of proceedings other than the initial application. This includes a requirement that the applicant satisfy the court that it has acted, and is acting, in good faith and with due diligence. By supporting the application for the extension and upholding the disclaimer, it can be inferred that the Monitor does not support the argument of Thorneloe to the effect that Laurentian has been acting in bad faith.

[74] My summary of the factors set out in s. 32(4) of the CCAA is as follows:

(a) the Monitor approved the proposed disclaimer;

(b) the Disclaimer will enhance the prospects of a viable compromise or arrangement being made in respect of Laurentian;

(c) the Notice of Disclaimer will have financial consequences to Thorneloe, but this is not a sufficient reason to disallow the Notice of Disclaimer. Thorneloe was offered an alternative, similar to Huntington, which was not accepted.

[75] In addition, it seems to me that, in the circumstances of this case, it is necessary to consider the broader implication of disallowing the Notice of Disclaimer – namely the potential demise of Laurentian.

[76] The dilemma facing the court is clear. If Thorneloe's motion succeeds, with the result that the Disclaimer is not effective, it could lead to an unraveling of Laurentian's restructuring plan and the collapse of Laurentian. This in turn would have significant impact on all faculty, students and the greater Sudbury community. It would also result in the financial collapse of Thorneloe. Obviously, this is not a desirable outcome.

[77] If the Notices of Disclaimer are upheld, I acknowledge that this could lead to the cessation of operations of Thorneloe. I do not lightly discount the impact on faculty, employees and students at Thorneloe, but the impact is significantly less than if Laurentian and Thorneloe are both forced to suspend or cease operations.

[78] Given these two undesirable options, the better choice or to put it another way, the least undesirable choice, is to uphold the Notices of Disclaimer.

DISPOSITION

[79] In the result, the motion brought by Thorneloe to invalidate the Notice of Disclaimer is dismissed.

Chief Justice G.B. Morawetz

Date: May 7, 2021

TAB 7

Allarco Entertainment Inc. (Re)

Alberta Judgments

Alberta Court of Queen's Bench

Judicial District of Edmonton

J.B. Veit J.

Heard: September 2, 3, 8 and 9, 2009.

Judgment: September 14, 2009.

Docket: 0903 09146

Registry: Edmonton

[2009] A.J. No. 996 | 2009 ABQB 503 | 58 C.B.R. (5th) 140 | 12 Alta. L.R. (5th) 341 | [2010] 4 W.W.R. 299 | 483 A.R. 53 | 2009 CarswellAlta 1458 | 180 A.C.W.S. (3d) 569

IN THE MATTER OF The Companies' Creditors Arrangement Act R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF Allarco Entertainment Inc. and Allarco Entertainment 2008 Inc. and Alliance Films Inc.

(63 paras.)

Case Summary

Bankruptcy and insolvency law — Companies' Creditors Arrangement Act (CCAA) matters — Application of Act — Debtor company — Compromises and arrangements — Directions — Eligible financial contract — Motion by creditor for finding court lacked jurisdiction to vary contract and debtor unable to repudiate contract allowed in part — Creditor offered debtor right to advertise and broadcast package of programming on pay-per-view channels for overall price — Initial order varied contract to allow debtor to pay for movies per view — Initial order forced creditor to provide post-production services without immediate payment since debtor could advertise movies without payment — Order contrary to CCAA — Debtor's termination of contract upheld as it negotiated in good faith — Unreasonable to expect debtor to borrow money to pay contracts.

Bankruptcy and insolvency law — Proceedings — Practice and procedure — Courts — Jurisdiction — CCAA matters — Motion by creditor for finding court lacked jurisdiction to vary contract and debtor unable to repudiate contract allowed in part — Creditor offered debtor right to advertise and broadcast package of programming on pay-per-view channels for overall price — Initial order varied contract to allow debtor to pay for movies per view — Initial order forced creditor to provide post-production services without immediate payment since debtor could advertise movies without payment — Order contrary to CCAA — Debtor's termination of contract upheld as it negotiated in good faith — Unreasonable to expect debtor to borrow money to pay contracts.

Motion by the creditor for an ordering finding the court lacked jurisdiction to vary its contract and a finding the debtor was not able to terminate its contract. The creditor provided the debtor with the right to advertise and broadcast and package of movie programming for an overall price. The debtor operated pay-per-view stations. The debtor applied for protection from creditors and in the initial order, the court accepted its proposal and varied the contract with the creditor to allow the debtor to pay for movies per viewing. The creditor argued that the variation was outside the court's jurisdiction and created a negative incentive for the debtor to use its service. The debtor argued the variation was acceptable because there was a gap in the CCAA with respect to post-production services. The creditor refused to accept per viewing payment and the debtor repudiated from the contracts.

HELD: Motion allowed in part.

This was only the initial stages of the CCAA proceedings so it was inappropriate for the court to draw up a contract for parties that had already negotiated one. The pay-per-viewing order was contrary to the CCAA, because it effectively required the creditor to provide post-production services without immediate payment. The contract between the creditor and debtor was for the service of the right to advertise and broadcast movies, not just the right to a single broadcast, so the initial order allowed the debtor to advertise without payment. The initial order was varied to remove the pay-per-viewing order. The debtor was able to terminate the contracts, however. The creditor had attempted to improve its position and become a secured creditor and refused to accept the debtor's proposal. The debtor had attempted to negotiate in good faith and it would be unreasonable to expect the debtor to borrow more money to meet its contract obligations to the creditor.

Statutes, Regulations and Rules Cited:

Bankruptcy Code, s. 503(b)

Companies' Creditors Arrangement Act, *R.S.C. 1985, c. C-36, s. 11*, s. 11.3(a)

Divorce Act, *R.S.C. 1985, c. 3 (2nd Supp.)*,

Counsel

Frank R. Dearlove, for the Applicant, Alliance Films Inc.

Charles P. Russell, Q.C., for Allarco Entertainment Inc. and Allarco Entertainment 2008 Inc.

Richard T.G. Reeson, Q.C., for Alberta Treasury Branches.

Michael J. McCabe, Q.C., for Pricewaterhouse Coopers Inc.

David Ullmann, for MGM Television of Canada, a division of Metro-Goldwyn-Mayer Studios, Inc.

Marc-Andre Morin, for Twentieth Century Fox/Incendo Television Distribution Inc. and, Incendo Media Inc.

Harry Fogul, for Twentieth Century Fox/Incendo Television Distribution Inc.

Eric Vallieres, for TVA Films, a division of TVA Group Inc.

Patrick Roche, for Maple Pictures Corp.

Roger P. Simard, for National Bank of Canada.

Andre Bennett, President & CEO, Cinema Esperanza International Inc., for Cinema Esperanza International Inc.

Danny M. Nunes, for NBC Universal.

Bertrand Langlois, CA, VP Finance, Christal Films Distributions Inc., for Christal Films Distributions Inc.

Alan H. Brown, for Starz Media LLC.

Memorandum of Decision

J.B. VEIT J.

Summary

1 On June 16, 2009, the Allarco Entertainment companies, which operate Super Channel - a pay-per-view television channel - obtained protection from their creditors pursuant to the provisions of the *Companies' Creditors Arrangement Act*. As part of the initial, *ex parte*, order under the statute, Allarco Entertainment obtained a "pay-per-play" regime in relation to its obligations to Alliance Films Inc., a program supplier. Alliance Films now applies for a variation of the initial order: it argues that the court had no jurisdiction to grant what amounts to a major, unilateral, variation of its contracts with Allarco Entertainment. For an overall fee which was to be paid in instalments, the Alliance contracts allowed Allarco Entertainment to exhibit films and television series, including the right to exhibit through subscription video on demand, for a limited number of times over a specific time period. Alliance asserts that the contract fees are paid for the ongoing right to exhibit the films or series episodes, that there is no "pay-per-play" provision in the contracts, and that the courts should not have imposed such a variation on Alliance.

2 Alternatively, Alliance argues that if the court does have jurisdiction to approve such contract variations, the court should not have exercised its discretion in favour of this variation because a "pay-per-play" regime constitutes a negative incentive on the debtor, Allarco Entertainment, to use the service provided by Alliance.

3 Alliance Films Inc. brought this motion in July, 2009. The court adjourned the motion on the condition that Allarco Entertainment negotiate in good faith with Alliance. The resulting negotiations were unsuccessful. On August 17, 2009, Allarco Entertainment terminated its contracts with Alliance Films. In its amended motion, in addition to asking for a variation in relation to the "pay-per-play" term in the initial order, Alliance also now asks the court to invalidate Allarco Entertainment's terminations.

4 *In its initial order, even if the court did have jurisdiction to vary the Allarco Entertainment/Alliance Film contracts by establishing a different payment structure than the one set out in the contracts, it should not have done so: a post-protection service provider usually has the right to maintain its contract prices.*

5 The CCAA states that where, under licence agreements, a contractor provides new services to a debtor who has obtained creditor protection, that service provider is entitled to "immediate payment"; this is compared to the provider who provided services prior to the granting of creditor protection, whose right to enforce payment is stayed. The CCAA does not state the basis on which compensation is to be paid for post-protection services. Allarco Entertainment argues that the basis for compensation should be "what is just and reasonable"; here, the debtor claims that a "pay-per-play" payment scheme is fair because it will get rid of instalment payments to Alliance, the payment of which will hinder Allarco Entertainment's ability to re-organize. Alliance Films argues that, at this stage of the CCAA proceedings, the court does not have the right to make unilateral contract changes. At this stage of the proceedings, the broad wording of the CCAA, which is remedial legislation, does allow the courts to make some contracts between debtors and creditors: for example, with respect to utilities such as electricity, the court can allow the service provider to be paid not only the usual utility rate but also a security deposit: ***Hydro-Québec.*** Another example is the court's decision that some contract provisions relate to past services, and cannot therefore be enforced, and that other contract provisions relate to post-protection services for which the debtor incurs an obligation of immediate payment: ***Nortel***. These are examples of the limited way in which the courts have jurisdiction to vary contracts in an initial order under CCAA proceedings. It is not necessary to articulate the principle which applies to the jurisdiction of the court in relation to contracts, s. 11.3(a) of the CCAA, and initial orders, but if that were required, it may be that, in the initial order courts have only a limited jurisdiction to affect contractual rights and that contractual payment terms negotiated between debtors and creditors generally represent the payments which debtors are required to make if they use the services set out in those contracts post-protection as that scale of payment best represents both a fair and reasonable price for the services and business in the

ordinary course. This principle arises from the common law's respect for contractual obligations. Generally, contracts cannot be varied by courts: contracts represent, in effect, a law which private parties have agreed applies to them. Court can interpret or rectify, but not vary, contracts. Even courts of equity generally limited themselves to deciding which contracts, or portions of contracts, would not be enforced by the justice system. Legislation could, of course, give to the courts the jurisdiction to vary or create contracts; however, given the clear state of the common law on this issue, explicit statutory provisions would be required to give courts a general jurisdiction to vary contracts. Such explicit authority is not given to courts in the CCAA at this stage of proceedings. The court's only authority in the situation here was to distinguish between those portions of the Alliance contracts which represent services that have already been performed, the enforcement of which is stayed, and those portions which deal with the provision of ongoing services, the payment for which Allarco Entertainment was required to make according to the contract if it wished to continue using Alliance's services.

6 *Allarco Entertainment is, however, entitled to terminate its contracts with Alliance Films.*

7 After the issuance of the initial order, Allarco Entertainment negotiated with Alliance in good faith. The granting of protection from creditors is designed to promote such negotiations. Alliance is not required to continue to provide services to Allarco Entertainment post-protection; on the other hand, Allarco Entertainment is entitled to terminate contracts. The court does have a general oversight jurisdiction to determine if the termination of a contract by a debtor is just and reasonable. On this motion, Allarco Entertainment has satisfied that test: among other important aspects of the statutory test, the evidence establishes that, during the negotiations, Alliance Films was attempting to obtain a security status for its contracts which did not exist in its original contracts. Granting new security to Alliance post-protection would have given Alliance an advantage over other Allarco Entertainment creditors. Allarco Entertainment was in fact prevented from acceding to these attempts by Alliance Films.

Cases and authority cited

8 By Alliance Film: ***Thomson Knitting Inc., Re*** [1925] O.J. No. 212, 1925 CarswellOnt 5 (Ont. S.C. in Bankruptcy, App. Div.) citing ***William Hamilton Mfg. Co. v. Hamilton Steel and Iron Co.*** (1911), 23 O.L.R. 270; ***Doman Industries Ltd., Re*** [2003] B.C.J. No. 562, 2003 CarswellBC 538 (B.C.S.C.); ***Skeena Cellulose Inc., Re*** [2003] B.C.J. No. 1335, 2003 CarswellBC 1399 (B.C.C.A); ***Doman Industries Ltd., Re***, [2004] B.C.J. No. 1402, 2004 CarswellBC 1545 (B.C.C.A In Chambers); ***T. Eaton Co., Re*** [1999] O.J. No. 4216, 1999 CarswellOnt 3542 (Ont. S.C.J. [Commercial List]) citing ***Keddy Motor Inns Ltd., Re*** (1992), 13 C.B.R. (3d) 245 (N.S.C.A.); ***Doman Industries Ltd., Re*** [2004] B.C.J. No. 1149, 2004 CarswellBC 1262 (B.C.S.C.); ***Companies Creditors' Arrangement Act,*** R.S.C. 1985, c. C-36, as amended, s. 11.3; ***Stelco Inc., (Re)*** [2005] O.J. No. 1575, 2005 CarswellOnt 1537 (C.A.); ***In Re Enron Corp.*** 279 B.R. 695 (N.Y. Bankr. Gonzalez 2002); ***In Re Kmart Corporation*** 293 B.R. 905; ***In Re Thatcher Glass Corporation*** 59 B.R. 797 at 6 (Banker D. Conn. 1986).

9 By the Allarco Entertainment corporations: ***Lehndorff General Partner Ltd., Re***, 9 B.L.R. (2d) 275 (Ont. Ct. J. (Gen. Div.)); ***T. Eaton Co., Re***, (1997) 46 C.B.R. (3d) 293 (Ont. Ct. J. (Gen. Div.)); ***Nortel Networks Corp., Re***, [2009] O.J. No. 2558, 2009 WL 1763447 (Ont. Sup. Ct.); ***In Re Kmart Corporation, et al., Debtors***, 293 B.R. 905 (Ill. Bankr. Sonderby 2003); ***In Re Enron Corp. et al. Debtors***, 279 B.R. 695 (N.Y. Bankr. Gonzalez 2002); ***Skeena Cellulose Inc., Re***, (2002), 43 C.B.R. (4th) 187 (B.C.S.C.); ***Blue Range Resource Corp., Re***, (2000), 192 D.L.R. (4th) 281 (Alta. C.A.); ***T. Eaton Co., Re***, (1999), 14 C.B.R. (4th) 288 (Ont. S.C.J.); ***Doman Industries Ltd., Re*** (2004), 29 B.C.L.R. (4th) 178 (S.C.); ***Blue Range Resource Corp., Re***, (1999), 245 A.R. 154 (Q.B.); ***New Skeena Forest Products Inc., Re***, 2005 BCCA 192; ***Woodward's Ltd., Re***, (1993), 100 D.L.R. (4th) 133 (B.C.S.C.); ***Campeau v. Olympia & York Developments Ltd.*** (1992), 14 C.B.R. (3d) 303 (Ont. Ct. J. Gen. Div.); ***Air Canada (Re)*** 66 O.R. (3d) 257, [2003] O.J. No. 2976 (C.A.); ***Sagecrest Dixon Inc. (Re)*** [2009] O.J. No. 1127 (Comm.List); ***Air Canada (Re)*** [2003] O.J. No. 6239 (Comm.List).

10 By the court: ***Smith Brothers Contracting Ltd. (Re)*** [1998] B.C.J. No. 728 (B.C. Sup. Ct.); ***West Bay SonShip Yachts v Esau*** 2009 BCCA 31, [2009] B.C.J. No. 120; ***Smoky River Coal (Re)*** 2001 ABCA 209, [2001] A.J. No. 1006; ***Hydro-Québec c Fonderie Poitras ltée*** 2009 QCCA 1416, [2009 J.Q. no 7438; ***Les Boutiques San Francisco Incorporées*** [2004] Q.J. No. 2886.

11 Appendix A: The payment scheme in the initial order

1. Background

12 The following information is uncontested, or if contested, the court is able to come to a conclusion on the existence of a fact without ordering a trial of that issue.

a) Factual

13 The Allarco Entertainment companies operate Super Channel, an English language general interest pay television channel, one of only 3 pay-per-view television channels in Canada. The business of the companies is licensed and regulated by the Canadian Radio-Television and Telecommunications Commission, CRTC. One of the licensing requirements is the delivery of a certain proportion of Canadian content programming, which requirement ensures greater value for programming packages which satisfy that requirement.

14 The Allarco Entertainment companies rely on broadcasting distribution undertakings, BDUs, such as Rogers, Shaw and Bell TV, to sell Super Channel as a programming option. By law, the BDUs are obligated to treat all program networks equally, and not to unfairly encourage their customers to purchase the services of one program network in preference to others. Allarco Entertainment has an ongoing complaint about one of the BDUs, alleging that that distributor has not dealt fairly with Super Channel; this complaint is now the subject of a lawsuit, which is being case managed in Ontario. In a parallel mode, Allarco Entertainment has also laid its complaints against that BDU with the CRTC; there has not yet been a resolution of those complaints by the Commission.

15 When they applied for an initial order under the CCAA, the Allarco Entertainment companies had approximately 425 outstanding program license agreements, PLAs, with various entertainment program suppliers. Although the Allarco Entertainment companies had their own form of PLA which it used whenever possible, some of the more well known program licensors required the Allarco Entertainment companies to enter into the licensors' standard form of PLA. Approximately $64,000,000.00 of programming has been delivered to the Allarco Entertainment companies, for which payment had not been made when those companies applied for protection from their creditors.

16 Allarco Entertainment's PLAs with Twentieth Century Fox are the most significant component of the Super Channel programming cost.

17 Alberta Treasury Branch is the first secured creditor of the Allarco Entertainment companies; it holds general security agreements containing a charge over Allarco Entertainment's present and after acquired personal property. The ATB facility is currently fully drawn. ATB has agreed, on certain conditions, to reestablish the MasterCard facility for Allarco Entertainment. ATB has also indicated to Allarco Entertainment that it is prepared, on certain conditions, to forbear in pursuing recovery under the guarantee of the ATB facility.

18 Alliance has 5 PLAs with Allarco Entertainment. The PLAs typically give to Allarco Entertainment the right to play the programs offered in a package on an exclusive basis. Moreover, the first time an individual program is broadcast, Allarco Entertainment can advertise the play as a premiere, which has added value over and above the rights of exclusive broadcast.

19 When Alliance first brought this motion, it was concerned mainly with two of its program licence agreements with Allarco Entertainment, the January 15, 2008 PLA - Super Channel Q1 08 package - and the February 25th 2008 PLA - Super Channel Q2 08 package. Those agreements are similarly structured. However, there are at least two important terms which are found in the latter agreement which are not found in the former.

20 The first of these terms is:

> Security Interest
>
> Licensee shall grant Licensor a security interest in respect of Licensee's payment obligations and Licensee shall execute and deliver documentation necessary to effect the foregoing.

Although Q2 2008 was agreed to and accepted by the parties on March 31st, 2008, by June 16, 2009, no security documents had been prepared by either Allarco Entertainment or Alliance Films. Alliance characterizes this contractual term as an equitable charge which has all the validity of a legal charge.

21 The second of the terms is:

> Termination Rights
>
> In the event of default by Licensee (including failure to pay amounts when due and/or if assignment for the benefit of creditors, seeks relief under any bankruptcy law or similar law for the protection of debtors, or allows a petition of bankruptcy to be filed against it, or a receiver or trustee to be appointed for substantially all of its assets that is not removed with 30 days), Licensor shall be entitled to terminate or suspend Licensee's rights with respect to programming (i) licensed hereunder; and/or (ii) licensed to Licensee by Licensor pursuant to any other agreement. In the event Licensor decides to terminate Licensee's rights to programming, all rights will automatically revert to Licensor, free and clear of any and all encumbrances and Licensor shall be entitled to immediate possession of all related materials.

In its PLAs which contained termination rights, Alliance did not terminate its contracts with Allarco Entertainment once it knew that Allarco Entertainment had obtained an initial order under the CCAA.

22 Alliance has 3 other PLAs with Allarco Entertainment. Alliance did not focus on these 3 PLAs because no payments are due at this time in relation to those agreements. Of those additional agreements: PLA 2007/2008 Allarco Package does not contain any security or termination clauses; PLA Super Channel Q4-08 package does not contain a security clause but does contain a termination clause; and, PLA Super Channel Q3-08 Package contains both a security clause and a termination clause.

23 In their applications before the Court, Allarco Entertainment has provided the court with this broad stroke explanation of what its Plan of Arrangement might entail:

- sale to a third party investor of a portion or all of the equity in the business, having in mind the value of the existing CRTC license;
- ongoing active involvement in the business by entities related to Charles R. Allard, the sole director of Allarco Entertainment Inc.;
- significant reduction in both the cost of programming and general overhead expense would allow a viable business at a much lower level of subscriber involvement;
- success in the claim against the BDU would increase the number of subscribers;
- injection of funding into the business either by way of equity or further loans.

24 The Allarco Entertainment companies proposed, and in the initial order the court approved, PricewaterhouseCoopers Inc. as the Monitor under these proceedings. The Monitor has not, of course, taken a position on this application; however, the Monitor reports that, to date, it has not uncovered any abusive conduct by the Allarco Entertainment companies.

25 Paragraph 16 of the initial order provided that payment under the PLAs between Allarco Entertainment and various program licensors was to be made in accordance with the terms set out in para. 43 of the affidavit of the President and Chief Operating Officer of the Allarco Entertainment companies. Those terms are set out in appendix A hereto.

26 Since the granting of the initial order, Allarco Entertainment has continued to advertise access to Alliance programming, including subscription on demand, SVOD, rights.

27 The initial order has been extended by court order to September 30, 2009.

28 There is a dispute between the parties about the proportion of the contract payments which Alliance Films has received, and would receive, since the protection order. That issue will be discussed further in relation to the termination by Allarco Entertainment of the Alliance contracts.

29 There is a dispute between the parties concerning the content of the negotiations which preceded the termination by Allarco Entertainment of the Alliance contracts. This dispute will be referred to in the discussion of the termination issue hereunder.

30 As of August 17, 2009, Allarco Entertainment repudiated its contracts with Alliance and noted, "Any damages suffered by Alliance as a result of such repudiation will be dealt with in the claims process in the CCAA proceedings".

31 Although the PLA providers set out in the Appearances section hereunder have been given notice of this application, only MGM has provided evidence and submissions on the motion, although many of the other parties attended the hearing by telephone. MGM is owed in excess of $1,400,000.00 in outstanding claims for licensing fees not paid to it prior to the date of the initial order in these proceedings. MGM would have expected payments in excess of $2,000,000.00 between the date of the initial order and February 2010 in the ordinary course. MGM will continue to provide Allarco with new films, at a discounted price, while MGM defers certain other payments for films which have already been delivered to Allarco. MGM is of the view that the continuation of the CCAA process is in the best interest of MGM and likely in the best interest of many other programming suppliers in these proceedings.

b) Legislative

32 Section 11 of the CCAA reads:

> 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.
>
> (2) An application made for the first time under this section in respect of a company, in this section referred to as an "initial application", shall be accompanied by a statement indicating the projected cash flow of the company and copies of all financial statements, audited or unaudited, prepared during the year prior to the application, or where no such statements were prepared in the prior year, a copy of the most recent such statement.
>
> (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);
>
> (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.
>
> (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.

...

(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 satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

33 In 1997, the following amendment was made to s. 11 of the BCCA:

11.3 No order made under section 11 shall have the effect of

(a) prohibiting a person from requiring immediate payment for goods, services, use of leased or licensed property or other valuable consideration provided after the order is made; or

(b) requiring the further advance of money or credit.

(Emphasis added)

2. At this stage of the CCAA proceedings, does the court have the jurisdiction to approve unilateral contract changes proposed by Allarco Entertainment to Alliance Film contracts?

34 The short answer to this question is, No.

35 As a prelude to the discussion of the specific issue which is before the court, the court observes that the conclusion reached by Bauman J. in ***Smith Brothers***, a leading decision on the interpretation of s. 11.3 of the CCAA, to the effect that it is the use (emphasis in the original at para. 19) of "leased property, not the making of the lease itself, after the stay order, which is within the purview of s. 11.3(a)" also apply here. The implications of that finding are twofold: the Alliance contracts are "true" licenses within the meaning of ***Smith Brothers*** - which means on the one hand that they are not security documents - and, Alliance cannot be forced to provide the portions of those contracts which relate to the provision of services post-protection without an immediate claim for those services.

36 The nature of the Alliance contracts is that they provide a service - the right to advertise and broadcast the availability of a package of programming - rather than the right to make a single broadcast. The advertising by Allarco Entertainment of the availability of the Alliance Films packages, including SVOB rights, constitutes "use" of the Alliance Films licensed property.

37 Allarco argues that s. 11.3 (a) of the CCAA which entitles a service provider to require immediate payment for services provided after the initial order does not indicate the payment basis on which those services will be provided. Allarco Entertainment suggests that this gap in the legislation is one which the court has the jurisdiction to fill and that the test for determining payment should be what is a just and equitable basis for compensation. Alliance argues that there is no gap, or that if there is a gap, the terms of the contract relating to payment should be accepted as being the proper basis for the provision of post-protection services.

38 To provide guidance in filling the gap, Allarco Entertainment proposes American jurisprudence pursuant to s. 503(b) of the *Bankruptcy Code* which allows a court to give priority treatment to "administrative expenses".

However, in order to do so, the court must conclude not only that the debt arises out of a transaction with the debtor in possession, but also that the payment of the debt is beneficial to the operation of the debtor's business. Allarco notes that the concept of "beneficial" is narrowly interpreted, as is to be expected in a regime where those administrative expenses receive priority. For example, in ***Kmart Corporation***, the bankruptcy court asserted that "post-petition performance alone does not automatically translate into a benefit to the estate, even if there was inducement on the part of the debtor"; the same principle was also applied in ***Enron***.

39 I agree with Allarco Entertainment that there is a gap in the CCAA relating to the payment for post-protection services.

40 However, with respect, I disagree with Allarco Entertainment's proposed use of American jurisprudence. As the B.C. Court of Appeal emphasizes in ***West Bay SonShip***, although similar policy objectives inform Canadian and American insolvency legislation, and while certain American decisions might even be persuasive in certain Canadian insolvency situations, in each specific potential use of American jurisprudence care must be exercised to ensure that, in the particular case, both the American legislative scheme is similar to that in Canada and, in the absence of expert evidence on the state of American law, that the American reasoning in a particular case is not conflated with the state of American jurisprudence on the issue.

41 For example, here the Alliance Films PLAs are, in Canadian or Albertan parlance, executory contracts. However, American authorities are not helpful on the treatment of "executory contracts" in the CCAA partly because the specialized interpretation of that term in American bankruptcy law is different from the interpretation of that term in Alberta and perhaps in Canada:

> 31 In "A Joint Report of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals - Joint Task Force on Business Insolvency Law Reform - March 15, 2002", the authors cited the following meanings for "executory contract":
>
> What is an executory contract? Neither the CCAA nor the BIA use the expression, but the United States Bankruptcy Code does in s. 365 ("Code, s. 365"). In general contract law, "executory contract" means a contract under which one or both parties still have obligations to perform. However, in U.S. bankruptcy law the expression is normally given a narrower meaning. According to the most widely accepted definition in the United States, an executory contract for the purposes of Code s. 365 is:
>
> > a contract under which both the obligations of the bankrupt ["A"] under the contract and the other party to the contract ["B"] are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other.
> >
> > (Countryman, "Executory Contracts in Bankruptcy" (1974) 57 Minnesota Law Review 439 (Part 1), at 460).

42 More pertinently in this particular case, while there is in the American *Bankruptcy Code* a priority for administrative expenses which include "the actual, necessary costs and expenses of preserving the estate", there is no such limitation in s. 11.3 of the CCAA. Here, all post-protection service providers are entitled to claim immediate payment for their services. Therefore, the American jurisprudence is not, in this particular case, helpful.

43 In any event, however, no decision has been brought to my attention in which an American court has, other than in a utility situation which will be discussed later in the context of Canadian case law, itself calculated a price other than the contract price for the provision of post-protection services. Indeed, the weight of American jurisprudence on the issue appears to be that the contract price is assumed to be a reasonable price unless the debtor can show that the contract price is clearly unreasonable.

44 In the circumstances here, rather than to rely on American jurisprudence for guidance, it is more appropriate to rely on Canadian law and on first principles. As has been noted in much of the jurisprudence which interprets the CCAA, there is jurisdiction in the statute for a court to work out arrangements that will maximize benefits to all

affected parties. As our Court of Appeal put it in ***Smoky River Coal, (Re)***:

> 16 CCAA orders become the roadmap for the proceedings and the litigation which may follow. Orders must therefore be drafted with clarity and precision. The purpose of the CCAA must be kept at the forefront in both drafting and interpreting a CCAA order. The CCAA is remedial legislation. As was stated in Re Lehndorff General Partner Ltd. *(1992), 17 C.B.R. (3d) 24* (Ont. Gen. Div):
>
> > The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable a plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court.
> >
> > (Emphasis added)

45 The court's jurisdiction is not, however, unlimited. One limiting feature is the timing of the court's intervention. There is no doubt that, at the stage of the approval or failure of a plan, a court can impose terms on an unwilling creditor. We are not, however, at that stage.

46 At this stage, that is the stage of the initial order, whatever services are provided post-protection are offered by service providers who are entitled to be paid for those services. Generally, two payment regimes will be adopted. One is that ongoing service providers will accept, at least until the presentation of a plan, some new, negotiated, plan. Obviously if the parties to a contract agree to a variation of the terms of that contract, that variation governs. However, a service provider is not required to provide post-protection services without the right to claim immediate payment. If a service provider will not agree to modify its contractual payment terms in order to provide post-protection services, then the debtor must either terminate the contract or pay the contractual amount. In reaching this conclusion, I rely on the fact that, at the stage of the initial order, it would be inappropriate for a court to attempt to draw up a contract for the parties. What the parties have negotiated in a contract should generally be presumed to be a fair and reasonable price for the services provided. Not only are courts not business experts, but the cost of attempting to bring the court up to speed on the reasons that a creditor and a debtor each have for advancing a payment proposal would exhaust the financial capacity of an already insolvent debtor. At the stage of the presentation of a plan, the situation is, of course, different: at that stage the court has much more information on which to rely, including the business acumen of all other creditors.

47 Two exceptions to the general rule that contract terms govern have been identified in the jurisprudence. First, there are utility contracts: see ***Hydro-Québec***. Even though the original contract for service did not contain any form of security payment, a court approved a security deposit as a term of post-protection provision of services. The provision of utilities is, however, a unique form of contract. On the one hand, utility contracts are contracts of adhesion whose payment terms are typically regulated by government or government-established commissions, and, on the other, the debtor does not typically have any choice in service providers. In those circumstances, it is appropriate for a court to set the terms of payment for post-protection services since a utility provider should not be required to provide post-protection services which require the advance of further credit: see s. 11.3(b). It appears that American jurisprudence takes a similar view with respect to utilities: see ***Thatcher Glass***. The crucial nature of utility services requires the intervention of the court where the parties cannot agree on a fee for post-protection services; in other circumstances, a service provider can protect itself by refusing to provide services. These principles are usefully addressed by the Court of Appeal in ***Hydro-Québec***:

> 80 L'alinéa a) de l'article 11.3 de la LACC établit un principe clair : pendant la période de suspension, le fournisseur a droit d'être payé pour les services qu'il rend au fur et à mesure de leur utilisation.
>
> 81 Voici d'ailleurs les commentaires du professeur Richard H. McLaren au sujet de cet article:
>
> > Section 11.3 acts as an exemption to the stay provisions of s. 11 of the CCAA. It appears the section is meant to balance the rights of creditors with debtors. The section addresses the concern that judges had too much discretion in issuing stays. Under s. 11.3(a), if a person supplies goods or services or if

> the debtor continues to occupy or use leased or licensed property, the court will not issue a stay order with respect to the payment for such goods or services or leased or licensed property. In essence, s. 11.3(a) will not permit the court to prohibit these individuals from demanding payment from the debtor for goods, services or use of leased property, after a court order is made.16

82 Ce principe connaît cependant des limites pratiques. Il arrive parfois que la réalité s'oppose à ce que le fournisseur soit payé immédiatement pour les services qu'il fournit à une compagnie débitrice. La fourniture d'électricité en est un exemple patent : il s'agit d'un service continu qu'il est impossible de facturer au fur et à mesure de la consommation.

83 En pareilles circonstances, il est juste et équitable pour le fournisseur de services de demander des garanties de paiement. Commentant la décision Re Smoky River Coal Ltd.17, les auteurs Houlden, Morawetz et Sarra déclarent:

> Under its inherent powers, the court can create a security for creditors who supply goods and services to the debtor after the filing of a CCAA petition and can provide for the priority and ranking of such a security interest with respect to other security holders. If the plan under the CCAA fails, the court can determine who are entitled to share in the proceeds of the security interest.18

...

87 Au sujet du droit applicable, le juge Rolland s'exprime en ces termes:

> [13] Il découle de ce qui précède qu'un fournisseur ne peut exiger d'être payé d'avance pour un service à fournir.
>
> [14] Ainsi, un créancier peut exiger d'être payé immédiatement lors de la livraison, mais pas de recevoir un paiement d'avance pour des services à fournir.
>
> [15] La situation est relativement simple lorsqu'il s'agit d'un bien individualisé, vendu et livré.
>
> [16] Cela peut être plus compliqué dans les cas d'un approvisionnement continu d'un service comme l'électricité, le téléphone ou le gaz.
>
> [17] Exiger de la débitrice qu'elle paie un mois d'avance comme le demande Gaz Métro, alors qu'elle entend fermer plus de 30 locaux au cours des prochains jours ou semaines, a pour effet de créer un fardeau trop onéreux pour la débitrice.
>
> [18] La LACC ne fait pas exception quant aux créanciers qu'il s'agisse de fournisseur d'un service continu par opposition à un fournisseur de biens.
>
> [19] Le tribunal a discrétion pour établir une procédure permettant au fournisseur de ne pas être préféré ou pénalisé par rapport aux autres créanciers.
>
> (je souligne)

48 In that particular case, the court concluded that a $42,000.00 guarantee was reasonable in the circumstances.

49 The second exception from the obligation to pay the contract price for post-protection service, an exception which constitutes a lesser intrusion on the freedom of contract than the outright establishment of new payment terms, is the selection by a court from amongst the provisions of one contract of certain services for which the debtor must pay the contract price while other provisions are identified as ones for which the debtor is not immediately required to pay: ***Nortel***. In that case, the contract - a collective agreement - included both payments to persons who were no longer providing service to the debtor and payments to persons who were providing post-protection service to the debtor. The union advanced two arguments in support of its claim that all contract payments should be made post-protection. The first was that the services that had been provided in the past were part of the consideration for services that were being provided post-protection. The second was that, because of a statutory requirement, the union did not have the freedom which most service providers have, to refuse to provide ongoing service to a debtor which has received protection from its creditors. (On this latter point, there is a certain analogy between the union - which could not, for legislative reasons, withdraw its services despite the wording of s.

11.3(a) - and Alliance, which cannot withdraw the services which it provided in three contracts because those contracts grant licences to Allarco Entertainment without termination rights arising on insolvency.) The ***Nortel*** court rejected both arguments. Although the court decided which portions of the contract had to be paid, it did not purport to vary the contractual basis for payment; it merely decided which portions of the contract were eligible for payment post-protection.

50 It appears that a similar approach was taken in ***Les Boutiques San Francisco***: the debtor could either decide to terminate the contract for display shelves, or pay the contract price for those units.

51 There may be other exceptions to the general rule but I have not been provided with any Canadian case law which has identified any such exceptions.

52 The two exceptions to the rule that post-protection services are to be paid according to the contract price reenforce the generality of the rule. Generally, contracts cannot be varied by courts: they can be interpreted or rectified but not varied. Even courts of equity limited themselves to remedies which recognized the basic authority of contracts: a court of equity might, for example, require a contracting party to render proper accounts even though that was not a term of the contract if the rendering of accounts was necessary to enforce the contract. Similarly, a court of equity might grant relief from the consequences of certain contracts - such as contracts that were unconscionable. In other cases, a court might decide that, for public policy reasons, certain contracts, such as gambling contracts, would not be enforced by the justice system.

53 Legislation could, of course, give to the courts a broad jurisdiction to create or vary contracts or to over-ride them. An example of the latter is the *Divorce Act* which provides that a court should taken into account any contract between the parties in relation, for example, to spousal support, but that the court is not limited in making a spousal support order by the terms of the contract between the parties.

54 Given the respect for contracts in the common law, explicit statutory provisions are required to give courts the jurisdiction to impose unilateral variations in contracts. Such explicit authority is not given to courts in the CCAA at the initial order stage.

55 Moreover, as was noted at the outset, it is important to correctly identify the nature of the Alliance PLAs: these are not pay-per-play contracts, but rather contracts which allow Allarco Entertainment to advertise the availability of Alliance product without in fact broadcasting Alliance product. The effect of imposing a pay-per-play payment term on Alliance at this stage would be to impose upon Alliance the obligation to provide a continuing service - allowing Allarco Entertainment to continue to advertise the availability of Alliance programming - without providing payment for that service. Indeed, as Alliance has emphasized, Allarco Entertainment's web-site continued, post-protection, to advertise Alliance programming. It is not necessary on this application to determine whether forcing Alliance to continue to provide its services to Allarco Entertainment can also be characterized as requiring Alliance to make a further advance of credit to Allarco.

56 For the reasons set out above, having now heard argument from the party affected, this court varies para. 16 of its initial, *ex parte*, order by removing the reference to para. 43(b) of the Knox affidavit and replacing it with a reference to the contractual payments due to Alliance.

3. Should the court invalidate Allarco Entertainment's termination of the Alliance Films contracts?

57 The short answer to this question is, No.

58 Alliance correctly states that the statutory right of a debtor which has obtained protection from its creditors to

terminate contracts is subject to judicial oversight. Alliance argues that it is not reasonable for Allarco Entertainment to terminate its contracts because:

- Allarco was able to obtain a "pay-per-play" clause and they should therefore be required to honour the contracts;
- the exchanges between Allarco and itself establish that Allarco was intent on obtaining a "pay-per-play" provision to give itself additional, inappropriate, power in its negotiations with Alliance;
- it is not appropriate for Allarco Entertainment to defend its actions by starting from the proposition that it has only so much cash available; rather, Allarco should be required to raise additional funds;
- Allarco Entertainment did not negotiate in good faith.

59 For the purpose of this application, the court sets the following test which Allarco Entertainment must meet for termination of its contracts with Alliance Films: the termination must be fair, appropriate, reasonable, and must have been issued after good faith negotiations. I have concluded that Allarco Entertainment meets that test.

60 In coming to that conclusion, the most important of the reasons considered by the court is the evidence that Alliance attempted, during the negotiations, to become a secured creditor, an effort that would have given Alliance an unfair advantage over other Allarco Entertainment creditors. The fact that Alliance was negotiating for such security benefits is acknowledged by Alliance; it takes the position, however, that this was not a "new" feature since some of its contracts contained provision for granting security. With respect, this is not defensible. Each contract must be enforced on its own; three of the Alliance contracts did not contain a security clause. With respect to those agreements, the addition of a security clause would be "new". Moreover, even with respect to those two contracts which did contain a security clause, no security documents had been executed.

61 In addition to the grave concern about Alliance attempting to improve its position relative to other debtors, there are other factors which the court weighs in Allarco Entertainment's favour in concluding that it should not invalidate Allarco's termination of Alliance contracts:

- while it is true that, during the negotiations, Allarco Entertainment was the beneficiary of a "pay-per-play" regime and had thus obtained what it wanted relative to Alliance as a creditor, Allarco Entertainment was also aware that Alliance had attacked the legitimacy of that provision. While on this motion Allarco valiantly argued in favour of the "pay-per-play" regime relative to Alliance, it is not unreasonable to assume that Allarco also came to an informed decision that it was at least vulnerable on that issue;

- there was a reasonable business basis for Allarco Entertainment's original application for a "pay-for-play" regime relative to Alliance. It appears to me that the main business argument in Allarco's failure is that substantial ongoing payments to Alliance throughout the year as opposed to what the evidence describes as the overwhelming position in other contracts which provide for payments at the beginning and at the end of the licence period, or at the beginning, after 12 months and at the end of the licence period seriously hamper Allarco's attempts to establish a plan which would allow them to go forward rather than to fall into bankruptcy;

- there is a dispute between Allarco Entertainment and Alliance about the cost to Alliance of the "pay-per-play" provision: Allarco states that it had paid more than 5 cents on the dollar of contractual obligations. Alliance states that termination of its contracts will place it in a worse position that the PLA providers with whom Allarco has been able to reach an accommodation. While it may be true that termination will be less advantageous to Alliance than going forward on some accommodation basis, part of the point of the CCAA is to allow for the termination of some contracts so long as the test for termination is met;

- similarly, it is a reasonable business concern of Allarco's to have fresh programming to offer potential subscribers and that such programming not consist solely of leftovers from other potential licensees;

- it would not make sense to impose upon an insolvent company the obligation to borrow more money in order to meet all its debts before it terminated certain of its contracts. Such an inflexible rule would make an effective reorganization impossible. On the evidence on this motion, at this stage of the CCAA proceedings, Allarco Entertainment has made reasonable arrangements with its banker and guarantor;

- there is no evidence that Allarco negotiated in bad faith. Rather, the evidence suggests that Allarco was attempting to make reasonable accommodations with Alliance. For example, it is not reasonable that Allarco should be required to take only that programming which has been refused by all other potential licensees. Nor is it the case that Alliance is irrevocably linked to Allarco: Alliance has other markets to which it can offer its programming;

- finally, the opinion of MGM - a creditor which is roughly in the same position relative to Allarco Entertainment as is Alliance - that there have been significant changes in the business of all affected companies which legitimizes the writing down of entertainment packages for the purposes of the development of a CCAA plan supports the general approach which Allarco Entertainment has taken in the negotiations.

62 Although Alliance Film's notice of motion requests an order invalidating Allarco Entertainment's termination of the Alliance Films contract, at the hearing Alliance suggested that what it really wanted was a determination of the variation agreement first. If that issue were resolved in its favour, Alliance then hoped that further negotiations with Allarco Entertainment would be possible. Alliance suggested that even if Allarco Entertainment were to maintain its termination of the contracts, then Alliance may require some additional evidence to support its position that the termination should not be approved. With respect, I cannot adopt that approach. The determination about whether a termination at this stage meets the required test should be made as close as possible to the date of termination in order to ensure that the court has the same overall perspective as did the parties as of the date of termination.

4. Costs

63 If the parties are not agreed on costs, I may be spoken to within 30 days of the release of this decision.

J.B. VEIT J.

* * * * *

Appendix A

The following are the portions of para. 43 of Mr. Knox's first affidavit which are incorporated by reference in para. 16 of the initial court order:

(a) For those existing Program License Agreements in which the fee for delivery of a single broadcast, such as a prize fight, must be paid upon delivery of that Program, the cash flow contemplates such payment as each Program is delivered;

(b) In the case of those existing Program License Agreements with fixed terms and with a limited number of Exhibition Days, and where the license window is already open, the Cash Flow Projections have been prepared based upon a formula where the overall cost of the Contract is divided by the total number of Exhibition Days permitted, with that Exhibition Day rate being applied for the number of Exhibition Days the Business actually runs that program during the Cash Flow Projection period;

(c) For existing Program Licensing Agreements which provide for monthly payments, those payments falling due during the CCAA proceedings will be paid;

(d) As a license window opens during the CCAA Proceedings on a Licensing Agreement now in existence, license fees shall be paid in accordance with that Licensing Agreement; and

(e) For Programming which is obtained by the Business during the CCAA Proceedings under Licensing Agreements not now in existence, the licensing fees shall be paid in accordance with the terms of each such Program License Agreement.

(Emphasis added)

The only program licence agreements which come within the terms set out in para. (b) above are the Alliance Films Inc. PLAs.

End of Document

TAB 8

DEBTORS AND CREDITORS SHARING THE BURDEN:

A Review of the *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act*

Report of the Standing Senate Committee on Banking, Trade and Commerce

Chair
The Honourable Richard H. Kroft

Deputy Chair
The Honourable David Tkachuk

November 2003

Ce rapport est aussi disponible en français.
Des renseignements sur le Comité sont donnés sur le site:
www.senate-senat.ca/bancom.asp

Information regarding the Committee can be obtained through its web site:
www.senate-senat.ca/bancom.asp

DEBTORS AND CREDITORS SHARING THE BURDEN:

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Report of the Standing Senate Committee on Banking, Trade and Commerce

Table of Contents

The Committee

The following Senators have participated in the study:

The Honourable Richard H. Kroft, C.M., Chair of the Committee
The Honourable David Tkachuk, Deputy Chair of the Committee

and

The Honourable Senators:

W. David Angus
Michel Biron, C.M.
D. Ross Fitzpatrick
Céline Hervieux-Payette, P.C.
James F. Kelleher, P.C.
E. Leo Kolber (past Chair of the Committee)
Paul J. Massicotte
Michael A. Meighen
Wilfred P. Moore
Donald H. Oliver
Marcel Prud'homme, P.C.
Raymond C. Setlakwe, C.M. (retired from the Senate on July 3, 2003)

Ex-officio members of the Committee:

The Honourable Senators: Sharon Carstairs, P.C. (or Fernand Robichaud, P.C.) and John Lynch-Staunton (or Noël A. Kinsella)

Other Senators who have participated from time to time on this study:

The Honourable Senators Maria Chaput, Leonard J. Gustafson, Pana Merchant and Madeleine Plamondon

Staff of the Committee:

Mr. Yoine Goldstein, Special Advisor to the Committee, Partner, Goldstein, Flanz & Fishman

Ms. June M. Dewetering, Acting Principal, Parliamentary Research Branch, Library of Parliament

Mr. Denis Robert, Clerk of the Committee, Committees and Private Legislation Directorate, The Senate

Mrs. Kelly J. Bourassa, Barrister and Solicitor, Policy Advisor to the Chair

Ms. Rhonda Walker, Policy Advisor to the Deputy Chair

J. Executory Contracts

Executory contracts are contracts under which something remains to be done by one or more of the parties to the contract. In essence, it is a contract where there are obligations yet to be completed. Examples include leases, intellectual property rights and employment contracts, among others. Neither the BIA nor the CCAA uses the expression "executory contract."

Nevertheless, the existence of these contracts in a situation of insolvency raises the question of the extent to which these private contracts – negotiated in good faith and with due consideration of risk – should be altered or terminated, under what circumstances and by whom. Alteration or termination of contractual rights change expectations, reduce predictability in contracting and increase risks, which will have negative implications. As well, both contracting parties may experience harm, since the continuation of a contract may be in the best interest of both parties.

… the existence of [executory] these contracts in a situation of insolvency raises the question of the extent to which these private contracts – negotiated in good faith and with due consideration of risk – should be altered or terminated, under what circumstances and by whom.

Canadian legislation in this area has existed for some time. The *Bankruptcy Act* passed in 1949 contained few restraints on completed contracts; as well, it explicitly recognized the applicability of provincial/territorial law to real estate leases. Various omnibus bills in the 1970s and 1980s, all of which died on the Order Paper, proposed that an insolvent person who wished to make a proposal could disclaim any executory contract, and the co-contracting party would have the right to file a claim in the proposal for damages; the insolvent company could continue as a going concern, while the co-contracting party to the disclaimed contract would be no worse off than if a bankruptcy had occurred.

Amendments to the BIA in 1992 provide that, after a reorganization begins, secured creditors cannot exercise their security; the termination of a lease, licensing agreement or public utility because of default was also prevented. Debtors, however, were given the ability to disclaim leases on real property.

Witnesses presented the Committee with divergent opinions on whether disclaimer of executory contracts should be allowed, with the Court's permission, by insolvency practitioners or by co-contracting parties. Some witnesses told us that a company involved in a reorganization should be permitted to renounce such contracts. This view was held, for example, by Mr. Mendelsohn, who told the Committee – in reference to the CCAA – that "reorganizing entities [do and should] have the ability to renounce executory contracts, … with appropriate judicial supervision." After noting that, under the BIA, only commercial leases of real estate where the reorganizing entity is the lessee can be renounced, he argued that a coherent system of restructuring must permit the entity to renounce other executory contracts as well. He informed us that "[i]f executory contracts have to be renounced, they have to be renounced whether … [the] company [is big or small]."

Mr. Mendelsohn also shared the view that a bankruptcy trustee should be able to assign and transfer executory contracts to third parties, including licensing arrangements and leases of premises. He believed that "a trustee in bankruptcy should be given the right to realize, for the benefit of creditors, whatever economic value resides in the assets, including executory contract assets."

The Joint Task Force on Business Insolvency Law Reform also spoke about the ability to disclaim executory contracts and assignment to third parties. In the Joint Task Force's opinion, "[t]here should be a general right to disclaim (reject) executory contracts (including real property leases) in all bankruptcy and reorganization proceedings." Although it does not believe that insolvent organizations or the trustee in bankruptcy should require Court approval in order to disclaim these contracts existing at the date of commencement of proceedings, the Joint Task Force argued that "the legislation could impose some pre-conditions to the exercise of the disclaimer power either generally, or with respect to certain types of contracts."

Regarding the ability to assign executory contracts, the Joint Task Force informed the Committee that "trustees in

bankruptcy and court-appointed receivers should have the power to assign executory contacts (not including eligible financial contracts) both in connection with going concern transactions and on a liquidation basis," subject to a number of limitations. It went on to note, however, that "[t]here should be provision for the court to prohibit an assignment if [the non-bankrupt party to the contract] establishes that the proposed assignee does not meet, in a material way, criteria reasonably applied by [it] before entering into similar agreements … or the proposed assignee is less creditworthy than [the bankrupt] was when the executory contract was entered into and reasonable assurances of payment have not been provided with respect to any credit required to be extended to the assignee by [the non-bankrupt party] under the executory contract after the assignment."

The Canadian Bankers Association, however, told the Committee that "[i]nsolvency law constraints on contracts can affect pre-insolvency contracting behaviour and may reduce credit availability. The new economy dictates that companies must be innovative and dynamic. In order to finance such new enterprises, financiers must be able to rely on the negotiated terms of their contracts."

A particular executory contract – a collective agreement – was discussed by several witnesses, including representatives of organized labour. In general, their view is that the Court should not be able to terminate a collective agreement, in whole or in part. The CAW-Canada told the Committee that "the CCAA offers no authority to a Court to abrogate a collective agreement. Nor should it do so. Still, some counsel and commentators believe that Superior Courts in Canada have an 'inherent jurisdiction' to issue an order pursuant to the CCAA which suspends or temporarily cancels one or more terms of a collective agreement. We fundamentally disagree."

A particular executory contract – a collective agreement – was discussed by several witnesses, including representatives of organized labour.

In the union's opinion, "[t]here can be no dispute that if the preservation of the status quo is a key objective of the CCAA, then the terms and conditions of employment defined in a collective agreement at the time of the issuance of a CCAA order must be maintained subject to the parties' mutual authority to negotiate changes." From this perspective, the

CAW-Canada told the Committee that "[t]he CCAA should … make clear that it is not open to a Court, in exercising its 'inherent jurisdiction' to alter, waive, or override the provisions of a collective agreement without the consent of the employer and the relevant trade union."

A similar view was presented to the Committee by the United Steelworkers of America, which told us that "the Courts should not be entitled, under the guise of a CCAA proceeding, to interfere with the operation of freely negotiated collective agreements which affect the rights of many workers. … [U]nions have demonstrated, in times of legitimate economic crisis, that they are capable of acting responsibly and in the best interests of their membership to agree to amendments to a collective agreement which may be necessary to enable the employer to survive. This cooperative approach is to be preferred to an approach which would eliminate workers (sic) rights with the stroke of a pen and subvert the primacy of collective bargaining."

Moreover, the Canadian Labour Congress differentiated collective agreements from other executory contracts, and indicated to the Committee that "[j]ust as employees are not like other creditors, collective agreements are not like other contracts. … [T]he bankruptcy and CCAA courts should not be accorded any jurisdiction over collective bargaining agreements. … Unlike other creditors, workers are not in a position to negotiate the terms upon which they may become creditors of their employer. Unlike other creditors, they are not in a position to assess the risks that they are required to bear. Unlike other creditors, they are not able to guarantee their employer's obligation by way of a secured charge. And unlike senior executives, they are not in a position to have their termination entitlements, including golden parachutes, set aside in trust accounts and thereby protected from bankruptcy proceedings."

The labour federation also informed the Committee that it does not support disclaimer of collective agreements. In its view, "[t]he debtor company and the union are in the best

position to evaluate the needs of the company and are also the parties with the greatest interest in preserving the company as a going concern; they are, therefore, the appropriate parties to determine any changes to the collective agreement. The key incentive for the parties to reach an agreement is the threat that a failure to do so will lead to the bankruptcy of the debtor. … Neither the courts nor the monitor or receiver should have the power to vacate or amend a collective bargaining agreement that was arrived at within the provincial or federal statutory framework." The Canadian Labour Congress, however, went farther, and argued that "the value of each concession should be assigned unsecured creditor status with no less priority of valuation than any other unsecured creditor."

In support of the views of organized labour, Professor Sara commented that "treating collective agreements as commercial executory contracts that can be unilaterally set aside … is highly problematic."

From the perspective of intellectual property rights, the Intellectual Property Institute of Canada indicated its preference for an approach that would limit the right of disclaimer to "unprofitable," rather than "executory," contracts, since there is "too much uncertainty as to what types of agreements would be found to be 'executory'." The Institute also made other suggestions for change.

For example, the Institute recommended that: the time limit for the exercise of the right of disclaimer be three months; the Court have the discretion to maintain the contract if the disclaimer would cause undue hardship not compensable in damages; the Court be permitted to make an order discharging the agreement and ordering payment for damages for non-performance by the trustee; aggrieved persons be given the status of a creditor of the bankrupt, to the extent of any loss suffered by reason of the disclaimer; and, where the bankrupt is a licensor of intellectual property rights, the licensee have the right to elect – within one month after receipt of the notice of disclaimer – to retain the licence. Recommendations were also made by it with respect to patents, trademarks and trade secrets.

[The Committee received testimony] with respect to patents, trademarks and trade secrets.

Similarly, Mr. Baird, Q.C., spoke to the Committee about intellectual property issues and noted the debate that has existed for some years about "whether a trustee in bankruptcy or a bankrupt licensor or a debtor under the protection of the CCAA has the right to repudiate licences issued by the bankrupt or the insolvent debtor." In supporting a recommendation made by the Insolvency Institute of Canada, he said that "the BIA and the CCAA [should] be amended to provide protection for a licensee of a right to intellectual property similar to that provided in the United States."

The Writers' Union of Canada also commented on copyright, noting the absence of copyright issues in the CCAA and the extent to which "the *Bankruptcy and Insolvency Act* less frequently applies – or doesn't apply initially. … When [it] does apply, it provides writers with very limited protection and often too late. A receiver or trustee in bankruptcy may already have assigned his or her rights and sold the inventory, short circuiting a possible statutory reversion of rights, depriving the author of possible revenues from sales by the trustee, and interfering with the author's future opportunities for republication." It also recommended that a trustee not be permitted to transfer or assign the copyright, or any interest in it, since the relationship between a writer and his or her publisher is personal; the writer should be permitted to make any alternative arrangements in the event of his or her publisher's insolvency. Finally, the Union commented that there is a lack of clarity about whether a publishing agreement is a partial assignment of copyright or a licensing agreement under which the author retains the copyright.

… we urge relevant parties to engage in the discussion needed to ensure a satisfactory resolution to the full range of issues identified to us by the Intellectual Property Institute of Canada.

While we believe that there are a variety of unresolved issues related to the insolvency of a licensor or a licensee in the context of an intellectual property licence, intellectual property law is a highly specialized area and we feel that the limited examination given by the Committee to this particular aspect of insolvency does not enable us to make any meaningful recommendations for change. Nevertheless, we urge relevant parties to engage in the discussion needed to ensure a satisfactory resolution to the full range of issues identified to us by the Intellectual Property Institute of Canada.

More generally, the Committee supports the concept of permitting disclaimer of all executory contracts, since we believe that the flexibility to take this action increases the probability of successful reorganization and thereby – in some sense – a fresher, if not fresh, start for the business. We also feel, however, that the parties to executory contracts should meet in good faith with a view to negotiating mutually acceptable changes to their contract that would enable them to meet their goals and permit the contract to continue, albeit in a changed form. We strongly believe that, in most cases, the parties will be able to come to a successful resolution; however, it is likely that situations will arise in which the parties cannot reach agreement, and in these cases we believe that disclaimer should be permitted by the Court. Nevertheless, disclaimer should only be allowed where certain conditions are met, including good faith attempts to negotiate mutually acceptable changes to the contract and serious hardship in restructuring without the disclaimer. Believing that this approach would enhance fairness, predictability and effectiveness, the Committee recommends that:

… the Committee supports the concept of permitting disclaimer of all executory contracts, since we believe that the flexibility to take this action increases the probability of successful reorganization and thereby – in some sense – a fresh, if not fresher, start for the business.

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit disclaimer of executory contracts in existence on the date of commencement of proceedings under the Acts. This disclaimer should apply to all executory contracts, provided a number of conditions are met. In particular: the debtor should be obliged to establish inability or serious hardship in restructuring the enterprise without the disclaimer; the co-contracting party should be permitted to file a claim in damages in the restructuring; and, where a collective agreement is being disclaimed, the debtor should also have the burden of establishing that post-filing negotiations have been carried on, in good faith, for relief of too onerous aspects of the collective agreement and should establish in Court that the disclaimer is necessary in order to allow for a viable restructuring.

Moreover, the Committee is of the view that trustees, Court-appointed receivers and monitors should be able to assign executory contracts where doing so would enhance the value of the assets and, thereby, moneys available for

distribution to creditors. We recognize that while this circumstance would not permit the co-contracting party to choose its commercial partner, we feel that if the co-contracting party is no worse off financially, it would suffer no prejudice. As well, efficiency and effectiveness – two principles that we believe should characterize our insolvency system – would be enhanced. From this perspective, the Committee recommends that:

The *Bankruptcy and Insolvency Act* and the *Companies' Creditors Arrangement Act* be amended to permit trustees, Court-appointed receivers and monitors, if authorized by judgment, to assign executory contracts when appropriate, in connection with going concern transactions and on a liquidation basis, provided that two conditions are met: the proposed assignee is at least as credit worthy as the debtor was at the time the contract was entered into; and the proposed assignee agrees to compensate the other party for pecuniary loss resulting from the default by the debtor or give adequate assurance of prompt compensation.

TAB 9

Lehndorff General Partner Ltd. (Re)

Ontario Judgments

Ontario Court of Justice - General Division

Toronto, Ontario

Farley J.

Heard: December 24, 1992

Judgment: January 6, 1993

Court File No. B366/92

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

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 AND IN THE MATTER OF The Courts of Justice Act, R.S.O. 1990, c. C. 43 AND IN THE MATTER OF a plan of compromise in respect of Lehndorff General Partner Ltd., in its own capacity and in its capacity as general partner of Lehndorff United Properties (Canada) Lehndorff Properties (Canada) - and - Lehndorff Properties (Canada) II and in respect of certain of their nominees Lehndorff United Properties (Canada) Ltd., Lehndorff Canadian Holdings Ltd., Lehndorff Canadian Holdings II Ltd., Baytemp Properties Limited and 102 Bloor Street West Limited and in respect of The Lehndorff Vermogensverwaltung GmbH in in its capacity as limited partner of Lehndorff United Properties (Canada) Applicants

(36 pp.)

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

FARLEY J.

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

(a) short service of the notice of application;

(b) a declaration that the applicants were companies to which the CCAA applies;

(c) authorization for the applicants to file a consolidated plan of compromise;

(d) authorization for the applicants to call meetings of their secured and unsecured creditors to approve the consolidated plan of compromise;

(e) A stay of all proceedings taken or that might be taken either in respect of the applicants in their own capacity or on account of their interest in Lehndorff United Properties (Canada) ("LUPC"), Lehndorff Properties (Canada) ("LPC") and Lehndorff Properties (Canada) II ("LPC II") and collectively (the "Limited Partnerships") whether as limited partner, as general partner or as registered titleholder to certain of their assets as bare trustee and nominee; and

(f) certain other ancillary relief.

The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issued under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermogensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the Limited Partnership Act, *R.S.O. 1990, c. L.16* ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the Partnership Act, R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of intercorporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

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

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

(b) The restructuring of existing project financing commitments.

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

(d) Elimination or reduction of certain overhead.

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

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

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

(h) Consolidation of entities in the Group; and

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

Formal meetings of the beneficial limited partners of the Limited Partnerships are scheduled for January 20 and 21, 1993 in Germany and an information circular has been prepared and at the time of hearing was being translated into German. This application was brought on for hearing at this time for two general reasons: (a) it had now ripened to the stage of proceeding with what had been distilled out of the strategic and consultative meetings; and

(b) there were creditors other than senior secured lenders who were in a position to enforce their rights against assets of some of the applicants (and Limited Partnerships) which if such enforcement did take place would result in an undermining of the overall plan. Notice of this hearing was given to various creditors: Barclays Bank of Canada, Barclays Bank PLC, Bank of Montreal, Citibank Canada, Canada Trustco Mortgage Corporation, Royal Trust Corporation of Canada, Royal Bank of Canada, the Bank of Tokyo Canada, Funtauna Investments Limited, Canadian Imperial Bank of Commerce, Fuji Bank Canada and First City Trust Company. In this respect the applicants have recognized that although the initial application under the CCAA maybe made on an ex parte basis (s. 11 of the CCAA; Re Langley's Ltd., (1938) O.R. 123, *(1938) 3 D.L.R. 230* (C.A.); Re Kennoch Development Ltd. *(1991), 8 C.B.R. (3d) 95* (N.S.S.C.T.D.). The court will be concerned when major creditors have not been alerted even in the most minimal fashion (Re Inducon Development Corporation *(1992), 8 C.B.R. (3d) 306* (Ont. Gen. Div.) at p. 310). The application was either supported or not opposed.

"Instant" debentures are now well recognized and respected by the courts: see Re United Maritime Fisherman Co-Op *(1988), 67 C.B.R. (N.S.) 44*, at pp. 55-6, varied on reconsideration *(1988), 68 C.B.R. (N.S.) 170*, reversed on different grounds *(1988), 69 C.B.R. (N.S.) 161* at pp. 165-6; Re Stephanie's Fashions Ltd. *(1990), 1 C.B.R. (3d) 248* (B.C.S.C.) at pp. 250-1; Elan Corp. v. Comiskey *(1990), 1 O.R. (3d) 289*, *1 C.B.R. (3d) 101* (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); Ultracare Management Inc. v. Gammon *(1990), 1 O.R. (3d) 321* (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; in Re Companies' Creditors Arrangement Act; A.G. Can. v. A.G. Que., (1934) S.C.R. 659 at p. 661; *16 C.B.R. 1*; *(1934) 4 D.L.R. 75*; Meridian Developments Inc. v. Toronto-Dominion Bank; Meridian Developments Inc. v. Nu-West Group Ltd., *(1984) 5 W.W.R. 215* at pp. 219-20; Norcen Energy Resources v. Oakwood Petroleums Limited. et al. *(1988), 72 C.B.R. (N.S.) 1*, *63 Alta. L.R. (2d) 361* (Alta., Q.B.), at pp. 12-13 (C.B.R.); Re Ouintette Coal Limited *(1990), 2 C.B.R.(3d) 303* (B.C.C.A), at pp. 310-1, affirming Ouintette Coal Limited v. Nippon Steel Corporation et al. *(1990) 2 C.B.R. (3d) 291*, 47 B.C.L.R. 193 (B.C.S.C.), leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.).; Elan, supra at p. 307 (O.R.); Fine's Flowers v. Creditors of Fine's Flowers *(1992), 7 O.R. (3d) 193* (Gen. Div.), at p. 199 and "Re-Organizations under the Companies' Creditors Arrangement Act", Stanley E. Edwards, (1947), 25 Cdn. Bar Rev. 587 at p. 592.

The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. See Elan, supra at pp. 297 and p. 316; Stephanie's, supra, at pp. 251-2 and Ultracare, supra, at p. 328 and p. 330. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed: see Meridian, supra, at p. 220 (W.W.R.). The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors

and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and all of the creditors: see Ouintette, supra, at pp. 108-110; Chef Ready Foods Ltd. v. Hongkong Bank of Canada *(1990), 4 C.B.R. (3d) 311*, *51 B.C.L.R. (2d) 84* (B.C.C.A.), at pp. 315-318, (C.B.R.) and Stephanie's, supra, at pp. 251-2.

One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the Bankruptcy Act, *R.S.C. 1985, c. B-3*, before the amendments effective November 30, 1992 to transform it into the Bankruptcy and Insolvency Act ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an application under the CCAA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See Chef Ready, supra, at p. 318 and Re Assoc. Investors of Can. Ltd. *(1987), 67 C.B.R. (N.S.) 237* at pp. 245; rev'd on other grounds at (1988), 71 C.B.R. 72. It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See Assoc. Investors, supra, at p. 318; Re Amirault Co. (1951), 32 C.B.R. 1986, (1951) 5 D.L.R. 203 (N.S.S.C.) at pp. 187-8 (C.B.R.).

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

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

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

The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affects the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company. See Norcen, supra at pp. 12-7 (C.B.R.) and Ouintette, supra, at pp. 296-8 (B.C.S.C.) and pp. 312-4 (B.C.C.A.) and Meridian, supra, at pp. 219 ff. Further the court has the power to order a stay that is effective in respect of the rights arising in favour of secured creditors under all forms of commercial security: see Chef Ready, supra, at p. 320 where Gibbs J.A. for the Court stated:

> The trend which emerges from this sampling will be given effect here by holding that where the word "security" occurs in the C.C.A.A., it includes s. 178 security and, where the word creditor occurs, it

> includes a bank holding s. 178 security. To the extent that there may be conflict between the two statutes, therefore, the broad scope of the C.C.A.A. prevails.

The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see Wynden Canada Inc. v. Gaz Métropolitain Inc. (1982), 44 C.B.R. (N.S.) 285 (Que. S.C. in Bankruptcy) at pp. 290-1 and Ouintette, supra, at pp. 311-2 (B.C.C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see Re Northland Properties Limited et al. *(1988), 73 C.B.R. (N.S.) 141* (B.C.S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see In Re Nathan Feifer et al. v. Frame Manufacturing Corporation (1947), 28 C.B.R. 124 (Qué. C.A.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see Sklar-Peppler Furniture Corporation *(1992), 8 C.B.R. (3d) 312* (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

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

The power to grant a stay may also extend to prevent persons from exercising any right of set off in respect of the amounts owed by such a person to the debtor company, irrespective of whether the debtor company has commenced any action in respect of which the defense of set off might be formally asserted: see Ouintette, supra, at pp. 312-4 (B.C.C.A.).

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

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

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

It appears to me that Dickson J. in International Donut Corp. v. 050863 N.B. Ltd., unreported, (1992) N.B.J. No. 339 (N.B.Q.B.T.D.) was focusing only on the stay arrangements of the CCAA when concerning a limited partnership situation he indicated:

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

I am not persuaded that the words of s. 11 which are quite specific as relating as to a company can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in Campeau v. Olympia & York Developments Ltd. unreported, (1992) O.J. No. 1946 at pp. 4-7.

> The Power to Stay
>
> The Court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see Canada Systems Group (Est) Ltd. v. Allendale Mutual Insurance Co. *(1982), 29 C.P.C. 60* (H.C.), and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the Courts of Justice Act, *R.S.O. 1990, Chap. C. 43*, which provides as follows:
>
> s. 106 A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just.
>
> Recently, Mr. Justice O'Connell has observed that this discretionary power is "highly dependent on the facts of each particular case": Arab Monetary Fund v. Hashim (unreported), *[1992] O.J. No. 1330*.
>
> Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the Court is specifically granted the power to stay in a particular context, by virtue of statute or under the Rules of Civil Procedure. The authority to prevent multiplicity of proceedings in the same court, under Rule 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the CCAA, is an example of the former. Section 11 of the CCAA provides as follows:
>
> ...
>
> The Power to Stay in the Context of CCAA Proceedings:
>
> By its formal title the CCAA is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.
>
> In this respect it has been observed that the CCAA is "to be used as a practical and effective way of restructuring corporate indebtedness.": see the case comment following the report of Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. *(1988), 72 C.B.R. (N.S.) 1* (Q.B.), and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in Quintette Coal Ltd. v. Nippon Steel Corp. *(1990), 51 B.C.L.R. (2d) 105* at p. 113 (B.C.C.A.).
>
> Gibbs J.A. continued with this comment:
>
> To the extent that a general principle can be extracted from the new cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is a discretionary power to restrain judicial or extra judicial conduct against the debtor company the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period (emphasis added).
>
> I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of negotiating the compromise or arrangement. (In this respect, see also Sairex GmbH v. Prudential Steel Ltd. *(1991), 8 C.B.R. (3d) 62* (Ont. Gen. Div.) at p. 77).
>
> I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the Court's exercise of its power to stay proceedings. These principles were reviewed by Mr. Justice Montgomery in Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance, supra (a "Mississauga Derailment" case), at pp. 65-66. The balance of convenience must

> weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The Court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

It is quite clear from Empire-Universal Films Limited et al. v. Rank et al., (1947) O.R. 775 (H.C.) that McRuer C.J.H.C. considered that the Judicature Act then [and now the CJA] merely confirmed a statutory right that previously had been considered inherent in the jurisdiction of the court with respect to its authority to grant a stay of proceedings. See also McCordic et al. v. Township of Bosanquet *(1974) 5 O.R. (2d) 53* (H.C.) and Canada Systems Group (Est) Ltd. v. Allendale Mutual Insurance Co. *(1982) 29 C.P.C. 60* (H.C.) at pp. 65-6.

Montgomery J. in Canada Systems, supra, at pp. 65-6 indicated:

> Goodman J. (as he then was) in McCordic v. Bosanquet *(1974), 5 O.R. (2d) 53* in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in Edmeades v. Thames Board Mills Ltd., [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in Edmeades was approved by Lord Justice Davies in Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis), [1972] 1 All E.R. 430, [1972] 1 W.L.R. 326 (sub nom. Lane v. Willis; Lane v. Beach) (C.A.).
>
> ...
>
> In Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd. *(1972), 25 D.L.R. (3d) 419*, *5 C.P.R. (2d) 122*, appeal allowed by consent without costs (sub nom. Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.) 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.), Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:
>
> > "The principles which must govern in these matters are clearly stated in the case of Empire Universal Films Ltd. et al. v. Rank et al., *[1947] O.R. 775* at p. 779, as follows [quoting St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al., [1936] 1 K.B. 382 at p. 398]:
> >
> > '(1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.'"

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

A limited partnership is a creation of statute, consisting of one or more general partners and one or more limited partners. The limited partnership is an investment vehicle for passive investment by limited partners. It in essence combines the flow through concept of tax depreciation or credits available to "ordinary" partners under general partnership law with limited liability available to shareholders under corporate law. See Ontario LPA sections 2(2) and 3(1) and Lyle R. Depburn, Limited Partnerships, De Boo (1991), at p. 1-2 and 1-12. I would note here that the limited partnership provisions of the Alberta PA are roughly equivalent to those found in the Ontario LPA with the interesting side aspect that the Alberta legislation in s. 75 does allow for judgment against a limited partner to be charged against the limited partner's interest in the limited partnership. A general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership. In particular a general partner is fully liable to each creditor of the business of the limited partnership. The general partner has sole control over the property and business of the limited partnership: see Ontario LPA ss. 8 and 13. Limited partners have no liability to the creditors of the limited partnership's business; the limited partners' financial exposure is limited to their contribution. The limited partners do not have any "independent" ownership rights in the property of the limited partnership. The entitlement of the limited partners is limited to their contribution plus any profits thereon, after satisfaction of claims of the creditors. See Ontario LPA sections 9, 11, 12(1), 13, 15(2) and 24. The process of debtor and creditor relationships associated with the limited partnership's business are between the general partner and the creditors of the business. In the event of the creditors collecting on debt and enforcing security, the creditors can only look to the assets of the limited partnership together with the assets of the general partner including the general partner's interest in the limited partnership. This relationship is recognized under the Bankruptcy Act (now the BIA) sections 85 and 142.

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

It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See Lindley on Partnership, 15th ed. (1984), at p. 33-5; Seven Mile Dam Contractors v. R. in Right of British Columbia *(1979), 13 B.C.L.R. 137* (S.C.) affirmed *(1980), 25 B.C.L.R. 183* (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad E. Milne, (1985) 23 Alta. Law Rev. 345, at p. 350-1. Milne in that article made the following observations:

> The preponderance of case law therefore supports the contention that a limited partnership is not a separate legal entity. It appears, nevertheless, that the distinction made in Re Thorne between partnerships and trade unions could not be applied to limited partnerships which, like trade unions, must rely on statute for their validity. The mere fact that limited partnerships owe their existence to the statutory provision is probably not sufficient to endow the limited partnership with the attribute of legal personality as suggested in Ruzicks unless it appeared that the Legislature clearly intended that the limited partnership should have a separate legal existence. A review of the various provincial statutes does not reveal any procedural advantages, rights or powers that are fundamentally different from those advantages enjoyed by ordinary partnerships. The legislation does not contain any provision resembling section 15 of the Canada Business Corporation Act [S.C. 1974-75, c. 33] which expressly states that a corporation has the capacity, both in and outside of Canada, of a natural person. It is therefore difficult to imagine that the Legislature intended to create a new category of legal entity.

It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, The Control Test of Investor Liability in Limited Partnerships (1983), 21 Alta L. Rev. 303; E. Apps, Limited Partnerships and the "Control" Prohibition: Assessing the Liability of Limited Partners (1991), 70 Can. Bar. Rev. 611; R. Flannigan, Limited Partner Liability: A Response (1992), 11 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there

must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner - the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: Control Test, (1992), supra, at pp. 524-5. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-a-vis) any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

It seems to me that using the inherent jurisdiction of this court to supplement the statutory stay provisions of s. 11 of the CCAA would be appropriate in the circumstances; it would be just and reasonable to do so. The business operations of the applicants are so intertwined with the limited partnerships that it would be impossible for relief as to a stay to be granted to the applicants which would affect their business without at the same time extending that stay to the undivided interests of the limited partners in such. It also appears that the applicants are well on their way to presenting a reorganization plan for consideration and a vote; this is scheduled to happen within the month so there would not appear to be any significant time inconvenience to any person interested in pursuing proceedings. While it is true that the provisions of the CCAA allow for a cramdown of a creditor's claim (as well as an interest of any other person), those who wish to be able to initiate or continue proceedings against the applicants may utilize the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain that particular stay. I seems to me that in such a comeback motion the onus would be upon the applicants to show that in the circumstances it was appropriate to continue the stay.

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

FARLEY J.

* * * * *

APPENDIX A

THE STAY

4. THIS COURT ORDERS that each of the Applicants shall remain in possession of its property, assets and undertaking and of the property, assets and undertaking of the Limited Partnerships in which they hold a direct interest (collectively the "Property") until March 15, 1993 (the "Stay Date") and shall be authorized, but not required, to make payment to Conventional Mortgage Creditors and to trade creditors incurred in the ordinary course prior to this Order including, without limitation, fees owing to professional advisors, wages, salaries, employee benefits, crown claims, unremitted source deductions in respect of income tax payable, Canada Pension Plan contributions payable, unemployment insurance contributions payable, realty taxes, and other taxes, if any, owing to any taxing authority and shall continue to carry on its business in the ordinary course, except as otherwise specifically authorized or directed by this Order, or as this Court may in future authorize or direct.

5. THIS COURT ORDERS that without in any way restricting the generality of paragraph 4 hereof, each of the Applicants, whether on behalf of a Limited Partnership or otherwise, be and is hereby authorized and empowered, subject to the existing rights of Creditors and any security granted in their favour, to:

   (a) borrow such additional sums as it may deem necessary,

(b) grant such additional security as it may deem necessary to any lender providing new advances subsequent to the date of this Order provided that such additional security expressly states that it ranks subsequent in priority to all then existing security including all floating charges, whether crystallized or uncrystallized,

(c) grant such additional security as it may deem necessary to any lender providing new advances subsequent to the date of this Order which may rank ahead of existing security if the consent is obtained of all secured creditors having an interest in the collateral in respect of which the additional security is granted to the granting of the additional security, and

(d) dispose of any of its Property subject, however, to the terms of any security affecting same, provided that no disposition of any Property charged in favour of any secured lender shall be made unless such secured lender consents to such disposition and to the manner in which the proceeds derived from such disposition are distributed,

the whole on at least three (3) business days' prior notice to all of the Senior Creditors and the Monitor and on such terms as to notice to any other affected creditor as this Court may direct, but nothing in this Order shall prevent any Applicant, whether on behalf of a Limited Partnership or otherwise, from borrowing further funds or granting further security against the Londonderry Mall substantially in accordance with any existing agreements in order to fund the project completion and leasing costs of the Londonderry Mall and nothing in this Order shall prevent any Senior Creditor from advancing further funds to any of the Applicants or the Limited Partnerships under any existing security, subject to the existing rights of such Senior Creditor and any subordinate creditor including pursuant to any postponements or subordinations as may be extant in respect thereof.

6. THIS COURT ORDERS that, until the Stay Date, the General Partner Company and LUPC shall cause the monthly interest and, as applicable, amortization owing by LUPC under CT1 and CT3, but not the arrears thereof, to be paid as and when due and to cause LUPC to perform all of its obligations to CT in respect of CT2 under its existing arrangement in respect of the segregation and application of the net operating income of the Northgate Mall.

7. THIS COURT ORDERS that, subject to paragraphs 4 and 6 and to subparagraph 5(d) hereof, the Applicants and Limited Partnerships be and are hereby directed, until further Order of this Court:

   (a) to make no payments, whether of capital, interest thereon or otherwise, on account of amounts owing by the Applicants to the Affected Creditors, as defined in the Plan, as of this date; and

   (b) to grant no mortgages, charges or other security upon or in respect of the Property other than for the specific purpose of borrowing new funds as provided for in paragraph 5 hereof.

but nothing in this Order shall prevent the General Partner Company or LUPC from making payments to Senior Creditors of interest and/or principal in accordance with existing agreements and nothing in this Order shall prevent the General Partner Company or the Limited Partnerships from making any funded monthly interest payments for loans secured against the Londonderry Mall.

8. THIS COURT ORDERS that until the Stay Date, the existing collateral position of Creditors in respect of marketable securities loans or credit facilities shall be frozen as at the date of this Order and all margin requirements in respect of such loans or credit facilities shall be suspended.

9. THIS COURT ORDERS that the Applicants shall be authorized to continue to retain and employ the agents, servants, solicitors and other assistants and consultants currently in its employ with liberty to retain such further assistants and consultants as they acting reasonably deem necessary or desirable in the ordinary course of their business or for the purpose of carrying out the terms of this Order or, subject to the approval of this Court.

10. THIS COURT ORDERS that, subject to paragraph 13 hereof, until the Stay Date or further Order of this Court:

(a) any and all proceedings taken or that may be taken by any of the Creditors, any other creditors, customers, clients, suppliers, lessors (including ground lessors), tenants, co-tenants, governments, limited partners, co-venturers, partners or by any other person, firm, corporation or entity against or in respect of any of the Applicants or the Property, as the case may be, whether pursuant to the Bankruptcy and Insolvency Act, S.C. 1992, c. 27, the Winding up Act, *R.S.C. 1985, c. W-11* or otherwise shall be stayed and suspended;

(b) the right of any person, firm, corporation or other entity to take possession of, foreclose upon or otherwise deal with any of the Property, or to continue such actions or proceedings if commenced prior to the date of this Order, is hereby restrained;

(c) the right of any person, firm, corporation or other entity to commence or continue realization in respect of any encumbrance, lien, charge, mortgage, attornment of rents or other security held in relation to the Property, including the right of any Creditor to take any step in asserting or perfecting any right against any Applicant or Limited Partnership, is hereby restrained, but the foregoing shall not prevent any Creditor from effecting any registrations with respect to existing security granted or agreed to prior to the date of this Order or from obtaining any third party consents in relation thereto;

(d) the right of any person, firm, corporation or other entity to assert, enforce or exercise any right, option or remedy available to it under any agreement with any of the Applicants or in respect of any of the Property, as the case may be, arising out of, relating to or triggered by the making or filing of these proceedings, or any allegation contained in these proceedings including, without limitation, the making of any demand, the sending of any notice or the issuance of any margin call is hereby restrained;

(e) no suit, action or other proceeding shall be proceeded with or commenced against any of the Applicants or in respect of any of the Property, as the case may be;

(f) all persons, firms, corporations and other entities are restrained from exercising any extra-judicial right or remedy against any of the Applicants or in respect ,of any of the Property, as the case may be;

(g) all persons, firms, corporations and other entities are restrained from registering or re-registering any of the Property which constitutes securities into the name of such persons, firms, corporations or other entities or their nominees, the exercise of any voting rights attaching to such securities, any right of distress, repossession, set off or consolidation of accounts in relation to amounts due or accruing due in respect of or arising from any indebtedness or obligation as at the date hereof; and

(h) notwithstanding paragraph 9(g) hereof, a Creditor may set off against its indebtedness to an Applicant, as the case may be, pursuant to any existing interest rate swap agreement any corresponding indebtedness of such Applicant, as the case may be, to such Creditor under the same interest rate swap agreement,

but nothing in this Order shall prevent suppliers of goods and services involved in completing the construction of the Londonderry Mall from commencing or continuing with any construction lien claims they may have in relation to the Londonderry Mall and nothing in this Order shall prevent the Bank of Montreal ("BMO") and the Applicants from continuing to operate the existing bank accounts of the Applicants and of the Limited Partnerships maintained with BMO, in the same manner as those bank accounts were operated prior to the date of this Order including any rights of set off in relation to monies deposited therein and nothing in this Order shall prevent CIBC from realizing upon its security in respect of CIBC1 and nothing in this Order shall prevent or affect either FB or CT in the enforcement of the security it holds on the Sutton Place Hotel and the Carleton Place Hotel, respectively.

11. THIS COURT ORDERS that no Creditor shall be under any obligation to advance or re-advance any monies after the date of this Order to any of the Applicants or to any of the Limited Partnerships, as the case may be, provided, however, that cash placed on deposit by any Applicant with any Creditor from

and after this date, whether in an operating account or otherwise and whether for its own account or for the account of a Limited Partnership, shall not be applied by such Creditor, other than in accordance with the terms of this Order, in reduction or repayment of amounts owing as of the date of this Order or which may become due on or before the Stay Date or in satisfaction of any interest or charges accruing in respect thereof.

12. THIS COURT ORDERS that all persons, firms, corporations and other entities having agreements with an Applicant or with a Limited Partnership, as the case may be, whether written or oral, for the supply or purchase of goods and/or services to such Applicant or Limited Partnerships, as the case may be, including, without limitation, ground leases, commercial leases, supply contracts, and service contracts, are hereby restrained from accelerating, terminating, suspending, modifying or cancelling such agreements without the written consent of such Applicant or Limited Partnership, as the case may be, or with the leave of this Court. All persons, firms, corporations and other entities are hereby restrained until further order of this Court from discontinuing, interfering or cutting off any utility (including telephone service at the present numbers used by any of the Applicants or Limited Partnerships, as the case may be, whether such telephone services are listed in the name of one or more of such Applicants or Limited Partnerships, as the case may be, or in the name of some other person), the furnishing of oil, gas, water, heat or electricity, the supply of equipment or other services so long as such Applicant or Limited Partnerships, as the case may be, pays the normal prices or charges for such goods and services received after the date of this Order, as the same become due in accordance with such payment terms or as may be hereafter negotiated by such Applicant or Limited Partnerships, as the case may be, from time to time. All such persons, firms, corporations or other entities shall continue to perform and observe the terms and conditions contained in any agreements entered into with an Applicant or Limited Partnerships, as the case may be, and, without further limiting the generality of the foregoing, all persons, firms, corporations and other entities including tenants of premises owned or operated by any of the Applicants or Limited Partnerships, as the case may be, be and they are hereby restrained until further order of this Court from terminating, amending, suspending or withdrawing any agreements, licenses, permits, approvals or supply of services and from pursuing any rights or remedies arising thereunder.

13. THIS COURT ORDERS that, upon the failure by any of the Applicants to perform their obligations pursuant to this Order, any Creditor affected by such failure may, on at least one day's notice to each of the Applicants and to all Senior Creditors and the Monitor, bring a motion to have the provisions of paragraphs 10, 11 or 12 of this Order set aside or varied, either in whole or in part.

14. THIS COURT ORDERS that from 9:00 o'clock a.m. on December 24, 1992 to the time of the granting of this Order, any act or action taken or notice given by any Creditors receiving such Notice of Application in furtherance of their rights to commence or continue realization, will be deemed not to have been taken or given, as the case may be, subject to the right of such Creditors to further apply to this Court in respect of such act or action or notice given, provided that the foregoing shall not apply to prevent any Creditor who, during such period, effected any registrations with respect to security granted prior to the date of this Order or who obtained third party consents in relation thereto.

15. THIS COURT ORDERS that all floating charges granted by any of the Applicants prior to the date of this Order, whether granted on behalf of any of the Limited Partnerships or otherwise, shall be crystallized, and shall be deemed to be crystallized, effective for all purposes immediately prior to the granting of this Order.

16. THIS COURT ORDERS that the Applicants shall be entitled to take such steps as may be necessary or appropriate to discharge any construction, builders, mechanics or similar liens registered against any of their property including, without limitation, the posting of letters of credit or the making of payments into Court, as the case may be, and no lender to any Applicant shall be prevented from doing likewise or from making such protective advances as may be necessary or appropriate, in which case such lender, in respect of such advances, shall be entitled to the benefit of any existing security in its favour as of the date of this Order in accordance with its terms.

17. THIS COURT ORDERS that the Applicants on or before January 1, 1993, shall provide the Senior Creditors with projections as to the monthly general, administrative and restructuring ("GAR") costs for the months of January, February and March, 1993, together with a cash-flow projection for LUPC for the period commencing on January 1, 1993 through to April 30, 1993 inclusive.

18. THIS COURT ORDERS that, notwithstanding the terms of this Order, the gross operating cash flow generated during the period commencing on the date of this Order to and until the Stay Date (the "Interim Period") by the Londonderry Mall shall be reserved and expended on the property in accordance with existing agreements, but all property management or other similar fees payable to any Applicant shall continue to be paid therefrom subject to the terms of any existing loan agreements affecting same.

End of Document

TAB 10

Doman Industries Ltd. (Re)

British Columbia Judgments

British Columbia Supreme Court

Vancouver, British Columbia

Tysoe J. (In Chambers)

Oral judgment: May 25, 2004.

Vancouver Registry No. L023489

[2004] B.C.J. No. 1149 | 2004 BCSC 733 | 29 B.C.L.R. (4th) 178 | 45 B.L.R. (3d) 78 | 1 C.B.R. (5th) 7 | 131 A.C.W.S. (3d) 859 | 2004 CarswellBC 1262

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 AND IN THE MATTER OF The Company Act, R.S.B.C. 1996, c. 62 AND IN THE MATTER OF The Canada Business Corporations Act, R.S.C. 1985, c. C-44 AND IN THE MATTER OF The Partnership Act, R.S.B.C. 1996, c. 348 AND IN THE MATTER OF Doman Industries Limited, Alpine Projects Limited, Diamond Lumber Sales Limited, Doman Forest Products Limited, Doman's Freightways Ltd., Doman Holdings Limited, Doman Investments Limited, Doman Log Supply Ltd., Doman-Western Lumber Ltd., Eacom Timber Sales Ltd., Western Forest Products Limited, Western Pulp Inc., Western Pulp Limited Partnership, and Quatsino Navigation Company Limited, petitioners

(38 paras.)

Case Summary

Corporations and associations law — Corporations — Fundamental changes — Arrangement — Creditors & Debtors law — Legislation — Debtors' relief — Companies' creditors arrangement act — Natural resources law — Timber.

Application by the petitioner Western Forest Products for authorization or approval of the termination of contracts. Western Forest products was a division of Doman Industries. Doman Industries carried on business in the forestry industry. It had sought protection under the Companies' Creditors Arrangement Act in an attempt to restructure its debts. The process of restructuring was nearing completion. Western Forest Products held several forest tenures. The logging of certain tenures had been contracted to Hayes and Strathcona. The contractors were protected under the Forest Act. The Forest Act dictated that Western Forest Products must offer a new or replacement contract to the contractors upon each expiry of the term of the contract so long as the contractor was not in default under the contract. Western Forest Products claimed that by terminating the contracts, they could achieve significant savings. Hayes and Strathcona disputed the quantum of savings that would be achieved and opposed the termination of the contracts.

HELD: Application dismissed.

The court had the jurisdiction under the Companies' Creditors Arrangement Act to cancel the contracts. The contracts could have been repudiated by Western Forest Products prior to the commencement of Companies' Creditors Arrangement Act proceedings. The cancellation was not necessary to achieve profitability for Doman Industries. While it was shown that the cancellation would achieve a savings for Western Forest Products, it was not shown that that savings was crucial to the success of the restructuring proposal. It was not shown that the prejudice to Hayes and Strathcona was ought weighed by the benefit to Western Forest Products.

Statutes, Regulations and Rules Cited:

Sylvan Lange

Canada Business Corporations Act.

Company Act.

Companies' Creditors Arrangement Act.

Forest Act.

Forestry Revitalization Act.

Partnership Act.

Counsel

Counsel for the Petitioner, Western Forest Products Ltd.: E.J. Harris, Q.C. and P.D. McLean

Counsel for Hayes Forest Services Ltd.: I.G. Nathanson, Q.C. and S.R. Schachter, Q.C.

Counsel for Tricap Restructuring Fund: M.I. Buttery

Counsel for Strathcona Contracting Ltd.: S.R. Ross

Counsel for Committee of Unsecured Noteholders: K. Zych

Counsel for Petro-Canada Inc.: C.E. Hirst

TYSOE J. (orally)

1 One of the Petitioners, Western Forest Products Ltd., ("Western") applies, in these proceedings under the Companies Creditors Arrangement Act (the "CCAA") involving the Doman group of companies, for authorization or approval of the termination of contracts it has with Hayes Forest Services Ltd. ("Hayes") and Strathcona Contracting Ltd. ("Strathcona").

2 The Doman group of companies ("Doman") carry on business in the B.C. forestry industry. Doman encountered financial difficulties and has been in the process of attempting to restructure under the CCAA for approximately one and a half years. The liabilities of Doman consist of secured term debt in the principal amount of U.S. $160 million, unsecured term notes in the principal amount of U.S. $513 million, unsecured trade debt in excess of $20 million, a secured operating line of credit and other miscellaneous obligations.

3 The restructuring process is nearing completion. A plan of compromise and arrangement (the "Restructuring Plan") has been filed and the meeting of creditors to consider it has been scheduled to be held in approximately two weeks. The deadline for creditors to file proofs of claim is today.

4 In very simple terms, the Restructuring Plan contemplates that the lumber and pulp assets of Doman will be transferred into new corporations and that the unsecured noteholders, trade creditors and other unsecured creditors will have their debt converted into shares in one of the new corporations, which will own the lumber assets and the shares of the other corporation holding the pulp assets. The secured term debt is to be refinanced and the secured

operating line of credit will be unaffected. The existing shareholders of Doman are to receive warrants entitling them to purchase a limited number of shares in the new parent corporation.

5 The implementation of the Restructuring Plan is subject to the fulfilment of numerous conditions precedent. One of the conditions is the termination of the contracts with Hayes and Strathcona which are the subject matter of this application.

6 Western holds certain forest tenure, including licenses relating to an area known as the Nootka Region on Vancouver Island and at least one island off the coast of Vancouver Island called Nootka Island. In 1991, the B.C. government decided that logging contractors should have a form of security similar to the tenure enjoyed by license holders and created the concept of replaceable contracts under the Forest Act.

7 The attributes of replaceable contracts were discussed at length by the B.C. Court of Appeal in Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., *[2003] B.C.J. No. 1335*, *2003 BCCA 344* and I will not repeat all of them here. In short, a replaceable contract is a form of evergreen contract which contains statutorily mandated provisions, the most important of which is that the license holder must offer a new or replacement contract to the contractor upon each expiry of the term of the contract as long as the contractor is not in default under the contract. If the parties are not able to agree on the new rates under the replacement contract, an arbitrator will determine the rates, which are mandated to be competitive within the industry and to permit the contractor to earn a reasonable profit on top of its costs. The contractors with such contracts are known in the industry as Bill 13 contractors. A license holder must have at least 50% of its annual allowable cut harvested by Bill 13 contractors.

8 Western has 7 full-phase Bill 13 logging contracts with 6 contractors for the Nootka Region. Hayes is one of those contractors and it has the full-phase contract for the Plumper Harbour area of the Nootka Region. A full-phase contract includes all aspects of logging ranging from road construction, falling, hauling, sorting and delivery to transportation points. Hayes sold the road construction aspect of its contract, and the replaceable contract for road construction was assigned to Strathcona.

9 When Doman first commenced these CCAA proceedings, it was anticipated that the restructuring process would be completed in a relatively short period of time. It was contemplated that all unsecured debt other than the unsecured bondholders would be paid in full and that the unsecured bondholders would take most, but not all, of the equity in Doman in exchange for some of the indebtedness owed to them and would take security for the remainder of their indebtedness. The confirmation or come-back Order of December 6, 2002 authorized a downsizing process for Doman, but it was not instituted in view of the anticipated restructuring.

10 The restructuring initially contemplated by Doman did not take place, in part because I made a ruling that the covenants in the trust deed for the secured term debt could not be overridden into the future. By the beginning of April 2004, the unsecured bondholders were pressing for their own restructuring plan and had made it clear that there should be some downsizing in Doman's operations, particularly the closure of Doman's pulp mill in Port Alice. On April 6, 2004, I declined Doman's application for an extension of the stay for the sole purpose of pursuing refinancing of its debt and the sale of the Port Alice pulp mill, but I also declined an application of the unsecured bondholders to call a meeting of creditors to consider its plan of arrangement. I extended the stay for the purpose of allowing Doman to file its own restructuring plan while still pursuing refinancing and sale alternatives, but I imposed a fairly concrete deadline by directing that the creditors meeting be held on June 7. In my April 6 Order, I authorized Doman to reinstitute its downsizing process with special emphasis on the closure of the Port Alice pulp mill if a purchaser was not located. I also placed a restriction on any downsizing by providing that any termination of a replaceable contract under the Forest Act was not to be effective unless authorized by the court.

11 By letters dated April 27, 2004, Western terminated its contracts with Hayes and Strathcona effective upon court approval of the terminations. An affidavit of Mr. Zimmerman, a Western employee, provided the following rationale for the decision to terminate these replaceable contracts:

> As part of the reorganization and "downsizing" processes of [Western], we have looked at methods to rationalize harvesting operations in the Nootka Region so as to reduce costs and improve profitability of [Western]. [Western] has worked in conjunction with representatives of the Bondholder committee who have asked for recommendations so as to increase profitability. [Western] has determined that within the Nootka Region, operational efficiencies can be achieved and significant cost savings can be achieved if the number of contractors is reduced and if that contractor's allocated volume is re-allocated to the remaining contractors. [Western] has recommended this reduction to the Bondholders Committee and the representatives of the Committee have asked that [Western] institute a rationalization and termination of contract, which is subject to Court approval as provided in this Court's Order of April 6, 2004.

The affidavit goes on to state that the rationalization can best be carried out by the termination of the Plumper Harbour contracts, principally because the contractor costs associated with this location are the highest in the Nootka Region. The volume under the contracts would then be re-allocated to other Bill 13 contractors in the Nootka Region. The average contract rate for logging a cubic metre of timber under the Hayes contract for the period from 1998 to 2001, as determined by arbitration, was approximately $4 higher than the average rate under the other contracts for the Nootka Region.

12 Mr. Zimmerman's affidavit indicated that Western did not intend to harvest at Plumper Harbour for the next three years and set out the savings that Western would be able to achieve by terminating the Hayes and Strathcona contracts. These savings were estimated at $5 million over the next three years and $800,000 for each year thereafter. These included annual savings of approximately $165,000 in road building costs, but the main reason Western wants to terminate its contract with Strathcona is that the full-phase contractor replacing Hayes may have its own road building capabilities. Mr. Zimmerman also exhibited to his affidavit a proposal which Hayes had made to Western in 1999 whereby Hayes offered to exchange its rights under its Bill 13 contract for the exclusive right to do helicopter logging in the Nootka Region with an annual minimum guarantee. In the proposal, Hayes stated that the average cut for many of the Bill 13 contractors had been reduced below an efficient economic operating level and that higher costs were being passed on to Western. The proposal was not accepted by Western because it did not want to give exclusive rights for helicopter logging with a guaranteed entitlement.

13 Representatives of Hayes and Strathcona swore affidavits disputing that the savings would be of the magnitude estimated by Mr. Zimmerman. They also set out the prejudice which their companies would suffer if the contracts were terminated, including the loss of employment and the inability to utilize fixed assets. Mr. Hayes deposed that there is no reasonable or rational economic reason for Western to forego harvesting in Plumper Harbour this year because most of the engineering and road construction costs have already been incurred. Mr. Hayes estimated that if Western harvested the timber on its logging plan for this year in Plumper Harbour, it would receive revenue, net of additional harvesting costs, of approximately $2 million.

14 The affidavit of Mr. Hayes also stated that Hayes recognized that the operations of the Bill 13 contractors in the Nootka Region are inefficient, unwieldy and costly. Despite this acknowledgment, Mr. Hayes expressed a view that the termination of its contract will not have a material impact on cost reduction in the Nootka Region when one takes into account that the Province will be taking back approximately 20% of Western's annual allowable cut in the Nootka Region pursuant to the recently enacted Forestry Revitalization Act and will thereby cause a reduction in the volumes harvested by all of the Bill 13 contractors. No affidavit was sworn by a Western representative to dispute this statement.

15 Mr. Zimmerman, Mr. Hayes and the deponent on behalf of Strathcona were cross-examined on their affidavits. In his cross-examination, Mr. Zimmerman stated that Western did intend to liquidate the developed timber at Plumper Harbour of approximately 130,000 cubic metres over the next two years before putting the area in abeyance for a three year period. Western has not introduced any evidence with respect to the anticipated costs if this developed timber is harvested or is harvested by other Bill 13 contractors rather than Hayes.

16 In addition to the Skeena Cellulose decision which dealt with the termination of replaceable contracts in CCAA

proceedings, counsel referred me to several other cases involving the termination of contracts, leases or licenses in CCAA proceedings.

17 In Re Dylex Ltd., *[1995] O.J. No. 595* (Ont. Ct. of Jus.), Farley J. authorized the insolvent company to repudiate the leases of three of its stores as part of a program to close 200 of its stores across Canada. The three stores had been a financial drain on Dylex. Although the closures were going to have a detrimental effect on the shopping centres in which the stores were located, Farley J. held that in weighing the balancing of interests in a CCAA context, the court's discretion should be exercised in favour of Dylex over the landlord, which was in sound financial condition. Farley J. declined to import into the CCAA the requirement applicable to proposals under the Bankruptcy and Insolvency Act that the insolvent company has to show that it would not be able to make a viable proposal unless it terminated the leases in question.

18 In Re Blue Range Resource Corp., *[1999] A.J. No. 788*, *1999 ABQB 1038*, the insolvent company had been authorized by the court under the initial stay order to terminate such of its contracts as it deemed appropriate to permit it to proceed with an orderly restructuring of its business. Blue Range terminated some of its natural gas supply contracts and three of the parties to such contracts sought to challenge the termination of their contracts. One of the issues they raised was that the stay order should be varied to provide that Blue Range would only be permitted to terminate the contracts if it was incapable of performing them or if the termination was essential to the success of their restructuring. Lo Vecchio J. dismissed the application to vary the stay order in this fashion. He made the following comments at paras. 36 through 38, which have been quoted in subsequent cases:

> The purpose of the CCAA proceedings generally and the stay in particular is to permit a company time to reorganize its affairs. This reorganization may take many forms and they need not be listed in this decision. A common denominator in all of them is frequently the variation of existing contractual relationships. Blue Range might, as any person might, breach a contract to which they are a party. They must however bear the consequences. This is essentially what has happened here.
>
> A unilateral termination, as in any case of breach, may or may not give rise to a legitimate claim in damages. Although the Order contemplates and to a certain extent permits unilateral termination, nothing in Section 16.e or in any other part of the Order would suggest that Blue Range is to be relieved of this consequence; indeed Blue Range's liability for damages seems to have been assumed by Duke and Engage in their set-off argument. The application amounts to a request for an order of specific performance or an injunction which ought not to be available indirectly. In my view, an order authorizing the termination of contracts is appropriate in a restructuring, particularly given that it does not affect the creditors' rights to claim for damages.
>
> The Applicants are needless to say not happy about having to look to a frail and struggling company for a potentially significant damages claim. They will be relegated to the ranks of unsecured judgment creditors and may not, indeed likely will not, have their judgments satisfied in full. While I sympathize with the Applicants' positions, they ought not to, in the name of equity, the guide in CCAA proceedings, be able to elevate their claim for damages above the claims of all the other unsecured creditors through this route.

19 Lo Vecchio J. held that the court has the necessary jurisdiction to permit termination of contracts and that the termination of the contracts in question was necessary to the company's survival program.

20 In Re T. Eaton Co., *[1999] O.J. No. 4216* (Ont. Sup. Ct. of Jus.), Farley J. refused to order specific performance of an exclusive license to provide credit card services that had been repudiated by the insolvent company as part of a sale of its assets which was the foundation of its restructuring plan. He held that the licensee could be adequately compensated in damages and should not have a higher claim than any other unsecured creditor. In the course of his reasons, he quoted the above portions of the Blue Range decision, and said the following at para. 7:

> It is clear that under CCAA proceedings debtor companies are permitted to unilaterally terminate in the sense of repudiate leases, and contracts without regard to the terms of those leases and contracts including any restrictions conferred therein that might ordinarily (i.e. outside CCAA proceedings) prevent

> the debtor company from so repudiating the agreement. To generally restrict debtor companies would constitute an insurmountable obstacle for most debtor companies attempting to effect compromises and reorganizations under the CCAA. Such a restriction would be contrary to the purposive approach to CCAA proceedings followed by the courts to this date.

Farley J. also spoke about being cognizant of the function of a balancing of prejudices within the general approach to the CCAA.

21 The issue of the court's jurisdiction to authorize the termination of replaceable contracts under the B.C. Forest Act was first addressed in the predecessor to the CCAA proceedings of Skeena Cellulose, Re Repap British Columbia Inc., June 11, 1997, Docket No. A970588 (B.C.S.C.). Thackray J. held that the court had the jurisdiction under the CCAA to authorize the insolvent company to terminate replaceable contracts. None of the replaceable contracts in question were actually terminated until the subsequent Skeena Cellulose proceedings.

22 In the Skeena Cellulose proceedings, the come-back order authorized the company to terminate replaceable contracts in order to facilitate the downsizing and consolidation of its business and operations. As part of Skeena Cellulose's plan of compromise and arrangement, a third party agreed to purchase the shares in the company for $8 million, which was to be used for distribution to the creditors having claims in excess of $400 million. It was a condition precedent to the purchase that two of Skeena Cellulose's five replaceable contracts be terminated, and letters of termination were sent. The two contractors applied to the court for a declaration that the terminations were invalid.

23 Brenner C.J.S.C. dismissed the application. In his decision (cited at *[2002] B.C.J. No. 2003*, *2002 BCSC 1280*), he said the following at para. 25:

> SCI has no authority to decline to replace the applicants' replaceable contracts under the terms of those contracts, or in accordance with the provisions of the Regulation that deal with when and how a replaceable contract can be terminated. The only authority for SCI to terminate, or indeed, jurisdiction for this court to approve such terminations, must be found in the terms of the Come-back Order, and in the provisions of the CCAA. To be effective, the terminations must:
>
> (a) comply with the procedures and conditions stipulated in the Come-back Order; and,
>
> (b) conform to the broader principles of economic necessity and fairness which underlie the court's discretionary jurisdiction under the CCAA.

Brenner C.J.S.C. expressed the view that the statutory privileges given to the Bill 13 contractors are not sufficient to justify the creation or recognition of a preference in favour of the contractors over other creditors.

24 The appeal from Brenner C.J.S.C.'s decision was dismissed. In its decision, the B.C. Court of Appeal held that the court had an equitable jurisdiction to supplement the CCAA by approving a plan of arrangement which contemplates the termination of contracts by the debtor corporation. Newbury J.A. held that in approving such a plan involving the termination of replaceable contracts, the court was not overriding provincial legislation because nothing in the legislation purported to invalidate a termination of a replaceable contract but that, in any event, the doctrine of paramountcy would result in preference being given to the CCAA over the B.C. Forest Act in the case of a conflict.

25 The Court of Appeal found no error in the exercise of discretion by Brenner C.J.S.C. Newbury J.A. said the following about the concept of fairness at para. 60:

> I have no difficulty in accepting the appellants' argument that fairness as between them and the other three evergreen contractors and as between the appellants and Skeena was a legitimate consideration in the analysis of this case. (Indeed, I believe the Chief Justice considered this aspect of fairness, even though he did not mention it specifically in this part of his Reasons.) The appellants are obviously part of the "broad

> constituency" served by the CCAA. But the key to the fairness analysis, in my view, lies in the very breadth of that constituency and wide range of interests that may be properly asserted by individuals, corporations, government entities and communities. Here, it seems to me, is where the flaw in the appellants' case lies: essentially, they wish to limit the scope of the inquiry to fairness as between five evergreen contractors or as between themselves and Skeena, whereas the case-law decided under the CCAA, and its general purposes discussed above, require that the views and interests of the "broad constituency" be considered. In the case at bar, the Court was concerned with the deferral and settlement of more than $400 million in debt, failing which hundreds of Skeena's employees and hundreds of employees of logging and other contractors stood to lose their livelihoods. The only plan suggested at the end of the extended negotiation period to save Skeena from bankruptcy was NWBC's acquisition of its common shares for no consideration and the acceptance by its creditors of very little on the dollar for their claims.

The Court of Appeal concluded that there was a business case for the terminations. Newbury J.A. stated that the situation in Dylex was no different in principle because, like the leases in Dylex, the replaceable contracts were too costly for Skeena Cellulose to continue operating under them.

26 Although the Court of Appeal's decision in Skeena Cellulose settles that the court has the necessary jurisdiction to deal with the termination of contracts, none of the above decisions includes any detailed discussion with respect to the basis upon which the court becomes involved in decisions to terminate contracts. Newbury J.A. discussed the jurisdiction in terms of the court approving a plan of arrangement which involves the termination of contracts, but the court will often authorize the termination of contracts prior to the formulation of a plan of arrangement.

27 If a debtor company repudiated a contract prior to commencing CCAA proceedings, the court would not have any direct involvement in the termination of the contract unless, possibly, the other party to the contract sought specific performance of the contract (which, as Brenner C.J.S.C. pointed out in Skeena Cellulose, is particularly inappropriate in an insolvency). The other party to the contract would have a claim for damages in respect of the repudiation and would be treated like any other unsecured creditor for the purposes of the plan of arrangement.

28 Once an insolvent company seeks the assistance of the court by commencing CCAA proceedings, the company comes under the supervision of the court. The supervision also involves a consideration of the interests of the broad constituency served by the CCAA mentioned in Skeena Cellulose by Newbury J.A. These interests, when coupled with the exercise by the court of its equitable jurisdiction, bring into play the requirements for fairness and reasonableness in weighing the interests of affected parties.

29 Generally speaking, the indebtedness compromised in CCAA proceedings is the debt which is in existence at the time of the CCAA filing, and the debtor company is expected to honour all of its obligations which become owing after the CCAA filing. It is common for the initial stay order or the come-back order to provide that the debtor company is to continue carrying on its business and to honour its ongoing obligations unless the court authorizes exceptions.

30 In many reorganizations under the CCAA, it is necessary for the insolvent company to restructure its business affairs as well as its financial affairs. Even if the financial affairs are restructured, the company may not be able to survive because portions of the business will continue to incur ongoing losses. In such cases, it is appropriate for the court to authorize the company to restructure its business operations, either during the currency of the CCAA proceedings or as part of a plan of arrangement. The process is commonly referred to as a downsizing if it involves certain aspects of the business coming to an end. The liabilities which are incurred as a result of the restructuring of the business operations, for such things as termination of leases and other contracts, are included in the obligations compromised by the plan of arrangement even though the debtor company will have been honouring its ongoing commitments under the leases and other contracts after the commencement of the CCAA proceedings. The inclusion of these liabilities in the plan of arrangement is an exception to the general practice of debtor companies paying the full extent of post-filing liabilities and compromising only the pre-filing liabilities.

31 It is within this context that the court is called upon to authorize the termination of contracts which the debtor

company could have repudiated without any authorization prior to the commencement of CCAA proceedings. The liabilities to be compromised have, in general terms, been crystallized by the filing of the CCAA petition, and the affairs of the debtor company are under the supervision of the court, which is required to exercise its equitable jurisdiction fairly and reasonably.

32 I do not approach the matter in the same fashion as Lo Vecchio J. did in Blue Range. I do not see the resistance of a party to the termination of a contract with the debtor company to be an attempt to elevate their claim for damages above the claims of all the other unsecured creditors. Apart from any monies which may have been outstanding under the contract at the time of the CCAA filing, the party to the contract was not an unsecured creditor who was going to be subjected to a compromise under a plan of arrangement. The party only becomes a creditor in respect of its damage claim if the contract is terminated. Although Lo Vecchio J. could be interpreted as suggesting in the quoted paragraphs 36 to 38 that a debtor company may terminate contractual relations as long as the resulting damage claim is included in its plan of arrangement, I do note that he subsequently commented that the termination of the contracts in that case was necessary to the company's survival program.

33 I prefer the approach of Farley J. in Dylex, which involves the court weighing the competing interests and prejudices in deciding what is fair and reasonable. I would anticipate that in the majority of cases a debtor company will be able to persuade the court to exercise its discretion in favour of the termination of contracts and other steps required to downsize or rationalize its business affairs. A debtor company must be insolvent to qualify under the CCAA and the insolvency may have been caused by over-expansion or continual losses by a part of the business. If the company is to have a reasonable prospect of surviving into the indefinite future, it will be appropriate to downsize its operations or bring an end to the losing aspects of the business. The interests of the broad constituency of stakeholders in taking reasonable steps to ensure the ongoing viability of the business will often outweigh the prejudice caused to parties having their contracts or other arrangements with the debtor company terminated and their consequential damage claim being included in the plan of arrangement. There is no single test for the debtor company to satisfy apart from demonstrating that the termination is fair and reasonable in all of the circumstances. As held in Dylex, it is not necessary for the debtor company to demonstrate that the termination of the contract is essential to the making of a viable plan of arrangement.

34 An example of this type of situation has already occurred in these proceedings. Doman's pulp mill at Port Alice has been losing money for a significant period of time and causing a financial drain on Doman's resources. At the suggestion of the bondholders, it was decided that the mill should be closed and should not be part of the restructured company. Although the closure of the mill would have had a devastating effect on the employees of the pulp mill and the Village of Port Alice as a whole, I authorized the closure because it would not have been reasonable to require the restructured company to operate a division of its business which was anticipated to continue to lose money. Fortunately, Doman was able to find another party who was willing to take over the pulp mill prior to its closure.

35 On the other hand, there will be circumstances where it will not be appropriate to authorize the debtor company to terminate contracts. For example, suppose that a debtor company became insolvent because its business had been operating at a loss but market conditions had changed and, with a financial restructuring of its existing debt, it was expected to be profitable in the future. Suppose further that the debtor company was party to a contract which did not cause the company to operate the relevant aspect of its business at a loss but the contract was not as favourable as the market would permit the company to obtain if it could divest itself of the existing contract. If the company could terminate the contract and enter into a new one with different rates, it could become substantially more profitable into the future. In these circumstances, it may well be inappropriate for the court to authorize the termination of the contract. The risk of the failure of the debtor company after its restructuring would be relatively low and, depending on the terms of the plan of arrangement, the future benefit of the contract termination may accrue to the shareholders of the company or to the creditors of the company who took risks in exchange for high rates of return.

36 On the present application, all that the evidence establishes is that Doman will likely be able to reduce its costs to some extent at some point in the future if it can terminate the two contracts in question. Mr. Zimmerman's

affidavit states that the reason Western made the recommendation to terminate the two contracts was to improve or increase its profitability. There is no evidence on this application with respect to the following points:

(a) whether the logging at Plumper Harbour under the existing contracts has produced a loss in the past or is expected to produce a loss in the future;

(b) whether other logging operations of Doman produce a greater loss;

(c) whether other aspects of Doman's business produce a loss and, if so, what consideration has been given to rationalizing that loss in comparison to the termination of the contracts in question;

(d) whether it is expected that the restructured company will operate at a profit;

(e) what parts of the constituency of stakeholders will benefit from the termination of the contracts in question;

(f) whether the developed timber at Plumper Harbour can be harvested in the next two years by other contractors at a cost less than the cost under the contracts in question; and

(g) what is the fallacy, if any, in the assertion of Mr. Hayes that the termination of the contracts will have no material impact on cost reduction after taking into account the 20% government take-back.

37 Some reliance was placed by counsel on the fact that the termination of these contracts is a condition precedent of the Restructuring Plan. In my view, this condition precedent is materially different than the condition precedent in Skeena Cellulose. In that case, it was an independent purchaser of the shares in Skeena that negotiated the condition on the basis that it was not prepared to purchase the shares unless two of the five replaceable contracts were terminated. The condition resulted from an arm's length negotiation which required the purchaser to put up funds to purchase the shares. In the present case, the bondholder committee produced the initial draft of the Restructuring Plan, which was finalized after a limited negotiation that served to advance the interests of the existing directors and shareholders of Doman. The condition precedent in question was not contained in the initial draft of the Restructuring Plan put forward by the bondholders and there is no evidence as to why the condition was inserted in the Restructuring Plan. I am unable to conclude that the condition precedent was the result of a truly adversarial negotiation and that, unlike the situation in Skeena Cellulose, the restructuring is unlikely to proceed if the condition is not satisfied.

38 In my opinion, therefore, there is insufficient evidence for me to conclude that the proposed contract terminations are fair and reasonable in all of the circumstances. All that the evidence available to me supports is a conclusion that the restructured company will have an opportunity of being more profitable if the contracts are terminated. It has not been demonstrated that the loss of this opportunity will outweigh the prejudice which will be suffered by Hayes and Strathcona if the contracts are terminated. In weighing the competing interests on the evidence before me, it is my conclusion that I should exercise my discretion against approving the contract terminations. I dismiss the application with costs.

TYSOE J.

End of Document

TAB 11

Boutique Jacob inc. (Arrangement relating to) **2011 QCCS 276**

SUPERIOR COURT

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL

NO: 500-11-039940-107

DATE: FEBRUARY 2, 2011

UNDER THE CHAIR OF: **THE HONORABLE** **MARTIN CASTONGUAY, JCS**

IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF:

JACOB STORE INC.
And
9101-2096 QUEBEC INC.
And
9192-4126 QUÉBEC INC.
Petitioners

And

PRICEWATERHOUSECOOPERS INC.
Monitor

And

AUSTEVILLE PROPERTIES LTD.
Petition

JUDGMENT

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[1] Austeville Properties Ltd. (hereinafter “Austeville”), asks the Court to annul the notice of termination sent to it on December 22, 2010 Boutique Jacob inc. (hereinafter "Jacob"), relating to the rental of premises located at 475 West Georgia Street, in Vancouver, British Columbia (hereinafter the "Leased Premises").

[2] To support his request, Austeville mainly relies on the particular facts surrounding the signing of the various agreements that have taken place, just as this termination would cause him a significant financial loss.

[3] Jacob contests this request by invoking his explicit right to terminate certain contracts, as part of his reorganization, all in accordance *with the Companies' Creditors Arrangement Act* [1] (hereinafter the "Act") .

[4] Jacob also argues that Austeville has not demonstrated that this termination will cause him "serious financial difficulties".

FACTS

[5] Jacob, in the early 2000s, operated some 18 outlets in Western Canada (Manitoba, Alberta, British Columbia).

[6] Over the years, expansion requires, this number of points of sale increases to 34 in 2010.

[7] The day-to-day administration of these retail businesses requires a management team of five people. They occupy the Leased Premises with an area of 1,973 square feet in a building of 98,000 square feet.

[8] The business relationship between the parties began in November 2005, when they first sign a lease for the leased locations, duration is from 1st February 2006 to 31 January 2009 [2] .

[9] On July 30, 2008, the parties agreed to certain modifications to the lease, namely for a term of two years at the rate of $ 23 per square foot. Particularly, Jacob can put an end to it at any time, by giving Austeville six months' notice. The rental is from 1st February 2009 to 31 January 2011 [3] .

[10] In May 2010, the parties begin new negotiations which will result in an agreement that the parties refer to as “Lease Modification and Extension”) [4] .

[11] The main changes are as follows:

a) New term of five years commencing on 1st October 2010;

b) For the months of October, November and December 2010, Jacob benefits from a free occupation;

c) The rate per square foot goes from $ 23 to $ 20;

d) Jacob gives up the right to terminate the lease on simple six months' notice.

[12] Mrs. Hélène D'Amour (hereafter “D'Amour”), notary by training and director of the real estate sector at Jacob, reports that this negotiation was carried out in the normal course of business, Jacob seeking the best agreement financial possible.

[13] D'Amour specifies that the negotiation and analysis of leases are his responsibility, the formal commitment, either the signing of leases or agreements, is the work of Jacob's sole administrator, Mr. Joseph. Basmaji. Moreover, the document noting the modifications to the lease is signed by it.

[14] D'Amour, at the time of the negotiation of modifications to the lease of the Leased Premises, was not informed of Jacob's financial difficulties.

[15] D'Amour explains that since November 2010 and as part of his reorganization, Jacob has terminated the leases of seven outlets in Western Canada, while six others have been the subject of an agreement. particular. This stipulates that the rent payable is based on sales made by Jacob and that the landlord in question can terminate the agreement with 60 days' notice.

[16] According to D'Amour, the situation of these six points of sale is temporary, each finding its account. Jacob only pays according to sales and the landlord has a minimum of income, the time to find another tenant.

[17] Be that as it may, due to the decrease in outlets in Western Canada, the administrative staff will be reduced from five to three employees.

[18] D'Amour was also very involved in the real estate aspect of Jacob's restructuring and soon found that the Leased Premises were superfluous under the circumstances, as the three employees could be relocated within outlets.

[19] Hence Jacob's decision to terminate the lease for the Leased Premises. The Controller testified to his agreement with this decision, he also signed jointly with Jacob the notice of termination sent to Austeville [5] .

[20] This is the gist of the evidence put forward by Jacob as to the lease binding her to Austeville.

[21] Austeville did not produce a witness and relies on the affidavit signed by Mr. Christopher Samis "Chief Financial Officer" of Austeville.

[22] This two paragraph affidavit indicates that the facts alleged in the Motion are true.

[23] This, in addition to the facts surrounding the various negotiations surrounding the leases that took place with regard to the Leased Premises and which are not denied, argues that Jacob, in May 2010, was already in restructuring mode and that it is in all knowledge of the facts that she has signed the Lease Modification Agreement granting her three months of free rent.

[24] In fact, the main part of his argument can be found in paragraphs 23 and 24 of his Application, which the Tribunal considers it useful to reproduce:

> "23. Therefore, this Court should not allow Jacob, after having benefited from a free rent period, to resiliate the Lease that had been duly negociated at a time where Jacob was well aware that its situation was just as precarious as it was on November 18, 2010 when Jacob obtained the issuance of the initial order.
>
> 24. If the proposed resiliation is to take place, Austeville will suffer significant financial losses , notably in that it will not be able to collect rent in the amount of $ 334,962.79 ($ 184,146.67 owed as Basic Rent and an estimated $ 150,816.12 owed as Additional Rent (as these terms are defined in the Lease)).
>
> (our emphasis)

[25] The Motion, like Jacob's contestation, finds its basis in section 32 of the Act, which reads as follows:

> "Termination of contracts
>
> **32.** (1) Subject to subsections (2) and (3), the debtor company may - on notice given in the prescribed form and manner to the other parties to the contract and to the controller and after obtaining the acquiescence of the latter - here with regard to the termination project - terminate any contract to which it is a party on the date on which proceedings were instituted under this law.
>
> Challenge
>
> (2) Within fifteen days after the date on which the company gives the notice referred to in subsection (1), any party to the contract may, by giving notice to the other parties to the contract and to the controller, apply to the court to order that the contract not be terminated.
>
> Lack of consent from the controller
>
> (3) If the monitor does not agree to the termination plan, the company may, upon notice to the other parties to the contract and to the monitor, request the court to order termination of the contract.
>
> Factors to consider
>
> (4) In deciding whether to make the order, the court shall consider, among others, the following factors:
>
> *a*) the controller's acquiescence to the termination plan, if applicable;
>
> *(b*) whether the termination will promote the conclusion of a viable transaction or arrangement with respect to the company;
>
> *(c*) the risk that the termination is likely to cause serious financial hardship to a party to the contract.
>
> Termination
>
> (5) The contract is terminated:

(a) thirty days after the date on which the company gives the notice referred to in subsection (1), if no request is made under subsection (2);

(b) thirty days after the date on which the company gives the notice referred to in subsection (1) or on a later date fixed by the court, if the latter denies the application made under subsection (2);

(c) thirty days after the date on which the company gives the notice referred to in subsection (3) or on any later date fixed by the court, if the latter orders the termination of the contract under that paragraph.

Intellectual property

(6) If the company has contractually authorized a person to use an intellectual property right, the termination does not prevent the person from using it or enforcing the exclusive use of it, provided that it complies with its contractual obligations with regard to the use of this right, for the period provided for in the contract and for any additional period of which it can and decides to avail itself of its own accord.

Losses arising from termination

(7) In the event of termination of the contract, any party to it who suffers losses arising from the termination is deemed to have a provable claim.

Reasons for termination

(8) Within five days of the date on which a party to the contract so requests, the company shall provide it in writing with the reasons for its proposed termination.

Exceptions

(9) This section does not apply to the following contracts:

a) eligible financial contracts;

b) collective agreements;

(c) financing agreements under which the company is the borrower;

(d) leases of immovables or real property under which the company is the lessor. "

[26] Section 32 of the Act has been in force since September 18, 2009.

[27] Prior to its entry into force, Canadian courts, faced with situations of termination of contracts, and in the absence of clear legislative provisions, resorted to the theory of inherent jurisdiction to decide this issue.

[28] Here is how Justice Farley of the Supreme Court of Ontario expressed himself in the *Dylex* case ***[6]*** :

> “[8] It is clear that s. 11 of the CCAA gives the power to the court to sanction a plan which includes termination of leases as part of the debtor's plan of arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 1991 CanLII 8306 (ON SCDC) , 86 DLR (4th) 621 (Ont. Gen. Div.), At p. 625; *Re Armbro Enterprises Inc.* (1993), 22 CBR (3d) 80 (Ont. Bktcy.) At p. 84. In the interim between the filing and the approval of a plan, the court has the inherent jurisdiction to fill in gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan: see *Re Westar Mining Ltd.* (1992), 1992 CanLII 1863 (BC SC), 14 CBR (3d) 88 (BSSC), at pp. 93-94 and generally *Lehndorff* , supra, at pp. 35-38. While not specifically mentioned in *Re Triangle Drugs Inc.* (1993), 1993 CanLII 8663 (ON SC) , 12 OR (3d) 219 (Bktcy.), It was inherent jurisdiction which I was relying on to fill the gap in that legislation, namely the *Bankruptcy and Insolvency Act* , RSC 1985, c. B-3 (as amended by SC 1992, c. 27) ("BIA"). "

[29] Thus, our courts have endorsed the principle that in certain circumstances, a debtor may terminate a contract as part of its reorganization.

[30] In this vein and in the absence of clarification from the legislator, our courts have developed various concepts aimed at providing a framework for the termination of contracts by a debtor on the

occasion of its restructuring.

[31] These concepts, developed over the course of the various cases heard by the courts, still have their usefulness, but it is now necessary to take into account the Act, as amended.

[32] Thus, Austeville argues that the criteria set out in section 32 (4) of the Act are not exhaustive and that the Tribunal can learn from the decisions of our courts *ante* September 18, 2009, whereas these exercised their inherent jurisdiction.

[33] However, when Austeville quotes Justice Tysoe's words in *Doman Industries et al.* ***[7]*** , it completely obscures the provisions of section 32 of the Act. Here is how it was expressed then:

> "[35] On the other hand, there will be circumstances where it will not be appropriate to authorize the debtor company to terminate contracts. For example, suppose that a debtor company became insolvent because its business had been operating at a loss but market conditions had changed and, with a financial restructuring of its existing debt, it was expected to be profitable in the future. Suppose further that the debtor company was party to a contract which did not cause the company to operate the relevant aspect of its business at a loss but the contract was not as favorable as the market would permit the company to obtain if it could divest itself of the existing contract. If the company could terminate the contract and enter into a new one with different rates, it could become substantially more profitable into the future. In these circumstances, it may well be inappropriate for the court to authorize the termination of the contract. "

[34] While the Tribunal agrees that it can draw certain lessons from decisions prior to the entry into force of recent amendments to the Act, they must still be related to these new legislative provisions.

[35] In this sense, the Tribunal adheres to the theory advanced by the authors Georgina R. Jackson and Janis Sarra [8] , that it is necessary in the first place to stick to the Law:

> "On the authors' reading of the commercial jurisprudence, the problem most often for the court to resolve is that the legislation in question is under-inclusive. It is not ambiguous. It simply does not address the application that is before the court, or in some cases, grants the court the authority to make any order it thinks fit. While there can be no magic formula to address this recurring situation, and indeed no one answer, it appears to the authors that practitioners have available a number of tools to accomplish the same end. In determining the right tool, it may be best to consider the judicial task as if in a hierarchy of judicial tools that may be deployed. The first is examination of the statute, commencing with consideration of the precise wording, the legislative history, the object and purposes of the Act, perhaps a consideration of Driedger's principle of reading the words of the Act in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament, and a consideration of the gap-filling power, where applicable. It may very well be that this exercise will reveal that a broad interpretation of the legislation confers the authority on the court to grant the application before it. Only after exhausting this statutory interpretive function should the court consider whether it is appropriate to assert an inherent jurisdiction . Hence, inherent jurisdiction continues to be a valuable tool, but not one that is necessary to utilize in most circumstances. "
>
> (our emphasis)

[36] The legislator having taken care to specify in which framework a debtor can terminate a contract and what are the means of dispute, it is through this prism that the Court will proceed to the analysis of the case under study.

A) The controller's agreement to the termination plan, if applicable.

[37] This is a simple question of fact which has been proven in this case.

B) Whether the termination will promote the conclusion of a viable transaction or arrangement with respect to the company.

[38] This concept was discussed many times in the decisions of our courts *prior to* 2009 and they are of definite usefulness.

[39] Here is how Justice Mayrand expressed herself in *PCI* ***[9]*** on the reasons justifying the termination of a contract:

"87. The reorganization of PCI was made necessary by the gigantic reorganization process of all the companies of the Pioneer group undertaken throughout North America. This implies that in the best economic and financial interest of the company, it can terminate contracts which are clearly not advantageous from an economic and financial point of view with the consequences which result therefrom. "

[40] To the same effect, Justice Farley, of the Ontario Superior Court, in the case of *T. Eaton Co (Re)* ***[10]*** :

"7. It is clear that under CCAA proceedings debtor companies are permitted to unilaterally terminate in the sense of repudiate leases, and contracts without regard to the terms of those leases and contracts including any restrictions conferred therein that might ordinarily (ie outside CCAA proceedings) prevent the debtor company from so repudiating the agreement. To generally restrict debtor companies would constitute an insurmountable obstacle for most debtor companies attempting to effect compromises and reorganizations under the CCAA.

Such a restriction would be contrary to the purposive approach to CCAA proceedings followed by the courts to this date. "

[41] As for the interpretation of the verb "will promote", the Court accepts the understanding that Judge Mayrand had following an exhaustive analysis of the case law, in the *SFK* case ***[11]*** :

"23. This being the case, the standard adopted by the courts allows the debtor to terminate a contract insofar as such termination proves to be advantageous and beneficial for its reorganization without her having to establish that it is of an essential element to it. "

[42] The Tribunal cannot and must not limit itself to considering only the situation of Austeville and the Leased Premises. It must also take into account all the measures envisaged by the debtor to consolidate her finances.

[43] Different types of industries may have different ways of restructuring, but in the case under study and as it appears from the Monitor's report, a viable arrangement necessarily involves eliminating unprofitable outlets.

[44] In the present case, the termination concerning the Leased Premises is a logical consequence of the termination of the leases relating to the points of sale in Western Canada.

[45] The administrative staff dropping from five to three employees, maintaining a room that can accommodate five people is not only incongruous, but also without economic logic.

[46] The Court concludes that the termination of the lease, as regards the Leased Premises, is advantageous and will promote a viable arrangement.

C) The risk that termination is likely to cause serious financial hardship to a party to the contract.

[47] At the outset, the Tribunal can only note that not only does Austeville not allege in its proceedings that the termination may cause it "serious financial difficulties" but, moreover, there is no iota of proof to that effect, the only argument being that it will suffer a significant loss.

[48] Suffering a significant loss is not the sole prerogative of Austeville, all other landlords whose leases were terminated will also incur significant losses.

[49] In fact, Austeville complains that Jacob, knowing he was in financial difficulty, had taken three months of free rent from him.

[50] However, the evidence does not reveal any bad faith on Jacob's part when negotiating changes to the lease.

[51] Moreover, the objective of the Law is not to punish a party following commercial maneuvers and for which a creditor would feel aggrieved.

[52] The aim of article 32 is twofold:

a) Specify within which framework and under which conditions a debtor can terminate a contract;

b) Prevent the creditor from being placed in a precarious situation by virtue of this termination.

[53] As for this second objective, the creditor would have to establish that in his own situation, the absence of this income or even of the profit generated by this activity would significantly weaken his

financial situation.

[54] In the present case, Austeville did not see fit to present such evidence, perhaps quite simply because it does not exist. Remember that the Leased Premises only represent 2% of the building, owned by Austeville.

CONCLUSION

[55] The Tribunal finds that Jacob has met the first two criteria of section 32 (4) of the Act and that Austeville has not discharged his burden of proving that the termination would cause him serious financial hardship.

FOR THESE REASONS, THE COURT:

[56] **DISMISSES** the request;

[57] With costs.

_____
MARTIN CASTONGUAY, JCS

Me Guy Martel
Me Danny Duy Vu
STIKEMAN ELLIOT
Boutique Jacob lawyers inc.

Me Marc Duchesne
BORDEN LADNER GERVAIS
Lawyer for Pricewaterhousecoopers inc.

Me Jonathan Warin
LAVERY, DE BILLY
Lawyer for Austeville Properties Inc.

Date of hearing: January 31, 2011

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[1] RSC (1985) c. C-36
[2] Exhibit R-1, page 7
[3] Exhibit R-2
[4] Exhibit R-3
[5] Exhibit R-4
[6] *In re: Dylex Limited and Others,*1995 CanLII (ON SC), para. 8
[7] *Doman Industries et al.* 2004 BCSC 733, s. 35
[8] Georgina R.JACKSON and JanisSARRA,*Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters*
[9] *PCI Chemicals Canada Inc. (Re),*2002 CarswellQue 831 (Que. CS)
[10] *T. Eaton Co. (Re)*, [1999] OJ No. 4216
[11] *AbitibiBowater Inc. (Re)*, 2009 CarswellQue 4937 (Que. CS)

TAB 12

Bank of Montreal v. Probe Exploration Inc.

Alberta Judgments

Alberta Court of Queen's Bench

Fraser J.

Heard: May 15, 2000.

Oral judgment: May 15, 2000.

Calgary Docket: 0001-02917

[2000] A.J. No. 1750 | 33 C.B.R. (4th) 173

Between Bank of Montreal, Plaintiff, and Probe Exploration Inc., Defendant

(49 paras.)

Counsel

Ms. K. Horner, for Applicant, PricewaterhouseCoopers Inc., Receiver/Manager of Probe Exploration Inc.

V.P. Lalonde, D. Kearl, for Respondent, Midcoast Canada Operating Corporation.

FRASER J. (orally)

1 PricewaterhouseCoopers Inc., the Receiver/Manager ("Receiver/Manager") of Probe Exploration Inc. ("Probe"), applies for an order authorizing the Receiver/Manager to immediately terminate or to terminate at a time established in its discretion certain agreements which Probe had entered into with Midcoast Canada Operating Corporation ("Midcoast") in connection with the purchase by Midcoast of Probe's gas processing facility at Calmar, Alberta. Leave will not be granted as applied for by the Receiver/Manager.

2 Midcoast is a midstream operator; it is in the business of providing natural gas producers with transportation, gathering, processing and marketing facilities. It does not own any petroleum or natural gas reserves in the area of the Calmar facility which it purchased from Probe on March 23, 1999. Midcoast processes all of Probe's sour gas reserves produced in the area plus a small volume of third party reserves.

3 Midcoast argues that without the processing provided by the Calmar facility all of Probe's sour gas production, as well as its natural gas liquids and crude oil reserves which are associated with its sour gas production in the area, would be unmarketable.

4 It argues further that without the services of Midcoast Probe's sour gas wells and oil wells with associated sour gas would be shut-in.

5 The Receiver/Manager argues in response that alternative facilities are available, albeit on the basis that new infrastructure, including a pipeline, would have to be built to use them. All of the Probe's sour gas processed at the

Calmar facility is delivered to the facility through Probe's upstream gathering facilities, and all of the gas processed by it leaves the Calmar facility via Probe's downstream transmission line.

6 Midcoast also argues that the development of any such alternative facilities would take at least a year. If the Calmar facility was not available to it during the year Probe's production would be shut-in during that period at a loss to Probe, as argued by Midcoast, of revenue of approximately $31,500,000.

7 Prior to March, 1999, Probe experienced severe financial difficulties, it was substantially indebted to the Bank of Montreal ("the Bank"). The bank was Probe's senior secured creditor.

8 As a result of financial problems, Probe sold the Calmar facility to Midcoast for $20 million. Midcoast argues that the purchase was made on terms designed to ensure the long-term viability of the facility. Those terms included the guarantee of minimum deliveries of sour gas, the dedication of gathering facilities, and the granting of a security interest in Probe's production and gathering facilities.

9 The terms were incorporated into a series of related agreements which will be described below. For the moment, it is sufficient to say that the Receiver/Manager now submits that termination of each of three of the agreements would enhance the value of Probe's interest in certain gas producing lands owned by Probe near the Calmar facility for the benefit of all creditors of Probe.

10 It is appropriate to note at this point that the bank is its is Probe's first secured creditor, and that the opinion was expressed on cross-examination by a manager of the Receiver/Manager that the bank was unlikely to be paid out from the proceeds of the liquidation of Probe. It would follow that Midcoast as Probe's second secured creditor, and ordinary creditors would not likely be paid anything following the completion of the liquidation of Probe.

11 The first of the three agreements which the Receiver/Manager wishes leave to terminate is termed a Gas Gathering and Treatment Agreement (the "GGT Agreement"). In that agreement, Probe agreed with Midcoast to dedicate all the gas which Probe produced from its interests and certain formations located near the Calmar facility for processing by Midcoast in the Calmar facility. The essence of the agreement is that Probe is required to deliver specified minimum volumes of gas during each of the first eight years of the agreement for processing at an initial rate of 55 cents per Mcf.

12 Midcoast has a charge and security interest over all of Probe's interest in the gas produced and the lands from which it is produced as security for the Probe performance of Probe's obligations under the agreement. The security interest is subordinate to the interest of the bank.

13 The evidence of the Receiver/Manager is its belief based on the current production of Probe from the dedicated land that a purchaser of the lands will be unlikely to meet the volume requirements of gas to be produced in years four to seven of the term of the agreement but will nevertheless be required to pay the aggregate minimum processing fees for those years. The aggregate processing fees payable in respect of the shortfall of gas would be approximately $2.2 million which the Receiver/Manager terms a penalty. The amount of the shortfall is based on current production and does not take into account a continuation of the decline in production which has occurred in recent years and which will not cease or increase without significant capital investment by a purchaser. The effect of the decline would be to increase the so-called penalty. The belief of the Receiver/Manager with respect to the effect of the GGT Agreement would appear to me to be reasonable.

14 The second agreement which the Receiver/Manager wishes to terminate is termed the Area of Interest Agreement (the "AOI Agreement"). In that agreement, Probe agreed to notify Midcoast of, among other things, any gas services it requires, unsolicited third party offers for gas services and natural gas pipelines or facilities it wishes to sell within certain lands, all of which are adjacent to or near the Calmar facility and file lands described in the GGT Agreement.

15 The AOI Agreement effectively gives to Midcoast a right of first refusal to match any third party offers to deal with Probe with respect to any of the matters covered by the agreement. The belief of the Receiver/Manager is that the AOI Agreement has the effect of reducing the realization value of Probe's interest in the lands covered by the agreement. The belief of the Receiver/Manager with respect to the effect of the agreement also appears to me to be reasonable and logical.

16 The third agreement which the Receiver/Manager wishes to terminate is the Probe System Gathering Agreement (which I will term the "PSG Agreement"). By that agreement, Probe granted Midcoast the right to use at no charge certain gas gathering facilities upstream from the Calmar facility to transport gas to the facility and to use certain transportation facilities downstream from the facility to enable Midcoast to transport gas from the facility at a fee of 1 cent per MCF. The obligations of Probe are covenants running with the land interest, forming part of Probe's upstream and downstream facilities.

17 Recent arrangements have been made by Probe for the use of similar facilities at fees from 8 to 12 cents per MCF. The Receiver/Manager is of the belief that termination of the PSG Agreement would increase the value of Probe's interest in the facilities governed by the agreement for the benefit of all of the creditors of Probe.

18 A fourth argument made between Probe and Midcoast at the time of the sale of the Calmar facility is also relevant to the application of the Receiver/Manager. It is termed the Intercreditor Agreement which provides for the subordination of the security interests of Midcoast granted under the GGT Agreement and the PSG Agreement to the security interest of the bank and the assets of Probe.

19 Clause 4 of the Intercreditor Agreement provides that where the bank or an agent of the bank or a private receiver appointed by the bank takes possession of the assets subject to the GGT Agreement or the PSG Agreement, such party shall assume the obligations of Probe under those agreements. The agreement is not stated to apply to a court-appointed Receiver/Manager.

20 The Receiver/Manager has engaged third party assistance to conduct a sale of the assets of Probe. The sale is being conducted on a liquidation rather than on a going-concern basis. The Receiver/Manager therefore submits that preservation of the goodwill of Probe is not a factor to be considered with respect to this application. I accept that such submission is reasonable.

21 The Bank and Probe agreed on March 1, 2000 to an order granting judgment to the bank against Probe in the amount of $108,629,412.07 plus interest and costs. PricewaterbouseCoopers Inc., which had previously been retained by the bank as its agent to review the financial affairs of Probe, was then appointed by the court without notice to Midcoast as the Receiver/Manager of Probe.

22 On May 2, 2000, the person, who is a manager of the Receiver/Manager, expressed the opinion on a cross-examination on his affidavit that it is highly unlikely that the bank will be paid out from the proceeds of the sale of Probe's assets.

23 Midcoast argues that the existence of the three agreements which the Receiver/Manager wishes leave to terminate does not detrimentally affect the realization value of Probe's assets. It argues with respect to the GGT agreement that the industry standard processing fee for gas is 90 cents per MCF which is much higher than the fee of 55 cents payable under the GGT Agreement. Midcoast submits that the savings in the processing fee would not be enjoyed by Probe if the agreement is terminated, and that would be a disadvantage to the creditors. While that may be true, the uncontradicted evidence is that the volumes of gas likely to be available will not be such in the first eight years of the agreement to allow Probe or a successor in ownership to benefit from the lower fee to allow it to escape the penalty which appears likely on the evidence to be imposed by the agreement. Any other view would, with respect, appear on the evidence to be speculation.

24 Midcoast argues that the Probe obligations under the AOI Agreement are not a hindrance in any way to a purchaser of Probe's assets. With respect, that argument is also difficult to accept. The existence of the right of first refusal means that unless Midcoast is, for whatever reason, publicly known to be out of the market to buy or deal, an unlikely eventuality, so long as Midcoast owns the Calmar facility, a third party purchaser would in bidding to deal with Probe merely be setting the price or terms at which Midcoast could buy or on which it could deal. That fact must discourage any third party from dealing with Probe, let alone detrimentally affecting the value of the Probe asset being bought. With respect, the agreement of Midcoast about the effect of the AOI Agreement is therefore rejected.

25 Midcoast also argues that the PSG Agreement does not reduce the realization value of Probe's interest in the lands related to the agreement. That argument is also rejected because if a third party is buying the transportation facilities governed by the agreement, it would be prevented from earning the return on them which is set according to normal industry standards. Given that the return would not be available, the value of the facilities must be depressed.

26 For this and the other reasons as stated, I would accept the contention of the Receiver/Manager that the agreements which it seeks leave to terminate must depress the value of the assets of Probe affected. It remains, however, to consider whether the court should grant leave to terminate the agreements.

27 The primary argument made by the Receiver/Manager in support of its application is that because the operation being carried out is a liquidation of the assets of Probe, goodwill is not a factor, and the Receiver/Manager should therefore be entitled to terminate the contracts. It cites statements from the text Beltnett on Receivership, and comments from Bayhold Financial Corp. v. Clarkson Co. *(1991), 86 D.L.R. (4th) 127* (N.S. C.A.). in support of its arguments. In particular, it cites the following statement from Bennett at page 342:

> In the proper case, the receiver may move before the court for an order to breach or vary an onerous contract including a lease of premises or equipment. If the receiver is permitted to disclaim such a contract between the debtor and a third party, the third party has a claim for damages and can claim set-off against any monies that it owes to the debtor. If the court-appointed receiver can demonstrate that the breach of the existing contracts does not adversely affect the debtor's goodwill, the court may order the receiver not to perform the contract even if the breach would render the debtor liable in damages. If the assets of the debtor or likely to be sufficient to meet the debt to the security holder, the court may not permit the receiver to break a contract since, by doing so, the debtor would be exposed to a claim for damages.

28 The argument is that because Probe is essentially in litigation it has no goodwill. Termination would therefore not adversely affect the goodwill because Probe has no goodwill because it is in litigation.

29 The Receiver/Manager also refers to another quotation front a previous edition of Bennett cited in the Bayhold Financial decision. That quotation reads as follows:

> As a general matter, the court-appointed receiver, unlike the privately appointed receiver, owes a duty to the holder and the debtor to preserve the goodwill and the property. The receiver will not be able upon appointment to close down the debtor's business. He will have to demonstrate that it is a losing proposition before the court will permit the receiver to break contracts and terminate the debtor's business.

30 The decision in Bayhold Financial also contains at page 137 the following additional statement:

> It is the duty of the receiver and manager of the property and undertaking of a company to preserve the goodwill as well as the assets of the business, and it would be inconsistent with that duty for him to disregard contracts entered into by the company before his appointment.

31 The case of Newdigate Colliery Ltd., Re, [1912] 1 Ch. 468 (Eng. Ch. Div.) is authority for the following proposition at page 478:

> ... the security of the mortgagee is on the undertaking and all the property present and future, including the uncalled capital, of this company. So that the property for which the receiver and manager is responsible includes this business and undertaking, and it is his duty to do, and our business to see that he does, everything reasonable and right for the protection of the property as an undertaking for the benefit of all the persons interested in it. The order asked for is an order directing the receiver and manager to disregard the interests of one of his constituents, the mortgagor, in order to benefit another of his constituents, namely, the mortgagee. It seems to me that such an order is necessarily wrong. No precedent has been cited for such an order. I have never heard of such an application before, and it seems to me in principle to be wrong. It is the duty of the judge who is taking control of the assets to deal with those assets with due regard to the interests of everybody concerned, and not to advance the interests of one of the persons concerned at the expense of the other.

32 Again the argument of the Receiver/Manager is that it does not have a duty to honour contracts because the company has no goodwill which the receiver is obligated to preserve. However, in my view, the receiver and the manager must have an overriding regard to the interests of all of its constituents including Midcoast.

33 Midcoast argues in response to the argument of the receiver and manager about goodwill that the three agreements which the Receiver/Manager wants terminated were entered into for valid consideration, namely the purchase price of the Calmar facility. To terminate the agreements, would involve the entry by the court into a transaction made between two parties for the benefit of one but the detriment of the other. It would be unfair to Midcoast for the court to interfere.

34 Midcoast argues that the Receiver/Manager has a duty to act with respect to the conduct of the receivership for the benefit of all the persons interested in it. In support of this argument, it cites the passage from the Newdegate decision which I have quoted. In my view, the grant of leave to terminate the contracts which I have described would prefer the interests of Probe and its primary secured creditor, the Bank, over the interests of another interested party Midcoast, although Midcoast is not a creditor at this time.

35 the view of the person who was cross-examined on behalf of the Receiver/Manager is correct, the effect of termination would likely be to relegate it to the status of an ordinary creditor in respect of its claim for damages for the breach of contract or resulting from the termination. At the same time termination would free Probe from the disadvantages and losses imposed by the contracts at the expense of Midcoast.

36 The receiver and manager is at page 478 of the Newdigate decision termed "an equitable mortgagee." Equity would, in my view, require it to deal fairly with all interested parties in the exercise of its duties as Receiver/Manager with respect to the equity of redemptions. To deal with Midcoast in the manner suggested by the receiver and manager would not, in my view, be fair and it should therefore not be allowed to breach its duty to be fair, at least in the circumstances now before the court.

37 I have in mind that the termination of the agreements would, among other things, deprive Midcoast of rights it bargained to get for the benefit of the Calmar facility. Termination would not appear to impose any similar disadvantage or loss of contractual right to Probe. The unequal treatment of the two parties imposed for the benefit of one of the parties or of the bank as its creditor would not, in my view, be equitable or fair.

38 The view expressed in the previous paragraph is reinforced by the fact that the Intercreditor Agreement, to which reference has been made above, clearly evidences a mutual intent to have a purchaser from Probe bound by the agreements now sought to be terminated. The fact that the agreement is not stated to apply to a court-

appointed Receiver/Manager may well be taken to evidence the assumption that a court-appointed receiver would be seen by all parties to have an obligation of fairness towards Midcoast imposed by the court, if necessary.

39 For the reasons which I have described, leave is not granted to the Receiver/Manager at this time to terminate the GGT Agreement, the AOI Agreement, or the PSG Agreement now existing between Probe and Midcoast.

40 I might add that the duties of a Receiver/Manager are not limited, in my view, to the preservation of goodwill of Probe. Such duties must primarily involve the conduct of the business or of the liquidation of the corporation which is the subject of the receivership. The obligation of the Receiver/Manager in carrying out those duties is to act for the benefit of all interested parties. As an officer of a court of equity charged with the obligation of managing the equity of redemption, the Receiver/Manager is bound to act in an equitable manner, to be fair and equitable to all. It cannot prefer one party over another.

41 The parties may, if they wish, speak to me regarding costs at their convenience.

42 Ms. Horner, Mr. Lalonde, is there anything further you wish me to deal with?

43 MR. LALONDE: No, I think we could deal with the costs at another occasion. I could seek instructions.

44 There is just one factual correction, My Lord. You indicated in your Reasons for Judgment that Midcoast, my client, is not a creditor of Probe at this point in time. It is to the extent of about $780,000 for arrears.

45 THE COURT: I'm sorry, I did not have a record of that having been spoken to during the hearing.

46 MR. LALONDE: It may not have been in the material, but I believe I submitted it to you in oral argument.

47 THE COURT: Thank you.

48 MS. HORNER: Thank you, My Lord.

49 MR. LALONDE: Thank you, My Lord.

End of Document

TAB 13

Legislative Summary LS-584E

BILL C-12: AN ACT TO AMEND THE BANKRUPTCY AND INSOLVENCY ACT, THE COMPANIES' CREDITORS ARRANGEMENT ACT, THE WAGE EARNER PROTECTION PROGRAM ACT AND CHAPTER 47 OF THE STATUTES OF CANADA, 2005

Marcia Jones
Law and Government Division

14 December 2007

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the disclaimer or resiliation, a party to the agreement may apply to the court for a declaration that the disclaimer or resiliation does not apply. The court must make this declaration, unless it is satisfied that a viable proposal could not be made in respect of the debtor without the disclaimer or resiliation of the agreement and of any other agreement that the debtor has already disclaimed or resiliated (BIA, sections 65.11 (1) and (3)-(4); CCAA, sections 32(1) and (3)-(4)).

The provisions on disclaimer and resiliation do not apply to the following contracts: an eligible financial contract; a commercial lease; a collective agreement; a financing agreement, if the debtor is the borrower; or a lease of real property or an immovable if the debtor is the lessor (BIA, sections 65.11(2); CCAA, section 32(2)).

Finally, if an agreement is disclaimed or resiliated, every other party to the agreement is deemed to have a claim for damages as an unsecured creditor (BIA, section 65.11(6); CCAA, section 32(6)).

2) Bill C-12

Bill C-12 makes the following key changes to the provisions on disclaimer and resiliation:

- The debtor is required to provide notice to the trustee (BIA) or monitor (CCAA) that it intends to disclaim, and is not permitted to issue the notice to the other parties unless the trustee or monitor approves of the proposed disclaimer. If the trustee/monitor approves, and the debtor sends notice, the other parties have 15 days to apply to the court for an order that the disclaimer does not apply. However, if the proposal trustee/monitor does not approve of the proposed disclaimer, the reorganizing debtor must apply to the court in order to disclaim the agreement (clause 26, sections 65.11(1) and (3)-(4) BIA; and clause 76, sections 32(1)-(3) CCAA).

- In determining whether to make an order for disclaimer/resiliation (on the application of the debtor), or an order that a disclaimer/resiliation does not apply (on the application of one of the parties to the agreement), the court must have regard to the following factors:
  a. whether the trustee (or monitor) approved the proposed disclaimer or resiliation;
  b. whether the disclaimer or resiliation would enhance the prospects of a viable proposal (or compromise or arrangement) being made in respect of the debtor; and
  c. whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

  (Clause 26, section 65.11(5) BIA; and clause 76, section 32(4) CCAA.)

- The debtor is required to provide written reasons for the proposed disclaimer or resiliation to any party to the agreement, within five days of being requested to do so by that party (clause 26, section 65.11(9) BIA; and clause 76, section 32(8) CCAA).

- Section 65.11 of the BIA is extended to apply to individual debtors who carry on a business. (Under Chapter 47, section 65.11 does not apply to individual debtors). However, only business-related agreements may be disclaimed or resiliated (clause 26, section 65.11(2) BIA).

Bill C-12 also clarifies the effective date of the disclaimer or resiliation. If the debtor issues a notice of disclaimer/resiliation, and no party to the agreement makes an application to the court, the agreement is disclaimed or resiliated 30 days after the day on which the debtor gives notice. If an application is made in response to the notice, but the court dismisses the application, the agreement is disclaimed or resiliated within 30 days after the day on which the debtor gives notice. If the debtor applies to the court for an order to disclaim or resiliate the agreement, and the court grants the order, the agreement is disclaimed or resiliated 30 days after the day on which the debtor gives notice or any later day fixed by the court (clause 26, section 65.11(6) BIA; and clause 76, section 32(5) CCAA).

Bill C-12 also clarifies that a party who suffers loss as a result of a disclaimer or resiliation has a "provable claim" (rather than "a claim for damages as an unsecured creditor," as is provided under Chapter 47) (clause 26, section 65.11(8); and clause 76, section 32(7) CCAA).

j. Intellectual Property Agreements (Clauses 26 and 76)

Chapter 47 amends the BIA and the CCAA to provide that if the debtor has, in any agreement, granted the use of intellectual property to a party to the agreement, a disclaimer or resiliation of the agreement does not affect the party's right to use the intellectual property, so long as that party continues to perform its obligations (section 65.11(5) BIA; section 32(5) CCAA).

Bill C-12 enhances the protection afforded to intellectual property licensees when a license of intellectual property is disclaimed. It stipulates that the disclaimer or resiliation does not affect a party's right to use the intellectual property, or to enforce an *exclusive use* of that property during the term of the agreement, *including where a party extends the term of the agreement as of right* – provided that the party continues to perform its obligations under the agreement in relation to the use of the intellectual property (clause 26, section 65.11(7) BIA; and clause 76, section 32(6) CCAA).

TAB 14

Clerk's stamp:

CLERK OF THE COURT
FILED
JUN 16 2015
JUDICIAL CENTRE
OF CALGARY

Court File Number	1501-05908
Court	COURT OF QUEEN'S BENCH OF ALBERTA
Judicial Centre	CALGARY
Plaintiff	CREDIT SUISSE AG, CAYMAN ISLANDS BRANCH, in its capacity as Administrative Agent under that certain First Lien Term Loan Credit Agreement dated March 31, 2014
Defendants	SOUTHERN PACIFIC RESOURCE CORP., SOUTHERN PACIFIC ENERGY LTD., 1614789 ALBERTA LTD., 1717712 ALBERTA LTD. AND SOUTHERN PACIFIC RESOURCE PARTNERSHIP.

RECEIVER'S FIRST REPORT TO THE COURT SUBMITTED BY PRICEWATERHOUSECOOPERS INC. DATED JUNE 15, 2015

Address for Service and Contact Information of Party Filing this Document:

Borden Ladner Gervais LLP

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TABLE OF CONTENTS

EXHIBITS

SOUTHERN PACIFIC RESOURCE CORP. ET AL
RECEIVER'S FIRST REPORT TO COURT
JUNE 15, 2015

1. INTRODUCTION

1.1 This report (the "**First Report**") is filed by PricewaterhouseCoopers Inc. ("**PwC**") in its capacity as receiver and manager (the "**Receiver**") of all the assets, undertakings and properties (collectively, the "**Property**") of Southern Pacific Resource Corp., Southern Pacific Energy Ltd., 1614789 Alberta Ltd., 1717712 Alberta Ltd. And Southern Pacific Resource Partnership (collectively referred to as the "**Company**").

1.2 On January 21, 2015 the Company successfully applied to the Court of Queen's Bench of Alberta (the "**Court**") for protection from its creditors under the *Companies' Creditors Arrangement Act* (the "**CCAA**") and was granted an order (the "**Initial CCAA Order**") staying its creditors until February 21, 2015. The Court appointed PwC as Monitor ("**Monitor**") under the Initial CCAA Order.

1.3 Pursuant to a number of Court Orders, the stay was extended to June 1, 2015 to allow the Company to run a sales and investment solicitation process ("**SISP**"). Ultimately the SISP did not result in a successful transaction and on June 1, 2015 the Company did not seek a further extension of the stay period under the CCAA.

1.4 On application of the Plaintiff, Credit Suisse AG, Cayman Islands Branch, in its capacity as Administrative Agent under that certain First Lien Term Loan Credit Agreement dated March 31, 2014, the Court granted the Receivership Order on June 1, 2015 which was subsequently amended on June 4, 2015 (the "**Receivership Order**").

1.5 Copies of this and all Receiver's reports are available on the Receiver's website www.pwc.com/car-stp. All prescribed materials filed by the Plaintiff, the Receiver and other parties relating to the Receivership proceedings are available to creditors and other interested parties in electronic format on the Receiver's website. In addition, all materials relating to the CCAA proceedings are also filed on the Receiver's website. The Receiver will make regular updates to the website to ensure creditors and interested parties are kept current and to add prescribed materials as required.

1.6 This report has been prepared to provide the Court with an update:

1.6.1 on the activities of the Receiver; and

1.6.2 report on the status of accounts between the Company and each of Altex Energy Ltd. ("**Altex**"), CIT Rail LLC ("**CIT**") and Genesis Rail Services LLC ("**Genesis**") as required by the Receivership Order.

1.7 Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars. Capitalized terms not otherwise defined herein are as defined in the Company's application materials and the Receivership Order.

1.8 Certain information contained in this report is based on information obtained from the Company's books and records and discussion with management and staff. The Receiver has not independently verified the accuracy or completeness of such information; accordingly the Receiver does not express an opinion thereon.

2. UPDATE ON THE ACTIVITES OF THE RECEIVER

2.1 Upon its appointment, the Receiver took immediate steps to secure and preserve the Property and ensure continued operations. These steps included:

2.1.1 engaging in discussions with the Company's employees and contractors to ensure continued and uninterrupted function at the Company's head office and its Senlac and McKay facilities;

2.1.2 taking all steps necessary to ensure safe and continued operations of the Company's Senlac heavy oil production facility;

2.1.3 taking all steps necessary to ensure safe cessation of production operations and continuation of the hibernation process for the Company's McKay oil sands facility;

2.1.4 setting aside and holding in trust the employee retention amounts as directed paragraph 36 of the Receivership Order; and

2.1.5 engaging in discussion with the Alberta Energy Regulator and various other provincial regulatory bodies in both Alberta and Saskatchewan.

3. OUTSTANDING DISPUTES WITH ALTEX, CIT AND GENESIS

3.1 As at the date of the Receivership Order, there were outstanding disputes between the Company and each of Altex, CIT and Genesis with respect to, among other things, claims alleged to have arisen subsequent to the dates the Company issued notices to disclaim their respective contracts in the CCAA.

3.2 Paragraph 39 of the Receivership Order provides that the claims advanced by Altex, CIT and Genesis for the period after January 21, 2015 are unaffected by the Receivership Order.

3.3 Furthermore, Paragraph 39 of the Receivership Order directs the Receiver to file and serve a report on or before June 15, 2015 as to the state of the accounts between the Company and each of Altex, CIT and Genesis.

3.4 With respect to Altex, CIT and Genesis, the exhibits and commentary contained in this report reflect pre and post-CCAA calculations and accounting information and are not intended to represent legal conclusions drawn by the Receiver in respect of the validity of any payments.

4. ALTEX

4.1 The accounting calculation of the claimed post-CCAA amounts as invoiced by Altex and as per the Company's records (the Receiver does not express any view on the quantum or recoverability of amounts claimed by Altex in respect of the period after the Notice of Disclaimer was delivered) is summarized in the table below:

Summary of Altex Post CCAA Amounts from Company Records

	Per Company		Per Altex	
	$CDN	$USD	$CDN	$USD
Altex Fee	252,909.72		1,147,383.91	-
Service Fees	49,013.02	8,863.39	62,361.32	8,863.39
Credits	(14,201.46)	(184,808.68)	-	-
Total	**287,721.28**	**(175,945.29)**	**1,209,745.23**	**8,863.39**

4.2 Altex owns and operates a crude oil and diluent throughput rail terminal in Fort McMurray (the "**Lynton Facility**").

4.3 The Lynton Facility was designed and constructed to ship the Company's McKay dilbit.

4.4 The Company delivered dilbit by truck to the Lynton Facility and Altex loaded railcars and arranged for delivery to the sales destination in the southern United States.

4.5 In June 2012 the Company and Altex entered into the Terminal Construction and Rail Service Agreement (the "**Altex Agreement**"). The Altex Agreement requires the Company to pay Altex:

4.5.1 a monthly capital payment over a five year term; and

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4.5.2 monthly service fees based on throughput volume ("**Service Fees**").

4.6 The Company advises the actual cost to construct the Lynton Facility was significantly higher than the original budgeted cost of $22,378,200 and Altex requested that the Company pay a revised monthly capital payment based on a construction cost of approximately $34 million. Prior to the CCAA, the Company conducted an audit of the actual costs and was in discussions with Altex regarding the calculation base for a revised monthly capital payment. However agreement was not reached on the matter either before or during the CCAA.

4.7 Prior to the CCAA and pending resolution of this matter, Altex and the Company agreed to an interim monthly capital payment of $497,791 plus GST (the "**Altex Fee**"). This amount was based on the initial Lynton Facility cost budget of $22,378,200.

4.8 As of the date of the Initial CCAA Order, Altex had received the Altex Fee for January 2015 but was in arrears for Service Fees.

4.9 Shortly after the date of the Initial CCAA Order, Altex took the position that its outstanding pre-filing invoices for Service Fees were secured by a possessory lien over the Company's oil and gas substances both in Altex's possession at Lynton and in-transit on rail cars.

4.10 In the days following Altex took steps it deemed necessary to preserve its claimed position which included a slow down or cessation of loading activities at Lynton.

4.11 In order to facilitate a return to normal operations and ensure the Company's product was loaded on railcars and shipped to market, in late January 2015 the Company and Altex agreed that:

4.11.1 an amount equal to the lesser of the estimated value of the oil in Altex's possession at the date of the Initial Order and the amount owed to Altex at that date would be held in trust pending determination of Altex's lien claim;

4.11.2 the Altex Fee for February 2015 would be paid in advance;

4.11.3 payment for services for the period January 21 to January 31, 2015 would be paid upon mutual agreement of the amount due; and

4.11.4 payment of future Service Fees and the monthly Altex Fee would be made in advance.

4.12 The Company made the agreed payments and placed $800,000 in trust (the "**Altex Lien Fund**") with the Monitor's counsel, Borden Ladner Gervais LLP ("**BLG**"), pending a determination of the validity of the lien claim and Altex resumed normal loading operations at the Lynton Facility.

4.13 As at the date of the Receivership Order the dispute over the Altex Lien Fund had not been resolved. Accordingly, the Receivership Order requires that BLG continue to hold the $800,000 in trust pending resolution, either by agreement of the parties or direction of the Court.

4.14 A summary of the outstanding charges and credits totalling $66,357.82 CDN and $568,881.12 USD as they relate to the Altex Lien Fund is attached hereto as Exhibit "**A**".

4.15 Subsequent to January 30, 2015, the Company continued to pay the Altex Fee prior to the beginning of each month and also paid the estimated Service Fees, on a weekly basis, in advance.

4.16 On April 15, 2015 the Company issued a notice to disclaim the Altex Agreement effective May 15, 2015 (the "**Altex Disclaimer**"). A copy of the Altex Disclaimer is attached hereto as Exhibit "**B**".

4.17 Upon issuing the Altex Disclaimer, the Company immediately ceased the shipment of all product to the Lynton Facility.

4.18 As at April 15, 2015 the Company had pre-paid Service Fees for the period April 15 to April 20, 2015 in the amounts of $14,201.45 CDN, $184,808.68 USD (for rail cars that were ultimately never loaded or shipped) and the Altex Fee for April, 2015 had been paid.

4.19 Subsequent to receiving the Altex Disclaimer, Altex cooperated with the Company and fulfilled its obligation to load and arrange for delivery the Company's product inventory that was still held at the Lynton Facility.

4.20 The Company did not make payment of the pro-rated Altex Fee for the period May 1 to May 15, 2015 which coincided with the 30 day notice period of the Altex Disclaimer.

4.21 A summary of the Company's accounts as per the records of both the Company and the invoices from Altex as they relate to outstanding charges and credits for the pro-rated Altex Fee for May, 2015 and outstanding Service Fees is attached hereto as Exhibit "**C**".

4.22 On or about June 9, 2015, Altex issued invoices #789 and #790, copies of which are attached hereto as Exhibit "**D**", requesting payment for revised Altex Fees (the "**Revised Altex Fee**") based on a capital cost of $32,354,548.00. The Receiver is not aware of any agreement between the Company and Altex with respect to the quantum of the Revised Altex Fee.

4.23 Invoice #789 in the amount of $2,713,488.73 relates to the pre CCAA period and is calculated as the difference between the Revised Altex Fee for the period February 1, 2014 to January 20, 2015 and the Altex Fee payments made by the Company relating to the same period.

4.24 Invoice #790 in the amount of $1,147,383.91 relates to the post CCAA period and is calculated as the difference between the Revised Altex Fee for the period January 21, 2015 to May 15, 2015 and Altex Fee payments made by the Company relating to the period January 21, 2015 to April 30, 2015.

5. CIT

5.1 The accounting calculation of the claimed post-CCAA amounts as invoiced by CIT and as per the Company's records (the Receiver does not express any view on the quantum or recoverability of amounts claimed by CIT in respect of the period after the Notice of Disclaimer was delivered) is summarized in the table below:

Summary of CIT Post CCAA Amounts from Company Records

	Per Company	**Per CIT**
	$USD	$USD
May Rent	225,799.09	225,799.09
Charges	-	6,780.71
Credits	(98,703.39)	(106,765.10)
Total	**127,095.70**	**125,814.70**

5.2 Under its agreement with CIT (the "**CIT Agreement**") the Company leased rail cars for the purpose of transporting its product from the Lynton Facility to the Natchez Facility. As at the date of the Initial CCAA Order the leased fleet totalled 250 rail cars. However, due to recalls for manufacturing defects, the leased fleet was reduced by 50 rail cars on March 18, 2015.

5.3 The CIT Agreement provides for a monthly rent with adjustments credits ("**CIT Credits**") for time offline for maintenance. The CIT Credits are generally calculated up to 3 months in arrears.

5.4 All invoiced lease payments under the CIT Agreement ("**CIT Rent**") net of any CIT Credits received for the period January 21, 2015 to April 30, 2015 were paid by the Company.

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5.5 On April 30, 2015 the Company issued a notice to disclaim the CIT Agreement effective May 30, 2015 (the "**CIT Disclaimer**"). A copy of the CIT Disclaimer is attached hereto as Exhibit "**E**".

5.6 The Company did not make payment of the CIT Rent for May, 2015 of $225,799.09 USD.

5.7 As the CIT Credits associated with the return of 50 rail cars in March, along with various other CIT Credits, had not yet been processed by CIT's accounting system, the Company worked with CIT to estimate the CIT Credits due.

5.8 A summary of the CIT Rent for May, 2015 for 200 rail cars along with both CIT and the Company's estimated calculations of CIT Credits are attached hereto as Exhibit "**F**". The amount owed to CIT per CIT's estimates is $125,814.70 USD. The amount owed to CIT per the Company's estimates is $127,095.70 USD.

6. GENESIS

6.1 The accounting calculation of the claimed post-CCAA amounts as invoiced by Genesis and as per the Company's records (the Receiver does not express any view on the quantum or recoverability of amounts claimed by Genesis in respect of the period after the Notice of Disclaimer was delivered) is summarized in the table below:

Summary of Genesis Post CCAA Amounts from Company Records

	Per Company		Per Genesis	
	$CDN	**$USD**	**$CDN**	**$USD**
Genesis Fee		215,000.00		233,611.58
Overpayments		(62,438.85)	-	-
Credits	(22,092.71)	(9,300.00)	-	-
Total	**(22,092.71)**	**143,261.15**	**-**	**233,611.58**

6.2 The Company's contract with Genesis (the "**Genesis Agreement**") required it to pay a monthly fixed capital fee (the "**Genesis Fee**") of $215,000 USD for dedicated tank capacity (the "**Genesis Tank**") at the Genesis owned loading terminal located in Natchez, Mississippi (the "**Natchez Terminal**").

6.3 In May 2014 the Company commenced offloading its product into tanks with dedicated capacity for Exxon (the "**Exxon Tanks**") at the Natchez Terminal and ceased using the Genesis Tank.

6.4 The throughput fee associated with the offloading of the Company's product to the Exxon Tanks was paid by Exxon.

6.5 Although it was no longer using the Genesis Tank, the Company continued to pay the monthly Genesis Fee and as at January 21, 2015, the date of the Initial CCAA Order, Genesis Fee payments for the periods up to November 2014 had been made. The December 2014 and January 1-20, 2015 Genesis Fee payments were stayed by the CCAA.

6.6 On February 27, 2015, the Company paid Genesis $76,290.32 USD being the pro-rated post CCAA portion of the Genesis Fee for the period January 21, 2015 to January 31, 2015.

6.7 Pursuant to the terms of the contract, the Genesis Fee was subject to annual inflationary increases per the Federal Energy Regulatory Commission Index. However, as at the date of the CCAA, Genesis had never applied these increases and had always invoiced the Company for a Genesis Fee of $215,000 USD.

6.8 On or around March 5, 2015, Genesis provided the Company with revised invoices to reflect the previously unapplied annual inflationary increases ("**Revised Genesis Invoices**") for the 15 month period of January 2014 to March 2015.

6.9 The Revised Genesis Invoices increased the Genesis Fee to $224,873.45 USD per month for 2014 and $233, 611.58 USD for 2015 (the "**Adjusted Genesis Fees**").

6.10 The Revised Genesis Invoices totalling $508,786.80 USD for the pre CCAA period and $473,827.15 USD for the post CCAA period account for the difference between all previously paid Genesis Fees and the Adjusted Genesis Fees. Copies of the Revised Genesis Invoices are attached hereto as Exhibit "**G**".

6.11 On March 9, 2015 Genesis demanded payment for the Revised Genesis Invoices for the 15 month period January 2014 to March 2015, and refused to offload rail cars at the Natchez Terminal until payment was received.

6.12 After numerous discussions between respective legal counsel for Genesis, the Company and the Monitor, the Company agreed to pay Genesis all post CCAA fees owing (January 21-31, 2015, February 2015 and March 2015), calculated based on the 2015 Adjusted Genesis Fee in order for Genesis to resume offloading activities.

6.13 The aggregate payment of Revised Genesis Invoices #11801595, #11801517 and #11801579 in the amount of $473,827.27 USD was wired to Genesis on March 16, 2015 and offloading activities resumed shortly thereafter.

6.14 As a result of the payment made on March 16, 2015 and the payment of the Adjusted Genesis Fee for April, 2015, the Company's records indicate that it has overpaid the Genesis Fee for the Period January 21, 2015 to April 30, 2015 by the following amounts:

Genesis Fee Overpayment Amounts from Company Records

	$USD
January 21-30, 2015	6,604.11
February 2015	18,611.58
March 2015	18,611.58
April 2015	18,611.58
Total	**62,438.85**

6.15 The 7 day period during which Genesis refused to offload rail cars created logistics issues for the Company. In particular, it caused the Company to incur additional costs as a direct result of its inability to mobilize the rail cars stranded at the Natchez Terminal. The Company incurred additional costs as a result of transferring additional rail cars in and out of service. Copies of the invoices totalling $9,300 USD and $22,092.71 CDN are attached hereto as Exhibit "**H**".

6.16 On April 30, 2015 the Company issued a notice to disclaim the Genesis Agreement effective May 30, 2015 (the "**Genesis Disclaimer**"). A copy of the Genesis Disclaimer is attached hereto as Exhibit "**I**".

6.17 The Company paid the Adjusted Genesis Fees up to and including April 2015 but did not make payment of the Adjusted Genesis Fee for the period ending May 30, 2015 of $233,611.58 USD.

This report is respectfully submitted this 15th day of June, 2015.

PricewaterhouseCoopers Inc.
Court Appointed Receiver and Manager of
Southern Pacific Resource Corp. et al

Paul Darby
Senior Vice President

pwc

Action No.: 1501-05908
E-File No.: CVQ16CREDITSUISSE
Appeal No.: _____

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE OF CALGARY

BETWEEN:

CREDIT SUISSE AG,
CAYMAN ISLANDS BRANCH, in its capacity as
Administrative Agent under that certain
First Lien Term Loan Credit Agreement
dated March 31, 2014

Plaintiffs

and

SOUTHERN PACIFIC RESOURCE CORP.,
SOUTHERN PACIFIC ENERGY LTD.,
1614789 ALBERTA LTD.,
1717712 ALBERTA LTD. and
SOUTHERN PACIFIC RESOURCE PARTNERSHIP

Defendants

P R O C E E D I N G S

Calgary, Alberta
October 28, 2016

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TABLE OF CONTENTS

Proceedings taken in the Court of Queen's Bench of Alberta, Calgary Courts Centre, Calgary, Alberta

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October 28, 2016	Afternoon Session
The Honourable	Court of Queen's Bench
Madam Justice Romaine	of Alberta
D.M. Wood	For the Applicants
G. Bruni	For the Applicants
C.D. Simard	For the Respondent
J. Cameron	For the Monitor
G. Kumar	Court Clerk
N. Arevalo	Court Clerk

Discussion

THE COURT: Thank you. Please be seated.

Okay. Are we ready to proceed?

MR. WOOD: Yes.

THE COURT: Thank you.

MR. WOOD: Good afternoon, My Lady. My name is David Wood, and I am here on behalf of Altex Energy Ltd. Accompanying me is my associate, Mr. Gino Bruni, who has a far better command of all the numbers in this application than I do, and so --

THE COURT: Okay. Thank you.

MR. WOOD: -- I would be looking to him if any questions come up about the numbers. My friend, Mr. Simard, is here for the lender, Credit Suisse, and Ms. Jessica Cameron is here for the monitor.

THE COURT: Right. Thank you.

Submissions by Mr. Wood

MR. WOOD: Now, My Lady, on behalf of Altex, you should have the following materials: the application filed August 24th, the affidavit of Mr. John Zahary sworn and filed August 24th, a supplemental affidavit of Mr. Zahary sworn and filed October 24th, and a brief and authorities of Altex filed October 17th, 2016.

THE COURT: I do. Thank you.

MR. WOOD: Now, I'm not going to go through our brief in detail, but there are a few submissions that I wish to make, primarily in response to submissions made by my friend in the lenders' brief.

THE COURT: All right.

MR. WOOD: Altex's claim is made up of both pre and post-filing amounts. There are two types of charges under the agreement. There are service charges and a monthly capital fee. The service charges are for services provided under the agreement, while the monthly capital fee is related to the construction of the terminal facility that was dedicated to Southern. The pre-filing claim is for both service charges and monthly capital fees. The post-filing claim is for monthly capital fees for the period between when the agreement was disclaimed and when the notice period for the disclaimer notice ran out as well as some service charges.

I want to deal briefly with volumes of product that we say were under the control or in the possession of Altex.

THE COURT: Okay. Perhaps we should go back, though, to the capital fee. Well, no. Go ahead. You talk about volumes of product. Okay.

MR. WOOD: There's not really any dispute about the actual volumes of product at the terminal and in transit, but there is a dispute about how that product should be valued.

Altex has used the market value of the oil. The lender, as we understand it, has used a net value in its brief, such as in paragraph 84, and we believe that the value in that paragraph is in U.S. dollars, although it's not stated there. Our understanding is that the number comes from the first supplement to the first receiver's report dated October 25th, and it's stated to be in U.S. dollars there.

In any event, Altex's position is that there's no reason why the net value should be used, nor has the receiver provided any basis for how it discounted the gross value of the substances. So as a result, Altex doesn't understand how the receiver calculated its net

value.

I want to turn next to the capital fee. Altex designed and constructed the terminal, which was dedicated to Southern. The purpose of the capital fee was to permit Altex to recover from Southern the costs associated with designing and constructing the terminal.

The primary input into the capital fee is what's called in the agreement the terminal capital costs, and that's defined in section 2.8 of the agreement, which appears as Exhibit A to Mr. Zahary's first affidavit on page 18. It's clear from that provision that the terminal capital costs are intended to be the actual costs to design and build the terminal. If there was a dispute about those costs, Southern had the right to audit the costs, and the parties were required to try and resolve any dispute and to revise the terminal capital costs. If they agreed to a revision, the revised terminal capital costs, as they were called, would be used to calculate the monthly capital fee.

The actual costs were approximately $32.4 million, but the monthly capital fee was based on an interim basis, we say, on the budgeted cost of $22.4 million. It's clear from the agreement, in our submission, however, that the -- either the terminal capital costs or the revised terminal capital costs would be used to calculate the monthly capital fee.

Now, when Altex provided the actual costs to Southern, Southern exercised its right to audit, and Altex and Southern discussed revised terminal capital costs. Those discussions resulted in the email dated December 23rd, 2014, which appears as the first page of Exhibit F to Mr. Zahary's first affidavit.

A key term set out in the email was a revised terminal capital cost of $25 million plus an additional $2.9 million adjustment, which appears in the second paragraph of the email. This was stated to be subject to final approval by the respective boards of Altex and Southern. It was approved by Altex. Mr. Zahary indicated when he was cross-examined on his affidavit that he had blanket authority from Altex's board to accept the offer. He also testified that he doesn't know whether there was formal approval by Southern's board, and he also said that after this email, which was a couple of days before Christmas, a lot of Southern management and employees started leaving, and the amount of communication between the parties diminished.

Nevertheless, in our submission, there are sufficient grounds for you to find that there was a revised terminal capital cost of $27.9 million, the amount shown in the December 23rd email. However --

THE COURT: I'm sorry. What are those sufficient grounds since there doesn't appear to be any -- any evidence of approval by Southern's board of

directors?

MR. WOOD: Well, that's the only thing that was missing.

THE COURT: Okay.

MR. WOOD: If you are unable to find that there was a revised terminal capital cost, our contention is that in the absence of a revised terminal capital cost, the monthly capital fee is to be calculated based on the actual terminal capital costs, which is the actual cost of $32.4 million.

THE COURT: And is there -- can you refer me to the agreement that would provide that in the absence of agreement that that would be the --

MR. WOOD: Well, the default under section 2.8 is the terminal capital cost, and it's clear from that provision that that refers to actual costs and not forecast or estimates. And we say that because of the existence of the audit right and also the -- because the intention of the capital fee is to allow --

THE COURT: I'm sorry, Mr. Wood. Perhaps you should take me to that, then.

MR. WOOD: Sure. That's Exhibit A to Mr. Zahary's first affidavit.

THE COURT: Right.

MR. WOOD: At the top of page 18.

THE COURT: Page 18. Okay. Section 2.8?

MR. WOOD: Yes. And there it says that: (as read)

> Altex shall provide Southern with a detailed accounting of all capital costs and other costs and expenses incurred by Altex with regard to the design and construction of the terminal.

In our submission, those words clearly --

THE COURT: But within 90 days following the end -- the end service date.

MR. WOOD: Yes.

THE COURT: Yeah. And that, of course -- the agreement was disclaimed before that happened, I assume.

MR. WOOD: No. That's not my understanding.

THE COURT: Okay. Okay.

MR. WOOD: Because the terminal was constructed, and it was up and running, and Altex was tendering volumes of oil.

THE COURT: Was it? Okay. Okay.

MR. WOOD: And so in our submission, the language in 2.8 clearly points to actual costs. I mean, they're the costs and expenses incurred by Altex in regard to the design and construction of the terminal.

THE COURT: Was 2.8 operative at any point? I mean, did it -- did Southern decline to audit, or did it audit?

MR. WOOD: No, Ma'am.

THE COURT: No.

MR. WOOD: Southern did audit, and then --

THE COURT: Okay.

MR. WOOD: There was --

THE COURT: Is this -- okay. Yeah.

MR. WOOD: Yes.

THE COURT: No, I understand. And that's when --

MR. WOOD: That's when they had the discussions about revising --

THE COURT: And no --

MR. WOOD: -- the capital cost --

THE COURT: And no agreement was reached. Right.

MR. WOOD: -- and that resulted in the --

THE COURT: Okay. Got you.

MR. WOOD: -- December 23rd email.

THE COURT: Thank you. Sorry. Sorry. I thought you were pointing me to a new provision. Okay. Go ahead.

MR. WOOD: I want to turn next to Altex's pre-filing claims. Its claims are based on the principles of set-off and, in the alternative, on the existence of statutory particular liens.

With respect to set-off, Altex's submissions begin at paragraph 39 of its brief, and Altex maintains that it has a claim under the principles of contractual, legal, and equitable set-off. The contractual set-off provision, which is section 6 -- 7.6(b) of the agreement, gives Altex the right to set off against the amount unpaid by Southern any sums due or accruing to Southern from Altex. 7.6(d) gives Altex the right to sell any of the delivered substances as shall be sufficient to pay Southern's indebtedness.

There's no dispute that there were amounts unpaid by Southern. The dispute is about whether there were any sums due or accruing to Southern from Altex.

THE COURT: Right.

MR. WOOD: And our submission is that the value of the oil in Altex's possession or under its control, which Altex was bound to deliver to Southern, meets the requirement of a sum accruing to Southern from Altex for the purposes of the contractual set-off.

THE COURT: So why should I imply into the words "any sums due or owing to Southern" that conclusion?

MR. WOOD: Well, our submission on -- in that regard -- our submission there is that it is a sum in the sense that the value is what the claim would

have been against Altex by Southern had Altex failed to deliver the substances.

And our argument with respect to legal set-off is essentially the same. The issue under legal set-off is whether both obligations are debts. Again, there's no dispute that Southern was indebted to Altex. The question is whether Altex was also indebted to Southern. Again, our contention is that the debt owed to Southern was the value of the oil in Altex's possession or control, and we acknowledge that that requires a broad and liberal interpretation of the word "debt."

Equitable set-off is available whether or not the cross-obligations are mutual debts or even debts at all provided that there is a relationship between the cross-obligations so that it would be inequitable to permit one to proceed without taking the other into account. It's enough under equitable set-off that the opposing claims flow from the same transaction or relationship between the parties.

Our contention is that the obligation from Altex to Southern was the obligation to deliver possession of the oil tendered by Southern and that the relevant sum is the value of the oil that was in Altex's possession or control. And in our submission, at least for the purposes of equitable set-off, that is consistent with the finding of the Court of Appeal in paragraph 19 of the *Blue Range* decision, which appears at tab 10 of our materials, where the Court found that monies owing for past deliveries of gas could be set off against anticipated damages.

THE COURT: What about the argument that you can't claim equitable set-off arising out of a -- your own breach?

MR. WOOD: Well, certainly there was -- there was no breach of the agreement. Altex was specifically given the right to set off and the right to hold back and sell substances in order to secure any indebtedness it was owed by Southern under the agreement.

We also submit that Altex's action was not a breach of the initial order. Paragraph 15 of that order allowed Altex to take an action against the applicant where such an action must be taken in order to comply with statutory time limitations in order to preserve their rights at law.

Altex's right to set off existed only so long as it had control over and possession of the oil. This is a time limitation, although not a statutory one. And in our submission, it's important to note that Altex did not exercise its right to set off or sell deliver -- delivered substances but took the minimum action required to preserve that right.

Now, the lender argues that set-off can only be used as a defence, and we say that is not always the case. Set-off has been permitted when raised by a plaintiff. And we refer you to the Ontario decision of *Ferrum Inc. v. Three Dees Management Ltd.* There's a highlighted paragraph on the final page of that decision. In that case, the plaintiff sought declaratory relief that its award against the defendant could be set off against a debt owed to the defendant. And at paragraph 22, the Court said:

> Finally it was argued that there could be no set-off because the defendant Three Dees had made no claim against the plaintiff and set-off was available only as a defence. The plaintiff should withhold rent and wait to be sued. It is true that the principles of set-off are invoked normally as a response to a claim, but no case was cited to me to show that they were not available otherwise. I see no reason why the application of a salutary equitable principle should depend upon whether a party is plaintiff or defendant or upon whether a claim that will inevitably be made has as yet been asserted.

And Altex invites you to follow the principles set out in that paragraph.

Altex also notes that section 21 of the *CCAA*, which provides that:

> The law of set-off or compensation 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.

In the *Blue Range* decision, the Alberta Court of Appeal affirmed the principle that section 18.1 of the *CCAA*, as it was then -- it's now section 21 -- that concerns about the priority of creditors are irrelevant in the face of this section. The Court said in paragraph 13:

> Under section 18.1 set off was available to Duke and Engage and the chambers judge erred in taking into account potential prejudice to other creditors.

To conclude on the issue of set-off, Altex submits that it has entitle -- established its entitlement to set-off either under contractual set-off, legal set-off, or equitable set-off.

Now, with respect to Altex's lien claims, its submissions regarding its lien claims are set

out in paragraphs 66 to 73, and Altex relies on those submissions. I do want to talk a bit about actual versus constructive possession.

There's no doubt that Altex had actual possession of the oil that was stored at its own facility. Altex argues that it also had constructive possession of the oil in transit and Altex contracted with CN for transportation services.

The lender argues that Altex didn't have the requisite degree of control over the oil in transit necessary to support a claim of constructive possession. The lender points to section 5.1(c) of the relevant agreement, which says that: (as read)

> Altex shall have care, custody, and control for handling only for such period of time as the delivered substances are located at the terminal.

Key words there are "for handling."

Section 5.6 of the agreement gives Altex the right to sell the oil if Southern Pacific failed to take delivery. This is a clear demonstration, in our submission, that Altex had the the necessary degree of control over the oil in transit.

The lender also argues that the agreement between CN and Altex only obliged CN to transport oil between A and B for a specified fee. We agree that's what the agreement says. But CN is in the business of transporting goods for its customers. Altex was CN's customer; Southern Pacific was not. If Altex contacted CN and said, We want the oil that we tendered to you delivered somewhere else, in our submission there is no reason to believe that CN would not have accommodated that request, although it might have required a different or supplemental agreement and the transport charges would likely have been different.

In our submission, at all times Altex had the relevant degree of control over the oil in transit to support the conclusion that it had constructive possession.

Now, I want to turn to the post-filing claim. At post-filing, Altex agreed to provide services under the agreement in return for payment in advance. This agreement is reflected in paragraph 4.11.4 of the receiver's first report dated June 15th, 2015, where it says payment of future service fees and the monthly Altex fee would be made in advance.

The agreement was later disclaimed, but the disclaimer was not effective until the end of the 30-day notice period. That means, of course, that the agreement was still in place and, we say, as was also the receiver's agreement to pay in advance. It's not the case, as

the lender suggests, that Altex seeks payment for services that were never performed. The agreement was in force until the end of the disclaimer notice. Altex had to stand ready 24 hours a day, 7 days a week, to receive product for -- from Southern as required under the agreement until the end of the notice period.

The lender makes the point that Southern stopped sending oil immediately when the disclaimer notice was sent, but that doesn't change the fact that Southern had the right to tender oil to the terminal until the disclaimer was effective or the fact that Altex had to stand ready to receive oil from Altex (sic) until the end of the notice period.

Altex urges you to reject the lenders' suggestion that as soon as the disclaimer notice was issued Altex ought to have negotiated a new deal if it wanted to get paid. In our submission, Altex is entitled to the monthly capital fee for the notice period since under the agreement that fee is payable every month that the agreement is in force, whether or not Southern tenders any product. The agreement remained in force until the end of the disclaimer notice period, and the agreement to pay service charges and a monthly fee in advance likewise remained in force.

Finally, in response to some of the comments in the lenders' brief about the potential losses and hardship to the lender, our client has asked us to point out that it is a small Canadian company in comparison with the lender, and Altex believes that it stands to lose proportionally as much or more than the lender, including in particular the remaining unamortized cost of the terminal, which was to be recovered over the term of the agreement.

Subject to any questions you have and any submissions I may wish to make in response to my friend, that concludes my submissions.

THE COURT: Thank you, Mr. Wood.

MR. WOOD: Thank you.

THE COURT: Okay. Mr. Simard.

Submissions by Mr. Simard

MR. SIMARD: Thank you, My Lady.

As a preliminary matter, I will hand to Mr. Clerk something that you saw a preview of in the transcript of the questioning of Mr. Zahary, and that is Exhibit 1 to that questioning which we sent to you was --

THE COURT: Right.

MR. SIMARD: It's the CN agreement.

THE COURT: Right.

MR. SIMARD: And Altex asked that it be kept confidential, and we and the monitor agreed.

THE COURT: Okay.

MR. SIMARD: So I just circulated that form of sealing order earlier today.

THE COURT: Okay.

MR. SIMARD: It's obviously a confidential commercial agreement, and we're satisfied that it's appropriate to seal it on the file.

THE COURT: Yeah. I agree that given the nature of the document, it satisfies the *Sierra Club* tests, and I'll give you that sealing order. So we can --

MR. SIMARD: Thank you.

THE COURT: -- take care of that. Thanks.

MR. SIMARD: So in addition to that transcript that you have from us, you'll also have an affidavit of Donna Kathler, my assistant, dated September 19th. It just attached the PPR searches --

THE COURT: Oh, right, yeah.

MR. SIMARD: -- for Southern Pacific.

The book of materials we delivered, the thick binder, it was a bit ad hoc. I did not know what the state of your file would be. There would be some things in the *CCAA* file, so we tried to gather together things from the *CCAA* file that might be referred to as well as documents that you didn't receive recently and wouldn't have in hand. So I hope that completed the picture.

THE COURT: Okay.

MR. SIMARD: And then finally our brief was filed just this last Monday, October 24th.

THE COURT: Right.

MR. SIMARD: The comment my friend made at the start of his submission with respect to the dollar figure that's in paragraph 84 of our brief, the $200,000 figure, I'll explain that further when I get there.

THE COURT: Okay.

MR. SIMARD: He's right. It was taken from the monitor's -- or from the receiver's first supplemental report, and it should be in U.S. dollars. So I will go through that when we get there.

THE COURT: Okay.

MR. SIMARD: So as you know from the materials, My Lady, the lenders -- it's not just Credit Suisse. Credit Suisse is the agent. There are a number of lenders in the syndicate, but they are owed -- they were owed as at November 23rd, 2015, around $150 million. As you also know from the materials, the SISP that was conducted during the *CCAA* did not garner any bids sufficient to repay them.

I won't take you there, but I've included in the binder a confidential supplement to the receiver's second report from about a year ago, and at that time the receiver sold the Senlac asset, the Saskatchewan asset. So that was the only asset that was producing at that time. You'll see in paragraph 2.5, if you wish to turn it up -- and again, I won't take you there.

THE COURT: Okay. Go ahead.

MR. SIMARD: It's paragraph 2.5 on page 4 of that second -- of that confidential supplement to the receiver's second report.

THE COURT: Okay.

MR. SIMARD: You'll see the sale price there.

THE COURT: Okay.

MR. SIMARD: And so that to date is all that has come into the estate. That was the gross number that came into the estate to potentially become available to pay down the lenders' $150 million debt.

THE COURT: Okay.

MR. SIMARD: What is left in the estate now is the McKay asset. That's a Fort McKay oil sand asset. That's the asset that was producing but upon the receivership commencing in June of last year was hibernated by the receiver. That's explained in the fifth report. And it was hibernated because of the very poor economic conditions, so it has yet to be realized upon and turned into money. But you can take, I submit, from the fact that it wasn't even economic to produce and instead was hibernated that the prospects for the lenders receiving more in the way of a substantial return on their loan is not great in this case.

As you also know from the materials, Computershare was the collateral agent, and so Computershare on behalf of the lenders perfected the lenders' security interest over all of Southern Pacific's assets. That registration was January 2013.

Altex -- and I'll take you through this -- had what I submit is clearly a security interest granted to it in the agreement. Interestingly, the date of that agreement was 2012, June of 2012. So had Altex registered at the PPR, which would have been relatively simple, they would have been first in time, and this dispute might look very different. But they did not, and that's why we're here.

With respect to the capital cost true-up -- and that is the vast majority of the claims made by Altex today, 2.7 million pre-filing, 1.147 million post-filing -- we say that none of those claims are valid because there would have had to have been a consensus, an agreement between the parties about the revised terminal capital cost that would have had to be reduced to writing pursuant to the terms of the agreement.

And I won't take you through our detailed arguments, but starting on page 7 we set out a number of reasons why we say when you look at that email and when you look at the other factors and you look at the evidence that there are at least three different numbers in play, it's clear that the parties never reached consensus, never reached agreement on that revised terminal capital cost.

My friend said today that Altex's submission is that their evidence of the final actual cost of the plant was 32.4 million, and that is the number that should be used. He took you to

paragraph -- section 2.8 in the agreement. That's Exhibit A to Mr. Zahary's affidavit.

THE COURT: Right.

MR. SIMARD: And I'll just read you the last sentence. It's on page 18, the very last sentence after we talk about them giving the initial materials after plant startup and then the right to audit, which was exercised: (as read)

> Altex and Southern agree to act in good faith to resolve any claims or discrepancies and revise the terminal capital costs accordingly.

So that is where -- that is where the story ended. There was a dispute, and the parties were in the course after the audit of discussing that dispute, but they never reached agreement. There's no question they acted in good faith, but they did not resolve those claims.

So to say today that the actual cost is what should be used -- I would submit that on a project that large and complex, we have so much construction litigation, to say what the actual cost is is something that is subjective and in the eye of the beholder. And that the parties foresaw this is clear because they built in an audit right, and they built in a step two process whereby they would have to agree. And so clearly, whatever Altex believes is the actual cost today, that view was not shared by Southern Pacific, and they never reached agreement.

So we say the process that was followed was exactly that contemplated in 2.8. They just never got to the finish line. And you've seen from the receiver's first report that the receiver, having reviewed the information available to it, came to the same conclusion.

I'll turn next to set-off. And just to close on the true-up capital costs, so we say because there is no agreement, those numbers are completely off the table, the 2.7 pre-filing and the 1.147 post-filing.

To turn to set-off, set-off is a claim that's advanced for the pre-filing amounts. The pre-filing amounts are -- have been calculated by the receiver. They're set out in our brief at page 17, paragraph 49, and the amount is about $770,000. There's a U.S. component and a Canadian component, but using the Bank of Canada noon exchange rate on January 21st, the number -- the net Canadian number is 770,000.

THE COURT: Okay.

MR. SIMARD: Altex, their number is a bit higher. I think there's an additional invoice that they submit should be included so -- of about $30,000.

THE COURT: I thought --

MR. SIMARD: If you're looking for that reference in our brief, it was page 17, paragraph 49.

THE COURT: Okay. Thank you.

All right. Okay. Thank you.

MR. SIMARD: And then Altex's number, which is about 30,000 higher, so around 800,000, is at page 5, paragraph 17 of their brief.

THE COURT: Right.

MR. SIMARD: We submit that at a high level, there are two fundamental reasons why the set-off claims must fail, and the first one is because Altex unilaterally took steps to create facts or to attempt to create facts or funds that would give rise to a set-off. And the Courts have repeatedly said that parties cannot do that.

The first case we have submitted is *Kalta* at tab 2, one of your decisions, and it's exactly on point, in our submission. Fletcher Challenge, who was our client, they were a plant operator. By virtue of that position, Kalta's gas flowed through Fletcher's hands. Just like here, Southern Pacific's oil flowed through the possession of Altex. And when the receivership started in that case -- it was October 26th, 2000 -- Kalta owed fees to Fletcher Challenge for those processing services, just like the case here. We admit that there was about $770,000 owed on January 21st of last year.

The arrangements were also similar in that in the normal course the product flowed through Fletcher Challenge and it was purchased by a third party. So the third party would pay the sale proceeds directly to Kalta, the insolvent debtor. The money never flowed back through Fletcher Challenge's hands in the normal course, and that was exactly the case here as well. Altex received the oil, processed -- or transloaded it and sent it down the line, but ultimately the oil was purchased by third party purchasers, and that purchase money would never have flown back through Altex's hands.

And then what the parties did in each of the cases, the claimants, was very similar. After the receivership -- so after the stay was in place -- Fletcher Challenge in the next month, allocating the split month in which the receivership order kicked in, reallocated Kalta's

production to it. So it essentially diverted those funds that would have gone from a third party to Kalta into its own hands and then put them in trust with their counsel.

And so in that case, there actually was a fund generated. There was money by the time -- Fletcher Challenge came to court and said, Look, there's a fund. We have cross money claims. We can carry out a set-off here. But, of course, that's where the facts are different here. What happened here is when the *CCAA* started, as reported by the monitor, Altex suspended or slowed down its handling services and then got into a discussion with the monitor and with the company which resulted in the establishment of the trust fund.

But they never got to the stage, the advanced stage, that Fletcher Challenge got of actually taking that oil and somehow generating a fund. And I submit there's no -- there's no material distinction, but the fact is that Fletcher Challenge had something that looked a lot more like a claim for money by the debtor company whereas here Altex merely had the oil and was merely moving it down pursuant to the agreement.

Quintette Coal is another case that stands for that general proposition that parties cannot create facts so as to give themselves a right of set-off, and that's tab 5 at our brief. That was a *CCAA* case. This was a decision of the B.C. Court of Appeal. The initial order in that case -- it's an old case, 1990, but the initial order specifically prohibited set-off. And that appears at paragraph 4 on page 4 of the case. The page numbers are very faint in the lower right-hand corner, but you'll see in the middle of page 4 "and this court further orders."

So there was -- there was an initial order term expressly prohibiting set-off by coal purchasers. What some of the coal purchasers did, because they had a pre-*CCAA* arbitration award, they held back a portion of their purchase price for post-*CCAA* supply and tried to exert a set-off. So again, there was a cash -- there was an actual cash fund, and they tried to say, Well, these are just money cross-claims. But the Court in *Quintette*, just like Your Ladyship in *Kalta*, found that the creditor could not unilaterally breach its obligations so as to create the facts which would generate a set-off.

And I'll just read you from the very last page of Quintette, the last page under tab 5 of our brief, the rationale from the British Columbia Supreme Court in paragraph 22 starting at the -- part way through the fourth line:

> Set-off in law is only available as a defence. It has been described as "a shield and not a sword." In respect of the payments due for ongoing coal deliveries, Quintette has not sued for the amounts withheld. The Japanese companies have not therefore been put

into a position where they could raise the set-off shield.

And I'll come back to that concept of shield versus sword, but that was the rationale.

In the *Kalta* decision, you found that it was an issue of equity. When a party was seeking equitable set-off, it was an issue of equity to consider whether they unilaterally breached their obligations to create the fund, and that disqualified them for equitable set-off in that case. So the principle is the same here.

My friend also spoke to the initial order, and that is in our book of materials at tab 2. Mr. Gorman did not number the pages in his initial order, but I think it's the sixth page. It's the one that starts with paragraph 13 at the top.

THE COURT: Okay.

MR. SIMARD: And so in our submission, 13, 14, and 17 were all stay provisions that were breached by Altex and threatened to be further breached. So I'll just read you a few words from 13, starting in the second line: (as read)

> No proceeding or enforcement process shall be commenced or continued.

Down to 14, starting on the first line:

> All rights and remedies of any individual firm, corporation . . .

And then jumping down two lines.

> . . . whether judicial or extrajudicial against or in respect of the applicant or the monitor or affecting the business or the property are hereby stayed and suspended.

And then down at the very bottom of page 17:

> During the stay period, all persons having . . .

And if we jump to (b):

> . . . oral or written agreements . . .

Like Altex had here. And then down to the next paragraph:

> . . . are hereby restrained from discontinuing, altering, interfering with, suspending, or terminating . . .

Et cetera.

So what we know from the monitor's report at the time is that Altex in the few days after the *CCAA* ceased or slowed down its loading activities, and so that was a violation of paragraph 17 where it was obligated to continue to perform in the normal manner.

And the argument made by Altex in its brief is that we had remedies under the contract that would have allowed us to take this oil, sell this oil, generate a fund, et cetera, and that is in -- if you have Mr. Zahary's affidavit handy, it's article 7.6. It's on page 28. It's Exhibit A to his affidavit.

THE COURT: Okay.

MR. SIMARD: And so there you'll see, bottom left-hand side of the page, 7.6, remedies.

THE COURT: Yeah.

MR. SIMARD: The last three lines in that introductory clause: (as read)

> In the event Southern defaults in payment of any invoice and such default in payment continues for five days after receipt by Southern of a written demand from Altex for payment, then Altex may, without limiting its other rights . . .

Et cetera. Take some of these steps, which included enforcing the lien, setting off, selling, ceasing services, et cetera.

So the stay kicks in on January 21st. We don't have a notice from Altex. If we do, it's not in evidence, but I don't believe there was one. They can only exercise the remedies here if they first sent a notice and five days passed, but they were stayed from sending that notice, and they simply couldn't proceed. And that's obviously the nature of stays.

So that -- so their slowdown and suspension of their activities breached paragraph 17, in my submission. And then the things that they say they could have done or would have done to generate a fund would have breached paragraph 13 and paragraph 14 of the initial

order because they simply couldn't do those things by virtue of the stay, and they had preliminary steps, such as the sending of notices, before they could even do them under the agreement.

My friend in writing and today referred you to paragraph 15. That's on the same page of the initial order, tab 2 of our binder.

THE COURT: Okay. Thanks.

MR. SIMARD: And he suggested that paragraph 15 did justify the steps that he took. Paragraph 15 is the one that allows parties -- it's a carve-out from the stay to allow parties to take steps to comply with statutory time limitations. I would submit that the term statutory time limitations is a term of art and it has a very specific meaning, and the types of things that are designed to be caught in that carve-out are commencing a statement of claim where there's a limitation period or, what we commonly see, filing of a certificate of lis pendens, which you have to do within 180 days of commencing an action under the *Builders' Lien Act*. So those types of things, but not -- not Altex's action here in suspending or slowing down service and not its action in threatening to take a contractual remedy.

So I would submit section 15 doesn't -- doesn't save them, and it is not a carve-out that they can take advantage of.

So that's -- that's the first, what I call, fundamental reason why set-off cannot work here, because it can't flow from a party taking unilateral steps to create a fund or create facts.

The second fundamental reason is that set-off needs two money cross-claims. Whether it's debt claim versus debt claim in legal set-off or whether it's debt claim versus damages claim in equitable set-off, every case in both parties' books of authorities dealing with set-off deals with money claims. There has to be a money claim going both ways. And there never was a money claim by Southern Pacific against Altex.

The suggestion in my friend's brief is that had we been allowed to exercise remedies, had we been allowed to take oil and turn it into money, then we would have had money and then presumably Southern Pacific would have had to sue us for it. But, of course, that's not only speculative, it's also something that never happened. We're judging what the parties' rights were at January 21st, 2015. Even if those things had have happened, essentially Altex is arguing that Southern Pacific for purposes of the set-off argument should be forced to elect to sue for damages, but there's no obligation to do that. I -- had Altex gone further in the steps it had threatened, I submit that the most likely remedy would have been an application to this Court to restrain that behaviour and order Altex to

comply with the order or find them in contempt.

So there simply never was a money claim back from Southern Pacific against Altex, and in our submission that disqualifies all the grounds for set-off.

At pages 20 to 24 of our brief, we've gone through some more specific arguments on legal -- or contractual set-off, legal set-off, and equitable set-off. I won't take you through those. You've read them, and I can't add to them.

So those are the submissions on set-off.

With respect to the lien claim, I'll first address what funds are at issue because we know there's an $800,000 fund being held by PricewaterhouseCoopers or perhaps its counsel, Borden Ladner. But that -- that $800,000 was determined, as you would have seen in the evidence, from the amount owed to Altex. So it is not the amount that's automatically available by way of a lien claim.

The lien claim, any potential lien claim, in our submission, is limited to the value of the goods that were in Altex's possession on January 21st. There is -- as my friend said, there is an agreement in part. Everyone agrees that in the tanks at the Lynton facility there was approximately 11,000 barrels of oil and condensate. The receiver does value those -- puts a value on those volumes of $200,000, and that's where I --

THE COURT: Right.

MR. SIMARD: I just put the number in my brief, but it is -- my friend is right. It is U.S. dollars.

That's in the supplement to the receiver's first report. That was filed on September 19th. It's a short document, but on the very last page you'll see appendix A. So the number there is 200 -- the net number is $200,455, which is U.S. And using -- using the conversion rate that's in our brief and was on that date, it's 246,000 Canadian.

My friend submits that you should prefer Altex's calculation, which is about $450,000, in reference to the receiver's; but I would submit that the receiver does explain both in that table and in the report itself why the net number is the more appropriate number, and that is because there are two things at play. There is West Texas Intermediate and obviously the discount off West Texas Intermediate at the sales point.

But also the additional elements that the receiver factors in in its appendix A are the costs of getting the oil to that sales point. Obviously you can't sell it at the sales point price

unless you can get it there. And if it costs additional to get it there, in my submission that must be included in the calculation.

So we submit that the receiver's calculation should be preferred.

THE COURT: Okay. And that's under tab 3 of the first report? Appendix A, tab 3? No.

MR. SIMARD: I don't think I put that in our --

THE COURT: Oh, I see. Okay.

MR. SIMARD: -- book of materials.

THE COURT: Okay.

MR. SIMARD: It would be something loose --

THE COURT: Okay.

MR. SIMARD: -- that you would have received in late September.

THE COURT: Right. Okay.

MR. SIMARD: It should be in the file. But it's, yes, the September 19th supplement to the first receiver's report.

There is -- there was a supplemental affidavit from Mr. Zahary on Monday of this week.

THE COURT: Right.

MR. SIMARD: And so there's a -- it's not material, but I'll take you through it. There's an additional uncertainty about volumes.

In his original affidavit, in Exhibit C the evidence was that there were, in addition to that 11,000 barrels in storage at the site -- the original affidavit said in Exhibit C there were 25,000 barrels on railcars. There was no certainty as to where those are. I think he said most of them were in the United States, but he didn't know where they were. And then in the supplemental affidavit this week, on Monday, the evidence has changed. Instead of 25,000 barrels, it's 31,000 barrels were in transit, and of that there were two railcars on

site. So 2 out of 57 railcars.

The receiver then filed its second supplemental report this week in which -- I'll let Ms. Cameron speak to it, but I think they basically say we can't determine --

THE COURT: Yeah.

MR. SIMARD: -- what was where.

It doesn't make a material difference, in my submission. For the reasons I'll take you through, we don't think the legal claim for liens is good. But even if it was, it doesn't change the numbers. I'll take you through the calculations.

The receiver and Mr. Zahary agree that two railcars, if they were on site, that's about another 1,100 barrels. If you take the receiver's net sale price of $13.50 U.S., that's an additional $15,000, and at the conversion rate it's about 18,000.

So we say the maximum amount of the lien claim, if it were successful, would be what was in the tanks on site -- that's 246,000 -- and what was in the two railcars on site if you accept that evidence, 18,000, for a total of 264. So that's the quantum of the lien claim, in our submission.

You've seen in my friend's brief and heard from him today that they suggest they had constructive possession of the remainder, the other 55 railcars, wherever they were in North America. We -- we disagree that Altex had constructive possession and had effective lien rights, and I submit there are a number of flaws in that argument.

First, there is no evidence where those railcars were. As I said, Mr. Zahary in paragraph 15 of his first affidavit, he said they were in transit and mainly in the U.S.A., but nobody knows where they were. So just count the number of states and provinces between Alberta and Mississippi, and there's a large, large number of possibilities.

If we don't know where they were, we don't know what local lien laws would have applied to that property. I say it doesn't matter because, as you've seen in my brief, we say it's a *PPSA* dispute, and the *PPSA* of Alberta governs because of section 7(6). But in any event, they say they were out there somewhere. They say they have lien rights; but if they can't even prove to the Court where they were and what law would apply, I would submit that's a fatal flaw on the lien claim.

And secondly, just the very fact that Altex had no idea where those cars were, with respect, undercuts its argument that it had constructive possession of them. The reality

was they were in the care, custody, and control of CN, the carrier. CN no doubt knows where they were and could determine that, but they were not in the actual possession, the constructive possession, of Altex. So Altex was a bailee of the oil while it was holding it in their tanks, while it was transloading it, but then they -- they delivered up possession and sent it to the next bailee down the line, which was CN.

And we've made the point -- and I'll take you there in the agreement, paragraph 5.1(c). That's on page 21 of the agreement, which is again Exhibit A to Mr. Zahary's affidavit. Page 21, 5.1(c).

THE COURT: Right.

MR. SIMARD: And just at the very end. It's the last four lines: (as read)

> Altex shall have care, custody, and control of the delivered substances for handling as provided in this agreement only for such period of time as the delivered substances are located at the terminal, whether in the railcars or in the storage tanks.

So we submit that that -- that is an agreement about the -- between the parties about when Altex would have care, custody, and control, possession. Altex argues that because of the word handling -- I believe their submission is that because the word handling is in that sentence, this -- this just tells you when they had care, custody, and control for purposes of handling.

But what Altex -- to further develop their argument, what they have to suggest to you is that you should find that there's something else in the agreement that suggests they had care, custody, and control at a later stage, the transportation stage, by CN. But notably, there's no clause like that at all in this agreement. I would submit that they're asking you to read that in, and what they're asking you to read in is read the agreement as if there was another clause saying Altex shall have care, custody, and control of the delivered substances for transportation as provided in this agreement when the substances are in the possession of CN. Clearly, that term is not there.

And I would submit, My Lady, that in this clause, the most important word on this question is "only." "Only," if you read the sentence, modifies the concept of when Altex has care, custody, and control. Handling simply describes the purpose for which they had care, custody, and control, but "only" cuts it off, in our submission.

We agree with our friends. Altex under this agreement was contractually obliged to get

the oil to Mississippi, to get it to the terminal in Natchez, but that contractual obligation does not constitute possession or give it possession in some way. In fact, the way Altex satisfied that contractual obligation was to give up possession to CN. So the two concepts are different, in our view.

Our friend's point to the CN agreement -- that is the one in the confidential exhibit -- and they say that it shows that Altex has constructive possession. With respect, I don't see that anywhere in that agreement. It's almost devoid of substantive terms. But what is clear is that CN takes the oil from Lynton to Natchez in Mississippi, but there is no evidence in that agreement, I would submit, that anyone other than CN has total control and possession of the oil during that transit.

The first two cases in our friend's brief with respect to possession, *Fraser* and *Kocsis*, those are -- those are criminal cases that were construing the definition of possession in the *Criminal Code*, so we submit they're not helpful here.

I won't say anything more about constructive possession, but we say that there's simply no evidence and there's no -- there's no legal authority before you to say that Altex had constructive possession. All it had possession of for purposes of the lien analysis is what was on site, and that's valued at $264,000.

The primary reason, of course, that we say that the lien claims are not good is the *PPSA* reason and argument, and that flows from the *Kalta* case where again like -- exactly like this case, Fletcher Challenge had in its processing agreement a clause that gave it a charge and lien over the property, just like paragraph 7.6 in this agreement.

And I will take you there very briefly. Again, Mr. Zahary, Exhibit A. This is page 28, clause 7.6 at the bottom of the page.

THE COURT: Okay.

MR. SIMARD: And it's the opening words: (as read)

> Southern, in order to secure any indebtedness to Altex under this agreement, gives and grants to Altex as of the end service date a lien and charge on delivered substances to secure payment of any throughput and handling charges or other amounts payable to Altex by Southern pursuant to this agreement.

So the question is what is the nature of Altex's interest in the oil. And I handed to Mr. Clerk some sections of the *PPSA*.

THE COURT: Okay. Thank you.

MR. SIMARD: And to my friends. I will just briefly take you through a couple definitions. This is -- the first is on the fourth page, which is page 13, and the definition I draw to your attention is in the middle of the page, 1(1)(tt), security interest. So security interest means, (i), an interest in goods, et cetera, et cetera -- down about three lines -- that secures payment or performance of an obligation.

So that's exactly what we saw in 7.6, an interest in goods to secure payment or performance of, in this case, Southern Pacific's obligation to pay Altex for its services. So I submit it's a security interest.

And then if you go back one page to (qq), this answers the question of what Altex's status is. On page 12 of the *Act*, (qq) is two-thirds of the way down. Secured party means a person who has a security interest. Altex had a consensual security interest. That makes -- under this *Act*, it makes Altex a secured party.

And then I'll jump you back to the page we just looked at, 13, where (ss) near the top tells us that a security agreement means an agreement that creates or provides for a security interest. So that tells us that 7.6, if not the whole agreement, is a security interest. So Altex has a security interest in the delivered substances. That makes it a secured party under the *Act*, and this is a security agreement.

It's often said, My Lady, in the case law that the *PPSA* is a code; and that, in my submission, means that because -- what it means is that legislatively the *PPSA* fills the field. It comprehensively deals with how security interests, as we've just seen this is, are governed, how priority between security interests is determined, et cetera.

In this case, there's no question that perfection by priority by the lenders predated -- in fact, there was no perfection by Altex of any form, and so the priority dispute under the *Act* is clear. The lenders have first priority over all these goods.

The argument being put forward via the lien acts and via section 32 of the *PPSA*, in my submission respectfully, is an attempt to do indirectly what Altex failed to do directly but could have done by registering first. So it's an attempt to step outside of the -- of the *PPSA* and the priority rules which comprehensively govern this dispute.

And I will -- I want to read section 32 of the *PPSA* to you. It's in my friend's brief at tab 14. It's the very last page under tab 14. And so I submit that just on a reading of section 32, it's clear from the words used in that section that it is not a section that

applies to Altex and the dispute between Altex and the lenders. To start out, it says "where a person." Well, we know that under this *Act*, Altex is a secured party. It's not a person. I guess it's also a person, but it's a secured party, and there are separate provisions dealing with how secured parties' interests are governed.

> Where a person in the ordinary course of business furnishes materials or services with respect to goods . . .

Again, we know what is happening here is that Altex is performing the obligations under a security agreement that are performed -- that are secured by its security interest. So again, this applies to people who do not have security interest, do not have security interests -- sorry, security agreements and are not secured parties. And then the usage of the word "lien" in the third line. Again, we know what Altex has here is a security interest as defined in this *Act*.

So even the wording in section 32, I would submit, makes it clear that it is -- it is designed to cover other situations, like the *Craddock Trucking v. Leclair* situation where there was no consensual contractual security interest but rather somebody who performed work and had a right under the *Garageman's Lien Act*. But this provision is not designed to apply to people who are secured parties, who are performing the very obligations that are secured under the security agreement, and who are seeking to enforce their security interests.

I have -- we have set out in our brief -- and this is at page 26 and 27 -- some specific reasons why we say the *Possessory Lien Act* and the *Warehousemen's Lien Act* do not apply here. Again, I can't -- I can't add anything to those, but I draw your attention to those pages.

And then as well on page 29 of our brief -- I won't take you there, but we draw your attention to 7(6) of the *PPSA* which governs -- it's the conflict rule that governs security disputes over minerals extracted from well sites in Alberta, and it states that the Alberta *Personal Property Security Act* governs no matter where those minerals end up jurisdictionally. So we say that that applies here.

I'll turn finally to the post-*CCAA* claims of Altex. The receiver's calculation appears in its first report at Exhibit C. That first report is in our binder of materials. It's also an exhibit to Mr. Zahary's affidavit, so you have it in a few places. Exhibit -- this is a very thick -- the report is thick, and Exhibit C is probably about 30 percent of the way from the front. I do want to show it to you.

THE COURT: Okay.

MR. SIMARD: So if you flip through, you'll see after the text of the report there are a number of appendices, but in the top right-hand corner you'll see references to A numbers, B numbers, C numbers. So if you keep --

THE COURT: I'm sorry. Am I looking at the monitor's --

MR. SIMARD: No. Sorry. The receiver's first report.

THE COURT: The receiver's first report.

MR. SIMARD: And that is tab 7 in our --

THE COURT: I apologize. Yeah, yeah.

MR. SIMARD: -- in our materials.

THE COURT: Tab 7, yeah. Okay.

MR. SIMARD: Sorry about that. So maybe two-thirds --

THE COURT: I've just about got it.

MR. SIMARD: Yeah.

THE COURT: Okay.

MR. SIMARD: Yeah. So it's that table that says Altex post-*CCAA* charges and credits. So the receiver's calculation or the calculation they say per Southern Pacific's records, in the first two columns at the bottom, a Canadian figure and a U.S. figure. Those net out using the exchange rate as at April 15th, which was the day of the *CCAA* disclaimer notice, to about 69,000 Canadian. So it's a relatively small sum.

And remember, that is -- if you look above, you'll see that the receiver assumes for the purpose of coming up with that number that the contract has continued and payments must be made from the date of the disclaimer on April 15th right to the end of the 30-day period on May 15th. So if -- if everything had to be paid, the number would only be 69,000.

That number is not much different from Altex's if you -- of course, if you take out their capital cost true-up, which is a very large number, the number they claim for post-*CCAA*

fees owing is about 110,000. And that's in Mr. Zahary's affidavit at Exhibit M. So not a material difference.

You've seen the arguments in our brief, and I won't repeat myself. But despite what we generally say about companies and their obligations post-filing, under the current Alberta template order, it is not actually mandated that all post-*CCAA*s that apply must be paid in full. They are permitted but not directed to do so.

There have been a number of cases -- and we gave you some examples in *Fairwest* and *Verity* and *Smoky River*, an older case -- where post-petition trade creditors were not paid in full because there simply wasn't enough cash flow. So while the general principle at a high level is true, it's not -- it's not an absolute obligation of the *Act* or the initial order in this case that all post-*CCAA*s that apply must be paid for.

In this case we say it was because the evidence -- the parties seemed to be in agreement, although my friend does say that Altex had to have people on standby, et cetera. There were no services called for or provided after the April 15th disclaimer notice. So we submit that there's no unfairness here because Altex was, in fact, paid everything that it was -- it was paid for every service it provided post-*CCAA*. The only difference potentially of 69,000 -- I'm using the monitor's number -- is if it had to pay for that full period to May 15th, then it was owed another 69,000.

We've drawn the *Allarco* decision --

THE COURT: Can I just --

MR. SIMARD: Yes.

THE COURT: Can I ask you about that? Because Exhibit C seems to indicate that per Southern, that the May 1st to the May 15th pro rata capital fee was paid. Or it was owing. Is that --

MR. SIMARD: That's right.

THE COURT: Yeah, okay.

MR. SIMARD: So that's what I -- that's what I meant to say.

THE COURT: Okay.

MR. SIMARD: Is that the number --

THE COURT: The 69,000.

MR. SIMARD: The 69,000 net assumes that everything --

THE COURT: That it was paid.

MR. SIMARD: -- was owing --

THE COURT: Okay.

MR. SIMARD: -- for that entire period.

THE COURT: Okay.

MR. SIMARD: But that's not the true-up. That's based on the capital cost that was being paid --

THE COURT: Right. Yeah.

MR. SIMARD: -- by the parties throughout.

THE COURT: Okay. Got you. Can I ask you too how this -- how this compares to paragraph 49 of your brief.

MR. SIMARD: Yes.

THE COURT: Where you seem to come --

MR. SIMARD: Okay.

THE COURT: To have come to some different figures from the receiver.

MR. SIMARD: Sure. So 49 --

THE COURT: Page 17.

MR. SIMARD: Yes. So those are -- those are the figures.

THE COURT: Okay.

MR. SIMARD: Those are exactly the figures from Exhibit C.

THE COURT: Right.

MR. SIMARD: So pre-filing is 70 -- 770.

THE COURT: Right. And --

MR. SIMARD: We talked about that earlier.

THE COURT: And that's where the 69 comes from.

MR. SIMARD: Yeah.

THE COURT: Okay. Good.

MR. SIMARD: That's the -- the 69 --

THE COURT: Thank you.

MR. SIMARD: Yeah. The 69 is just -- it's applying -- it's applying a conversion, currency conversion rate to the U.S. dollar credit, the $175,000 credit, which then -- which then nets against the 287 and leaves a balance of 69.

THE COURT: Okay.

MR. SIMARD: So, My Lady, those -- unless you have other questions, those were -- those are my submissions.

THE COURT: Okay. No, no. I think that's fine. Thank you.

MR. SIMARD: Okay.

THE COURT: Mr. Wood.

Submissions by Mr. Wood

MR. WOOD: With respect to section 2.8 of the agreement, which deals with the capital cost, in our submission that provision is clear. It says you use the actual terminal costs unless the parties agree to revise terminal costs. We have

invited you to find that there were revised terminal costs. But if you find that there were not, then our submission is that the capital fee is based on the actual terminal costs.

Then my friend says that the actual cost is subjective. We disagree. What Altex actually spent, its actual cost, that's a simple fact. Clearly Altex spent more than the budgeted amount, and Southern was entitled to question the difference, which it did, but there's no dispute -- at least in our view there shouldn't be any dispute about what it was that Altex actually spent.

THE COURT: Well, are you saying there was no dispute? That what was disputed was something else other than -- what was disputed under 2.8?

MR. WOOD: The budgeted amount was -- I don't remember the exact number.

THE COURT: Right.

MR. WOOD: But it was 22 million, maybe 22.4. The actual cost came in at 32.4, and that's what we say was disputed, was --

THE COURT: Right.

MR. WOOD: You know, Southern wanted to know --

THE COURT: Right. So how -- so if there was no agreement that that was the actual -- those were the actual costs, but you want me to use it anyway?

MR. WOOD: Well, they were the actual costs in the sense that that's -- those were the dollars that were spent.

THE COURT: Okay.

MR. WOOD: Now, with respect to constructive versus actual possession, my friend says that the fact that Altex doesn't know where the oil was, at least while in transit, undercuts our claim for constructive possession. We disagree. That information was a phone call away to CN. The fact remains, in our submission, that Altex and only Altex could give CN instructions as to where to take the oil, and it's the only party who could do so.

My friend talked at some length about the *Direct Energy v. Kalta Energy* case, and I want to make a couple of points. In our view, what differs is that in that case Fletcher

unilaterally placed in trust amounts that were supposed to be allocated to Kalta for the sale of Kalta's gas. And you held in paragraph 26 that the unilateral accounting reallocation by Fletcher to put those funds aside wasn't authorized, and therefore Fletcher had breached the processing agreement.

THE COURT: Right.

MR. WOOD: We say that in this case Altex did not breach its agreement with Southern, and we say that --

THE COURT: Didn't it breach its agreement by ceasing or delaying its services?

MR. WOOD: Well, what we say is that it was specifically given a right to set off and to hold back and sell substances if there was an outstanding indebtedness, and we say that that -- that is a distinguishing characteristic, yes.

THE COURT: Okay.

MR. WOOD: Thank you.

THE COURT: Okay. Thank you. I'd like to give you my decision today. If you'll give me half an hour and come back at about quarter to, quarter to 4, I'll give you my oral decision.

(ADJOURNMENT)

Decision

THE COURT: Thank you. Please be seated. Sorry. It took me a little longer.

I am first going to address the amount of the claim.

The lenders submit that during the negotiations over how much should be put in trust pending their priorities dispute -- I'm sorry, pending this priorities dispute, Altex agreed with the monitor that the total amount of outstanding invoices owed by Southern Pacific to Altex as at January 21st, 2015, was $749,027.57 plus a $50,000 buffer amount. The receiver's calculation of the amounts owed to Altex in Canadian dollars is $770,291.31 pre-filing and $69,918.61 post-filing, calculated as set out in the receiver's first report.

It's clear that the main area of difference is Altex's claim for higher capital fees. With respect to the capital fees claimed by Altex, the evidence is clear that Southern Pacific and Altex were in dispute over the revised terminal capital cost, and the dispute was not resolved. Thus, as there was no agreement on the revised terminal capital cost, there is no justification under the contract for Altex to charge the increased amount.

Altex submits that I should use its roughly $32 million amount as actual costs. But whether or not that was the actual cost as it was to be calculated under the agreement was the subject of the dispute that was never resolved. In fact, Altex did not attempt to charge this higher amount until after the disclaimer of the agreement and the commencement of the receivership.

Since Southern -- since Southern Pacific paid Altex 100 percent of the unrevised agreed-upon capital fee both pre and post-filing, Altex has no claim under this heading save for a dispute over whether the capital fee for the time period May 1st to the 15th was owing, which I'll reference later.

With respect to whether Altex has priority over the $800,000 in trust or any additional amounts as calculated by the receiver, I am satisfied that firstly Altex is not entitled to any contractual set-off rights given that section 7.6(b) of the agreement only applies to any sums due or owing -- I'm sorry, any sums due or accruing to Southern from Altex. And given the plain meaning of this language, Altex cannot set off a money claim against a chattel.

On January 21st, 2015, Altex did not owe Southern Pacific any quantity of money against which it could exercise a set-off. Whether Southern eventually may have had a money claim had it been forced to sue Altex is speculative and not what actually happened.

Since there were no mutual money debts between the parties, Altex is not entitled to legal set-off either, nor is Altex entitled to equitable set-off because, like contractual and legal set-off, equitable set-off requires the existence of a money claim and a money cross-claim.

In addition, this situation is very similar to that addressed in *Direct Energy Marketing v. Kalta Energy*. Altex breached both its contractual obligations and the court-ordered stay to seek to improperly generate a fund against which it could assert set-off. Section 15 of the initial order does not apply.

To allow Altex to benefit from an improperly created situation would prefer Altex, an unsecured creditor, over other unsecured creditors and the lenders through the mechanism of a breach of the stay, which disentitles it to equitable relief.

Thus Altex is not entitled to priority over the funds in trust or its claims calculated by the receiver on the basis of any kind of set-off.

With respect to Altex's submission that it's entitled to priority on the basis of nonconsensual lien rights to the value of the goods in its possession arising under the *Possessory Lien Act* or the *Warehousemen's Lien Act*, again as set out in *Direct Energy*, Altex's lien was a consensual contractual lien governed by the *PPSA*. Although the agreement between Southern Pacific and Altex granted Altex a security interest in delivered substances to secure payment of any throughput and handling charges and other amounts payable to Altex, Altex never perfected this interest by registering at the PPR.

Thus this contractual security interest does not have priority over the registered lenders' charge.

Section 32 of the *PPSA* gives priority to nonconsensual security interests only and not contractual and consensual liens. On this issue, I accept the receiver's calculation of the value of that lien at a maximum of $246,000 Canadian. I accept the receiver's explanation of how that amount was calculated as set out in appendix A of its September 19th supplement to the receiver's first report as being reasonable and commercially sensible.

I cannot accept that Altex had constructive possession of the substances in transit given the language of section 5.1(c) of the agreement and the fact that Altex is not able to establish where the substances were at the time that it alleges it had constructive possession.

Given my conclusion that the *PPSA* applies, I do not have to consider the *Possessory Lien Act* or the *Warehousemen's Lien Act*.

With respect to whether Altex is entitled to a pro rata portion of the unrevised capital cost for the period of May 1st to 15th, 2015, I accept that even though services were not rendered, the notice period under the disclaimer was 30 days and that thus Altex is entitled to $69,918.61 as calculated by the receiver. Other than that, the remainder of Altex's claim to priority is dismissed.

I know that I went through that quite quickly, and I'm imagining that you're going to be wanting a transcript of it, but is there any question with respect to it that I could answer today?

MR. WOOD: No, Ma'am.

THE COURT: Okay. Thank you. Mr. Simard?

MR. SIMARD: No, thank you.

THE COURT: Okay. Thank you very much.

PROCEEDINGS CONCLUDED

Certificate of Record

I, Nancy Arevalo, certify that this recording is the record made of the evidence in the proceedings in the Court of Queen's Bench held in courtroom 1702 at Calgary, Alberta, on the 28th day of October, 2016, and that I and Gaurav Kumar were the officials in charge of the sound-recording machine during the proceedings.

Certificate of Transcript

I, Janice Plomp, certify that

(a) I transcribed the record, which was recorded by a sound-recording machine, to the best of my skill and ability and the foregoing pages are a complete and accurate transcript of the contents of the record, and

(b) the Certificate of Record for these proceedings was included orally on the record and is transcribed in this transcript

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TAB 15

CITATION: Target Canada Co. (Re), 2015 ONSC 1028
COURT FILE NO.: CV-15-10832-00CL
DATE: 2015-02-18

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: 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 TARGET CANADA CO., TARGET CANADA HEALTH CO., TARGET CANADA MOBILE GP CO., TARGET CANADA PHARMACY (BC) CORP., TARGET CANADA PHARMACY (ONTARIO) CORP., TARGET CANADA PHARMACY CORP., TARGET CANADA PHARMACY (SK) CORP., and TARGET CANADA PROPERTY LLC.

BEFORE: Regional Senior Justice Morawetz

COUNSEL: *Jeremy Dacks, John MacDonald* and *Shawn Irving,* for the Target Canada Co., Target Canada Health Co., Target Canada Mobile GP Co., Target Canada Pharmacy (BC) Corp., Target Canada Pharmacy (Ontario) Corp., Target Canada Pharmacy Corp., Target Canada Pharmacy (SK) Corp., and Target Canada Property LLC (the "Applicants")

Jay Swartz, for the Target Corporation

William Sasso, Sharon Strosberg and *Jacqueline Horvat*, Proposed Representative Counsel for the Pharmacy Franchisee Association of Canada

Susan Philpott, Employee Representative Counsel for employees of the Applicants

Alan Mark, Melaney Wagner, Graham Smith and *Francy Kussner,* for the Monitor, Alvarez & Marsal Inc.

J. Dietrich, for Merchant Retail Solutions ULC, Gordon Brothers Canada ULC and G.A. Retail Canada ULC

Andrew Hodhod, for Bell Canada

Harvey Chaiton, for the Directors and Officers

HEARD: February 11, 2015

RELEASED: February 18, 2015

ENDORSEMENT

[1] The Pharmacy Franchisee Association of Canada ("PFAC") brought this motion for the following relief:

a. appointing PFAC as the representative of the Pharmacists and Franchisees (collectively, the "Pharmacists") under the Pharmacy Franchise Agreements ("Franchise Agreements");

b. appointing Sutts, Strosberg LLP as the Pharmacists' Representative Counsel (the "Representative Counsel");

c. appointing BDO Canada ("BDO") as the Pharmacists' financial advisor;

d. directing that the Pharmacists' reasonable legal and other professional expenses be paid from the estate of the Target Canada Entities with appropriate administrative charges to secure payment;

e. directing that the "Disclaimer of Franchise Agreements" dated January 26, 2015 by the Franchisor, Target Pharmacy Franchising LP ("Target Pharmacy") be set aside;

f. declaring that the Franchise Agreements and/or related agreements may not be disclaimed without court order; and

g. directing that Target Pharmacy cannot deny the Pharmacists access to premises, discontinue supplies or otherwise interfere with a Pharmacist's operations without that Pharmacist's consent or a court order.

[2] On January 26, 2015, Target Pharmacy delivered Disclaimers of Franchise Agreements and related agreements to each of the Pharmacists operating the pharmacies at 93 locations across Canada (outside Quebec), seeking to shut down these pharmacies in the Target Canada store locations within 30 days.

[3] The Pharmacists ask the court to deny Target Pharmacy's Disclaimer of the Franchise Agreements because (i) the Disclaimers will not enhance the prospects of a viable arrangement being made; and (ii) the Pharmacists will suffer significant financial hardship as a consequence of the disclaimer, with insolvency and/or bankruptcy awaiting many of them.

[4] Under the proposed wind-down, Target Pharmacy is not responsible for pharmacy shut-down costs. Instead, the Pharmacists are responsible for (i) the payment of salaries, severance pay and other obligations to their own employees, suppliers and contractors; (ii) the relocation costs of their pharmacies; and (iii) the continuation of services to their patients in accordance with professional standards.

[5] The Pharmacists recognize that they face numerous challenges as a result of Target store closures. In relocating, or winding-down pharmacy operations, the Pharmacists are required to comply with applicable legislation, regulations and standards governing the conduct of pharmacists in Canada, including such matters as: notice of pharmacy closure; notice of intention to open a new pharmacy; the safe-guarding of personal health records; providing notice to patients respecting their personal health information; and safeguarding and disposing of narcotics and controlled substances.

[6] The Pharmacists seem to accept that when a Target store closes, the pharmacy within that store will also close. They state that they require "breathing space" that may be afforded to them by an order that the Franchise Agreements are not to be disclaimed at this time. They ask the court to direct Target Pharmacy and its Affiliates not to deny them access to their licenced space or otherwise interfere with the Pharmacist's operations without the consent of or on terms directed by the court. Practically speaking, the Pharmacists want to postpone the effect of the disclaimer in the hope of obtaining a continuation of support payments from Target Canada for an unspecified time.

[7] There is no doubt that the closure or pending closure of Target Canada is causing and will cause significant dislocation for a number of parties. For the most part, Target Employees will lose their jobs. Representative Counsel have been appointed to assist employees in a process that includes an Employee Trust.

[8] The closure of Target Canada also impacts suppliers to Target, especially sole suppliers. The insolvency of Target Canada and its filing under the *Companies' Creditors Arrangement Act* (CCAA) has no doubt resulted in Target defaulting on a number of contractual relationships. These suppliers will have claims against Target Canada that will be filed in due course.

[9] The closure of Target Canada also affects the Pharmacists. The insolvency of Target and its filing under the CCAA has resulted in Target defaulting on its contractual relationships with the Pharmacists. Target wishes to disclaim the Franchise Agreements. The Monitor approved the proposed disclaimer and, as noted, disclaimer notices were sent on January 26, 2015.

[10] The Pharmacists are challenging the disclaimer and seek an order under s. 32(2) of the CCAA that the Franchise Agreements not be disclaimed. Section 32(4) of the CCAA references a section 32(2) order and provides:

> **Factors to be considered** – In deciding whether to make the order, the court is to consider, among other things,
>
> (a) whether the monitor approved the proposed disclaimer or resiliation;
>
> (b) whether the disclaimer or resiliation would enhance the prospects of a viable compromise or arrangement being made in respect of the company; and
>
> (c) whether the disclaimer or resiliation would likely cause significant financial hardship to a party to the agreement.

[11] The reality that the Target stores will be closing provides, in my view, the starting point to analyze the issue being brought forward by the Pharmacists.

[12] Following the closing of a particular Target Store, it is unrealistic for the Pharmacist to carry on the operation of the pharmacy. As noted by counsel to the Applicants, as soon as operations cease at a particular location, the store will "go dark" and there will no longer be employee or security support that would permit the Franchisees to continue to operate. Further, counsel to the Applicants submits it would not be either commercially reasonable or practical for the Franchisees to continue to operate in a closed store, nor would it be reasonable or in the interests of stakeholders to require these locations to remain open in order to serve the interests of the Franchisees.

[13] It is in this context that the issue of the disclaimer has to be considered.

[14] Counsel to the Pharmacists seem to appreciate the reality of the situation, as reflected in the following references in their factum.

> 49. It is cold comfort for the Pharmacists to be advised that their losses in relation to the disclaimer of the Franchise Agreement are provable claims in the CCAA proceedings. The Pharmacists must pay their employees now. It is problematic that a provable claim may result in the possible recovery of some part of those payments, at a future uncertain date, if the funds are available in the Target Pharmacy Estate.
>
> 50. Evidence that simply provides that a debtor company will be more profitable with the disclaimer contracts is insufficient. Setting aside the disclaimers in this case will provide the Pharmacists with flexibility and time to make informed decisions and carry out their own relocation and/or wind-down in a manner that causes the least amount of damages to themselves and those who depend on them. …
>
> 53. Respectfully, such disclaimer should not be permitted until the court receives an independent report of the circumstances of each of the Pharmacists and directs the orderly wind-down and/or relocation of such operations on terms that are fair and reasonable. …
>
> 55. In no respect is the 30-day termination of the Franchise Agreements fair, reasonable and equitable to the Pharmacists, their employees and the public they serve. For many Pharmacists, it minimizes their capacity to relocate, [and] will leave them without funds to pay their employees, or the capacity to meet their ongoing obligations to their patients.

[15] It seems to me, having considered these submissions, that the Pharmacists recognize that it is inevitable that the pharmacies will be shut down.

[16] With respect to the factors to be considered as set out in s. 32(4), the disclaimer notices were approved by the Monitor. The Pharmacists complain that no reasons were provided in the notice approved by the Monitor. However, there is no requirement in s. 32(1) for the Monitor to provide reasons for its approval. This is reflected in Form 4 – Notice by Debtor Company to Disclaim or Resiliate an Agreement.

[17] However, the absence of reasons does not lead necessarily to the conclusion that the Monitor did not consider certain factors prior to providing its approval.

[18] The Monitor has made reference to the issues affecting the pharmacies in its Reports.

[19] The pharmacies were specifically the subject of comment in the Monitor's First Report at sections 8.2 – 8.5, and in the Second Report at section 6. Section 6.1 (h) of the Second Report specifically comments on the disclaimer notices. A summary of the reasons is provided at section 6.2.

[20] The information contained in the Monitor's reports establishes that there was communication as between Target Canada, the Monitor and the Franchisees such that it was clear that the stores were being closed. Specific reference to the communication is set out in the Monitor's Report at section 6.1(f), which in turn references the second Wong affidavit, filed by the Applicants.

[21] I am satisfied that the Monitor considered a number of relevant factors prior to approving the disclaimer notices.

[22] With respect to the second factor to be considered, namely whether the disclaimer would enhance the prospects of a viable compromise or arrangement being made in respect of the company, the Applicants have indicated they may be filing a plan of arrangement. I note that a plan may be required to ensure an orderly distribution of assets to the creditors.

[23] The Applicants seek to achieve an orderly wind-down and maximization of realizations to the benefit of all unsecured creditors. It seems to me that if the disclaimers are set aside it would delay this process because it would extend the time period for Target Canada to make payments to one group of creditors (the Pharmacists) to the detriment of the creditors generally. Further, in the absence of an effective disclaimer, the Target Entities will continue to incur significant ongoing administrative costs which would be detrimental to the estate and all stakeholders.

[24] The interests of all creditors must be taken into account. In this case, store closures and liquidation are inevitable. The Applicants should focus on an asset realization and a maximization of return to creditors on a timely basis. Setting aside the disclaimer might provide limited assistance to the Pharmacists, but it would come at the expense of other creditors. This is not a desirable outcome. I expressed similar views in *Timminco Ltd., Re*, 2012 ONSC 4471 at paragraph 62 as follows:

> [62] I have also taken into account that the effect of acceding to the argument put forth by counsel to Mr. Timmins would result in an improvement to his position relative to, and at the expense of, the unsecured creditors and other stakeholders of the Timminco Entities. If the Agreement is disclaimed, however, the monthly amounts that would otherwise be paid to Mr. Timmins would be available for distribution to all of Timminco's unsecured creditors, including Mr. Timmins. This equitable result is dictated by the guiding principles of the CCAA.

[25] I am satisfied that the disclaimer will be beneficial to the creditors generally because it will enable the Applicants to move forward with their liquidation plan without a further delay to accommodate the Pharmacists.

[26] The third factor is whether the disclaimer would likely cause significant financial hardship to a party to the agreement. This factor is addressed by Counsel to the Monitor at paragraph 27 of its factum.

> 27. On its own terms the CCAA effectively imposes a high threshold, beyond economic or financial loss, for the consideration under section 32(4): there must be evidence of financial *hardship*, it must be *significant* financial hardship, and it must be *likely* to be caused by the disclaimer. Financial loss or damage, without more, is not sufficient, in the Monitor's submission. It appears that Section 32 itself recognizes the distinction, providing expressly in ss. 32(7) that where a party suffers "a loss" in relation to the disclaimer the consequence is that such party "is considered to have a provable claim." (emphasis in original)

[27] In these circumstances, the pharmacies will inevitably close in the very near future whether or not the Franchise Agreements are disclaimed. I accept the submission of counsel to the Monitor to the effect that no Franchisee has adduced evidence that disallowing the Disclaimer and continuing to operate in otherwise dark, vacated premises would improve its financial circumstances.

[28] The situation facing the Pharmacists is not pleasant. However, in my view, setting aside the disclaimer will not improve their situation. Extending the time before the disclaimers take effect has the consequence of requiring Target Canada to allocate additional assets to the Pharmacists in priority to other unsecured creditors. This is not a desirable outcome.

[29] The Target Canada Entities, in consultation and with the support of the Monitor, have offered a degree of accommodation to the Pharmacists. The details are set out at paragraphs 64-66 of the affidavit of Mark Wong sworn February 16, 2015:

> 64. As outlined above, in consultation with and with the support of the Monitor, on February 9, 2015 the Target Canada Entities' legal advisors delivered an accommodation to PFAC's counsel intended to address the primary concern expressed by PFAC, namely that franchisees require additional time to transfer patient files and drug inventory and to relocate their respective pharmacy

businesses. Under the terms of the accommodation, TCC will permit the pharmacists to continue to operate at their respective existing TCC locations until the earlier of March 30, 2015 and three days following written notice by TCC to the pharmacist of the anticipated store closure at such pharmacist's location. The accommodation provides that the Notices of Disclaimer will continue in effect and the franchise agreements will be disclaimed on February 25, 2015, but the pharmacists will be entitled to remain on the premises for an additional period of time.

64. Under the terms of the accommodation, pharmacists will be able to continue operating in TCC stores for longer than the 30-day period contemplated. Depending on the date the Agent decides to vacate certain TCC stores, many pharmacists may be able to continue operating for 60 days or more following delivery of the Notices of Disclaimer and approximately 75 days following the date of the Initial Order. As I described above, at any time after the third anniversary of the opening date of the pharmacy, TCC Pharmacy would have the right to terminate the franchise agreement for any reason on 60 days' notice.

66. The March 30, 2015 date indicated in the accommodation made by Target Canada Entities is intended to be a reasonable compromise whereby pharmacist franchisees will get additional time to transfer patient files and inventory and relocate their businesses, while at the same time permitting the Target Canada Entities to undertake the orderly wind down of TCC pharmacy operations and the TCC retail stores as a whole. As I described above, in order to accommodate the continued operations of the pharmacies during the wind down process, TCC Pharmacy and TCC have not yet delivered notices of disclaimer to a number of third-party providers such as McKesson, Kroll and others, which TCC Pharmacy has maintained at considerable cost. The March 30, 2015 outside date for the operation of all TCC pharmacies will allow TCC Pharmacy to time the delivery of disclaimer notices to these third-party providers so as to avoid incurring additional unnecessary costs. The certainty provided by the firm outside date is also to the benefit of the pharmacies themselves, each of whom will be required to win down their operations and make alternate arrangements in the very short term as a result of the imminent closures of TCC retail stores.

[30] In the circumstances of this case, this accommodation represents, in my view, a constructive, practical and equitable approach to address a difficult issue.

[31] Having considered the factors set out in section 32(4) of the CCAA, the motion of PFAC for a direction that the disclaimer of the Franchise Agreements be set aside is dismissed, together with ancilliary relief related to the disclaimers. It is not necessary to address the standing issue raised by the Monitor.

[32] I turn now to the request of PFAC that it be appointed representative of the Franchisees and that Sutts, Strosberg LLP be appointed as the Pharmacists' Representative Counsel, and BDO as the Pharmacists' financial advisor.

[33] In view of my decision relating to the disclaimers, the scope of legal and financial services required by the Pharmacists may be limited. However, there are many transitional issues that remain to be addressed. First and foremost is dealing with the patient records and ensuring uninterrupted delivery of prescription drugs to all such patients. There is also interaction required between Target Pharmacy, the Franchisees, and the regulators, concerning the relocation or shut down of pharmacies and the return of certain products to suppliers. This is not a simple case where the Franchisee receiving the disclaimer notice can simply walk away from the scene. From a professional and regulatory standpoint, they still have to participate in the process.

[34] In addressing these transition issues and recognizing that similar circumstances exist for the Franchisees, there would appear to be some benefit in having a limited form of representation for the Franchisees. This would assist in ensuring that a consistent approach is followed not only in the wind-down or relocation aspect of the process, but also in the claims process. In my view, the estate could benefit if this process was coordinated.

[35] The Monitor and the Applicants would have a single point of contact which would likely result in a reduction in administrative time and costs during the liquidation and the claims process. I am satisfied that PFAC has the support of the majority of franchisees. PFAC is appointed as the Representative of the Pharmacists. Sutts, Strosberg LLP is appointed Representative Counsel and BDO is appointed as the Pharmacists financial advisor.

[36] The funding of this representational role is to be limited. The Applicants are to make available up to $100,000, inclusive of disbursements and HST, to PFAC to be used for legal and financial advisory services to be provided by Sutts, Strosberg, as Representative Counsel and BDO as financial advisor in these proceedings. PFAC can provide copies of invoices to the Monitor, who can arrange for payment of same. Any surplus funds at the conclusion of the representation are to be returned to the Applicants. The contribution to PFAC can be used only to cover legal and financial advisory services provided to date in these proceedings as well as to assist on the going forward matters, subject to the following parameters.

[37] Such assistance is to be limited to:

a. corresponding with the regulators concerning the wind-down process and the relocation process;

b. return of inventory; and

c. participating in the claims process.

[38] If the individual franchisees decide not to participate in PFAC, they should not expect any further accommodation in a financial sense.

[39] In arriving at this accommodation, I have taken into account that this limited funding will provide benefits to the Applicants under CCAA protection insofar as the legal and financial advisory services provided by Representative Counsel and BDO should reduce the overall administrative cost to the estate and will avoid a multiplicity of legal retainers. The representation and funding will also benefit the franchisees so that they can effectively shut-down or relocate their business and prepare any resulting claim in the CCAA proceedings.

[40] Given the limited nature of the Applicants' financial contribution, an administrative charge is not, in my view, required.

[41] In the result, PFAC's motion for representation status is granted, with limitations set out above. The motion in respect of the disclaimers is dismissed.

R.S.J. Geoffrey Morawetz

Date: February 18, 2015

TAB 16

Doman Industries Ltd. (Re)

British Columbia Judgments

British Columbia Court of Appeal

Vancouver, British Columbia

Low J.A. (In Chambers)

Oral judgment: June 30, 2004.

Released: July 8, 2004.

Vancouver Registry No. CA032015

[2004] B.C.J. No. 1402 | 2004 BCCA 382 | 201 B.C.A.C. 223 | 2 C.B.R. (5th) 141 | 132 A.C.W.S. (3d) 52 | 2004 CarswellBC 1545

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 AND IN THE MATTER OF the Canada Business Corporations Act, R.S.C. 1985, c. C-44 AND IN THE MATTER OF the Partnership Act, R.S.B.C. 1996, c. 348 AND IN THE MATTER OF Doman Industries Limited, Alpine Projects Limited, Diamond Lumber Sales Limited, Doman Forest Products Limited, Doman's Freightways Ltd., Doman Holdings Limited, Doman Investments Limited, Doman Log Supply Ltd., Doman-Western Lumber Ltd., Eacom Timer Sales Ltd., Western Forest Products Limited, Western Pulp Inc., Western Pulp Limited Partnership, and Quatsino Navigation Company Limited, appellants (petitioners), and Hayes Forest Services Limited and Strathcona Contracting Ltd., respondents (respondents)

(26 paras.)

Case Summary

Civil procedure — Appeals — Grounds for review — Interlocutory or final orders — Leave to appeal.

Application by the Doman Group for leave to appeal a decision of the trial judge dismissing an application by one of its companies, Western Forest Products, for court approval of cancellation of replacement contracts between Western and the respondent companies, Hayes and Strathcona. As a result of financial difficulties, the Doman Group was undergoing court supervised restructuring under the Companies' Creditors Arrangement Act. Cancellation of the contracts was a condition precedent under the restructuring plan and was subject to court approval, which approval the court denied. Western argued that the judge applied the wrong test or, alternatively, incorrectly applied the correct test.

HELD: Application dismissed.

The test was whether cancellation of the contracts was fair and reasonable as part of the reorganization of the insolvent company. The test entailed an inquiry into the effect of termination on the broad constituency representing a range of interests including individuals, companies, government agencies and the community. It was not an error for the judge to conclude that the rationale for cancellation of the contracts was unclear. He noted that the only evidence offered was that cancelling the contracts would help Western reduce costs and that evidence on other relevant points was missing. The judge was not convinced that the restructuring plan would fail without termination of the contracts. He weighed all arguments on both sides and properly exercised his discretion against approving termination of the contracts. The judge applied the correct principles and did not misapprehend the evidence.

Statutes, Regulations and Rules Cited:

Sylvan Lange

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

Forest Act, *R.S.B.C. 1996, c. 57*.

Counsel

P.G. Foy, Q.C. and P.D. McLean: Counsel for the Appellants

M. Buttery: Counsel for Tricap Restructuring Fund

S. Schachter, Q.C.: Counsel for Hayes Forest Services Ltd.

L. Friend, Q.C.: Counsel for the Informal Committee of Doman Unsecured Bondholders

S.R. Ross: Counsel for Strathcona Contracting

(leave to appeal; motion book; stand as appeal book, expedite appeal)

LOW J.A. (orally)

1 This is an application for leave to appeal an order of Mr. Justice Tysoe made on 25 May 2004 in these ongoing proceedings under the Companies Creditors Arrangement Act, *R.S.C. 1985, c. C-36* ("the CCAA"). The order dismisses an application by Western Forest Products Ltd. for court approval of cancellation by Western of replaceable contracts it has with Hayes Forest Services Ltd. and Strathcona Contracting Ltd. The Hayes contract is for logging and the Strathcona contract is for the construction of logging roads, both in the Nootka region of Vancouver Island in a specific area known as Plumper Harbour. Replaceable contracts are provided for in regulations made under the Forest Act, *R.S.B.C. 1996 c. 57*. They are designed to give contractors such as Hayes and Strathcona security of tenure similar to that enjoyed by the larger forestry companies that hold forest harvesting licences.

2 Western and the other petitioners are a collection of related forestry companies known as "the Doman Group". Western is a wholly owned subsidiary of Doman Industries Limited. To cope with otherwise insurmountable financial difficulties, the Doman Group brought proceedings in November 2002 seeking court-supervised and court-sanctioned financial and corporate restructuring under the CCAA. I understand that Mr. Justice Tysoe has had judicial responsibility for the proceedings throughout. In his reasons leading to the order for which leave to appeal is sought by Western, he introduced the history of the proceedings as follows:

> [3] The restructuring process is nearing completion. A plan of compromise and arrangement (the "Restructuring Plan") has been filed and the meeting of creditors to consider it has been scheduled to be held in approximately two weeks. The deadline for creditors to file proofs of claim is today.
>
> [4] In very simple terms, the Restructuring Plan contemplates that the lumber and pulp assets of Doman will be transferred into new corporations and that the unsecured noteholders, trade creditors and other unsecured creditors will have their debt converted into shares in one of the new corporations, which will own the lumber assets and the shares of the other corporation holding the pulp assets. The secured term debt is to be refinanced and the secured operating line of credit will be unaffected. The existing shareholders of Doman are to receive warrants entitling them to purchase a limited number of shares in the new parent corporation.

> [5] The implementation of the Restructuring Plan is subject to the fulfilment of numerous conditions precedent. One of the conditions is the termination of the contracts with Hayes and Strathcona which are the subject matter of this application.

3 On 6 April 2004, Mr. Justice Tysoe made an order that included a provision making termination of replaceable contracts by Western subject to court approval. On 27 April 2004, Western terminated its contracts with both Hayes and Strathcona in writing, to be effective upon court approval.

4 In lengthy and carefully worded reasons, the learned chambers judge discussed the evidence and the applicable law before exercising his discretion against approving the contract terminations. On this application, Western argues that his reasons disclose that he applied the wrong test or that, alternatively, he incorrectly applied the correct test. Western's position is supported by the Committee of Unsecured Noteholders who are the holders of unsecured notes having a face value of about $795,000,000, and by Tricap Restructuring Fund.

5 On an application for leave to appeal an interlocutory order in a civil proceeding, four criteria are considered: (1) whether the point on appeal is of significance to the practice; (2) whether the point is of significance to the action itself; (3) whether the proposed appeal raises a meritorious or arguable issue or whether the appeal is frivolous; and (4) whether the appeal will unduly hinder the progress of the action. Counsel said nothing directly applicable to the fourth factor. The arguments on both sides relate to the merits of the appeal and Western and the creditors supporting it say that the point of the appeal is of importance to the practice of insolvency law.

6 Hayes and Strathcona say that Western has not demonstrated any arguable misapprehension of the evidence or any arguable error in the judge's understanding or application of the law.

7 It is common ground that the order under attack is a discretionary order and, therefore, not easily overturned. Deference to the chambers judge is an even stronger factor here because this is a complex proceeding that Mr. Justice Tysoe has supervised from its inception. He is in a better position than is anybody else to balance the competing factors at play in the proceeding generally, as well as those at play with respect to the particular issue of cancellation of the two contracts.

8 This Court has already decided that replaceable contracts can be terminated in a CCAA proceeding notwithstanding that such contracts are mandated by statute as to many of their terms and as to arbitration of negotiable terms from time to time: see Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., *[2003] B.C.J. No. 1335*, *2003 BCCA 344*. There is no request in this case for the court to revisit that issue.

9 There is no dispute among the parties as to what a chambers judge must consider in determining whether to approve termination of a contract in a CCAA proceeding. The law was clearly stated by Madam Justice Newbury in Skeena Cellulose. The test is whether the business decision to cancel a contract as part of the reorganization of the insolvent company is fair and reasonable. In para. 53 she observed that the court approves the plan but does not create it. She stated that the plan "is a compromise arrived at by the debtor company and the requisite number of its creditors. The court should not readily interfere with their business decision, especially where the plan has been approved by a high percentage of creditors." She approved of comments by Mr. Justice Blair in Re Olympia & York Developments Ltd. *(1993), 12 O.R. (3d) 500*, that it is not the court's function "to second guess the business people with respect to the 'business aspects' of the Plan, descending into the negotiating arena and substituting [the court's] own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas."

10 Elsewhere in the Skeeena Cellulose decision it is said that if a contract termination is made in bad faith it ought not to be approved by the court. No doubt the existence of bad faith is simply an example of a situation in which it could not be said that the cancellation is fair and reasonable as part of a business plan. There is no suggestion of bad faith in the present case.

11 Madam Justice Newbury observed in para. 60 that the scope of the fairness and reasonableness enquiry is not

limited to the effect of the termination on the party who has the contract with the insolvent company. Nor is it limited to the creditors as a whole. A "broad constituency" is involved that includes a "wide range of interests that may be properly asserted by individuals, corporations, government entities and communities."

12 In Skeena Cellulose, the court reviewed the evidence and determined that it supported the conclusion reached by the chambers judge in the trial court that termination of the contracts in question was fair and reasonable in the circumstances.

13 In the present case, the chambers judge reviewed the evidence in support of the application to approve termination of the two contracts and the evidence and arguments to the contrary. He determined that he ought to exercise his discretion against approval of the terminations. He expressed his final conclusion thus:

> [38] In my opinion, therefore, there is insufficient evidence for me to conclude that the proposed contract terminations are fair and reasonable in all of the circumstances. All that the evidence available to me supports is a conclusion that the restructured company will have an opportunity of being more profitable if the contracts are terminated. It has not been demonstrated that the loss of this opportunity will outweigh the prejudice which will be suffered by Hayes and Strathcona if the contracts are terminated. In weighing the competing interests on the evidence before me, it is my conclusion that I should exercise my discretion against approving the contract terminations. I dismiss the application with costs.

14 Western seeks leave to attempt to persuade a panel of this Court that the chambers judge erred in three respects.

15 First, Western says that Mr. Justice Tysoe limited his enquiry to fairness as between Western, the two respondent contractors and the other creditors without taking into account the broader community as required by the authorities, particularly Skeena Cellulose. Western says this overly narrow scope is apparent in para. 38 of the judgment that I have reproduced above.

16 In my opinion, this is not an arguable ground of appeal. Earlier in the judgment, the judge correctly stated the law in all respects as extracted from Skeena Cellulose. In para. 38 he stated that he had weighed the competing interests. It cannot be argued that he failed to take into account the interests of the community as a whole. He clearly directed his mind to the possibility of greater profitability, a matter of obvious interest to the entire community, and he weighed the strength of that possibility against the prejudice to Hayes and Strathcona. That balancing is precisely what he was required by law to do.

17 Second, Western argues that the judge erred by calling for more evidence as to the business efficacy of the terminations and thereby descended into the arena of business negotiation contrary to the authorities. I am not persuaded that it is arguable that he fell into error in this way.

18 Western refers to para. 37 of the reasons which reads:

> [37] Some reliance was placed by counsel on the fact that the termination of these contracts is a condition precedent of the Restructuring Plan. In my view, this condition precedent is materially different than the condition precedent in Skeena Cellulose. In that case, it was an independent purchaser of the shares in Skeena that negotiated the condition on the basis that it was not prepared to purchase the shares unless two of the five replaceable contracts were terminated. The condition resulted from an arm's length negotiation which required the purchaser to put up funds to purchase the shares. In the present case, the bondholder committee produced the initial draft of the Restructuring Plan, which was finalized after a limited negotiation that served to advance the interests of the existing directors and shareholders of Doman. The condition precedent in question was not contained in the initial draft of the Restructuring Plan put forward by the bondholders and there is no evidence as to why the condition was inserted in the Restructuring Plan. I am unable to conclude that the condition precedent was the result of a truly adversarial negotiation and

> that, unlike the situation in Skeena Cellulose, the restructuring is unlikely to proceed if the condition is not satisfied.

19 I had some trouble sorting out the last sentence of that paragraph but I now see that the judge was simply saying that he could not conclude either of two things. The first was that the condition precedent in the Restructuring Plan (court-approved termination of the Hayes and Strathcona contracts) was the result of a "truly adversarial [business] negotiation". The second was that the evidence did not support the conclusion that non-achievement of the condition precedent would sink the Plan. He made an obvious distinction between this case and Skeena Cellulose. In that case the condition precedent was insisted upon by a purchaser of the company shares who would not complete without it whereas in the present case the condition came into being by what the judge considered to be a process that was inadequately explained. This was simply a legitimate distinction of Skeena Cellulose on the facts as part of the analysis leading to the conclusion as to how the court's discretion ought to be exercised. I am unable to see how this part of the analysis could possibly be seen to amount to legal error or a misapplication of the law.

20 It cannot be said that the judge called for more evidence on the issue before him. He simply described the conflicting evidence and commented on some matters about which there was no evidence. In para. 11 he described the affidavit evidence offered by Western to justify the termination provision. There were conflicting projections and opinions in the affidavits of representatives of Hayes and Strathcona described in paras. 13 and 14. In para. 36 the judge commenced his analysis of the evidence thus:

> [36] On the present application, all that the evidence established is that Doman will likely be able to reduce its costs to some extent at some point in the future if it can terminate the two contracts in question. Mr. Zimmerman's affidavit states that the reason Western made the recommendation to terminate the two contracts was to improve or increase its profitability. There is no evidence on this application with respect to the following points:
>
> (a) whether the logging at Plumper Harbour under the existing contracts has produced a loss in the past or is expected to produce a loss in the future;
>
> (b) whether other logging operations of Doman produce a greater loss;
>
> (c) whether other aspects of Doman's business produce a loss and, if so, what consideration has been given to rationalizing that loss in comparison to the termination of the contracts in question;
>
> (d) whether it is expected that the restructured company will operate at a profit;
>
> (e) what parts of the constituency of stakeholders will benefit from the termination of the contracts in question;
>
> (f) whether the developed timber at Plumper Harbour can be harvested in the next two years by other contractors at a cost less than the cost under the contracts in question; and
>
> (g) what is the fallacy, if any, in the assertion of Mr. Hayes that the termination of the contracts will have no material impact on cost reduction after taking into account the 20% government take-back.

21 I do not understand Western to be arguing that there was any misapprehension of the evidence and I am unable to detect any suggestion in the judge's discussion of the evidence that he was calling for more evidence to keep negotiations alive. It is clear that all he did in para. 36 reproduced above was point out an absence of evidence that emphasized the weakness of Western's position and the strength of the position of Hayes and Strathcona. It is clear that this was simply a valid part of the analysis leading to a conclusion as to how the court's discretion ought properly to be exercised in the circumstances of the case.

22 Finally, Western argues that the chambers judge erred in placing on Western the onus of establishing how much saving would result from termination of the contracts and of demonstrating that the Restructuring Plan would likely not proceed without court approval of the terminations.

23 I am unable to find any arguable merit in this intended ground of appeal. As I have said, the judge properly enunciated the principles stated in Skeena Cellulose. I see nothing in his analysis that could possibly support an argument that he strayed from those principles or misapplied them to the facts. He did not require Western to quantify anticipated savings or increase in profit flowing from termination. Nor did he require Western to demonstrate that the Plan would fail if the court did not approve the contract terminations. He simply was not persuaded that the Plan would fail in that event. Then he weighed the evidence plus the arguments for and against termination and arrived at a conclusion. Again, that is precisely what he was required to do in exercising his discretion.

24 In summary, Western has not identified any arguable error of law, any misapprehension of the evidence or any arrival at unavailable factual conclusions on the part of the chambers judge.

25 I should say something about the argument made by Western's allies on this application to the effect that if this decision is not reviewed by the Court of Appeal it will adversely affect desired certainty in other CCAA proceedings. There was little elaboration of this argument. I think the answer to it is that, as between this case and Skeena Cellulose, the results were different because the circumstances in the two cases were different. The principles are stated identically in both but because each case must be decided on its own facts the results in the two cases happened to be different. Two cases in the same area of law involving the exercise of judicial discretion are not irreconcilable simply because of differing results.

26 The application for leave to appeal is dismissed.

LOW J.A.

End of Document

TAB 17

Court of Queen's Bench of Alberta

Citation: Bellatrix Exploration Ltd (Re), 2020 ABQB 809

Date: 20201222
Docket: 1901 13767
Registry: Calgary

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

-and-

In the Matter of the Compromise or Arrangement of Bellatrix Exploration Ltd.

Reasons for Decision
of the
Honourable Madam Justice B.E. Romaine

I Introduction

[1] The ultimate issue in this application is whether BP Canada Energy Group ULC or the First Lien Lenders to Bellatrix Exploration Ltd. have priority to certain funds held by the Monitor and by Bellatrix pending resolution of disputed claims. These claims include BP's breach of contract claim arising from Bellatrix's purported disclaimer of, and ongoing failure to perform under, a GasEDI agreement between Bellatrix and BP.

[2] Bellatrix has obtained protection from its creditors under the *Companies Creditors' Arrangement Act*, RSC 1985, c. C-36, as amended. It holds approximately US$14.2 million of the funds in issue and approximately US$1.6 million is held by PricewaterhouseCoopers Inc. in its capacity as Court-appointed Monitor of Bellatrix.

II Relevant Facts

[3] Bellatrix and BP were parties to a GasEDI Base contract for the short-term sale and purchase of natural gas and a Special Provisions for GasEDI Base Contract, both dated as of March 1, 2010 (collectively, with transaction confirmations, the "GasEDI Agreement").

[4] Bellatrix and BP entered into two transaction confirmations pursuant to the terms of the GasEDI Agreement, dated as of December 12, 2017.

[5] Pursuant to the GasEDI Agreement, Bellatrix was required to deliver natural gas to an agreed delivery point in Alberta. BP would then purchase and take title to that natural gas. Pursuant to the transaction confirmations, BP agreed to pay for the natural gas in accordance with a pricing formula based on posted index prices at specific or designated downstream pricing hubs in the US and Ontario, on a month to month basis. The GasEDI Agreement does not provide BP with a security interest in respect of Bellatrix's obligations under the contract.

[6] Bellatrix was granted protection under the CCAA by an initial order dated October 2, 2019.

[7] On November 25, 2019, with the Monitor's approval, Bellatrix sent BP a Disclaimer Notice with respect to the GasEDI Agreement, pursuant to section 32(1) of the CCAA. The Disclaimer Notice provided that the disclaimer of the GasEDI Agreement, unless successfully objected to by BP, would not take effect until December 25, 2019, 30 days later.

[8] On November 25, 2019, BP responded to the Disclaimer Notice, advising Bellatrix of its view that the GasEDI Agreement constituted an eligible financial contract ("EFC") under the CCAA, and that therefore it could not be disclaimed.

[9] On November 26, 2019, Bellatrix stopped delivering gas to BP.

[10] On November 27, 2019, Bellatrix offered to resume delivery of natural gas under the GasEDI Agreement during the disclaimer period if BP would agree not to withhold revenues owed to Bellatrix. Bellatrix proposed that BP pay Bellatrix revenue without any set-off, reduction or deduction. On the same day BP responded, refusing to accept the terms of this proposal.

[11] On November 28 and November 29, 2019, BP sent letters reiterating its position that the GasEDI Agreement was an EFC and could not be disclaimed, and demanding that Bellatrix immediately resume performance under the contract. In its letters, BP stated that, even if the GasEDI Agreement was not an EFC, Bellatrix continued to be bound by the terms of the agreement until the expiry of the disclaimer notice period, and that Bellatrix's unilateral breach thereof constituted a post-filing breach.

[12] Bellatrix had delivered natural gas to BP in accordance with the GasEDI Agreement from November 1 to November 25, 2019. The amount payable to Bellatrix by BP for that natural gas was US$1,583,859.38, subject to any valid rights of set-off. That amount would ordinarily have been paid on December 24, 2019.

[13] On December 6, 2019, Bellatrix, BP and the Monitor entered into an agreement pursuant to which BP paid the December payment to the Monitor in trust pending further resolution of matters relating to Bellatrix's disclaimer of the GasEDI Agreement. The agreement reserved all rights of BP in respect of the December payment, including the right, if applicable, to set-off or net the December payment against any obligations of Bellatrix to BP under the GasEDI Agreement.

[14] BP filed an application seeking a declaration that the GasEDI Agreement is an EFC within the meaning of the CCAA. BP sought additional relief in its application, including an order enjoining Bellatrix from unilaterally suspending deliveries of gas under the agreement, but due to time constraints, the parties agreed to limit submissions to the single issue of whether the GasEDI Agreement is an EFC. If BP had proceeded with the other relief it sought and been

successful, Bellatrix would have been required to deliver gas to BP, but not entitled to receive the proceeds of sale.

[15] On February 4, 2020, Jones, J. held that the agreement was an EFC: *Re Bellatrix Exploration Ltd.* [2020] AJ No 329 (the "EFC Decision"). This decision is under appeal, leave granted 2020 ABCA 178. The decision makes no reference to any obligation of Bellatrix with respect to continued performance of the agreement.

[16] On February 6, 2020, BP counsel wrote to Bellatrix counsel advising, among other things, that, as a result of the EFC Decision, BP expected Bellatrix to resume performance of the GasEDI Agreement.

[17] On February 11, 2020, counsel to Bellatrix responded noting that the EFC Decision did not address any of the other relief sought in BP's application, including a requirement that Bellatrix perform its obligations under the GasEDI Agreement. The response reiterated Bellatrix's position that BP has an unsecured claim in Bellatrix's CCAA proceedings. The response also advised that Bellatrix did not expect any potential purchaser or credit bid party to assume the terms of the GasEDI Agreement.

[18] Counsel to BP filed an order with respect to the EFC Decision on March 5, 2020. The order, among other things, grants BP leave to apply to the Court for such further advice and direction as may be required with respect to the remainder of relief sought in the GasEDI Agreement application.

[19] BP brought no application to address the remainder of the relief sought in the EFC determination application until BP filed its cross-application on August 7, 2020 to the application filed by the Agent to the First Lien Lender, five months later.

[20] On March 20, 2020, Bellatrix applied for, among other things, an order extending the stay of proceedings under the CCAA to May 7, 2020. As a result of Court closures due to the COVID-19 pandemic, the application was made via desk application, subject to any interested party objecting to the application.

[21] There were no objections to the application, and on March 31, 2020, the Court granted an order extending the stay of proceedings to May 7, 2020. The order provided for a further automatic stay extension to June 8, 2020, subject to, among other things, any objections from interested parties.

[22] In a May 1, 2020 decision allowing leave to appeal the EFC Decision, Strekaf, J.A. directed that the determination of how the interests of BP and other parties to the CCAA proceedings could best be protected pending the hearing of the appeal of the EFC Decision should be determined by this Court. No party has sought a stay of the EFC Decision.

[23] There were no objections to the automatic stay extension on June 8, 2020 from any interested parties, and the stay has continued. Applications for the stay extension orders submit that Bellatrix has been acting in good faith and with due diligence in carrying out the terms of all orders of the Court and in respect of all matters relating to the CCAA proceedings.

[24] On May 8, 2020, Hollins, J. granted an Approval and Vesting Order approving the sale of substantially all of Bellatrix's assets to Spartan Delta Corp. Bellatrix closed the sale on June 1, 2020. The GasEDI Agreement was not assumed by the purchaser.

[25] Pursuant to the Spartan transaction, the purchaser acquired substantially all of Bellatrix's assets and assumed all of Bellatrix's liabilities in respect of its wells, environmental obligations, pre-filing cure costs in respect of assumed contracts and certain other assumed labilities. The Spartan transaction also permitted the purchaser to make offers of employment to Bellatrix's employees.

[26] The First Lien Lenders are secured creditors of Bellatrix pursuant to a credit agreement dated June 4, 2019 and certain security granted in relation to that agreement. In contrast to the GasEDI Agreement, the credit agreement and the security granted in relation thereto secure any indebtedness that may become owing by Bellatrix under any swap contracts or other derivative agreements with the First Lien Lenders. The Agent of the First Lien Lenders, on behalf of the lenders, has a registered, valid and enforceable first priority security interest in all of Bellatrix's present and after-acquired personal property and a first priority floating charge on all of Bellatrix's present and after-acquired real property.

[27] On May 22, 2020, the Court granted a Stay Extension and Distribution Order authorizing Bellatrix to distribute $47.5 million, a portion of the net proceeds from the Spartan sale, to the Agent of the First Lien Lenders in partial satisfaction of their secured claim. Bellatrix held back certain funds from distribution, including funds for disputed claims such as the BP claim.

[28] Bellatrix remains indebted to the First Lien Lenders in excess of $44.5 million. Bellatrix may not be able to pay the secured claim of the First Lien lenders in full given the results of the sale process. In the circumstances, a claims process has not been initiated in these CCAA proceedings.

[29] The First Lien Lenders seek a declaration that they have a first priority interest in all the property of Bellatrix, including funds held back in relation to the BP claim, a declaration that amounts owing to BP, if any, are an unsecured claim, and an order directing the Monitor to make a further distribution to the Agent in the amount of approximately $28.9 million. Bellatrix supports this position and submits that the Agent for the First Lien Holders is entitled to distribution of the sale proceeds and the December payment of approximately $1.6 million held in trust by the Monitor in priority to BP.

[30] In a cross application, BP seeks judgement for damages in an amount equivalent to US$14.2 million, an order lifting the stay in the CCAA proceedings to permit BP to enforce the judgement, and an order directing the Monitor to pay BP the approximately US$1.6 million December payment from the held-back funds, an order directing Bellatrix to pay the remainder of the claimed damages out of the sale of proceeds of its assets, or, in the alternate, granting BP a charge over the property of Bellatrix in the amount of the claimed damages with priority over the secured creditors and *pari passu* with the Interim Lenders Charge, or in the further alternative, an order declaring that any funds held by the Monitor and Bellatrix up to the amount of the claimed damages are held in trust for BP.

III Issues

[31] The main issue is whether the CCAA grants BP, as the non-insolvent counterpart to an EFC that has not chosen to terminate the agreement, any security or priority for its damages as a result of Bellatrix's ongoing failure to perform under the agreement. In other words, does the exception to the debtor's right to disclaim an EFC set out in section 34(7)(a) of the CCAA create an obligation for the debtor to continue to perform the EFC throughout insolvency proceedings?

[32] Other issues include the following:

(a) Is BP entitled to the funds held by the Monitor in respect of the December payment pursuant to a right of set-off?

(b) Is BP entitled to lift the stay to permit it to obtain and enforce a judgment against the sale proceeds?

(c) Is BP entitled to equitable relief?

(d) Has BP proved the amount of its claim for damages?

IV Analysis

A. Does the exception to the debtor's right to disclaim an EFC set out in section 34(7)(a) of the CCAA create an obligation for the debtor to continue to perform the EFC throughout insolvency proceedings?

[33] The stay provision of the CCAA, which prevents termination of an agreement because of a contractual counterparty's insolvency, does not apply to an EFC: section 34(7).

[34] Section 34(8)(a) of the CCAA allows solvent counterparties to EFCs certain "permitted actions" during the stay period if they are allowed to take such actions under the specific EFC agreement, including netting or setting off or compensation of obligations between the company and the other parties to the EFC. However, section 34(10) does not permit enforcement actions to recover net termination values once they are determined. Rather, if net termination values are owed by the company to another party to the EFC, section 34(10) deems the non-insolvent counterparty "to be a creditor of the company with a claim against the company in respect of those net termination values".

[35] As noted by the First Lien Lenders, the purpose of protection for EFCs under the CCAA is to provide stability to financial markets by allowing a non-defaulting counterparty the right to terminate and crystallize claims arising under an EFC.

[36] Like other creditors of the company, the net claims of a non-insolvent counterparty after termination are subject to the stay of proceedings. The Canadian Bankers Association in its submissions in favour of EFC amendments to the *Bankruptcy and Insolvency Act* in 1991 commented that:

> ... it cannot be overemphasized that our proposal is not to benefit either party to an eligible financial contract. ... Any net amount, if owed to the other party, would be fully subject to the proposed stay provisions. What would be achieved is that the rights of both parties would have been reduced to a fixed and certain amount, just like an amount owed under a regular contract at the time of the stay. (emphasis added): as cited in *Re Androscoggin Energy LLC*, [2005] OJ No. 395 at para 3.

[37] The Insolvency Institute of Canada Report of the Task Force on Derivatives dated September 26, 2013 notes at pages 2 and 3 that:

> EFC protection is a significant exception to the stay of proceedings under the CCAA and BIA. There are two main purposes of the EFC safe harbours: (i) to protect non-defaulting counterparties from the risk of increasing exposure to the insolvent counterparty under the EFC and (ii) to reduce systemic risk in Canadian

> and global financial markets. Non-defaulting counterparties may be at risk because, in certain instances, the amounts under the EFCs are very substantial and the value of the underlying products subject to EFCs are volatile in nature and can change dramatically during an insolvency proceeding. If the solvent counterparty to an EFC is subject to a stay of proceedings and therefore unable to terminate its EFCs with the insolvent counterparty, there is a risk that the value of such EFCs could deteriorate sufficiently (from the insolvent counterparty's perspective) to put the solvent counterparty at risk. Systemic risk may arise where the solvent counterparty is a systemically important institution or where the solvent counterparty has entered into EFCs with one or more other counterparties. In extreme cases, the failure of one counterparty could have a domino effect, where the failure of one counterparty, particularly a derivatives dealer, triggers the failure of a second counterparty who is also a derivatives dealer and the failure of the second counterparty could trigger the failure of others. Multiple insolvencies may cause a lack of liquidity in the financial sector and unavailability of credit to solvent enterprises and, ultimately, systemic risk. The systemic risk could spread to global markets and lead to world-wide financial instability and, in extreme cases, recession.

[38] The protection offered to non-insolvent counterparties to an EFC is the ability to terminate the EFC and crystallize its loss despite the stay provision of the CCAA, a protection not afforded to other creditors. The other protection is allowing set-off if the EFC agreement itself permits it. The exceptions were included in the *Act* for the protection of the derivative market generally from volatile and systemic risk. They do not compel a CCAA debtor to continue to perform an EFC that has not been terminated, nor does the CCAA provide the non-insolvent counterparty with any priority for its claim, apart from the protection of the exemption.

[39] Unless the non-insolvent counterparty to the EFC has a security interest, it is an unsecured creditor, and participates in the CCAA proceedings on the same footing as other creditors: *Re Blue Range Resource Corp.*, 2000 ABCA 239 at para 9.

[40] Therefore, assuming that the GasEDI Agreement is an EFC, BP is allowed to terminate it and crystallize its loss. However, as BP has not done so, its remedy for Bellatrix's breach of the GasEDI Agreement is a claim in the CCAA proceedings as an unsecured creditor unless there are other remedies available to it in the specific circumstances.

[41] BP submits that, unless it is granted the relief it seeks, the practical effect of Bellatrix's conduct would be to render the disclaimer rules of the CCAA meaningless. It notes that a valid disclaimer under section 32(7) of the CCAA results in a "provable claim", unsecured unless otherwise provided for in the disclaimed contract. However, if CCAA debtors are allowed to breach executory contracts at will, the result is identical: the solvent party has a provable claim, unsecured unless otherwise provided for under the contract. BP submits that, if that is true, section 32(7) of the CCAA is without a purpose, as there is no practical difference between contracts that can and cannot be lawfully disclaimed. Either way, if the debtor chooses to breach the contract, the solvent counterparty is left with the same remedy – which in many cases, is no remedy at all.

[42] Therefore, BP submits that the "clear implication" of the statutory disclaimer provisions of the CCAA is that a company is required to perform its obligations under executory contracts as of the filing date, unless and until those contracts can be validly disclaimed under section 32.

[43] As noted previously, the exception from EFCs included in the disclaimer provisions of the *Act* do not expressly provide that an EFC must be performed. Such a mandatory requirement would thwart the objectives of the CCAA, since compelling a CCAA debtor to performs an EFC that it cannot afford to perform would in many cases affect its ability to attempt to restructure.

[44] The disclaimer provisions, while initiated by the debtor, provide the solvent party to a disclaimable contract an opportunity to object to the disclaimer and a process for doing so. Section 32(4) of the *Act* sets out factors that the court must consider in deciding the issue.

[45] While the solvent party to a contract that the debtor merely stops performing may not have available to it the same statutory process, it may apply to the court for an order compelling performance as BP initially purported to do. The court supervising the CCAA proceedings in its consideration of such an application would likely take into account factors similar to those set out in section 32(4), including whether compelling performance would interfere with the prospect of a viable arrangement, and whether refusing such an order would cause significant financial hardship to a party to the contract.

[46] While the considerations may be similar, a disclaimer proceeding is initiated by the debtor, provides for a statutory process and mandates a termination date for the disclaimer. As noted by Morawetz, J. in *Re Target Canada Co*, 2015 CarswellOnt 3274, the disclaimer is beneficial to creditors generally because it enables the debtor to move forward with a liquidation plan without further delay. In contrast, the unilateral non-performance of a contract gives rise to uncertainty for both the debtor and the counterparty as to the status of the contract, including whether or not the solvent counterparty at its election will accept the termination of the contract as repudiated, and the date of its termination.

[47] The disclaimer provisions are thus not rendered meaningless by the existence of a less formal option, but provide an opportunity for orderly termination and certainty to the parties to the disclaimed contract. Implying an obligation to perform an uneconomic contract that may affect the ability of the CCAA debtor to attempt to restructure would require more direct statutory language.

[48] It must be noted that Bellatrix attempted to resolve the issue through the disclaimer option before the GasEDI Agreement was found to be an EFC.

> B. Is BP entitled to the funds held by the Monitor in respect of the December payment pursuant to the right of set-off?

[49] Assuming that the GasEDI Agreement is an EFC, section 34(8)(a) of the CCAA permits the netting or setting off of obligations between the debtor company and the other party to the EFC if the EFC is terminated on or after the commencement of the CCAA proceedings and if such action is "in accordance with the provisions of the contract".

[50] However, BP has not terminated the GasEDI Agreement and is not seeking to terminate and set-off its position to reduce exposure to risk. Therefore, the set-off provisions of section 34(8)(a) are not available to it.

[51] BP seeks to maintain Bellatrix's obligation to perform the agreement but set-off amounts it owes to Bellatrix for previously delivered product. Whether or not the GasEDI Agreement is an EFC, the agreement does not on its terms allow the set-off of the December payment.

[52] Section 10.2 of the base contract in the GasEDI Agreement permits the non-defaulting party to withhold any amounts owed to the defaulting party when there is an event of default or a potential event of default and to set-off such amounts against "any amounts owed to the Defaulting Party under the [GasEDI Agreement] whether or not yet due" and set-off against such withheld amounts "any amounts owed the non-Defaulting Party hereunder (whether or not yet due)". BP submits that it is entitled to set-off its damages claim against the December payment, relying on the language "whether or not due" in section 10.2.

[53] However, BP is the payor, not the payee under the agreement and Bellatrix was not obligated to pay BP anything "hereunder", either when the agreement to hold the funds in trust was entered into or when the funds would normally be paid later in December. Although an event of default includes a party's failure to deliver gas "for the greater of 4 cumulative days or 5% of the number of days in a Delivery Period .... in any one transaction", and BP may have a claim for damages in an amount has not yet been determined, there were no amounts "owed to" BP at the time of the December payment in respect of which it could exercise any contractual right of set-off.

[54] Section 10.5 of the agreement states that a "Performing Party" has the right to withhold any or all payments due the non-performing party for the period of the applicable non-performance and net or set-off amounts due the Performing Party against such withheld amounts. Bellatrix stopped delivering gas on November 26, 2019. The December payment was for the delivery of gas between November 1 and November 25, 2019. Therefore, for the same reasons, section 10.5 of the agreement does not give BP a right of set-off.

[55] BP thus has no contractual right of set-off with respect to the December payment but submits that it has a right of equitable set-off, citing *Re Blue Range Resource Corp.*, 2000 ABCA 200. In *Blue Range*, the appellants were allowed to set-off anticipated damages they would incur under certain natural gas marketing contracts against payments owed under those contracts for the delivery of natural gas.

[56] In that case, as in this, the cost to the appellants to replace the gas was higher than the cost they were paying under the contracts. The Court of Appeal in *Blue Range* set out the principles from the Supreme Court of Canada decision in *Telford v Holt* (1987), 41 D.L.R. (4th) 385(S.C.C.), at 398 that apply when dealing with equitable set-off:

1. The party relying on a set-off must show some equitable ground for being protected against his adversary's demands;
2. The equitable ground must go to the very root of the plaintiff's claim before a set-off will be allowed;
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; and

5. Unliquidated claims are on the same footing as liquidated claims.

[57] The Court noted at para 19:

> The important point for invoking equitable set-off is the close connection of the transactions. Would it be manifestly unjust to require the appellants to pay the costs of the February and March deliveries in view of the fact that they will suffer significant losses due to the early termination of the same contract that called for the delivery of gas in February and March? In our view, such a requirement is unjust.

[58] In *Blue Range*, the CCAA debtor terminated the contracts. Here, BP's position is that the GasEDI Agreement has not been terminated, remains in full force and effect and that Bellatrix is required to perform the agreement.

[59] The First Lien Lenders and Bellatrix submit that BP does not meet the test for equitable set-off because it would not be "manifestly unjust" to allow Bellatrix to claim the December payment without taking into consideration the cross-claim.

[60] They point out that, in a letter dated February 11, 2020, Bellatrix's counsel advised BP on its position on the ability of a CCAA debtor to elect non-performance of an agreement. Bellatrix responded that the EFC Decision did not deal with the issue of performance or set-off. Bellatrix has been consistent in its position throughout the CCAA proceedings. Despite this, BP did not apply to lift the stay or to claim a right of set-off until this application was filed.

[61] While I have found later in this decision that BP's delay in taking action would not disentitle it from a equitable remedy, BP has not established an equitable ground for being protected, and therefore fails the *Telford* test for that reason. BP is not entitled to set-off the December payment, whether or not the GasEDI Agreement is an EFC.

[62] Bellatrix submits that, since BP does not fit within the permitted set-off provisions of section 34(8), but for the agreement among Bellatrix, BP and the Monitor to have the Monitor hold the December payment in trust, BP would have been in violation of the stay under the initial CCAA order had it purported to withhold the December payment. If it had unilaterally withheld the payment, BP would have deprived Bellatrix of substantial liquidity at a time when Bellatrix was seeking to pursue its strategic process to identify a going concern transaction for the benefit of its many stakeholders, relying on funds drawn under its Interim Financing Facility, and Bellatrix would have been unable to make various payments to secured and other unsecured creditors.

[63] However, as I have found that BP has neither a legal nor an equitable right of set-off, it is not necessary that I decide this issue.

C. Is BP entitled to lift the stay to permit it to obtain and enforce a judgement against the sale proceeds?

[64] As a corollary to the relief of lifting the stay, BP asks the Court to direct immediate payment of the alleged damages to BP out of the sale proceeds, less the December payment.

[65] The test for lifting a stay focuses on the totality of circumstances and the relative prejudice to the parties involved: *Alberta Energy Regulator v Lexin Resources Ltd*, 2019 ABQB 23 in the context of a receivership, citing *Alignvest Private Debt Ltd. v Surefire Industries Ltd.*, 2015 ABQB 148 (Alta. Q.B.) at para 40 and 43 (appeal on other grounds dismissed, [2015] A.J. No. 1234 (Alta. C.A.)).

[66] Guidance can be drawn from the provisisons of section 69.4 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 as amended, in determining whether a stay in CCAA proceedings should be lifted. The Court should be satisfied that the party applying to lift the stay is likely to be materially prejudiced by the stay or that it would be equitable to lift the stay on other grounds. The burden is on the applicant: *Re Ma*, [2001] O.J. No. 1189 (Ont. C.A.).

[67] Lifting the stay is not routine: there must be sound reasons to relieve against the stay: *Re Ma*, at para 3.

[68] In order for a party applying to lift the stay to show material prejudice, it must show that it would be treated differently or some way unfairly or would suffer worse harm than other creditors if the stay is not lifted: *Golden Griddle Corp. v Fort Erie Truck & Travel Plaza Inc.* (2005), 29 C.B.R. (5th) 62 (Ont. S.C.J.) at para 18-19. Examples may include hardship caused by the stay or necessity of payment or a situation where it is in the interests of justice to allow the stay to be lifted: *Re Canwest Global Communications Corp*, (2009), 61 CBR (5th) 200 (Ont S.C.J.). The prejudice to the applicant should be different qualitatively from that suffered by other creditors, who also lose, in whole or part, the benefit of their contracts by reason of the debtor's insolvency.

[69] BP submits that it suffers unique harm from the breach of the GasEDI Agreement, and argues that such prejudice favours the lifting of the stay to allow it to enforce its damages claim against Bellatrix. However, BP does not provide any valid reason why its damages claim is unique.

[70] First, BP submits that it is a post-filing creditor. This is incorrect: its damages claim arises from a pre-filing contract, whether it is an EFC or not.

[71] Second, BP notes, relying on *Bank of Montreal v Probe Exploration Inc*., [2000] AJ No 1752, that courts are reluctant to interfere with the rights of contractual parties in a liquidation scenario where the result would be to prefer the interests of the debtor and its primary secured creditor. However, I agree with the First Lien Lenders that the *Probe* case is distinguishable from the situation of Bellatrix's failure to perform under the GasEDI Agreement.

[72] In *Probe*, the unique facts included the existence of an intercreditor agreement that contemplated the mutual intent between the secured creditor and the party opposing the termination of the agreement at issue that any purchaser of Probe would be bound by Probe's obligations under the contract.

[73] BP submits in proposing the lifting of the stay that Bellatrix has abused and violated the CCAA process. As noted later in this decision, there is no basis for this allegation.

[74] BP also submits that the stay should be lifted because the GasEDI Agreement as an EFC is entitled to certain benefits. These benefits do not imply a right to lift the stay in the context of a damages claim. Section 34(10) of the *Act* makes it clear that such a claim merely makes the holder a creditor, in this case an unsecured creditor. The unique risks inherent in the status of an

EFC contract are recognized in the limited relief offered in section 34. The CCAA does not provide any special security or priority for a damages claim arising from an EFC.

[75] Finally, as noted by the Agent, this is the end of the CCAA process, and in the nature of a priorities dispute. There exists no valid reason to lift the stay or to order the immediate payment to BP of damages out of the sale proceeds or to grant BP a priority charge on the sale proceeds ranking *pari passu* with the Interim Lenders Charge unless consideration of good faith or equity compel that result.

D. Is BP entitled to equitable relief?

[76] BP seeks a declaration of constructive trust as a remedy for Bellatrix's breach of the GasEDI Agreement, arguing that Bellatrix's stakeholders have been unjustly enriched. BP also submits that Bellatrix has engaged in a pattern of abusive conduct and has unjustly appropriated approximately $14.5 million by breaching a contract that it is prohibited from disclaiming.

[77] The onus of proving a constructive trust rests with the claimant. It is a discretionary remedy that will not be imposed without taking into account the interest of others who may be affected by granting the remedy: *Re Hoard*, 2014 ABQB 426 at para 26.

[78] As noted at para 23 of *Hoard*, given that the BIA provides a code by which legislators have balanced the interest of those adversely affected by the bankruptcy, the legal rights of creditors should not be defeated unless it would be unconscionable not to recognize a constructive trust. The same reasoning applies to the CCAA.

1. Unjust enrichment

[79] A constructive trust can be used to remedy unjust enrichment where monetary damages are inadequate and there is a link or causal connection between the claimant's contribution and the property in which the constructive trust is claimed: *Moore v Sweet*, 2018 SCC 52 at para 91. Therefore, even if the elements of unjust enrichment are satisfied in this case, there is no link between the funds that are the proceeds of sale of Bellatrix's assets and BP. The most that could be recovered through this remedy would be the December payment.

[80] The doctrine of unjust enrichment requires an enrichment, a corresponding deprivation, and the absence of a juristic reason for the enrichment: *Hoard*, at para 26.

[81] With respect to the requirement of enrichment, the Alberta Court of Appeal noted in *Luscar Ltd v Pembina Resources Ltd*, 1994 ABCA 356 at para 129 that:

> where there exists a contract under which parties are governed, and one party gains by the breach of the same, that party is not truly enriched, because the breaching party takes that gain subject to its liability for breach of contract.

[82] With respect to deprivation, BP was not required to provide any goods or services to Bellatrix or take on any financial risk or exposure. As noted in this decision, BP has failed to establish the amount of any financial hardship it may have suffered as a result of Bellatrix's disclaimer or breach of the GasEDI Agreement.

[83] BP concedes that the provisions of the CCAA can provide a juristic reason for an enrichment, but submits that BP is in a unique position as compared to other CCAA creditors in that Bellatrix has breached a contract that it was prohibited from breaching, both by the CCAA and by the Court.

[84] As noted previously, the CCAA does not prohibit a debtor from failing to perform a contract, be it an EFC or otherwise. Nor is it correct that in failing to perform the GasEDI Agreement, Bellatrix is in breach of a court order. There is nothing in either the EFC Decision or the order that emanates from it that compels performance of the agreement.

[85] The statutory priority of the First Lien Lenders under the CCAA constitutes a juristic reason to deny recovery to BP through the doctrine of unjust enrichment.

[86] BP submits that Bellatrix conceded in its submissions before the Court in the application to determine whether the agreement is an EFC that, if it was, Bellatrix would be obligated to perform it. However, Bellatrix actually stated that if the agreement was an EFC, it would be required either to perform it "or otherwise to pay damages to BP".

[87] Therefore, BP is not entitled to a constructive trust as a remedy for unjust enrichment.

2. Wrongful Conduct

[88] In *Soulos v Korkontzilas*, (1997) 36 C.B.R (3d) 1, the Supreme Court held that a constructive trust can also be used to right wrongful conduct. The following conditions must be met : the insolvent company must be under an equitable obligation in relation to the activities giving rise to the assets in its hands; the property in the hands of the insolvent company must be shown to have resulted from deemed or actual agency activities in breach of its equitable obligation to the claimant; the claimant must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the insolvent company remain faithful to their duties; and there must be no factors that would render the imposition of a constructive trust unjust in all the circumstances.

[89] Subsequent decisions emphasize that the property sought to be impressed with the trust must be the property obtained through the wrongful act, *Hoard* at para 35.

[90] BP submits that the timing of Bellatrix's purported disclaimer and breach of contract was not a coincidence, in that Bellatrix knew payments for gas delivery under the GasEDI Agreement would be subject to BP's contractual right to set them off against BP's damages for Bellatrix's breach of contract. It argues that Bellatrix timed its delivery of the disclaimer notice and its breach of contract for the day immediately after BP made its payment for October gas deliveries on November 25, 2019, thus depriving BP of the ability to set that payment off against damages.

[91] However, although it issued a disclaimer notice on November 25, 2019, Bellatrix continued to deliver gas under the agreement until November 24, 2019 and thus was not in breach of the contract until after that date. It did not mislead BP about the timing of its decision. While the decision on the timing of the disclaimer notice may have been strategic, it was not wrongful conduct.

[92] BP also alleges that the timing of the disclaimer notice put it in the position of being an involuntary interim lender, as Bellatrix was able to use funds that BP may have been able to set-off if it had known about the disclaimer earlier.

[93] BP's position is different from the position of an interim lender that advances funds to an insolvent debtor to finance an uncertain restructuring process. BP did not advance the roughly $14.5 million that Bellatrix estimated it would be able to achieve in additional revenue by selling its gas elsewhere, and BP it is not out of pocket for that amount.

[94] BP also submits that failure to perform the agreement allowed Bellatrix to sell the gas it would have been required to sell BP to other parties and use the proceeds to fund operations and pay other creditors, including the actual interim lender, and that this was wrongful conduct.

[95] As noted previously, Bellatrix's decision to cease performing an uneconomic contract during the CCAA process is not wrongful conduct: it allowed the company to generate increased revenue it would not be able to generate under the BP agreement to fund the company's operations while it attempted to restructure. BP was not required to pay for gas that was not delivered or provide any services to Bellatrix. While the outcome of the process was a liquidation, it was a going concern liquidation that was the best opportunity for the preservation of jobs and likely the maximization of value.

[96] As noted previously, there is no merit to the allegation that Bellatrix misled the Court. As was the case with unjust enrichment, there is no link or causal connection between the alleged wrongful acts and the proceeds of sale of Bellatrix's assets.

[97] In short, BP has no basis to claim a constructive trust based on wrongful conduct.

[98] In *Re Hollinger Inc*, 2013 ONSC 531 at para 39, leave to appeal denied in 2014 ONCA 282, the Ontario Court of Justice found that there is no legitimate reason for the proprietary remedy where the claimant relies on the remedy to try and gain a super-priority over other creditors in the CCAA. BP has an unsecured monetary damages claim and it should not be entitled to a constructive trust that would subvert the priorities of other creditors unless it has established that it would be unconscionable not to recognize such a trust. BP has not done so.

3. Bad Faith

[99] BP also relies on section 18.6 of the CCAA, a new provisison that provides that any interested person in any proceedings under the *Act* shall act in good faith with respect to the proceedings, and that if it is satisfied that an interested person fails to act in good faith, the Court may make the appropriate order. The duty of acting in good faith is not a new duty for a CCAA debtor: sections 11.02(3), 33(3), 50(12), 50.4(11) and 65.12(2)

[100] As I have noted previously, BP has not established any wrongful conduct by Bellatrix, which has merely used the tools available to it under the CCAA. Bellatrix was faced with an uneconomic agreement that it could not afford to perform while attempting to restructure. Bellatrix advised BP at an early stage of the proceedings that, in the circumstances, the agreement would never be accepted by a purchaser of Bellatrix's assets, which BP as a sophisticated party would likely have recognized. BP had the option of terminating the agreement as an EFC and exercising its right to set-off after termination, but chose the option of maintaining that Bellatrix was required to continue to perform the agreement.

[101] While Bellatrix breached the GasEDI Agreement by non-performance, it has been transparent and candid throughout with respect to its position and conduct. Although it did not abide by the statutory 30 days notice under its notice of disclaimer, that was after BP refused to accept the disclaimer and advised Bellatrix of its view that the agreement was an EFC.

[102] It is not unusual for a CCAA debtor to fail to perform uneconomic ongoing monthly contracts, both before and after filing, whether formally disclaimed or not, and such failure to perform is not per se bad faith.

[103] The December payment has been held in trust pending a resolution of the issues of set-off and priority, so Bellatrix has not failed to act in good faith with respect to the payment. The timing of the disclaimer notice, while strategic, was not bad faith conduct, and Bellatrix has not, as alleged by BP, misled the Court or failed to comply with a Court order.

[104] The Monitor has stated that it is satisfied that Bellatrix has acted in good faith throughout the proceedings.

[105] As noted by Dr. Janis Sarra in "La bonne foi est une considération de base – Requiring Nothing Less than Good Faith in Insolvency Law Proceedings", Annual Review of Insolvency Law, eds Janis Sarra & Barbara Romaine, Toronto: Thomson Reuters Canada, 2014:

> The court will find bad faith conduct where a debtor, creditor or their professionals fail to meet the requirements to act candidly, honestly, forthrightly and reasonably in their dealings with one another and the court; where parties act capriciously and arbitrarily; or where they lie or otherwise knowingly mislead each other about matters relating to the insolvency proceedings.

[106] Bellatrix has not exhibited conduct that would fall within these categories and has not acted in bad faith.

[107] The First Lien Lenders and Bellatrix point out that BP failed to allege that Bellatrix was not acting in good faith through four stay applications, and only raised the allegation at the end of August, 2020. However, BP responds that, as Bellatrix as a concession to BP agreed to hold back an amount from the sale proceeds to cover BP's damages claim, it had no need to object to the stay extension. While I have not found bad faith by Bellatrix, I accept that BP's failure to object to the stay does not preclude its claim of bad faith in the circumstance.

4. Delay

[108] The First Lien Lenders and Bellatrix submit that it would be inequitable to grant BP the super-priority it seeks for damages in priority to the stakeholders of Bellatrix.

[109] They note that BP initially applied for various forms of relief, including orders directing Bellatrix to resume performance of the GasEDI Agreement and to remedy any existing default, but ultimately only pursued the issue of characterization of the GasEDI Agreement as an EFC. While BP may have been constrained by time limits in its initial application heard on January 23, 2020, it knew by February 25, 2020, that Jones, J's decision dealt only with the characterization of the GasEDI Agreement as an EFC, and that it was free to proceed with the remainder of the relief it sought before any other commercial duty judge. The order emanating from the decision grants BP leave to apply for further advice and direction with respect to the remaining relief.

[110] While the pandemic interfered with regular commercial duty chambers in March and April, during Bellatrix's May 22, 2020 application before Hollins, J. to make interim distributions to certain priority and secured lenders. BP advised the Court that it may have a priority claim against Bellatrix and asked the Court to set aside US$14.5 million to be held in trust pending resolution of the disclaimer dispute with Bellatrix. The Court refused and suggested that BP bring its own application if it was concerned that it was facing disadvantage. It was not until August 7, 2020, in response to First Lien Lenders priority application, that BP

brought a cross-application seeking relief similar to that it had originally sought in December, 2019.

[111] The First Lien Lenders submit that it would be inequitable and prejudicial to the First Lien Lenders if BP were now allowed a priority claim in relation to Bellatrix's breach of the GasEDI Agreement. Bellatrix remains indebted to the First Lien Lenders in excess of $44 million and it is clear that Bellatrix would not be able to pay the First Lien Lenders' secured claims in full if BP's unsecured damages claim is paid in priority to its claim.

[112] Bellatrix points out that BP did not proceed to seek the remainder of its relief at a time when Bellatrix may have been able to perform the contract if ordered to do so. Now, nine months later, it has no assets that would allow performance.

[113] BP responds that it has protested its treatment from the start, and that the First Lien Lenders have suffered no prejudice from the delay, as they and Bellatrix were aware of BP's claim from December, 2019, even though BP did not act on it until after the sale of assets had been concluded. As noted in *Re Blue Range Resources Corp.*, 2000 ABCA 285, albeit in a different context, the fact that creditors will receive less money if late claims are allowed is not prejudice. "Re-organization under the CCAA involves compromise. Allowing all legitimate creditors to share in the available proceeds is an integral part of the process. A reduction in that share can not be characterized as prejudice: *Cohen, Re* (1956), 36 C.B.R. 21 (Alta. C.A.) at 30-31": *Blue Range* at para 40.

[114] Bellatrix and the First Lien Lenders were fully aware of BP's claim, and there is no evidence that earlier determination of the claim would have caused Bellatrix to do anything differently with respect to the sale of assets. This is not a case of a creditor "lying in the weeds", or even a case where BP implied that it had changed its position even though it did not take earlier action. In the specific circumstances of this case, including the disruption of court proceedings caused by the COVID pandemic, I would find that BP is not disentitled to relief on the basis of delay if I am incorrect on its entitlement to equitable relief.

E. Has BP proved the amount of its claim for damages?

[115] The amount of damages claimed by BP, in this application, $14.5 million, is equal to the amount that Bellatrix estimated, as part of the EFC determination application, that it could generate as additional revenue from the date of the disclaimer until the end of October, 2020, based on certain assumptions.

[116] BP concedes that its damages claim is based on this estimate. However, that estimate must be reduced by the fact that Bellatrix did not realize any revenues for its natural gas after the sale of its assets closed on June 1, 2020.

[117] I agree with Bellatrix and the First Lien Lenders that benefits to Bellatrix of the disclaimer do not necessarily equate to BP's entitlement to damages. BP has not provided any evidence of its actual damages relating to the disclaimer of or non-performance under the GasEDI Agreement, taking into account any mitigation BP would have been able to obtain by entering into other arrangements for the purchase of natural gas or otherwise.

[118] Therefore, the claim remains an unliquidated unsecured claim.

V Conclusion

[119] The First Lien Lenders are entitled to a declaration that they have a first priority interest in all the property of Bellatrix, including the December payment held in trust and funds held back from the sale of assets. Any amounts owing to BP are an unsecured claim. The Monitor is authorized to make a further distribution to the Agent in the amount of approximately $28.9 million, the exact amount subject to its final calculations.

[120] BP's cross-application is dismissed.

Dated at the City of Calgary, Alberta this 22nd day of December, 2020.

B.E. Romaine
J.C.Q.B.A.

Appearances:

Kelly Bourassa and James Reid
for National Bank of Canada, as Agent

Robert J Chadwick and Caroline Descours
for Bellatrix Exploration Ltd.

Howard A Gorman, Q.C. and Gunnar Benidiktsson
for BP Canada Energy Group LLC

Joseph G.A. Kruger, Q.C. and Robyn Gorofsky
for the Monitor Pricewaterhousecoopers Inc.

TAB 18

CITATION: Bank of Montreal v. 592931 Ontario Inc., 2021 ONSC 4412
COURT FILE NO.: CV-21-00658033-00CL
DATE: 20210618

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

RE: BANK OF MONTREAL, Applicant

AND:

2592931 ONTARIO INC., W.G.K. FITNESS INC., 2039675 ONTARIO INC., WGWINDSOR 2 FITNESS INC., WG BRAMPTON FITNESS INC., WGH FITNESS INC., CFC WELLAND INC., W.G.C. FITNESS INC., 2014595 ONTARIO INC., CFC BRANTFORD INC., CFC WATERDOWN INC., CFC LONDON SOUTH INC., W.G.G. FITNESS INC., WGWINDSOR FITNESS INC., W.G.W FITNESS INC., WGLONDON FITNESS INC., and WG ORILLIA INC., Respondents

APPLICATION UNDER Section 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended and Section 101 of the *Courts of Justice Act,* R.S.O. 1990, c. c-43, as amended

BEFORE: S.F. Dunphy J.

COUNSEL: *David Ward, Erin Craddock* and *Tony Van Klink,* for Applicant, Bank of Montreal

Clifton Prophet and *Thomas Gertner* for the Monitor, Richter Advisory Group Inc.

David Ullmann, for 2839203 Ontario Inc.

Jason Squire, Earl Cherniak QC and *Domenico Magisano for 2592931 Ontario Inc., et al*

Matthew Gottlieb and *Crystal Li,* for 2837083 Ontario Inc.

Chenyang Li, for 6917194 Canada Inc.

Sandra Johnston, for ALK Limited Partnership

Aiden Nelms, for McCowan & Associates Ltd.

Max Prince, for N&D Supermarket Limited

Chris Burr, for Johnson Health Technologies Canada Commercial Inc.

HEARD at Toronto: June 8, 2021

REVISED REASONS FOR DECISION

[1] These motions were heard and decided on June 8, 2021. I issued written reasons that evening that were subject to non-substantial revision and correction. I have made minor clerical changes – correcting a typographical error or inserting an obviously missing word – in the text of the reasons below. Such amplification as I have thought necessary to these reasons are contained at the end to make it clear what parts of these reasons were the "original" and what part was "supplementary".

[2] There are three motions before me, all concerning the fate of a related group of companies that I shall identify as the Crunch Group. The Crunch Group operate fitness clubs at a variety of locations in Ontario. It will escape the attention of none that fitness clubs have been among the hardest hit businesses by the variety of lock-downs and closure orders issued by the Government of Ontario in connection with the pandemic. These motions come just as it appears that a thaw in the lockdown may permit cautious optimism that the fitness clubs will be given permission to open and help Ontarians shed their Covid pounds.

[3] Following a series of defaults on approximately $12 million in credit facilities and various refinancing discussions throughout the second half of 2020, Bank of Montreal applied to the Court for a Receiver pursuant to the *Bankruptcy and Insolvency Act,* R.S.C. 1985, c. B-3 on March 2, 2021. As often happens in such cases, the Bank's application gave rise to a flurry of negotiations and activity. As happens much less often in such cases, that activity actually resulted in something of a deal emerging to avoid receivership.

[4] When the Bank's receivership application came on for a hearing on March 4, 2021, it was adjourned *sine die* on the terms set forth in the order. A Monitor was appointed to monitor the debtors' affairs and finances but not to take control of them. The debtors were to remain in possession of their property, to carry on business in the usual and ordinary course and not to dissipate their property. The Monitor was given a number of enumerated powers incidental to its role. Among them was the authority "as agent for the [Bank]" to undertake a sale and investment solicitation process (a "SISP" as these things are commonly called). The debtors and their officers and directors were ordered to cooperate with the Monitor in carrying out the SISP but little more was provided in the order of March 4, 2021 regarding the actual details of the SISP. This was left to the Monitor "as agent of the Bank" to determine.

[5] While the receivership application remained adjourned *sine die*, a stay of proceedings was put in place.

[6] What was the nature of the deal that caused this about-face? On March 3, 2021 the debtor companies signed a letter agreement drafted by the Bank confirming the following details among others:

a. The debtors or their nominee would make an irrevocable offer to the Bank for the sale by the Bank of the indebtedness of the companies at a stipulated minimum price without conditions beyond standard ones which offer must be open for acceptance until 5:00pm on April 29, 2021;

b. The debtors would consent to an order adjourning the receivership application and appointed the Monitor to run the SISP;

c. The debtors would provide their full co-operation in the SISP;

d. The SISP would run until to April 16, 2021 subject to possible extension on the recommendation of the Monitor to April 29, 2021; and

e. The companies would consent to a receivership order in the form provided by the Bank's lawyers to be held in escrow.

[7] The irrevocable offer mentioned in the Bank's letter was provided and was also dated March 3, 2021. For convenience sake, I shall refer to the Bank's counterparts in that agreement – entitled "Assignment of Debt and Security" - as the "purchaser". The purchaser is in fact two individuals and a corporation. It is sufficient to note that the purchaser is not at arm's length to the debtors.

[8] The recitals to this agreement mention the amount of the debt, the security held for it and that BMO "*has agreed to assign* and transfer the Loan Agreements (including the Indebtedness), together with its interest in the Collateral….to the *Assignee on the terms set forth herein*" (emphasis added). Among other features of this agreement to be noted (emphasis added to quotes by me where italics appear):

a. S. 1.1 – the parties agree that the recitals are true and correct and an integral part of the Agreement;

b. S. 1.2 "in consideration of the sum of [redacted] paid by the Assignee to BMO *by the end of business on April 30, 2021* (the Closing Date), BMO hereby does sell, assign and transfer" the debt and security;

c. S. 1.4 the parties "shall, from time to time, *take all reasonable steps necessary* to execute, acknowledge and deliver…such further instruments, transfers and other documents to give effect to this Agreement".

[9] The Agreement was amended on April 19, 2021. The recitals to that amending agreement note that the Agreement of March 3, 2021 had been signed by the purchaser and that it was "open for acceptance by BMO up to April 29, 2021 at 5:00pm". The

amending agreement increased the purchase price, amended the Closing Date from April 30 to the end of business on May 14, 2021 and added a requirement for the payment by the purchaser of a material deposit that would be non-refundable should the purchaser fail to close.

[10] The bank got exactly what it bargained for. The Monitor ran a full SISP. A number of interested parties participated in it. The debtors cooperated fully including to the point of assisting potential competitors to kick tires and look inside the operation.

[11] One potential bidder was involved in last minute negotiations with the Monitor right up until minutes before the 5:00pm expiry of the purchaser's offer – an expiry time, it might be recalled, that the Bank itself had inserted in the March 3, 2021 letter agreement the debtors and purchaser agreed to abide by.

[12] On April 29, 2021 the Bank accepted the offer of the purchaser as amended. The bank was not obliged to accept it – it could have continued to negotiate with the other potential purchaser if it wished, but it would have lost the backstop that the Agreement provided. The Bank's acceptance technically came half an hour late via a lawyer's email that asked for confirmation that the small delay would not be objected to (it was not).

[13] The Bank took two steps in the following days that have caused the purchaser and debtor companies to question the Bank's good faith, particularly in the context of growing pressure being applied by a disappointed bidder in the SISP. Unfortunately, I am persuaded that their fears are not without foundation. One of the two incidents created a distraction but did not in and of itself prevent a successful closing. The other one undeniably did.

[14] The March 3, 2021 letter agreement contained undertakings of the Bank regarding the operation of the debtors' bank accounts during the SISP period. Since the transaction was originally slated to be closed the day after the expiry of the SISP period (prior to the amendment on April 19, 2021 that extended Closing), this was originally of no particular moment. For whatever reason, nobody had thought to extend the assurances regarding the ordinary course operation of the banking accounts after April 29, 2021 when the Closing Date was extended to May 14, 2021. A number of the debtors' bank accounts were closed for a period of time with little warning on April 30, 2021. This was eventually sorted out but the debtors and purchaser contend (and I agree) a degree of confusion and distraction was caused by this issue arising as it did when the purchaser and management were expecting to be focused on closing. Given the continued court-ordered stay of proceedings, the presence of the Monitor and an agreed deal less than 24 hours old, some consultation and discussion before peremptory action might have been the preferable course for the Bank to adopt. Some accounts were re-opened the next day – one was not re-opened until May 6, 2021.

[15] I cannot find that the account closure incident is the reason why the purchaser failed to close on May 14, 2021 but it was certainly a contributing factor.

[16] Viewed in isolation, I should be loathed to attribute bad faith to actions of a bank for which clumsiness, ham-fistedness or obduracy are available and normally adequate explanations. However there was more at work here.

[17] The purchaser had raised money from a variety of sources to fund the purchase price. The assignment agreement was not conditional on financing but that does not mean that the purchaser had funds sitting in a dark bank vault waiting to be summoned. Financing had been arranged but like all financing it had some conditions.

[18] One material tranche of the financing had a condition that the purchaser provide a fully executed copy of the underlying agreement prior to the advance of funds. That condition strikes me as neither rare nor unreasonable. Whatever my opinion may be, it was the investor's condition and it was one that ought not to have been difficult to satisfy.

[19] On May 4, 2021, the purchaser requested a copy of the fully executed assignment agreement. It will be recalled that this agreement – and the amendment to it – had been fully executed on the part of the purchaser and debtors while waiting for the Bank to accept it by the deadline the Bank stipulated and agreed to.

[20] Later that same day, the Bank's lawyer wrote back saying that he "was planning on having the agreement signed and delivered on closing" and that he did "not want a fully signed copy floating around if the assignment doesn't actually proceed".

[21] The Bank's position was both mystifying and wrong. The agreement as amended had a fixed closing date: May 14, 2021. By the terms of the amending agreement, it was open for acceptance by BMO no later than fifteen days prior to the Closing Date and acceptance of a written contract is normally signified by signing in the place provided below the line "in witness whereof the parties have set their hand on the day and year first above written". Although s. 1.1 of the agreement uses language of present conveyance ("hereby does sell"), this language is found in a sentence which itself is future looking – referencing as it does the future payment of the purchase price by the end of business on the Closing Date. The Closing Date, it will be recalled, is necessarily later than the last day for acceptance of the agreement. The "consideration clause" does not reference actual receipt of the purchase price on or before signature but "the promises and mutual agreements and premises herein".

[22] Read as a whole – for that is how contracts are read – the agreement was unambiguously an executory contract rather than a simple present conveyance. The suggestion that the Bank might somehow be held to have agreed to waive receipt of the purchase price by delivering a fully executed copy of the agreement when acceptance was *intended* to precede closing is far-fetched. Were that distant prospect to have been a significant and *bona fide* concern, a party acting in good faith and actually desirous of closing the transaction it had just accepted might have addressed the concern in any one of a hundred ways. Belts and suspenders have never been in short supply in the desks

of commercial solicitors. Faced with the choice of being reasonable and flexible or crossing its arms and saying “No”, the Bank chose the latter course.

[23] The purchaser wrote back to the Bank’s lawyer on May 6, 2021 and explained why this refusal to deliver up an executed counterpart of the agreement already signed by the purchaser was proving problematic. They explained that some of the investors in the assignee required a fully executed agreement before advancing and offered to hold the fully executed agreement in escrow subject to being returned should the agreement fail to be completed. The same request was repeated via a telephone call on Monday May 10, 2021. The Bank’s lawyer wrote back the next day acknowledging that the Bank understood that the “agreements signed by BMO are being requested as part of the efforts to secure the necessary funds to complete the assignment” but repeating that the agreement as amended would not be provided prior to closing and that the agreement “is not conditional on financing” adding (wrongly) that the “agreements are the operative assignment documents”.

[24] The purchaser lost the commitment of the financier who had requested to see the executed copy of the agreement between the purchaser and the Bank instead of a mere lawyer’s email before funding. That loss was not necessary had the Bank been acting in good faith to compete the transaction and was the proximate cause why the transaction failed in fact to close by the close of business on May 14, 2021. The purchaser tried to cobble together a Plan B that has given rise to some controversy that I shall address below. Ultimately that too failed to get the job done.

[25] Just before 2pm on May 14, 2021, the Bank’s counsel wrote to the purchaser’s counsel indicating that the Bank was ready willing and able to close by 5:00 pm but that the “closing funds must be received by 5:00 pm today”. This email was written after the purchaser’s counsel wrote to indicate that funds were arriving but they were having administrative difficulties in getting them all cleared on time. A short extension of time to Monday to allow the funds to clear was requested.

[26] I have reviewed purchaser’s counsel’s trust ledger and I am satisfied that the difficulties mentioned were real. The funds were being gathered from a number of sources. One investor, for example, tendered a bank draft but the actual deposit of it did not show up in the firm’s trust ledger until the following business day (in this case, Monday morning).

[27] There is significant dispute as to how ready willing and able to close the purchaser was by the close of business on May 14, 2021. A big part of that dispute has to do with the debtors’ funds that were loaned to the purchaser in what was intended to be an overnight loan to facilitate closing following the loss of an investor on the theory that the investor would fund post-closing once satisfied that the Bank had indeed gone through with the transaction.

[28] I am satisfied that including the disputed funds loaned on a short-term basis by the debtor, the purchaser had the funds on hand and in the trust account ready to transfer by the next business day (Monday the 17th). There is however no getting round the fact that the funds required to press “send” and close the transaction were not deposited and cleared in the solicitor’s trust account of the purchaser by 5:00pm on Friday May 14, 2021. The loan from the debtors is thus something of a red herring here.

[29] It is also undisputed that the Bank never delivered an executed copy of the assignment agreement that it purported to accept via lawyer’s email on April 29,2021. The Bank advised through its lawyers that it finally signed the document on April 29, 2021 at approximately 1:30pm on May 14, 2021 but would not deliver it until after the purchaser was in funds and in a position to transfer same prior to 5:00pm on that day. It is not clear that the Bank ever indicated that it did not intend to sign the document - that on its face (as amended) required acceptance by a date and time well in advance of closing - until a few hours before closing. It does not appear that the purchaser learned of that position before May 4, 2021.

[30] Time is short and a decision needs to be rendered in a time frame that makes it relevant. I find that the Bank bears the responsibility for this agreement failing to close on May 14, 2021.

[31] I was urged to find that the Bank set about to sabotage the agreement drawn by the prospect of a richer deal from the bidder with whom it negotiated until the 11th hour on April 29, 2021. It was also suggested that there had perhaps been some leaking of information to a bidder. I do not find any need to infer the tiniest breach of protocol or duty in the bidder having become convinced that it potentially held a winning hand. Mr. Gottlieb was not born yesterday and if his client was in the running up until the very last second, it took no great leap of intuition on his part to infer that his client’s offer – even if not fully finalized – was one the Bank found attractive enough to try to massage into a binding format right up to the wire. His interventions in the days that followed – and they were in my view entirely proper and above-board – did have an effect. They were effective in applying just enough pressure on the Bank to dampen its enthusiasm towards working to complete the agreement it had bound itself to close.

[32] The Bank was not of course required to be enthusiastic. The common law requirement of good faith in the execution of contractual agreements, the explicit requirement in the contract to “take all reasonable steps necessary” to give effect to the Agreement and the recent addition of s. 4.2(1) of the *BIA* under which statute the receiver was appointed and the Notice of Application was initiated all provide me with ample grounds to hold the Bank to a higher standard than passive resistance to completing a deal it has agreed to and entered into under the protection of a process at least partly supervised by the Court.

[33] In assessing the Bank’s conduct, I attach some weight to the Bank’s surprising and abrupt decisions with regard to closing the operating bank accounts. As I have said,

these steps were not decisive in preventing closing but they were an utterly unnecessary irritant that might easily have been talked through and resolved short of unilateral damaging actions followed by negotiated resumption of activities.

[34] I attach far more weight to the baffling decision to leave the agreement unsigned and undelivered until hours before closing after the Bank unambiguously signified its acceptance of it via email. The tiniest degree of flexibility in maintaining a position that was as stubbornly held to as it was clumsily advanced would have prevented the purchaser's loss of critical financing from which all else flows. The Bank knew full well that the purchaser's financing hung in the balance and chose not to lift a finger to prevent it from being lost. It stuck to its guns holding to a position that it must objectively have understood to be at least debatable when solutions at zero cost and risk to the Bank could be had with the application of a few minutes thought and a modicum of common sense and good will.

[35] Our courts are still wrestling with the boundaries of what "good faith" in the execution of obligations means in practice. Whatever the boundaries may be, I am satisfied that this conduct is well outside of them. The Bank's lack of flexibility and willingness to compromise on an issue that could easily be addressed with no risk whatsoever to the Bank leads me to conclude that the Bank was consciously or unconsciously trying to free itself from the Agreement it made.

[36] I reach that conclusion without casting any stones in the direction of a party I was urged to call a bitter bidder. Mr. Gottlieb did not have all of the information the parties had and as I have said, I don't find the positions he took to have crossed any lines. His client's interest lay in exploring the opportunities to have a new process take place with only partial information about all that had in fact taken place to which his client was not privy. I find no fault in the way he pursued that interest nor can any have failed to appreciate what his client's interests were at every step of the way.

[37] The purchaser and debtors would have been able to close on time on May 14, 2021 but for the Bank's unreasonable actions when it should have been working in good faith towards closing.

[38] The commercial necessity for a resolution now rather than months from now – from the perspective of all of the parties- is quite clear. The status of the agreement between the Bank and the purchaser must be resolved before any consideration of a second SISP or any other process can be fairly considered. Further delay when these businesses are on the cusp of reopening could have unforeseen risks.

[39] The purchaser and debtors advise that they are ready willing and able to close if I so order. I do so order. I am ordering the Bank to be ready, willing and able to close the transaction by Friday June 11, 2021 at 3:00pm and to do so if the purchaser tenders the stipulated purchase price in readily available funds. The parties had already identified the documents needed and steps to be taken for closing on May 14, 2021 so I do not

think that I need to provide paint by number instructions. Should further direction by me be needed, I am prepared to provide it.

[40] The parties shall close on June 11 precisely as they were preparing to close on May 14 but for the funds transfer issues that arose at that time. There shall be no adjustment to the purchase price to account for the small delay – whatever order I may make on costs will not fully compensate for the loss of this last few weeks in preparing to re-open as the lock-down is ending and I find the delay was caused by the Bank. The equities divide reasonably evenly on that score.

[41] If and only if the transaction fails to close on June 11, 2021, I shall address the other two motions that were before me today (the matter of the transfer to Blaney McMurtry and the matter of approving the "run-off" SISP). There will be no excuses for failure to close – I require only a binary "yes or no" answer on June 11, 2021 as to whether I am required to address the other two motions or not. This is a simple transaction with sparse terms. I expect it to close if the money is there and I am taking the purchaser at its word that it will be.

[42] The parties will understand that these reasons have been assembled in a very short time frame following argument which itself was preceded by extensive evidence and facta. I invite them to provide me with a consolidated list of the nits, gremlins and typos that slipped through my fingers as I put this together. I shall issue any necessary corrections next week. I shall not alter the substance, but I reserve the right to supplement my reasons or to clarify the wording.

[43] I have not addressed costs and I do not intend to until after the matter has either closed or failed to close. I am not thereby encouraging anyone to start inflating their expectations nor indeed have I determined to award any costs to anyone – more the normal outcome of Commercial Court motions. I shall advise of the procedure if any to be followed after I am notified of the fate of the closing.

[44] The Monitor has kindly volunteered to take on the distribution of this endorsement. I ask the Monitor to assume the responsibility of reporting to me whether closing occurs on Friday on time as per my order.

[45] I thank the parties for their ably focused submissions in the best "real time litigation" traditions of the Commercial List.

[46] The following paragraphs are supplementary or clarifying remarks that go beyond clerical clean-up of the reasons as originally issued by me.

[47] My description of the facts was deliberately general so as not to disclose information regarding purchase price that might prove deleterious should the transaction fail to close. Among the figures that I did not disclose was the amount of the deposit paid by the purchaser in trust following the April 19, 2021 amending agreement. I do not wish it to be supposed that I did not take the fact that the Bank stood to retain – at least

potentially – a quite material deposit amount into account in assessing the actions of the bank against the standard of good faith that the common law, s. 4.2 of the BIA and the further assurances of the Agreement itself all impose.

[48] It is not necessary for me to attribute lack of good faith to any particular motive and I do not. I mentioned three background facts as supplying an indication that lack of good faith may be at play. These were (i) the potentially non-refundable deposit; (ii) the intense negotiations with another bidder up until the last minute prior to acceptance of the Agreement; and (iii) the pressures exerted by that same bidder in the following days which provided some assurances of continuing interest of that same bidder regarding terms the Bank had clearly indicated its interest in. Lack of good faith (a term that should not be casually equated with "bad faith") is an assessment made regarding actual objective facts of things done or not done and is not premised solely on questionable motives. I have had regard to the circumstances suggesting motive, but I do not purport to be reading the Bank's corporate mind. I can however infer that the three factors mentioned may have played a role in hindering the Bank from focusing on the first order of business which was to work in good faith to close the Agreement that it had voluntarily agreed to without being distracted by visions of what might be were it not to close.

[49] Regarding the closure of the bank accounts, as indicated above, this was eventually sorted out but it contributed to the overall problem. It should not have happened, particularly where there was a court-ordered stay of proceedings in effect at the Bank's request and which the Bank evidently thought did not apply to its own actions.

[50] As regards the executed Agreement issue, I have expressed my views regarding the executory nature of the Agreement on acceptance and prior to Closing. I do not wish to be taken as finding fault with counsel for adopting a position that had at least some foundation in the awkward wording of the Agreement itself simply because a judge subsequently disagreed with that position. These things happen. Where I found that the good faith standard came into play was in the failure of the Bank to address the issue reasonably when it arose. At the very least, it should have been clear that there was at least some chance that the Bank was wrong in its insistence that it had no obligation to deliver the executed Agreement after an unambiguous acceptance of it. Clinging to that position in the face of objectively reasonable doubt as to its correctness coupled with clear indications that it was *needlessly* placing the completion of the Agreement in jeopardy is where I found the behaviour veered past the boundaries of good faith conduct. The means of satisfying the Bank's concerns about delivery of an executed Agreement were numerous and risk-free. The purchaser's counsel immediately offered one of them to accommodate the Bank. In the world of good faith, some discussion about how to resolve the concern ought to have followed.

[51] Since writing this supplement, I have been advised that the Agreement was closed per my order on June 11, 2021. I withheld release of these reasons in the event the parties had noticed errors that escaped my attention. Evidently, they did not, a fact more

likely due to their being busy with getting the deal done rather than any tribute to my typing accuracy.

S.F. Dunphy J.

Date: June 8 and June 18, 2021

TAB 19

C.M. Callow Inc. v. Zollinger

Supreme Court of Canada Judgments

Supreme Court of Canada

Present: R. Wagner C.J. and R.S. Abella, M.J. Moldaver, A. Karakatsanis, S. Côté, R. Brown, M. Rowe, S.L. Martin and N. Kasirer JJ.

Heard: December 6, 2019;

Judgment: December 18, 2020.

File No.: 38463.

[2020] S.C.J. No. 45 | *[2020] A.C.S. no 45* | *2020 SCC 45* | *2021EXP-10* | *EYB 2020-368790*

C.M. Callow Inc., Appellant; v. Tammy Zollinger, Condominium Management Group, Carleton, Condominium Corporation No. 703, Carleton Condominium Corporation, No. 726, Carleton Condominium Corporation No. 742, Carleton Condominium Corporation No. 765, Carleton Condominium Corporation No. 783, Carleton Condominium Corporation No. 791, Carleton Condominium Corporation, No. 806, Carleton Condominium Corporation No. 826, Carleton Condominium Corporation No. 839 and Carleton Condominium Corporation No. 877, Respondents, and Canadian Federation of Independent Business and Canadian Chamber of Commerce, Interveners

(238 paras.)

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR ONTARIO

Case Summary

Contracts — Performance and discharge — Performance — Termination — General principles — Appeal by CM Callow ("Callow") from judgment that set aside trial judgment in Callow's favour allowed — In 2012, parties entered winter maintenance contract that entitled Baycrest to terminate on 10 days' notice — Baycrest decided to terminate agreement but did not inform Callow and actively engaged in discussions about renewal — Baycrest gave notice of termination in September 2013 — Trial judge found Baycrest breached agreement by acting in bad faith by actively deceiving Callow and awarded damages of $80,742 — Court of Appeal erred in finding that trial judge improperly expanded duty of honest performance — By exercising termination clause dishonestly, Baycrest breached duty of honesty on matter directly linked to performance of contract, even if notice period was satisfied.

Contracts — Misrepresentation — Silence — Good faith — Appeal by CM Callow ("Callow") from judgment that set aside trial judgment in Callow's favour allowed — In 2012, parties entered winter maintenance contract that entitled Baycrest to terminate on 10 days' notice — Baycrest decided to terminate agreement but did not inform Callow and actively engaged in discussions about renewal — Baycrest gave notice of termination in September 2013 — Trial judge found Baycrest breached agreement by acting in bad faith by actively deceiving Callow and awarded damages of $80,742 — Court of Appeal erred in finding that trial judge improperly expanded duty of honest performance — By exercising termination clause dishonestly, Baycrest breached duty of honesty on matter directly linked to performance of contract, even if notice period was satisfied.

Contracts — Remedies — Damages — General principles — Position had the contract been performed —

Amount — Consequences of breach — Loss of profit — Appeal by CM Callow ("Callow") from judgment that set aside trial judgment in Callow's favour allowed — In 2012, parties entered winter maintenance contract that entitled Baycrest to terminate on 10 days' notice — Baycrest decided to terminate agreement but did not inform Callow and actively engaged in discussions about renewal — Baycrest gave notice of termination in September 2013 — Trial judge found Baycrest breached agreement by acting in bad faith by actively deceiving Callow and awarded damages of $80,742 — Court of Appeal erred in finding that trial judge improperly expanded duty of honest performance — By exercising termination clause dishonestly, Baycrest breached duty of honesty on matter directly linked to performance of contract, even if notice period was satisfied.

Damages — In contract — Breach of contract — Loss of profits — Consequent to breach — Type of contract — Repairs or services — Appeal by CM Callow ("Callow") from judgment that set aside trial judgment in Callow's favour allowed — In 2012, parties entered winter maintenance contract that entitled Baycrest to terminate on 10 days' notice — Baycrest decided to terminate agreement but did not inform Callow and actively engaged in discussions about renewal — Baycrest gave notice of termination in September 2013 — Trial judge found Baycrest breached agreement by acting in bad faith by actively deceiving Callow and awarded damages of $80,742 — Court of Appeal erred in finding that trial judge improperly expanded duty of honest performance — By exercising termination clause dishonestly, Baycrest breached duty of honesty on matter directly linked to performance of contract, even if notice period was satisfied.

Appeal by CM Callow Inc. ("Callow") from a judgment of the Ontario Court of Appeal that set aside a trial judgment in Callow's favour. In 2012, the respondent group of condominium corporations ("Baycrest") entered into a two-year winter maintenance contract and a separate summer maintenance contract with Callow. The winter maintenance agreement entitled Baycrest to terminate the agreement on 10 days' written notice. In early 2013, Baycrest decided to terminate the winter maintenance agreement but chose not to inform Callow of its decision. During the spring and summer of 2013, Callow and Baycrest discussed the renewal of the winter maintenance agreement. Callow believed it was likely to obtain the renewal and that Baycrest was satisfied with its services. In the summer of 2013, Callow performed extra work beyond the summer maintenance contract at no charge, as an incentive for Baycrest to renew the winter maintenance agreement. Baycrest gave Callow 10-days' notice of its decision to terminate the winter maintenance agreement in September 2013. The trial judge allowed Callow's claim for breach of contract. She found Baycrest breached the winter maintenance agreement by acting in bad faith by actively deceiving Callow. She awarded damages of $80,742 to place Callow in the same position as if the breach had not occurred, which included lost profits, wasted expenditures and an unpaid invoice. The Court of Appeal found the trial judge erred by improperly expanding the duty of honest performance beyond the terms of the winter maintenance agreement and any deception related to a new contract not yet in existence.

HELD: Appeal allowed.

The organizing principle of good faith recognized in Bhasin v. Hrynew was not a free-standing rule, but manifested itself through existing good faith doctrines. The duty of honest performance in contract applied to all contracts and required that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. In determining whether dishonesty was connected to a contract, the relevant question was whether a right under that contract was exercised, or an obligation under the contract was performed, dishonestly. The Court of Appeal erred in concluding Baycrest's dishonesty was only about a future contract. The trial judge did not deny the existence of Baycrest's termination right but fixed on the wrongful manner in which it was exercised. The duty of honest performance precluded Baycrest's active deception by which it knowingly misled Callow into believing the winter maintenance agreement would not be terminated. By exercising the termination clause dishonestly, Baycrest breached the duty of honesty on a matter directly linked to the performance of the contract, even if the 10-day notice period was satisfied. There was no basis to disturb the trial judge's conclusions. The trial judge correctly proceeded on the premise Callow was entitled to be placed in the same position as if the breach had not occurred. If Baycrest's dishonesty had not deprived Callow of the opportunity to bid on other contracts, then Callow would have made an amount at least equal to the profit lost under the winter maintenance

agreement. As awarded by the trial judge, Callow was entitled to damages for the lease of machinery in addition to the lost profit. Concurring and dissenting reasons were provided.

Statutes, Regulations and Rules Cited:

Civil Code of Quebec, C.C.Q. 1991, art. 6, art. 7, art. 1375

Subsequent History:

NOTE: This document is subject to editorial revision before its reproduction in final form in the Canada Supreme Court Reports.

Court Catchwords:

Contracts -- Breach -- Performance -- Duty of honest performance -- Clause in winter maintenance agreement permitting unilateral termination of contract without cause upon 10 days' notice -- Contract terminated by condominium corporations with required notice to contractor -- Contractor suing for breach of contract -- Trial judge finding that statements and conduct by condominium corporations actively deceived contractor and led it to believe contract would not be terminated -- Trial judge awarding damages for breach of contract -- Whether exercise of termination clause constituted breach of duty of honest performance.

Court Summary:

In 2012, a group of condominium corporations ("Baycrest") entered into a two-year winter maintenance contract and into a separate summer maintenance contract with C.M. Callow Inc. ("Callow"). Pursuant to clause 9 of the winter maintenance contract, Baycrest was entitled to terminate that agreement if Callow failed to give satisfactory service in accordance with its terms. Clause 9 also provided that if, for any other reason, Callow's services were no longer required, Baycrest could terminate the contract upon giving 10 days' written notice.

In early 2013, Baycrest decided to terminate the winter maintenance agreement but chose not to inform Callow of its decision at that time. Throughout the spring and summer of 2013, Callow had discussions with Baycrest regarding a renewal of the winter maintenance agreement. Following those discussions, Callow thought that it was likely to get a two-year renewal of the winter maintenance contract and that Baycrest was satisfied with its services. During the summer of 2013, Callow performed work above and beyond the summer maintenance contract at no charge, which it hoped would act as an incentive for Baycrest to renew the winter maintenance agreement.

Baycrest informed Callow of its decision to terminate the winter maintenance agreement in September 2013. Callow filed a statement of claim for breach of contract, alleging that Baycrest acted in bad faith. The trial judge held that the organizing principle of good faith performance and the duty of honest performance were engaged. She was satisfied that Baycrest actively deceived Callow from the time the termination decision was made to September 2013, and found that Baycrest acted in bad faith by withholding that information to ensure Callow performed the summer maintenance contract and by continuing to represent that the contract was not in danger despite knowing that Callow was taking on extra tasks to bolster the chances of the winter maintenance contract being renewed. She awarded damages to Callow in order to place it in the same position as if the breach had not occurred. The Court of Appeal set aside the judgment at first instance, holding that the trial judge erred by improperly expanding the duty of honest performance beyond the terms of the winter maintenance agreement. Further, it held that any deception in the communications during the summer of 2013 related to a new contract not yet in existence, namely the renewal that Callow hoped to negotiate, and therefore was not directly linked to the performance of the winter contract.

Held (Côté J. dissenting): The appeal should be allowed and the judgment of the trial judge reinstated.

Per Wagner C.J. and Abella, Karakatsanis, Martin and **Kasirer** JJ.: The duty to act honestly in the performance of the contract precluded the active deception by Baycrest by which it knowingly misled Callow into believing that the winter maintenance agreement would not be terminated. By exercising the termination clause dishonestly, it breached the duty of honesty on a matter directly linked to the performance of the contract, even if the 10-day notice period was satisfied. Accordingly, the Court of Appeal should not have interfered with the conclusions of the trial judge.

The duty of honest performance in contract, formulated in *Bhasin v. Hrynew*, *2014 SCC 71*, *[2014] 3 S.C.R. 494*, applies to all contracts and requires that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract. In determining whether dishonesty is connected to a given contract, the relevant question is whether a right under that contract was exercised, or an obligation under that contract was performed, dishonestly. While the duty of honest performance is not to be equated with a positive obligation of disclosure, in circumstances where a contracting party lies to or knowingly misleads another, a lack of a positive obligation of disclosure does not preclude an obligation to correct a false impression created through that party's own actions.

The organizing principle of good faith recognized in *Bhasin* is not a free-standing rule, but instead manifests itself through existing good faith doctrines. While the duty of honest performance and the duty to exercise discretionary powers in good faith are distinct, like each of the different manifestations of the organizing principle, they should not be thought of as disconnected from one another. The duty of honest performance shares a common methodology with the duty to exercise contractual discretionary powers in good faith by fixing on the wrongful exercise of a contractual prerogative. Each of the specific legal doctrines derived from the organizing principle rest on a requirement of justice that a contracting party have appropriate regard to the legitimate contractual interests of their counterparty. They need not subvert their own interests to those of the counterparty by acting as a fiduciary or in a selfless manner. This requirement of justice reflects the notion that the bargain, the rights and obligations agreed to, is the first source of fairness between parties to a contract. Those rights and obligations must be exercised and performed honestly and reasonably and not capriciously or arbitrarily where recognized by law.

The duty of honesty as contractual doctrine has a limiting function on the exercise of an otherwise complete and clear right since the duty, irrespective of the intention of the parties, applies to the performance of all contracts, and by extension, to all contractual obligations and rights. Instead of constraining the decision to terminate in and of itself, the duty of honest performance attracts damages where the manner in which the right was exercised was dishonest. This focus on the manner in which the termination right was exercised should not be confused with whether the right could be exercised. No contractual right, including a termination right, can be exercised dishonestly and, as such, contrary to the requirements of good faith.

The requirements of honesty in performance can go further than prohibiting outright lies. Whether or not a party has knowingly misled its counterparty is a highly fact-specific determination, and can include lies, half-truths, omissions, and even silence, depending on the circumstances. One can mislead through action, by saying something directly to its counterparty, or through inaction, by failing to correct a misapprehension caused by one's own misleading conduct.

The duty of honest performance is a contract law doctrine, not a tort and therefore a nexus with the contractual relationship is required. A breach must be directly linked to the performance of the contract. The framework for abuse of rights in Quebec is useful to illustrate the required direct link between dishonesty and performance from *Bhasin*. Authorities from Quebec serve as persuasive authority and comparison between the common law and civil law as they evolve in Canada is a particularly useful and familiar exercise for the Court. Like in the Quebec civil law, no contractual right may be exercised dishonestly and therefore contrary to the requirements of good faith. The direct link exists when the party performs their obligation or exercises their right under the contract dishonestly. While the duty of honest performance has similarities with civil fraud and estoppel, it is not subsumed by them. Unlike estoppel and civil fraud, the duty of honest performance does not require a defendant to intend that the plaintiff rely on their representation or false statement.

The duty of honest performance attracts damages according to the ordinary contractual measure. The ordinary approach is to award contractual damages corresponding to the expectation interest. That is, damages should put the injured party in the position that it would have been in had the duty been performed. Although reliance damages, which are the ordinary measure of damages in tort, and expectation damages will be the same in many if not most cases, they are conceptually distinct, and there is no basis to hold that a breach of the duty of honest performance should in general be compensated by way of reliance damages.

In the instant case, Baycrest knowingly misled Callow in the manner in which it exercised clause 9 of the winter maintenance agreement and this wrongful exercise of the termination clause amounts to a breach of contract. Even though Baycrest had what was, on its face, an unfettered right to terminate the winter maintenance agreement on 10 days' notice, the right had to be exercised in keeping with the duty to act honestly. Baycrest's deception was directly linked to this contract, because its exercise of the termination clause was dishonest. It may not have had a free-standing obligation to disclose its intention to terminate, but it nonetheless had an obligation to refrain from misleading Callow in the exercise of that clause. Baycrest had to refrain from false representations in anticipation of the notice period. If someone is led to believe that their counterparty is content with their work and their ongoing contract is likely to be renewed, it is reasonable for that person to infer that the ongoing contract is in good standing and will not be terminated early. Having failed to correct Callow's misapprehension that arose due to these false representations, Baycrest breached its duty of good faith in the exercise of its right of termination. Damages thus flow for the consequential loss of opportunity. While damages are to be measured against a defendant's least onerous means of performance, the least onerous means of performance in this case would have been to correct the misrepresentation once Baycrest knew Callow had drawn a false inference. Had it done so, Callow would have had the opportunity to secure another contract for the upcoming winter.

Per Moldaver, **Brown** and Rowe JJ.: As a universally applicable minimum standard, all contracts must be performed honestly. Contracting parties may therefore not lie to, or otherwise knowingly mislead, each other about matters directly linked to performance. If a plaintiff suffers loss in reliance on its counterparty's misleading conduct, the duty of honest performance serves to make the plaintiff whole. It does not, however, impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract. The dividing line between (1) actively misleading conduct, and (2) permissible non-disclosure has been clearly demarcated by cases addressing misrepresentation and the same settled principles apply to the duty of honest performance, although it also applies (unlike misrepresentation) to representations made after contract formation.

There is, in the context of misrepresentation, a rich law accepting that sometimes silence or half-truths amount to a statement. Although contracting parties have no duty to disclose material information, a contracting party may not create a misleading picture about its contractual performance by relying on half-truths or partial disclosure. Representations need not take the form of an express statement. So long as it is clearly communicated, it may comprise other acts or conduct on the part of the defendant. The entire context, which includes the nature of the parties' relationship, is to be considered in determining, objectively, whether the defendant made a representation to the plaintiff. The question is whether the defendant's active conduct contributed to a misapprehension that could be corrected only by disclosing additional information. Contracting parties are required to correct representations that are subsequently rendered false, or which the representor later discovers were erroneous. The question of whether a representation has been made is a question of mixed fact and law, subject to appellate review only for palpable and overriding error.

The legal aim in remedying a breach of contract is to give the innocent party the full benefit of the bargain by placing it in the position it would have occupied had the contract been performed. But the justification for awarding expectation damages does not apply to breach of the duty of honest performance. In such cases, the issue is not that the defendant has failed to perform the contract, thereby defeating the plaintiff's expectations. It is, rather, that the defendant has performed the contract, but has also caused the plaintiff loss by making dishonest extra-contractual misrepresentations concerning that performance, upon which the plaintiff relied to its detriment. The plaintiff's complaint is not lost value of performance, but detrimental reliance on dishonest misrepresentations. The

interest being protected is not an expectation interest, but a reliance interest. And just as these are unrelated interests, an expectation measure of damage is unrelated to the breach of the duty of honest performance.

Much like estoppel and civil fraud, the duty of honest performance vindicates the plaintiff's reliance interest. A contracting party that breaches this duty will be liable to compensate its counterparty for any foreseeable losses suffered in reliance on the misleading representations. The duty of honest performance is not subsumed by estoppel and civil fraud; rather, it protects the reliance interest in a distinct and broader manner since the defendant may be held liable even where it does not intend for the plaintiff to rely on the misleading representation. Irrespective of the defendant's intention, all a plaintiff need show is that, but for its reliance on the misleading representation, it would not have sustained the loss.

Disposing of the present case is a simple matter of applying the Court's decision in *Bhasin*; Callow's claim should be resolved by applying only the duty of honest performance. There is no basis for disturbing the trial judge's conclusions. Baycrest's conduct did not fall on the side of innocent non-disclosure. The trial judge found that active communications between the parties deceived Callow. Baycrest identifies no palpable and overriding error to justify overturning these conclusions. The proper measure of damages represents the loss Callow suffered in reliance on Baycrest's misleading representations.

The majority relies on the civilian concept of "abuse of rights" in its analysis. In so doing, it departs from the Court's accepted practice in respect of comparative legal analysis. The principles that apply to this appeal are determinative and settled. Canada's common law and civil law systems have adopted very different approaches to the place of good faith in contract law. The majority's reliance on the civilian doctrine of abuse of a right distorts the analysis in *Bhasin* and elides the distinction between honest performance and good faith in the exercise of a contractual discretion.

Courts should draw on external legal concepts only where domestic law does not provide an answer or where it is necessary to modify or otherwise develop an existing legal rule. Courts may also look to the experience of other legal systems in considering whether a potential solution to a legal problem will result in negative consequences, or to observe that a domestic legal concept mirrors one found in another system. Even where comparative analysis is appropriate, it must be undertaken with care and circumspection. The golden rule in using concepts from one of Canada's legal systems to modify the other is that the proposed solution must be able to completely and coherently integrate into the adopting system's structure.

*Per***Côté** J. (dissenting): The appeal should be dismissed. Callow's recourse cannot be based on a breach of the duty of honest performance. Although Baycrest's conduct may not be laudable, it does not fall within the category of active dishonesty prohibited by that duty.

The duty of honest performance is described in *Bhasin* as a simple requirement not to lie or knowingly mislead about matters directly linked to performance of the contract. The requirement that parties not lie is straightforward; however, the kind of conduct covered by the requirement that they not otherwise knowingly mislead each other is not. The law imposes neither a duty of loyalty or of disclosure nor a requirement to forego advantages flowing from the contract on a contracting party. Absent a duty to disclose, it is far from obvious when exactly one's silence will knowingly mislead the other contracting party or at what point a permissible silence turns into a non-permissible silence that may constitute a breach of contract. In any event, the duty of honest performance should remain clear and easy to apply.

The obligations flowing from the duty of honest performance are negative obligations. Extending the duty beyond that scope would detract from certainty in commercial dealings. Therefore, silence cannot be considered dishonest within the meaning of *Bhasin* unless there is a positive obligation to speak. Such an obligation does not arise simply because a party to a contract realizes that his counterparty is operating under a mistaken belief. Absent a duty of disclosure, a party to a contract has no obligation to correct his counterparty's mistaken belief unless the party's active conduct has materially contributed to it. What constitutes a material contribution will obviously depend upon the context, which includes the nature of the parties' relationship as well as the relevant provisions of the contract.

Parties that prefer not to disclose certain information -- which they are entitled not to do -- are not required to adopt a new line of conduct in their contractual relationship simply because they chose silence over speech.

In the context of a right to terminate a contract without cause, a party that intends to end an agreement does not have to convey hints in order to alert his counterparty that their business relationship is in danger. No obligation to speak arises when a party becomes aware of his counterparty's mistaken belief that the contract will not be terminated unless the party has taken positive action that materially contributed to that belief. If one party leads another to believe that their contract will be renewed, it follows that the other party can reasonably expect their business relationship to be extended rather than terminated. But an inference to that effect cannot be drawn in the abstract. In order to infer that one party, through discussions about renewal, led the other party to think that there was no risk their existing agreement would be terminated, the inference-drawing process must obviously take into account the nature of the risk at stake and what was actually communicated during those discussions. Otherwise, the inference would entail a palpable and overriding error that would be subject to appellate review.

In the present case, Baycrest bargained for a right to terminate its winter agreement for any reason and at any time upon giving 10 days' notice. In her assessment of Baycrest's conduct, the trial judge did not ask herself if Baycrest lied or otherwise knowingly misled Callow about the exercise of its right to terminate the winter agreement for any other reason than unsatisfactory services. She wrongfully insisted on addressing alleged performance issues despite the fact that the winter agreement could be terminated even if Callow's services were satisfactory. The trial judge also did not consider that the active deception had to be directly linked to the performance of the contract. It is clear that the representations she found had been made by Baycrest were not directly linked to the performance of the winter agreement. The trial judge's misunderstanding of the applicable legal principles vitiated the fact-finding process.

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History and Disposition:

APPEAL from a judgment of the Ontario Court of Appeal (Lauwers, Huscroft and Trotter JJ.A.), *2018 ONCA 896*, *429 D.L.R. (4th) 704*, *86 B.L.R. (5th) 53*, *[2018] O.J. No. 5855* (QL), *2018 CarswellOnt 18697* (WL Can.), setting aside a decision of O'Bonsawin J., *2017 ONSC 7095*, *[2017] O.J. No. 6176* (QL), 2017 CarswellOnt 18587 (WL Can.). Appeal allowed, Côté J. dissenting.

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Brandon Kain, *Adam Goldenberg*, *Vivian Ntiri* and *Miriam Vale Peters*, for the appellant.

Anne Tardif, *Rodrigue Escayola* and *David Plotkin*, for the respondents.

Catherine Beagan Flood and *Nicole Henderson*, for the intervener the Canadian Federation of Independent Business.

Jeremy Opolsky and *Winston Gee*, for the intervener the Canadian Chamber of Commerce.

The judgment of Wagner C.J. and Abella, Karakatsanis, Martin and Kasirer JJ. was delivered by

N. KASIRER J.

I. Introduction

1 This appeal concerns a clause in a commercial winter maintenance agreement that permitted the clients to terminate the contract unilaterally, without cause, upon giving the contractor 10 days' notice. The dispute does not turn on whether the clause represented a fair bargain between the parties. There is also no issue about the meaning of the termination clause. The dispute turns rather on the manner in which the respondents (collectively "Baycrest") exercised the termination clause. Acknowledging that 10 days' notice was given the appellant, C.M. Callow Inc. ("Callow"), argues that Baycrest exercised the termination clause contrary to the requirements of good faith set forth by this Court in *Bhasin v. Hrynew*, *2014 SCC 71*, *[2014] 3 S.C.R. 494*, in particular the duty to perform the contract honestly.

2 In *Bhasin*, Cromwell J. recognized a general organizing principle of good faith, which means that "parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily" (para. 63). This organizing principle, he explained, "is not a free-standing rule, but rather a standard that underpins and is manifested in more specific legal doctrines and may be given different weight in different situations" (para. 64). The organizing principle of good faith manifests itself through "existing doctrines" addressing "the types of situations and relationships in which the law requires, in certain respects, honest, candid, forthright or reasonable contractual performance" (para. 66).

3 In this appeal, the applicable good faith doctrine is the duty of honesty in contractual performance. As Cromwell J. explained in *Bhasin*, at para. 73, the duty of honesty applies to all contracts as a matter of contractual doctrine, and means "simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract". Callow says Baycrest's failure to exercise its right to terminate in keeping with the mandatory duty of honest performance amounted to a breach of contract. It points to the trial judge's findings that Baycrest withheld the information that the contract was in danger of termination. Baycrest then continued to represent that the contract was not in danger and knowingly declined to correct the false impression it had created and under which Callow was operating. This dishonesty continued for several months, "in anticipation of the notice period" wrote the trial judge and, claims Callow, resulted in it foregoing the opportunity to bid on other winter contracts and thereby justifies an award of damages (*2017 ONSC 7095*, at para. 67 (CanLII)).

4 Baycrest, for its part, recalling that Cromwell J. explicitly stated in *Bhasin* that the duty of honest performance does not amount to a duty to disclose, argues that its silence did not constitute dishonesty. It also says the alleged dishonesty was not connected to the contract in place at the time because, in its submission, the impugned communications related to the possibility of a future contract not yet executed. The Court of Appeal agreed and overturned the trial judge's decision (*2018 ONCA 896*, *429 D.L.R. (4th) 704*).

5 I respectfully disagree with the Court of Appeal on whether the manner in which the termination clause was exercised ran afoul of the minimum standard of honesty. The duty to act honestly in the performance of the contract precludes active deception. Baycrest breached its duty by knowingly misleading Callow into believing the winter maintenance agreement would not be terminated. By exercising the termination clause dishonestly, it breached the duty of honesty on a matter directly linked to the performance of the contract, even if the 10-day notice period was satisfied and irrespective of their motive for termination. For the reasons that follow, I would allow the appeal and restore the judgment of the Ontario Superior Court of Justice.

II. Background

6 Baycrest includes 10 condominium corporations managed by Condominium Management Group and a designated property manager. Each corporation has its own board of directors to manage its affairs and, collectively, they established a Joint Use Committee ("JUC"). The JUC makes decisions regarding the joint and shared assets of the condominiums. In 2010, the condominium corporations entered into a two-year winter maintenance agreement with Callow, a corporation owned and operated by Christopher Callow. Pursuant to the terms of the agreement, Callow provided winter services, including snow removal, to the condominium corporations.

7 At the conclusion of the two-year term in 2012, the corporations entered into two new agreements with Callow. Joseph Peixoto -- president of one of the condominium corporations, and representative on the JUC - - negotiated the main pricing terms with Mr. Callow for the renewal of the winter maintenance contract, which also added a separate summer maintenance services contract.

8 At issue in this appeal is the winter maintenance agreement, which had a new two-winter term from November 1, 2012 to April 30, 2014. Pursuant to clause 9, the corporations were entitled to terminate the winter maintenance agreement if Callow failed to give satisfactory service in accordance with the terms of this Agreement. Moreover, clause 9 provided that "if for any other reason [Callow's] services are no longer required for the whole or part of the property covered by this Agreement, then the [condominium corporations] may terminate this contract upon giving ten (10) days' notice in writing to [Callow]" (A.R., vol. III, at p. 10).

9 During the first winter of the two-winter term, there were complaints from occupants of various condominiums, many of which related to snow removal from individual parking stalls. In January 2013, Mr. Callow attended a JUC meeting to address the concerns. The minutes reflected the positive nature of this meeting, recording that "[t]he Committee confirmed that [Callow] has been diligent in addressing this issue as best as could be expected considering the nature of the storms recently experienced" (A.R., vol. III, at p. 35). After the meeting, the property manager at the time also sent a follow-up email to the JUC members: "I know that your Board has been generally satisfied with the snow removal -- so there is nothing outstanding to report here" (p. 39).

10 A few months later -- still in the first year of the agreement -- respondent Tammy Zollinger became the property manager. About three weeks after Ms. Zollinger's arrival, another JUC meeting was held, this time without Mr. Callow present. During the meeting, Ms. Zollinger advised the JUC to terminate the winter maintenance agreement with Callow "due to poor workmanship in the 2012-13 winter" (A.R., vol. III, at p. 43). The minutes went on to indicate that Ms. Zollinger had reviewed the contract and advised the JUC members that they could terminate the contract with Callow with no financial penalty. Ms. Zollinger further advised that she would get quotes from other snow removal contractors. The JUC voted to terminate the winter maintenance agreement shortly thereafter, "in either March or April" of 2013 (trial reasons, at para. 51). Baycrest chose not to inform Mr. Callow of its decision to terminate the winter maintenance agreement at that time.

11 Although only one winter of the two-winter term had been completed, Callow began discussions throughout the spring and summer of 2013 with Baycrest regarding a renewal of the winter maintenance agreement. Specifically, Mr. Callow had various exchanges with two condominium corporations' board members, one of whom was Mr.

Peixoto. Following these conversations, wrote the trial judge, "Mr. Callow thought that he was likely to get a two-year renewal of his winter maintenance services contract and they were satisfied with his services" (para. 41).

12 Meanwhile, Callow continued to fulfill its obligations under the winter and summer maintenance agreements including, pursuant to the latter arrangement, finishing "spring cleanup", cutting grass on a weekly basis and conducting garbage pick-up. Furthermore, during the summer of 2013, Callow "performed work above and beyond [its] summer maintenance services contract" (para. 42), even doing what Mr. Callow described as some "freebie" work, which he hoped would act as an incentive for Baycrest to renew the winter maintenance agreement at the end of the upcoming winter.

13 Conversations between Callow and Mr. Peixoto continued into July 2013, at which time Callow decided to improve the appearance of two gardens. In an email dated July 17, 2013, Mr. Peixoto wrote to another condominium corporation board member regarding this "freebie" work, writing in part: "It's nice he's doing it but I am sure it's an attempt at us keeping him. Btw, I was talking to him last week as well and he is under the impression we're keeping him for winter again. I didn't say a word to him cuz I don't wanna get involved but I did tell [Ms. Zollinger] that [Mr. Callow] thinks we're keeping him for winter" (A.R., vol. III, at p. 73).

14 Baycrest did not inform Callow about the decision to terminate the winter maintenance agreement until September 12, 2013. At that point, Ms. Zollinger advised Callow by way of email "that Baycrest will not be requiring your services for the winter contract for the 2013/2014 season, as per section 9 of the contract, Baycrest needs to provide the contractor with 10 days' notice" (A.R., vol. III, at p. 49).

15 Callow consequently filed a statement of claim for breach of contract, alleging that Baycrest acted in bad faith by accepting free services while knowing Callow was offering them in order to maintain their future contractual relationship. Moreover, Callow alleged that Baycrest knew or ought to have known that Callow would not seek other winter maintenance contracts in reliance on the representations that Callow was providing satisfactory service and the contract would not be prematurely terminated. Accordingly, "[a]s a result of these misrepresentations and/or bad faith conduct, [Mr. Callow on behalf of Callow] did not bid on other tenders for winter maintenance contracts. [Baycrest is] now liable for Callow's damages for loss of opportunity" (A.R., vol. I, p. 45, at para. 30). Finally, Callow alleged that Baycrest was unjustly enriched by the free services it provided in the summer of 2013.

16 Callow sought damages in the amount of $81,383.68 for breach of contract, an amount equivalent to the one year remaining on the winter maintenance agreement, damages for intentional interference with contractual relations, inducing breach of contract, and negligent misrepresentation. It also asked for damages in the amount of $5,000.00 for unjust enrichment, an amount equivalent to the "freebie" work, and pre- and post-judgment interest and costs on a substantial indemnity basis.

III. Prior Decisions

A. *Ontario Superior Court of Justice (O'Bonsawin J.)*

17 In her review of the circumstances of the dispute, the trial judge commented on the testimony of several key witnesses, concluding that Mr. Callow was a credible witness. In contrast, she found that Baycrest's witnesses -- including a former property manager, as well as Ms. Zollinger and Mr. Peixoto -- had "provided many exaggerations, over-statements and constantly provided comments contrary to the written evidence" (para. 11). The trial judge thus preferred Mr. Callow's version of events to that of Baycrest.

18 At trial, Baycrest advanced two main submissions. First, it argued that, as a matter of simple contractual interpretation, clause 9 clearly and unambiguously states that it could terminate the contract for any reason by providing Callow with 10 days' notice in writing. Second, even though no cause had to be shown to invoke clause 9, Baycrest nonetheless argued that the evidence before the trial judge demonstrated that Callow's level of service did not comply with the contractual specifications and was not to its complete satisfaction.

19 The trial judge dismissed both arguments. First, she found that Callow's work met the requisite standard. While there were complaints about Callow's work, she observed that "a significant portion related to the clearing of parking stalls, which was the fault of owners/tenants who did not move their vehicles". "Was the quality of Callow's work below standard?" asked the trial judge, "The evidence leads me", she wrote, "to answer no" (para. 55).

20 Second, the trial judge held that this was not a simple contractual interpretation case. In her view, the organizing principle of good faith performance and the duty of honest performance were engaged. The trial judge explained that, as Cromwell J. noted in *Bhasin*, the duty of honest performance should not be confused with a duty of disclosure. "However," she wrote, "contracting parties must be able to rely on a minimum standard of honesty" to ensure "that parties will have a fair opportunity to protect their interests if the contract does not work out" (para. 60, citing *Bhasin*, at para. 86). For the purposes of drawing a distinction between the failure to disclose a material fact and active dishonesty, the trial judge observed that "[u]nless there is active deception, there is no unilateral duty to disclose information before the notice period" (para. 61).

21 The trial judge was satisfied that Baycrest "actively deceived" Callow from the time the termination decision was made in March or April 2013 to the time when notice was given on September 12, 2013. Specifically, she found that Baycrest "acted in bad faith by (1) withholding the information to ensure Callow performed the summer maintenance services contract; and (2) continuing to represent that the contract was not in danger despite [Baycrest's] knowledge that Callow was taking on extra tasks to bolster the chances of renewing the winter maintenance services contract" (para. 65). Given the active communications between the parties during the summer of 2013, "which deceived Callow", the trial judge "[did] not accept [Baycrest's] argument that no duty was owed to disclose the decision to terminate the contract before the notice" (para. 66). "The minimum standard of honesty", she concluded, "would have been to address the alleged performance issues, to provide prompt notice, or to refrain from any representations in anticipation of the notice period" (para. 67).

22 The trial judge tied Baycrest's dishonesty to the way in which it delayed invocation of the 10-day notice period set out in clause 9, while it actively deceived Callow that the contract was not in jeopardy. Her reasons relied upon, by analogy, the law recognizing a duty to exercise good faith in the manner of dismissal when terminating an employee. She noted that Baycrest "intentionally withheld the information in bad faith" (para. 69). She expressly acknowledged that exercising a termination clause is not, in itself, evidence of a breach of good faith. However, in this case, Baycrest deliberately deceived Callow about termination, which was a breach of the duty of honest performance.

23 By reason of this contractual breach, the trial judge awarded damages to Callow, in order to place it in the same position as if the breach had not occurred. These damages amounted to $64,306.96, a sum equivalent to the value of the winter maintenance agreement for one year, minus expenses that Callow would typically incur; a further amount of $14,835.14, representing the value of one year of a lease of equipment that Callow would not have leased if it had known the winter maintenance was to be terminated; and $1,600.00 for the final invoice for the summer work, which Baycrest had failed to pay to Callow. Costs were awarded to Callow.

24 The trial judge was also satisfied that Baycrest was unjustly enriched due to the "freebie" work performed by Callow during the summer of 2013. She declined, however, to award damages for the unjust enrichment since Callow failed to provide evidence of its expenses.

B. *Court of Appeal for Ontario (Lauwers, Huscroft and Trotter JJ.A.)*

25 Baycrest appealed, arguing that the trial judge erred in two respects. First, it alleged she erred by improperly expanding the duty of honest performance beyond the terms of the winter maintenance agreement. Second, it argued the trial judge erred in assessing damages.

26 The Court of Appeal unanimously agreed with Baycrest on the first point, and set aside the judgment at first

instance. The Court of Appeal recognized, as the trial judge had found, that the "[d]irectors of two of the condominium corporations and members of the JUC were aware that Mr. Callow was performing 'freebie' work, and knew he was under the impression that the contracts were likely to be renewed" (para. 5). Nonetheless, the court stressed that *Bhasin* was a modest, incremental step, and good faith is to be applied in a manner so as to avoid commercial uncertainty. As such, the duty of honesty "does not impose a duty of loyalty or of disclosure or to require a party to forego advantages flowing from the contract" (para. 12, citing *Bhasin*, at para. 73).

27 The Court of Appeal further emphasized that Callow had made two concessions in its factum. First, Callow acknowledged that Baycrest was not contractually required to disclose its decision to terminate the winter maintenance agreement prior to the 10-day notice period. Second, Callow acknowledged that the failure to provide notice on a more timely basis was not, in and of itself, evidence of bad faith. Because there is "no unilateral duty to disclose information relevant to termination", the court reasoned Baycrest "[was] free to terminate the winter contract with [Callow] provided only that [it] informed him of [its] intention to do so and gave the required notice. That is all that [Callow] bargained for, and all that he was entitled to" (para. 17). While the trial judge's findings "may well suggest a failure to act honourably," the Court of Appeal expressed its view that the findings "do not rise to the high level required to establish a breach of the duty of honest performance" (para. 16).

28 In any event, the Court of Appeal said that any deception in the communications during the summer of 2013 related to a new contract not yet in existence, namely the renewal that Callow hoped to negotiate. Accordingly, in its view, any deception could not be said to be directly linked to the performance of the winter contract (para. 18).

29 Given the Court of Appeal's conclusion, it did not address damages.

IV. Analysis

A. *Overview of the Appeal*

30 This appeal presents this Court with an opportunity to clarify what constitutes a breach of the duty of honest performance where it manifests itself in connection with the exercise of a seemingly unfettered, unilateral termination clause. Pointing to what it calls Baycrest's active deception in the exercise of the clause, Callow says this conduct was a breach of the duty of honest performance recognized in *Bhasin*.

31 Before this Court, Callow does not dispute the meaning of clause 9. Nor does Callow's argument on appeal concern the adequacy of the bargain struck with Baycrest or whether the termination was unjustified. Callow is not saying, for instance, that it should have been afforded more notice because the 10-day period was unfair in the circumstances. I recognize that, at trial, there was some question as to whether the termination was fitting given Callow's work record. Indeed, the trial judge found in Callow's favour on this point, concluding that it had provided satisfactory services. But the suggestions that Callow was terminated for some improper purpose or motive, or even that the termination was unreasonable, need not be determined on this appeal. The narrow question addressed here is whether Baycrest failed to satisfy its duty not to lie or knowingly deceive Callow about matters directly linked to the performance of the winter maintenance agreement, specifically by exercising the termination clause as it did.

32 In the present circumstances, Callow says Baycrest misled Mr. Callow about the possible renewal of the winter maintenance agreement and, as a result, it knowingly deceived him into thinking it was satisfied with Callow's performance of the agreement then in force for the upcoming winter season. Callow says it mistakenly inferred, as a consequence of this dishonesty, that there was no danger of the existing winter contract being terminated pursuant to clause 9 of the contract. This, Callow submits, was to the full knowledge of Baycrest, who failed to correct its false impression which amounted to a breach of the duty of honest performance. In short, Callow says this deceitful conduct meant the exercise of the termination clause was wrongful in that it was breached even if, strictly speaking, the required notice was given. This should give rise, claims Callow, to compensatory damages on the ordinary measure as the trial judge had ordered: damages for lost profits, wasted expenditures and an unpaid invoice.

33 In addition to the duty of honest performance, Callow invokes a free-standing duty to exercise contractual

discretionary powers in good faith, which, it argues, Cromwell J. also recognized in *Bhasin* and which would justify the same award in damages. Furthermore, in the event the Court disagrees that there has been a breach of one or another of those existing duties, Callow submits, alternatively, that this Court should recognize a new duty of good faith, which would prohibit "active non-disclosure".

34 In answer, Baycrest notes the concessions made by Callow before the Court of Appeal, specifically that clause 9 on its face did not require it to give more notice. Baycrest agrees with the Court of Appeal that whatever communications took place between the parties, those communications concerned a future contract and were not directly related to the performance of the winter contract then in force. The agreement granted Baycrest an unqualified right to terminate the contract on notice for any reason, which is precisely what occurred. Recalling that the duty to act honestly in performance is not a duty of disclosure and does not impose a duty of loyalty akin to that of a fiduciary, Baycrest says that Callow seeks to have it subvert its own interest by requiring it to inform Callow of its intention to end the winter maintenance agreement before the stipulated 10 days' notice. The Court of Appeal was thus correct in concluding that the bargain struck by the parties entitled Baycrest to end the contract as it did. In a similar vein, with respect to the duty to exercise discretionary powers in good faith, Baycrest says that because it respected the terms of the contract, the issue of abuse of contractual discretion does not arise on the facts of this case.

35 In any event, Baycrest emphasizes the conclusion reached by the Court of Appeal that any discussions in the spring and summer of 2013 that may have misled Callow were connected to pre-contractual negotiations. Thus, any dishonesty cannot be said to be directly linked to the performance of the winter maintenance agreement.

36 The appeal should be allowed. I respectfully disagree with the Court of Appeal on two main points.

37 First, *Bhasin* is clear that even though Baycrest had what was, on its face, an unfettered right to terminate the winter maintenance agreement on 10 days' notice, the right had to be exercised in keeping with the duty to act honestly, i.e. Baycrest could not "lie or otherwise knowingly mislead" Callow "about matters directly linked to the performance of the contract". According to the Court of Appeal, any dishonesty was about a renewal, which was in turn connected to pre-contractual negotiations to which the duty as stated in *Bhasin* does not apply. I respectfully disagree. In my view, the Court of Appeal may have erroneously framed the trial judge's findings at paragraph 6, writing that she found that Baycrest had represented "that the winter contract was not in danger <u>of non-renewal</u>" (emphasis added). Referring instead to the ongoing winter services agreement, the trial judge had found Baycrest misrepresented "that the contract was not in danger despite [Baycrest's] knowledge that Callow was taking on extra tasks to bolster the chances of renewing the winter maintenance services contract" (para. 65). In determining whether dishonesty is connected to a given contract, the relevant question is generally whether a right under that contract was exercised, or an obligation under that contract was performed, dishonestly. As I understand it, the trial judge's finding was that the dishonesty in this case was related not to a future contract but to the termination of the winter maintenance agreement. If someone is led to believe that their counterparty is content with their work and their ongoing contract is likely to be renewed, it is reasonable for that person to infer that the ongoing contract is in good standing and will not be terminated early. This is what the trial judge found. Simply said, Baycrest's alleged deception was directly linked to this contract because its exercise of the termination clause in this contract was dishonest.

38 Second, the Court of Appeal erred when it concluded that the trial judge's findings did not amount to a breach of the duty of honest performance. While the duty of honest performance is not to be equated with a positive obligation of disclosure, this too does not exhaust the question as to whether Baycrest's conduct constituted, as a breach of the duty of honesty, a wrongful exercise of the termination clause. Baycrest may not have had a free-standing obligation to disclose its intention to terminate the contract before the mandated 10 days' notice, but it nonetheless had an obligation to refrain from misleading Callow in the exercise of that clause. In circumstances where a party lies to or knowingly misleads another, a lack of a positive obligation of disclosure does not preclude an obligation to correct the false impression created through its own actions.

39 In light of these points, it is my view that this is not a simple contractual interpretation case bearing on the

meaning to be given to clause 9. Nor is this a case involving passive failure to disclose a material fact. Instead, as recognized by the Court of Appeal, "[n]ot only did [Baycrest] fail to inform [Callow] of [its] decision to terminate, ... [it] actively deceived Callow as to [its] intentions and accepted the 'freebie' work [it] performed, in the knowledge that this extra work was performed with the intention/hope of persuading [Baycrest] to award [Callow] additional contracts once the present contracts expired" (para. 15 (emphasis added)). While Baycrest was not required to subvert its legitimate contractual interests to those of Callow in respect of the existing winter services agreement, it could not, as it did, "undermine those interests in bad faith" (*Bhasin*, at para. 65).

40 For the reasons that follow, this dispute can be resolved on the basis of the first ground of appeal relating to the duty of honest performance. Baycrest knowingly misled Callow in the manner in which it exercised clause 9 of the agreement and this wrongful exercise of the termination clause amounts to a breach of contract under *Bhasin*. In the circumstances, I find it unnecessary to answer Callow's argument that, irrespective of the question of honesty, Baycrest breached a duty to exercise a discretionary power in good faith. Nor is it necessary to extend *Bhasin* to recognize a new duty of good faith relating to what Callow has described as "active non-disclosure" of information germane to performance.

B. *The Duty of Honest Performance*

(1) The Dishonesty Is Directly Linked to the Performance of the Contract

41 I turn first to Callow's submission that the Court of Appeal erred in concluding that the dishonesty was not connected to the contract "then in effect" (C.A. reasons, at para. 18). As I will endeavour to explain, while Baycrest had the right to terminate, it breached the duty of honest performance in exercising the right as it did.

42 Callow relies on the duty of honest performance in contract formulated in *Bhasin*. This duty, which applies to all contracts, "requires the parties to be honest with each other in relation to the performance of their contractual obligations" (para. 93). While this formulation of the duty refers explicitly to the performance of contractual obligations, it applies, of course, both to the performance of one's obligations and to the exercise of one's rights under the contract. Cromwell J. concluded, at paragraphs 94 and 103, that the finding that the non-renewal clause had been exercised dishonestly made out a breach of the duty:

> The trial judge made a clear finding of fact that Can-Am "acted dishonestly toward Bhasin in exercising the non-renewal clause": para. 261; see also para. 271. There is no basis to interfere with that finding on appeal. It follows that Can-Am breached its duty to perform the Agreement honestly.
>
> ...
>
> As the trial judge found, this dishonesty on the part of Can-Am was directly and intimately connected to Can-Am's performance of the Agreement with Mr. Bhasin and its exercise of the non-renewal provision. I conclude that Can-Am breached the 1998 Agreement when it failed to act honestly with Mr. Bhasin in exercising the non-renewal clause. [Emphasis added.]

This same framework for analysis applies to this appeal. The trial judge here made a clear finding of fact that Baycrest acted dishonestly toward Callow by representing that the contract was not in danger even though a decision to terminate the contract had already been made (paras. 65 and 67). There is no basis to interfere with that finding on appeal. As I will explain, it follows that Baycrest deceived Callow and thereby breached its duty of honest performance.

43 I begin by recognizing the debate as to the extent to which good faith, beyond the duty of honesty, should substantively constrain a right to terminate, in particular one found in a contract (see, e.g., W. Courtney, "Good Faith and Termination: The English and Australian Experience" (2019), 1 *Journal of Commonwealth Law* 185, at p. 189; M. Bridge, "The Exercise of Contractual Discretion" (2019), 135 *L.Q.R.* 227, at p. 247). For some, the right to terminate is in the nature of an "absolute right" insulated from judicial oversight, unlike the exercise of contractual discretion (see E. Peel, *The Law of Contract* (15th ed. 2020), at para. 18-088). To this end, I recall that Cromwell J.

observed that "[c]lassifying the decision not to renew the contract as a contractual discretion would constitute a significant expansion of the decided cases under that type of situation" (*Bhasin*, at para. 72). I need not and do not seek to resolve this debate in this case. I emphasize that Cromwell J. himself recognized that, regardless of this debate, the non-renewal clause could not be exercised dishonestly (para. 94). Whatever the full range of circumstances to which good faith is relevant to contract law in common law Canada, it is beyond question that the duty of honesty is germane to the performance of this contract, in particular to the way in which the unilateral right to terminate for convenience set forth in clause 9 was exercised.

44 As a further preliminary matter, I recall that the organizing principle of good faith recognized by Cromwell J. is not a free-standing rule, but instead manifests itself through existing good faith doctrines, and that this list may be incrementally expanded where appropriate. In this case, Callow invokes two existing doctrines: the duty of honest performance and the duty to exercise discretionary powers in good faith. In my view, properly understood, the duty to act honestly about matters directly linked to the performance of the contract -- the exercise of the termination clause -- is sufficient to dispose of this appeal. No expansion of the law set forth in *Bhasin* is necessary to find in favour of Callow. Rather, this appeal provides an opportunity to illustrate this existing doctrine that, I say respectfully, was misconstrued by the Court of Appeal.

45 While these two existing doctrines are indeed distinct, like each of the different manifestations of the organizing principle, they should not be thought of as disconnected from one another. Cromwell J. explained that good faith contractual performance is a shared "requirement of justice" that underpins and informs the various rules recognized by the common law on obligations of good faith contractual performance (*Bhasin*, at para. 64). The organizing principle of good faith was intended to correct the "piecemeal" approach to good faith in the common law, which too often failed to take a consistent or principled approach to similar problems and, instead, develop the law in this area in a "coherent and principled way" (paras. 59 and 64).

46 By insisting upon the thread that ties the good faith doctrines together -- expressed through the organizing principle -- courts will put an end to the very piecemeal and incoherent development of good faith doctrine in the common law against which Cromwell J. sought to guard. While the duty of honest performance might bear some resemblance to the law of misrepresentation, for example, in a way that good faith in other settings may not, *Bhasin* encourages us to examine how other existing good faith doctrines, distinct but nonetheless connected, can be used as helpful analytical tools in understanding how the relatively new duty of honest performance operates in practice.

47 The specific legal doctrines derived from the organizing principle rest on a "requirement of justice" that a contracting party, like Baycrest here in respect of the contractual duty of honest performance, have appropriate regard to the legitimate contractual interests of their counterparty (*Bhasin*, at paras. 63-64). It need not, according to *Bhasin*, subvert its own interests to those of Callow by acting as a fiduciary or in a selfless manner that would confer a benefit on Callow. To be sure, this requirement of justice reflects the notion that the bargain, the rights and obligations agreed to, is the first source of fairness between parties to a contract. But by the same token, those rights and obligations must be exercised and performed, as stated by the organizing principle, honestly and reasonably and not capriciously or arbitrarily where recognized by law. This requirement of justice, rooted in a contractual ideal of corrective justice, ties the existing doctrines of good faith, including the duty to act honestly, together. The duty of honest performance is but an exemplification of this ideal. Here, based on its failure to perform clause 9 honestly, Baycrest committed a breach of contract, a civil wrong, for which it has to answer.

48 When, in *Bhasin*, Cromwell J. recognized a duty to act honestly in the performance of contracts, he explained that this duty "should not be thought of as an implied term, but a general doctrine of contract law that imposes as a contractual duty a minimum standard of honest contractual performance" (para. 74). Characterizing this new duty as a matter of contractual doctrine was appropriate, Cromwell J. wrote, "since parties will rarely expect that their contracts permit dishonest performance of their obligations" (para. 76). The duty therefore applies even where -- as in our case - - the parties have expressly provided for the modalities of termination given that the duty of good faith "operates irrespective of the intentions of the parties" (para. 74). No contractual right, including a termination right, can be exercised dishonestly and, as such, contrary to the requirements of good faith.

49 Cromwell J.'s choice of language is telling. It is not enough to say that, temporally speaking, dishonesty occurred while both parties were performing their obligations under the contract; rather, the dishonest or misleading conduct must be directly linked to performance. Otherwise, there would simply be a duty not to tell a lie, with little to limit the potentially wide scope of liability.

50 The duty of honest performance is a contract law doctrine, setting it apart from other areas of the law that address the legal consequences of deceit with which it may share certain similarities. One could imagine analyzing the facts giving rise to a duty of honest performance claim through the lens of other existing legal doctrines, such as fraudulent misrepresentation giving rise to rescission of the contract or the tort of civil fraud (see, e.g., B. MacDougall, *Misrepresentation* (2016), at s.1.144-1.145). However, in *Bhasin*, Cromwell J. wrote explicitly that while the duty of honest performance has similarities with civil fraud and estoppel "it is not subsumed by them" (para. 88). For instance, unlike estoppel and civil fraud, the duty of honest performance does not require a defendant to intend that the plaintiff rely on their representation or false statement. Cromwell J. explicitly defined the duty as a new and distinct doctrine of contract law, not giving rise to tort liability or tort damages but rather resulting in a breach of contract when violated (paras. 72-74, 90, 93 and 103). We are not asked by the parties to depart from this approach.

51 In light of *Bhasin*, then, how is the duty of honest performance appropriately limited? The breach must be directly linked to the performance of the contract. Cromwell J. observed a contractual breach because Can-Am "acted dishonestly toward Bhasin in exercising the non-renewal clause" (para. 94). He pointed, in particular, to the trial judge's conclusion that Can-Am "acted dishonestly with Mr. Bhasin throughout the period leading up to its exercise of the non-renewal clause" (para. 98; see also para. 103). Accordingly, it is a link to the performance of obligations under a contract, or to the exercise of rights set forth therein, that controls the scope of the duty. In a comment on *Bhasin*, Professor McCamus underscored this connection: "Cromwell J was of the view that the new duty of honesty could be breached in the context of the exercise of a right of non-renewal. That was the holding in *Bhasin*" ("The New General 'Principle' of Good Faith Performance and the New 'Rule' of Honesty in Performance in Canadian Contract Law" (2015), 32 *J.C.L.* 103, at p. 115). While the abuse of discretion was not the basis of the damages awarded in *Bhasin*, the duty of honest performance shares a common methodology with the duty to exercise contractual discretionary powers in good faith by fixing, at least in circumstances like ours, on the wrongful exercise of a contractual prerogative.

52 Importantly, Callow does not seek to bar Baycrest from exercising the termination clause here; like in *Bhasin*, it only seeks damages flowing from the fact that the clause was exercised dishonestly. In other words, Callow's argument, properly framed, is that Baycrest could not exercise clause 9 in a manner that breached the duty of honesty, however absolute that right appeared on its face.

53 Good faith is thus not relied upon here to provide, by implication, a new contractual term or a guide to interpretation of language that was somehow an unclear statement of parties' intent. Instead, the duty of honesty as contractual doctrine has a limiting function on the exercise of an otherwise complete and clear right because the duty, irrespective of the intention of the parties, applies to the performance of all contracts and, by extension, to all contractual obligations and rights. This means, simply, that instead of constraining the decision to terminate in and of itself, the duty of honest performance attracts damages where the manner in which the right was exercised was dishonest.

54 The issue, then, is not whether the clause was properly interpreted, or whether the bargain itself is inadequate. Moreover, what is important is not the failure to act honestly in the abstract but whether Baycrest failed to act honestly in exercising clause 9. Stated simply, no contractual right can be exercised in a dishonest manner because, pursuant to *Bhasin*, that would be contrary to an imperative requirement of good faith, i.e. not to lie or knowingly deceive one's counterparty in a matter directly linked to the performance of the contract.

55 This argument invites this Court to explain if and how Baycrest wrongfully exercised the termination clause, quite apart from any notice requirement. I would add that this focus on the *manner* in which the termination right

was exercised should not be confused with *whether* the right could be exercised. Callow does not allege that Baycrest did not have the right to terminate the agreement -- this entitlement to do so on 10 days' notice, pursuant to clause 9, is not at issue here. However, according to Callow, that right was exercised dishonestly, in breach of the duty in *Bhasin*, obliging Baycrest to pay damages as a consequence of its behaviour. Accordingly, I would draw the same distinction made by Cromwell J. in *Bhasin* regarding the exercise of the non-renewal clause at issue in that case: Can-Am acted dishonestly towards Mr. Bhasin in exercising the non-renewal clause as it did, and was liable for damages as a result, but it was not precluded from exercising its prerogative not to renew the contract.

56 In service of its argument that Baycrest breached the duty of honest performance in its exercise of clause 9 of the contract, Callow points to references in *Bhasin* to Quebec law (at paras. 32, 35, 41, 44, 82 and 85) and in particular to Cromwell J.'s reference to the theory of the abuse of contractual rights set forth in arts. 6, 7 and 1375 of the *Civil Code of Québec* ("*C.C.Q.*" or "*Civil Code*") (para. 83). Callow observes that the requirement not to abuse contractual rights is recognized as a feature of good faith performance in Quebec. It submits that the allusion to the doctrine of abuse of rights was an indication of the requirements of good faith in *Bhasin* and argues that the same framework can usefully illustrate how the common law duty of honesty constrains the termination clause in this case.

57 I agree that looking to Quebec law is useful here. The direct link between the dishonest conduct and the exercise of clause 9 was not properly identified by the Court of Appeal in this case and Quebec law helps illustrate the requirement that there be such a link from *Bhasin*. In my view, Baycrest's dishonest conduct is not a wrong independent of the termination clause but a breach of contract that, properly understood, manifested itself upon the exercise of clause 9. Through that direct link between the dishonesty and the exercise of the clause, the conduct is understood as contrary to the requirements of good faith. This emerges more plainly when considered in light of the civilian doctrine of contractual good faith alluded to in *Bhasin*, specifically the fact that, in Quebec "[t]he notion of good faith includes (but is not limited to) the requirement of honesty in performing the contract" (para. 83). Thus, like in Quebec civil law, no contractual right may be exercised dishonestly and therefore contrary to the requirements of good faith. Properly raised by Cromwell J., this framework for connecting the exercise of a contractual clause and the requirements of good faith is helpful to illustrate, for the common law, the link made in *Bhasin* that the Court of Appeal failed to identify here.

58 Mindful no doubt of its unique vantage point which offers an occasion to observe developments in both the common law and the civil law in its work, this Court has often drawn on this country's bijural environment to inform its decisions, principally in private law appeals. While this practice has varied over time and has been most prevalent in civil law cases in which common law authorities are considered, the influence of bijuralism is not and need not be confined to appeals from Quebec or to matters relating to federal legislation (see J.-F. Gaudreault-DesBiens, *Les solitudes du bijuridisme au Canada* (2007), at pp. 7-22). In its modern jurisprudence, this Court has recognized the value of looking to legal sources from Quebec in common law appeals, and has often observed how these sources resolve similar legal issues to those faced by the common law (see, e.g., *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*, [1992] 1 S.C.R. 1021, at pp. 1143-44; *Deloitte & Touche v. Livent Inc. (Receiver of)*, *2017 SCC 63*, [2017] 2 S.C.R. 855, at para. 138; see also *Kingstreet Investments Ltd. v. New Brunswick (Finance)*, *2007 SCC 1*, *[2007] 1 S.C.R. 3*, at para. 41). Used in this way, authorities from Quebec do not, of course, bind this Court in its disposition of a private law appeal from a common law province, but rather serve as persuasive authority, in particular, by shedding light on how the jurisdictionally applicable rules work. In my respectful view, it is uncontroversial that, when done carefully, sources of law may be used in this way (*Farber v. Royal Trust Co.*, *[1997] 1 S.C.R. 846*, at para. 32, citing J.-L. Baudouin, "L'interprétation du Code civil québécois par la Cour suprême du Canada" (1975), 53 *Can. Bar Rev.* 715, at p. 726). As Robert J. Sharpe put it, writing extra-judicially, judges "should strive to maintain the coherence and integrity of the law as defined by the binding authorities, using persuasive authority to elaborate and flesh out its basic structure" (*Good Judgment: Making Judicial Decisions* (2018), at pp. 171-72).

59 This does not mean the appropriate use of these sources is limited to cases where there is a gap in the law of the jurisdiction in which the appeal originates, in the sense that there is no answer to the legal problem in that law, or where a court contemplates modifying an existing rule. Respectfully said, I am aware of no authority of this Court

supporting so restrictive an approach and note that, while unresolved, there are serious debates in both the common law and the civil law as to what exactly a "gap" in the law might be (see, e.g., J. Gardner, "Concerning Permissive Sources and Gaps" (1988), 8 *Oxford J. Leg. Stud.* 457; J. E. C. Brierley, "Quebec's 'Common Laws' (*Droits communs*): How Many Are There?", in E. Caparros et al., eds., *Mélanges Louis-Philippe Pigeon* (1989), 109). Taking this approach would unduly inhibit the ability of this Court to understand the law better in reference to how comparable problems are addressed elsewhere in Canada. It would be wrong to disregard potentially helpful material in this way merely because of its origin.

60 In private law, comparison between the common law and civil law as they evolve in Canada is a particularly useful and familiar exercise for this Court. This exercise of comparison between legal traditions for the purposes of "explanation" and "illustration" has been described as "worthwhile", "useful" and "helpful" (*Farber*, at para. 32 and 35; *St. Lawrence Cement Inc. v. Barrette*, 2008 SCC 64, [2008] 3 S.C.R. 392, at para. 76; *Norsk*, at p. 1174, per Stevenson J. (concurring)). Principles from the common law or the civil law may serve as a "source of inspiration" for the other, precisely because these "two legal communities have the same broad social values" (*Bou Malhab v. Diffusion Métromédia CMR inc.*, 2011 SCC 9, [2011] 1 S.C.R. 214, at para. 38). The common law and the civil law are not the only legal traditions relevant to the work of the Court; yet, the opportunity for dialogue between these legal traditions is arguably a special mandate for this Court given the breadth and responsibilities of its bijural jurisdiction. This opportunity has been underscored in scholarly commentary, including in the field of good faith performance of contracts (e.g., L. LeBel and P.-L. Le Saunier, "L'interaction du droit civil et de la common law à la Cour suprême du Canada" (2006), 47 C. de D. 179, at p. 206; R. Jukier, "Good Faith in Contract: A Judicial Dialogue Between Common Law Canada and Québec" (2019), 1 *Journal of Commonwealth Law* 83).

61 Writing extra-judicially, LeBel J. has observed that this exercise is part of the function of this Court, as a national appellate court, adding that [TRANSLATION] "because it has the ability to do so today, thanks to its institutional resources, the Supreme Court now assumes the symbolic responsibility of embracing a culture of dialogue between the two major legal traditions" ("Les cultures de la Cour suprême du Canada : vers l'émergence d'une culture dialogique?", in J.-F. Gaudreault-DesBiens et al., eds., *Convergence, concurrence et harmonisation des systèmes juridiques* (2009), 1, at p. 7). This Court's unique institutional capacity as the apex court of common law and civil law appeals in Canada allows it to engage in dialogue that makes it "more than a court of appeal for each of the provinces" (F. Allard, *The Supreme Court of Canada and its Impact on the Expression of Bijuralism* (2001), at p. 21). The opportunity for dialogue presents itself specifically in the context of the common law good faith doctrines. Pointing to the writing of LeBel J. and to how Quebec sources were deployed in *Bhasin*, one comparative law scholar wrote recently that while the distinctiveness of Canada's legal traditions must be "maintained and jealously protected, [this] need not prevent [them] from learning from [one another]" (R. Jukier, "The Legacy of Justice Louis LeBel: The Civilian Tradition and Procedural Law" (2015), 70 S.C.L.R. (2d) 27, at p. 45). Professor Waddams has remarked that the reference to Quebec law in *Bhasin* is an "invitation" to consider civil law concepts, including abuse of rights, in the development of the common law relating to good faith (see "Unfairness and Good Faith in Contract Law: A New Approach" (2017), 80 S.C.L.R. (2d) 309, at pp. 330-31). This would be consistent with a broader pattern of "more pronounced reciprocal influence between traditions as comparative analysis becomes increasingly prominent in [this Court's] judgments" (Allard, at p. 22).

62 Indeed, this Court has undertaken this exercise in some common law and civil law appeals in which good faith principles are engaged, including *Bhasin* itself (see also *Potter v. New Brunswick Legal Aid Services Commission*, 2015 SCC 10, [2015] 1 S.C.R. 500, at para. 30; *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701, at paras. 75 and 96, citing *Farber*). Cromwell J. pointed to the comfort that can be drawn from the experience of the civil law of Quebec, for example, by those common lawyers who fear that a new duty of honest performance would "create uncertainty or impede freedom of contract" (*Bhasin*, at para. 82). Cromwell J. also pointed to substantive points of comparison in support of his analysis on the similarity between implied terms in the common law and good faith in Quebec as well as on the fact that good faith in Quebec law also includes a requirement of honesty in performing contracts (paras. 44 and 83). Strikingly, in one recent Quebec example that is especially relevant here, Gascon J., writing for a majority of this Court, quoted *Bhasin* on the degree to which the organizing principle of good faith exemplifies the notion that a contracting party should have "appropriate regard" to the legitimate contractual interests of their counterparty. He noted that "[t]his statement applies equally to the duty of good faith in Quebec

civil law" (*Churchill Falls (Labrador) Corp. v. Hydro-Québec*, 2018 SCC 46, [2018] 3 S.C.R. 101, at para. 117). I note this only as an instance of accepted judicial reasoning in this field, where comparisons are rightly said to be difficult. A majority of the Court nevertheless invoked a leading common law authority on good faith to illuminate the civil law's distinct treatment as both helpful and persuasive.

63 In the same way, I draw on Quebec civil law in this appeal to illustrate what it means for dishonesty to be directly linked to contractual performance. As I will explain, the civil law framework of abuse of rights helps to focus the analysis of whether the common law duty of honest performance has been breached on what might be called the wrongful exercise of a contractual right.

64 This appeal makes plain a need for clarification on the question of when dishonesty is directly linked to the performance of a contract. The Court of Appeal recognized the duty of honest performance, but concluded that the communications at issue were not directly linked to performance of the existing contract: "Communications between the parties may have led Mr. Callow to believe that there would be a new contract, but those communications did not preclude [Baycrest] from exercising their right to terminate the winter contract then in effect" (para. 18). The Court's reasons also conclude that Baycrest could exercise the termination clause "provided only that [it] informed him of [its] intention to do so and gave the required notice. That is all [Callow] bargained for, and all that [it] was entitled to" (para. 17). The Court of Appeal apparently did not consider that the manner in which the termination right was exercised amounted to a breach of the duty to act honestly. This was, for the trial judge in the present appeal, the matter directly linked to the performance of the contract in the dispute with Callow.

65 These diverging conclusions in this case are unsurprising given that this Court recognized the duty of honest performance as a "new" good faith doctrine relatively recently (*Bhasin*, at para. 93). Nevertheless, the reasons in *Bhasin* indicate how the required connection between the dishonesty and performance is made manifest. When Cromwell J. summarized the new duty, he suggested that it required honesty "about matters directly linked to the performance of the contract" and, later, "in relation to the performance of their contractual obligations" (paras. 73 and 92). But this latter formulation does not of course comprehensively describe the required link, not least of all because it speaks of honesty in the performance of an obligation, and says nothing about the exercise of a right. Yet, in applying the duty to the facts in *Bhasin*, this Court concluded that there was a breach of the duty on the basis of the trial judge's finding that Can-Am acted dishonestly in the exercise of the non-renewal clause (paras. 94 and 103).

66 Further, I note that while the duty of honest performance has similarities with the pre-existing common law doctrines of civil fraud and estoppel, these doctrines do not assist in our analysis of the required link to the performance of the contract. The duty of honest performance is a contract law doctrine (*Bhasin*, at para. 74). It is not a tort. It is its nature as a contract law doctrine that gives rise to the requirement of a nexus with the contractual relationship. While other areas of the law involving dishonesty may be useful to understand what it means to be dishonest, they provide no obvious assistance in determining what is and is not directly linked to the performance of a contract.

67 In my view, the required direct link between dishonesty and performance from *Bhasin* is made plain, by way of simple comparison, when one considers how the framework for abuse of rights in Quebec connects the manner in which a contractual right is exercised to the requirements of good faith. Specifically, the direct link exists when the party performs their obligation or exercises their right under the contract dishonestly. When read together, arts. 6, 7 and 1375 *C.C.Q.* point to this connection by providing that no contractual right may be exercised abusively without violating the requirements of good faith. Article 7 in particular provides "[n]o right may be exercised with the intent of injuring another or in an excessive and unreasonable manner, and therefore contrary to the requirements of good faith." While the substantive content of this article is not relevant to the common law analysis, the framework is illustrative. This article shows how the requirements of good faith can be tied to the exercise of a right, including a right under a contract. It is the exercise of the right that is scrutinized to assess whether the action has been contrary to good faith.

68 Under the civil law framework of abuse of rights, it is no answer to say that, because a right is unfettered on its

face, it is insulated from review as to the manner in which it was exercised. Moreover, the doctrine of abuse of right does not preclude the holder from exercising the contractual right in question. As Professors Jobin and Vézina have written on abuse of contractual rights in Quebec, [TRANSLATION] "[t]he doctrine of abuse of right does not lead to the negation of the right as such; rather, it addresses the use made of the right by its holder" (J.-L. Baudouin and P.-G. Jobin, *Les* obligations (7th ed. 2013), by P.-G. Jobin and N. Vézina, at No. 156). It has been said that good faith in the civil law has a [TRANSLATION] "*limiting function*" in directing standards of ethical conduct to which parties must conform, as a matter of imperative law, when performing the contract: [TRANSLATION] "It [i.e. the limiting function of good faith] thus seeks to sanction a party's improper conduct in the exercise of the party's contractual prerogatives." (M. A. Grégoire, *Liberté, responsabilité et utilité : la bonne foi comme instrument de justice* (2010), at p. 225). That is what is at stake here: whether the ethical standard expressed in the common law duty to act honestly in performance, as a manifestation of the organizing principle of good faith recognized in *Bhasin*, limits the manner in which Baycrest can exercise its right to terminate the winter maintenance agreement. By focusing attention on the exercise of a particular right under a particular contract, a direct link to the performance of that contract is helpfully drawn.

69 Thus, in *Houle v. Canadian National Bank*, *[1990] 3 S.C.R. 122* -- a Quebec case cited in *Bhasin*, at para. 85 -- the contracting party's right to demand repayment of the loan, as stipulated in the contract, was upheld (p. 169). The "abuse of right" identified by the Court was the manner in which the right was exercised. This is, as I have noted, broadly similar to *Bhasin*. There, Can-Am had a contractual right of non-renewal, but Can-Am nonetheless exercised that right in a dishonest manner, and thus breached the duty of honest performance (para. 94). This was a wrongful exercise of the right in that it was exercised contrary to the mandatory requirement of good faith performance.

70 There are special reasons, of course, to be cautious in undertaking the comparative exercise to which Callow invites us here. One is that there are important differences between the civilian treatment of abuse of contractual rights and the current state of the common law. The *Civil Code* provides that no right may be exercised with the intent to injure another or in an excessive and unreasonable manner and therefore contrary to the requirements of good faith requiring that parties conduct themselves in good faith, in particular at the time an obligation is performed. Insofar as the organizing principle in *Bhasin* speaks to a related idea that parties generally must perform their contractual duties honestly and reasonably and not capriciously or arbitrarily, this principle, unlike Quebec law, is not a free-standing rule but rather a standard that underpins and manifests itself in more specific doctrines. Further, in *Bhasin*, positive law was only formally extended by recognizing a general duty of honesty in contractual performance.

71 An additional reason is the common law's fabled reluctance to embrace the standard associated with the civilian idea of "abuse of rights", including abuse of contractual rights, a doctrine to which *Bhasin* alluded in para. 83 (see, e.g., the survey in H. C. Gutteridge, "Abuse of Rights" (1933), 5 *Cambridge L.J.* 22, at pp. 22 and 30-31).[1] Mindful of this, Cromwell J. recalled the "fundamental commitments of the common law of contract" to the "freedom of contracting parties to pursue their individual self-interest" and -- importantly to the theory of abuse of rights -- that the organizing principle he recognized "should not be used as a pretext for scrutinizing the motives of contracting parties" (para. 70). Others have observed that the civilian conception of legal rights -- *droits subjectifs* in the French tradition -- are conceptually different from "rights" in the common law, or even that the preoccupation with the "social" dimension of limits to rights, as opposed to a purely "economic" aspect of a freely-negotiated bargain, is peculiar to the civil law (see, e.g., F. H. Lawson, *Negligence in the Civil Law* (1950), at pp. 15-20). Still others have observed the differing techniques for the genesis of new rules of law according to the common law and civil law methods (see, e.g., P. Daly, "La bonne foi et la common law: l'arrêt *Bhasin* c. *Hrynew*", in J. Torres-Ceyte, G.-A. Berthold and C.-A. M. Péladeau, eds., *Le dialogue en droit civil* (2018), 89, at pp. 101-2). One should not lose sight of the fact that, as intellectual and historical traditions, the common law and the civil law represent, in many respects, distinctive ways of knowing the law.

72 It is true that LeBel J., writing extra-judicially prior to this Court's decision in *Bhasin*, in which he concurred, noted that in the dialogue between the common law and the civil law in this Court's jurisprudence, good faith offered an example of [TRANSLATION] "coexistence" rather than "convergence" or "divergence" (LeBel, at pp. 12-15). Yet

as he noted, comparison in this field that respects the "intellectual integrity" of distinctive traditions remains a viable part of the dialogue between common law and the civil law at this Court (p. 15). While the requirements of honest contractual performance in the two legal traditions may be rooted in distinct histories, they have come together to address similar issues, at least in the context of dishonest performance (*Bhasin*, at para. 83). The civil law provides a useful analytical guide to illustrating the relatively recent common law duty. Two reasons in particular underlie the usefulness of the comparative exercise here.

73 First, I stress that I do not rely on the civil law here for the specific rules that would govern a similar claim in Quebec. Rather, within the constraints imposed on this Court by the precedent in *Bhasin* and the wider common law context, I draw on abuse of rights as a framework to understand the common law duty of honest performance. Second, there is no serious concern here that looking to Quebec law will throw the common law into a state of uncertainty. As Cromwell J. did in *Bhasin*, this Court can take comfort from the experience of Quebec to allay fears that applying this general framework of wrongful exercise of rights will result in commercial uncertainty or inappropriately constrain freedom of contract. Notwithstanding their differences, the common law and the civil law in Quebec share, in respect of good faith, some of the "same broad social values" that justify comparison generally (*Bou Malhab*, at para. 38). As noted, this Court pointed to a shared concern for the proper compass of good faith in that it "does not require acting to serve [the other contracting party's] interests in all cases" and both anchor remedies in corrective, not distributive justice (*Churchill Falls*, at para. 117, citing *Bhasin*, at para. 65). As Professor Moore wrote, prior to his appointment as a judge [TRANSLATION] "the value of individual autonomy, and the fear that good faith is an imprecise concept, are not exclusive to the common law. They are discussed at length in civil law commentary and jurisprudence" ("Brèves remarques spontanées sur l'arrêt *Bhasin c. Hrynew*", in J. Torres-Ceyte, G.-A. Berthold and C.-A. M. Péladeau, eds., *Le dialogue en droit civil* (2018), 81, at p. 84). For these reasons, it is not inappropriate to illustrate the duty of honest performance using the framework of the wrongful exercise of a right. Dishonesty is directly linked to the performance of a given contract where it can be said that the exercise of a right or the performance of an obligation under that contract has been dishonest.

74 Applying *Bhasin* to this case, and drawing on the illustration provided by the Quebec civil law sources Cromwell J. himself cites, I am of the respectful view that the Court of Appeal erred when it concluded that the dishonesty here was only about a future contract. Properly understood, the alleged dishonesty in this case was directly linked to the performance of the contract because Baycrest's exercise of the termination right provided to it under the contract was dishonest.

75 The termination right was exercised dishonestly according to the trial judge in our case, notwithstanding the fact that its terms -- the 10-day notice -- were otherwise respected. Pointing to the dishonest representations, regarding the danger to the contract and made in anticipation of the notice period, she held that the duty to act honestly was linked to the termination of the contract and the exercise of that right in the circumstances was a breach of contract. The trial judge did not deny the right of Baycrest to terminate the contract, but the manner in which it did so was wrongful -- in breach of the duty of honesty -- and for that it owed Callow damages. Importantly, this does not deny the existence of the termination right but fixes on the wrongful manner in which it was exercised.

(2) Baycrest's Conduct Constitutes Dishonesty

76 The second issue to be resolved is whether Baycrest's conduct amounts to dishonesty within the meaning of the duty of honest performance in *Bhasin*. Callow takes issue with the Court of Appeal's conclusion that while the facts may have suggested a failure to act honourably, they did not rise to the level of a breach of this duty. To dispose of this appeal, then, we must determine what standard of honesty was expected of Baycrest in its exercise of clause 9.

77 There is common ground that parties to a contract cannot outright lie or tell half-truths in a manner that knowingly misleads a counterparty. It is also agreed here that the failure to disclose a material fact, without more, would not be contrary to the standard. Beyond this, however, the parties continue to disagree about what might constitute knowingly misleading conduct as that idea was alluded to in *Bhasin*.

78 Callow argues that while this Court in *Bhasin* held that the duty of honest performance does not impose a duty of disclosure, it left open the possibility that an omission to inform can nonetheless be knowingly misleading in certain circumstances. Callow acknowledges that the line between a misrepresentation and the innocent failure to disclose is not always easy to draw. But by "positively misleading" Mr. Callow that the winter maintenance agreement was likely to be renewed in 2014, he was led to infer, mistakenly and to the knowledge of Baycrest, that a decision had not been made to terminate the existing contract in 2013. Failing to correct this false impression, in Callow's view, was a breach of its obligation to act honestly in the performance of the winter maintenance agreement. It meant that clause 9 was not exercised in keeping with the obligatory duty to perform the contract honestly imposed in *Bhasin*.

79 Baycrest submits that "active deception" -- a term invoked by the trial judge, as well as both parties -- requires actual dishonesty, in the sense that an outright lie is necessary. "Silence", said its counsel at the hearing, "can only constitute misrepresentation when there is a duty to speak". Since the duty of honest performance does not bring with it a duty of disclosure, "silence cannot constitute dishonesty or an act of misrepresentation, whether done intentionally or, I suppose, accidentally" (transcript, at p. 37).

80 Baycrest is right to say that the duty to act honestly "does not impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract" (*Bhasin*, at para. 73; see also A. Swan, J. Adamski and A. Y. Na, *Canadian Contract Law* (4th ed. 2018), at p. 347). Cromwell J. referred to *United Roasters, Inc. v. Colgate-Palmolive Co.*, 649 F.2d 985 (4th Cir. 1981), in support of his conclusion that the duty of honest performance is distinct from a free-standing duty to disclose information (para. 87). In *United Roasters*, the terminating party had decided in advance of the required notice period to terminate the contract. The court held that no disclosure of that intention was required other than what was stipulated in the contract. In Cromwell J.'s view, this made "it clear that there is no unilateral duty to disclose information relevant to termination" (para. 87).

81 One might well understand that courts would shy away from imposing a free-standing positive duty to disclose information to a counterparty where it would serve to upset the corrective justice orientation of contract law. Whether or not a positive duty to cooperate of this character should be associated with the principle of good faith performance in the common law, a party to a contract has no general duty to subordinate their interests to that of the other party in the law as it now stands (see *Bhasin*, at para. 86). Requiring a party to speak up in service of the requirements of good faith where nothing in the parties' contractual relationship brings a duty to do so could be understood to confer an unbargained-for benefit on the other that would stand outside the usual compass of contractual justice. Yet where the failure to speak out amounts to active dishonesty in a manner directly related to the performance of the contract, a wrong has been committed and correcting it does not serve to confer a benefit on the party who has been wronged. To this end, Cromwell J. clarified that the "situation is quite different ... when it comes to actively misleading or deceiving the other contracting party in relation to performance of the contract" (para. 87). In such circumstances, contractual parties should be mindful to correct misapprehensions, lest a contractual breach of the *Bhasin* duty be found.

82 By noting that liability flowed from active dishonesty and not a unilateral duty to disclose, Cromwell J. indicated that the duty of honesty is consonant with the ordinary principles of contractual justice: that *Bhasin* does not impose a duty to disclose or a fiduciary-type obligation means that performing a contract honestly is not a selfless or altruistic act. One might well say that performing one's own end of a bargain honestly is in keeping with the pursuit of self-interest as long as the law can be counted on to require the same honest conduct from one's counterparty. Whatever constraints it justifies on Baycrest's ability to terminate the contract based on values of honesty associated with good faith, it does not require it to confer a benefit on Callow in exercising that right. As Cromwell J. explained, having appropriate regard for the legitimate contractual interests of the contracting parties "does not require acting to serve those interests in all cases" (para. 65). This explains, to my mind, the limited character of the duty of honesty: it is not a device that allows a court, in the name of a conception of good faith resting on distributive justice, to require the party that has to exercise a contractual right or power "to serve" the other party's interest at the expense of their own.

83 This emphasis on the corrective justice foundation of the duty to act honestly in performance is, in my view, helpful to understanding why a facially unfettered right is nonetheless constrained by the imperative requirement of good faith explained in *Bhasin*. I recall that Cromwell J. sought to reassure those who feared commercial uncertainty resulting from the recognition of this new duty by explaining that the requirement of honest performance "interferes very little with freedom of contract" (para. 76). After all, the expectation that a contract would be performed without lies or deception can already be thought of as a minimum standard that is part of the bargain. I agree with the sentiment expressed by the Chief Justice of Alberta in a case that relied on *Bhasin* and *Potter*: "Companies are entitled to expect that the parties with whom they contract will be honest" in their contractual dealings (*IFP Technologies (Canada) Inc. v. EnCana Midstream and Marketing*, *2017 ABCA 157*, *53 Alta. L.R. (6th) 96*, at para. 4). In that sense, while the duty is one of mandatory law, in most cases it can be thought of as leaving the agreement and both parties' expectations -- the first source of justice between the parties -- in place. By extension, requiring that a party exercise a right under the contract in keeping with this minimum standard only precludes the commission of a wrong and thus repairing that breach, where damage resulted, may be thought of as consonant with the principles of corrective justice. Where a party has lied or otherwise knowingly misled the other contracting party in respect of a matter that is directly linked to the performance of the contract, it amounts to breach of contract that must be set right, but the benefits of the bargain need not be otherwise reallocated between the parties involved.

84 That said, I emphasize once again that it is unquestionable that the duty is imposed as a matter of contractual doctrine rather than by implication or interpretation, and, by virtue of its status as contractual doctrine, parties are "not free to exclude" the duty altogether (*Bhasin*, at para. 75). Even if the parties, as here, have agreed to a term that provides for an apparently unfettered right to terminate the contract for convenience, that right cannot be exercised in a manner that transgresses the core expectations of honesty required by good faith in the performance of contracts.

85 This framework for measuring the wrongful exercise of the termination right does not turn on Baycrest's motive in exercising clause 9 beyond the observation that it did so dishonestly. The right of termination was, on its face, one without cause: Baycrest may have had legitimate grievances against Callow or some ulterior motive for its knowing deception -- it is of no moment. The negative view that the property manager may have had of Callow, alluded to by the trial judge (at para. 14), is not the source of the breach of the duty of honest performance.

86 Moreover, I note that Cromwell J. described the requirements of the duty of honesty negatively: while the duty of honest performance does not require parties to act angelically by subordinating their own interests to that of their counterparty (*Bhasin*, at para. 86), they must *refrain* from lying or knowingly misleading their counterparty (para. 73). As a "negative" obligation -- that is, in the absence of a recognized duty to act, the injunction it imposes is one not to act dishonestly -- it sits more plainly with the ordinary objectives of corrective justice and what one scholar sees as the traditional posture of the common law in favour of contractual autonomy and individual freedom in private law. [TRANSLATION] "It is clear", wrote Professor Daly in a comment on the common law method consecrated in *Bhasin*, "that the duty of honesty recognized in *Bhasin* is a negative obligation -- not to lie -- rather than a positive obligation -- to act in good faith" (pp. 101-2). This same orientation has been observed as animating the analogous contractual duty of good faith in the civil law. While positive obligations to cooperate in performance may be otherwise required by the law of good faith, scholars have observed that the notional equivalent of the duty of honest performance in Quebec civil law most typically imposes negative obligations -- to refrain from lying, for example -- in the measure of the abuse of a contractual right (Baudouin and Jobin, at No. 161). Care must be taken, I hasten to say, not to confuse the [TRANSLATION] "duty to act faithfully" recognized in this regard, with the fiduciary duty of loyalty that stands outside of good faith in both legal traditions.

87 I would add that, as Cromwell J. made plain, the recognition of the duty to act honestly in performance does not necessarily mean that the ideal spoken to in the organizing principle of good faith set forth in *Bhasin* might not manifest itself otherwise. Even within the limited compass of corrective justice, circumstances may arise in which the organizing principle would encourage the view that contractual rights must be exercised in a manner that was neither capricious nor arbitrary, for example, or that some duty to cooperate between the parties be imposed,

though recognizing that, contrary to fiduciary duties, "good faith performance does not engage duties of loyalty to the other contracting party or a duty to put the interests of the other contracting party first" (*Bhasin*, at para. 65). But for present purposes, it is not necessary to go that further step: I am of the view that where the exercise of a contractual right is undertaken dishonestly, the exercise is in breach of contract and this wrong must be corrected. That is what happened here.

88 The question that remains is whether Baycrest lied to or knowingly misled Callow and thus breached the duty to act honestly.

89 I recognize that in cases where there is no outright lie present, like the case before us, it is not always obvious whether a party "knowingly misled" its counterparty. Yet, Baycrest is wrong to suggest that nothing stands between the outright lie and silence. Elsewhere, as in the law of misrepresentation, for instance, one encounters examples of courts determining whether a misrepresentation was present, regardless of whether there was some direct lie (see A. Swan, "The Obligation to Perform in Good Faith: Comment on *Bhasin v. Hrynew*" (2015), 56 *Can. Bus. L.J.* 395, at p. 402). As Professor Waddams has written, "[a]n incomplete statement may be as misleading as a false one, and such half-truths have frequently been treated as legally significant misrepresentations." Ultimately, he wrote, "it is open to the court to hold that the concealment of the material facts can, when taken with general statements, true in themselves but incomplete, turn those statements into misrepresentations" (*The Law of Contracts* (7th ed. 2017), at No. 441). Similarly, where a party makes a statement it believes to be true, but later circumstances affect the truth of that earlier statement, courts have found, in various contexts, that the party has an obligation to correct the misrepresentation (see *Xerex Exploration Ltd. v. Petro-Canada*, *2005 ABCA 224*, *47 Alta. L.R. (4th) 6*, at para. 58; see also C. Mummé, "*Bhasin v. Hrynew*: A New Era for Good Faith in Canadian Employment Law, or Just Tinkering at the Margins?" (2016), 32 *Intl J. Comp. Lab. L. & Ind. Rel.* 117, at p. 123).

90 These examples encourage the view that the requirements of honesty in performance can, and often do, go further than prohibiting outright lies. Indeed, the concept of "misleading" one's counterparty -- the term invoked separately by Cromwell J. -- will in some circumstances capture forms of silence or omissions. One can mislead through action, for example, by saying something directly to its counterparty, or through inaction, by failing to correct a misapprehension caused by one's own misleading conduct. To me these are close cousins in the catalogue of deceptive contractual practices (see, e.g., *Yam Seng Pte Ltd. v. International Trade Corp. Ltd.*, [2013] E.W.H.C. 111, [2013] 1 All E.R. (Comm.) 1321 (Q.B.), at para. 141).

91 At the end of the day, whether or not a party has "knowingly misled" its counterparty is a highly fact-specific determination, and can include lies, half-truths, omissions, and even silence, depending on the circumstances. I stress that this list is not closed; it merely exemplifies that dishonesty or misleading conduct is not confined to direct lies. No reviewable error has been shown in the finding of dishonesty that took place in anticipation of the exercise of clause 9 here. I would not interfere with the trial judge's view here on a matter that is owed deference. Deference should be shown to the trial judge in reviewing her discretionary exercise of weighing the evidence, especially given credibility played a part in her analysis, as she explained.

92 Reading the whole of the first instance judgment, I see no consequential error in the account given by the trial judge of the law on the duty of honest performance. She did not base her conclusions on some free-standing duty to disclose information. Instead, she examined whether Baycrest knowingly misled Callow as to the standing of the winter maintenance agreement, and thus wrongfully exercised its right of termination. Despite this, however, Baycrest argues that the trial judge erred in failing to recognize that its conduct did not reach the "much higher standard" spoken to in *Bhasin*. I disagree. No such error has been shown.

93 It is helpful for our purposes to recall that on the facts in *Bhasin*, part of the dishonest conduct concerned the respondent Can-Am's plans to reorganize its activities in Alberta. Its plan contemplated invoking its contractual right of non-renewal to force a merger between Mr. Bhasin and his competitor, Mr. Hrynew. In effect, this reorganization would have given Mr. Bhasin's business to Mr. Hrynew. Can-Am, however, had said nothing of its plan to Mr. Bhasin. When Mr. Bhasin first heard of the merger plans he questioned an official of Can-Am about its intentions. "[T]he official 'equivocated'", Cromwell J. explained, "and did not tell him the truth that from Can-Am's perspective

this was a 'done deal'" (para. 100). Cromwell J. later concluded that "Can-Am's breach of contract consisted of its failure to be honest with Mr. Bhasin about its contractual performance and, in particular, with respect to its settled intentions with respect to renewal" (para. 108). Cromwell J. wrote: "The trial judge made a clear finding of fact that Can-Am 'acted dishonestly toward Bhasin in exercising the non-renewal clause'. There is no basis to interfere with that finding on appeal. It follows that Can-Am breached its duty to perform the Agreement honestly" (para. 94 (references omitted)).

94 It is true that Baycrest remained silent about its decision to terminate Callow's contract and that clause 9, on its face, did not impose on it a duty to disclose its intention except for on the 10-day notice requirement. That said, it had to refrain, as the trial judge said, from "deceiv[ing] Callow" through a series of "active communications" (para. 66). When it failed to refrain from doing so in anticipation of exercising its termination right, it deceived Callow into thinking it would leave the existing winter services agreement intact.

95 These "active communications", as I understand the trial judge's findings of fact, came in two forms. First, Mr. Peixoto made statements to Mr. Callow suggesting that a renewal of the winter maintenance agreement was likely. As the trial judge found, "[a]fter his discussions with Mr. Peixoto and Mr. Campbell, Mr. Callow thought that he was likely to get a two-year renewal of his winter maintenance services contract and [it was] satisfied with his services [under the existing agreement which had one winter to run]. This assumption is also supported by the documentary evidence, especially by the private e-mails between Mr. Peixoto and Mr. Campbell" (para. 41).

96 Baycrest attempts to recast the significance of this finding, arguing that Mr. Callow only had casual discussions with two of the JUC members -- Mr. Peixoto and Mr. Campbell -- about the possibility of a contract renewal. Such casual discussions, it says, cannot rise to the level of a lie. This position ignores the key finding in the trial judge's reasons that it was Mr. Peixoto -- the JUC member who negotiated the main pricing terms with Callow for the winter maintenance agreement -- who made statements to Mr. Callow suggesting that a renewal was likely (paras. 23 and 40-43). After making credibility findings against Mr. Peixoto, the trial judge found that he had "led Mr. Callow to believe that all was fine with the winter [contract]" and that Baycrest was "interested in a future extension of Callow's contracts" (para. 47). This dishonesty did not take place in the abstract: the trial judge found it to be relevant to the exercise of clause 9.

97 The second form of "active communications" that deceived Callow was related to the "freebies" Callow had offered Baycrest in the summer of 2013. As the trial judge found, Callow performed this free work because Mr. Callow wanted to provide an incentive for Baycrest to renew the winter maintenance agreement. Baycrest, for its part, gladly accepted the services offered by Callow.

98 Again, Baycrest attempts to recast the significance of these findings, arguing that "there is nothing inherently unlawful or unfair about accepting a contractor's incentives offered in the hopes of securing a new contract or the renewal of an existing contract" (R.F., at para. 112). Whether or not that is the case, I again stress that Mr. Peixoto "understood that the work performed by Callow was a 'freebie' to add an incentive for the boards to renew his winter maintenance services contract" and "advised Mr. Callow that he would tell the other board members about this work" (trial reasons, at para. 43). These active communications by Baycrest suggested, deceptively, that there was hope for renewal and, perforce, the current contract would not be terminated.

99 Considering Baycrest's conduct as a whole over those few months, it was certainly reasonable for Mr. Callow, who was led to believe that a renewal was likely, to infer that Baycrest had not decided to terminate the ongoing contract. Moreover, Baycrest knew Mr. Callow was under this false impression, as shown by the email sent by Mr. Peixoto on July 17, 2013 and, nonetheless, continued to give him the impression that a renewal was likely even though the decision to terminate him was made (see trial reasons, at para. 48). Upon realizing that Mr. Callow was under this false impression, Baycrest should have corrected the misapprehension; in the circumstances, its conduct misled Callow.

100 I respectfully disagree with the idea that the deception in this case only concerned termination for unsatisfactory services and did not extend to termination for any other reason. The trial judge found that the

dishonest conduct involved representations that the contract was not in danger at all when Baycrest knew it would be terminated (para. 65).

101 The Court of Appeal did not interfere with these findings, nor has Baycrest argued that the trial judge made any palpable and overriding errors. Accordingly, in light of the trial judge's findings of fact, I agree that Baycrest intentionally withheld information in anticipation of exercising clause 9, knowing that such silence, when combined with its active communications, had deceived Callow. By failing to correct Mr. Callow's misapprehension thereafter, Baycrest breached its contractual duty of honest performance. This is in stark contrast to *United Roasters*, where the defendant merely withheld its decision to terminate the agreement. Unlike in this case, the defendant there did not engage in a series of acts that it knew would cause the plaintiff to draw an incorrect inference and then fail to correct the plaintiff's misapprehension.

102 In this sense, this case is broadly similar to *Dunning v. Royal Bank* *(1996), 23 C.C.E.L. (2d) 71* (Ont. C.J. (Gen. Div.)), one of the examples of breaches of the duty to exercise good faith in the manner of dismissal provided by Iacobucci J. in support of his conclusions in *Wallace*. While it was decided in the distinctive good faith setting of the employment context, *Dunning* is an appropriate analogy to the present case because in *Bhasin* Cromwell J. explicitly recognized that "the duty of honesty was a key component of the good faith requirements which have been recognized in relation to termination of employment contracts" (*Bhasin*, at para. 73, citing *Wallace*, at para. 98; *Honda Canada Inc. v. Keays*, *2008 SCC 39*, *[2008] 2 S.C.R. 362*, at para. 58). It seems to me that if the duty of honest performance was a key component of the good faith requirements spoken to in *Wallace* and *Keays*, a similar framework applies, again bound together through the organizing principle. As Iacobucci J. explained, the employee's job in *Dunning* had been eliminated, but the employer told him another position would probably be found for him and the new assignment would necessitate a transfer. While the employee was being reassured about his future, the employer was contemplating his termination. Eventually, the employer chose to terminate the employee but withheld that information from the employee for some time, despite knowing the employee was in the process of selling his home in anticipation of the transfer. News of the termination only came after the employee had sold his home. Such conduct, Iacobucci J. observed, clearly violated the expected standard of good faith in the manner of dismissal.

103 As *Dunning*, *Wallace* and *Keays* make plain, an employer has the right to terminate an employment contract without cause, subject to the duty to provide reasonable notice. However broad that right may be, however, an unhappy employee can allege a distinct contractual breach when the employer has mistreated them in the manner of dismissal. In the end, as Cromwell J. noted, "contracting parties must be able to rely on a minimum standard of honesty from their contracting partner in relation to performing the contract as a reassurance that if the contract does not work out, they will have a fair opportunity to protect their interests" (*Bhasin*, at para. 86). When Baycrest deliberately remained silent, while knowing that Mr. Callow had drawn the mistaken inference the contract was in good standing because it was likely to be renewed, it breached the duty to act honestly. In my view, the trial judge did not create a new duty of disclosure in correcting that wrong but rather sought to denounce the Baycrest's conduct. Remedying that with an order for damages to repair Baycrest's failure to exercise clause 9 in accordance with the requirements of the duty of honest performance did not confer a benefit on Callow; it merely set matters right on the usual measure of corrective justice following this breach of contract. Respectfully stated, it is therefore my view that the Court of Appeal erred in concluding that Baycrest's conduct was dishonourable but not dishonest.

104 I would note, however, that I do agree in part with the Court of Appeal's observation that the trial judge went too far in concluding that "[t]he minimum standard of honesty would have been to address the alleged performance issues, to provide prompt notice, or to refrain from any representations in anticipation of the notice period" (trial reasons, at para. 67). In my respectful view, to impute these first two requirements would amount to altering the bargain struck between the parties substantively, a conclusion not sought by Callow before this Court. That said, I agree with the trial judge that, at a minimum, Baycrest had to refrain from false representations in anticipation of the notice period. Having failed to correct Mr. Callow's misapprehension that arose due to these false representations, I too would recognize a contractual breach on the part of Baycrest in the exercise of its right of termination in clause 9. Damages thus flow for the consequential loss of opportunity, a matter to which I now turn.

C. *Damages*

105 Baycrest submits that Callow is not entitled to any damages for the breach. Baycrest argues that the trial judge erred in fixing the quantum of damages, first, by awarding Callow its expected profits over the full balance of the contract; second, by misapprehending the evidence relating to Callow's expenses; and, finally, by awarding both the loss of profit and the expenses incurred.

106 On the first point, I note that the trial judge correctly proceeded on the premise that, "[d]ue to the breach of contract, [Callow] is entitled to be placed in the same position as if the breach had not occurred" (para. 79). Indeed, as Cromwell J. explained in *Bhasin*, breach of the duty of honest contractual performance supports a claim for damages according to the ordinary contractual measure (para. 88).

107 The ordinary approach is to award contractual damages corresponding to the expectation interest (*Atlantic Lottery Corp. Inc. v. Babstock*, 2020 SCC 19, at para. 108). That is, damages should put Callow in the position that it would have been in had the duty been performed.

108 While it has rightly been observed that reliance damages and expectation damages will be the same in many if not most cases, they are nevertheless conceptually distinct. As Professor Stephen Smith wrote: "Defendants are ordered to do what they promised to do, not to do whatever is necessary to ensure the claimant is not harmed by relying on the promise" (*Atiyah's Introduction to the Law of Contract* (6th ed. 2006), at p. 405). Damages corresponding to the reliance interest are the ordinary measure of damages in tort (*PreMD Inc. v. Ogilvy Renault LLP*, 2013 ONCA 412, 309 O.A.C. 139, at para. 65). This measure may be appropriate where it would be difficult for the plaintiff to prove the position they would have been in had the contract been performed. Reliance damages in contract mean putting the injured party in the position it would have been in had it not entered into the contract at all (para. 66).

109 I see no basis to hold that a breach of the duty of honest performance should in general be compensated by way of reliance damages. I recall that the duty of honest performance is a doctrine of contract law. Its breach is not a tort. Not only would basing damages in this case on the reliance interest set this contractual breach apart from the ordinary measure of contractual damages, but it would depart from the measure as it was applied in *Bhasin* (para. 108; see also MacDougall, at s.1.130). In my respectful view, there is no basis to depart from *Bhasin* on this point which, in any event, was not argued by the parties. Further, I note that this view is shared by authors who have written that the duty of honest performance protects a party's expectation interest, rather than reliance interest (see, e.g., McCamus (2015), at pp. 112-13). Finally, while reliance damages and expectation damages coincide on the facts here, there is good reason to retain, in my view, the ordinarily applicable measure of contractual damages that seeks to provide the plaintiff with what they had expected. Professor Waddams has written that this can have a positive deterrent effect: "One of the legitimate arguments in favour of the current rule and against a rule measuring damages only by the plaintiff's reliance is that a rule protecting only reliance would fail to deter breach in a large number of cases where the defendant calculated that the plaintiff's provable losses were less tha[n] the cost of performance" ("Breach of Contract and the Concept of Wrongdoing" (2000), 12 S.C.L.R. (2d) 1, at pp. 18-19).

110 Baycrest nevertheless argues that the trial judge did not actually consider what position Callow would be in if it had fulfilled the duty and instead awarded the value of the balance of the winter maintenance agreement. In so doing, it argues, she fell into the same error as the trial judge in *Bhasin*, who simply awarded damages as though the contract had been renewed. Baycrest says that this Court has appropriately condemned this approach because the parties did not intend or presume a perpetual contract.

111 Moreover, Baycrest points to *Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303, for the proposition that damages are assessed by that mode of performance which is least burdensome to the defendant. Callow, it is said, is entitled to no more than the minimum that Baycrest was obligated to do pursuant to the contract. Since clause 9 allowed it to terminate the winter maintenance agreement at any point on 10 days' notice, no damages should flow.

112 In my view, *Hamilton* is of no assistance to Baycrest in this case. While Cromwell J. referenced this principle in *Bhasin*, he did so in the context of whether the Court should recognize a broad, free-standing duty of good faith, for which the appellant there had argued. Briefly stated, the appellant's position was that the respondent, Can-Am, would have been in breach of such a duty since it had attempted to use the non-renewal clause to force Mr. Bhasin into a merger. Cromwell J. declined to recognize such a broad duty, reasoning that "Can-Am's contractual liability would still have to be measured by reference to the least onerous means of performance, which in this case would have meant simply not renewing the contract" (*Bhasin*, at para. 90; see also J. D. McCamus, *The Law of Contracts* (3rd ed. 2020), at pp. 23-25). Because no damages would have flowed from this breach, it was unnecessary for the Court to decide whether a broad, free-standing duty of good faith should be recognized.

113 It bears emphasizing that, despite Cromwell J.'s comments related to *Hamilton*, he nonetheless awarded damages to the appellant flowing from the breach of the respondents' obligation to perform the contract honestly. Damages were awarded using the ordinary measure of contractual expectation damages, namely to put Mr. Bhasin in the position he would have been in had Can-Am not breached its obligation to behave honestly in the exercise of the non-renewal clause (*Bhasin*, at paras. 88 and 108). This resulted in Mr. Bhasin being compensated for the value of his business that eroded (paras. 108-10). As Professors O'Byrne and Cohen helpfully explain, "if Can-Am had dealt with Bhasin honestly on all fronts (though without requiring it to disclose its intention not to renew), Bhasin would have realized much sooner that his relationship with Can-Am was in tremendous jeopardy and reaching a breaking point. He could have taken proactive steps to protect his business, instead of seeing it 'in effect, expropriated and turned over to Mr. Hrynew'" ("The Contractual Principle of Good Faith and the Duty of Honesty in *Bhasin v. Hrynew*" (2015), 53 Alta. L.R. 1, at p. 8 (footnotes omitted)).

114 How is it that damages were awarded for a breach of the duty of honest performance despite the principle outlined in *Hamilton*? While damages are to be measured against a defendant's least onerous means of performance, the least onerous means of performance in this case would have been to correct the misrepresentation once Baycrest knew Callow had drawn a false inference. Had it done so, Callow would have had the opportunity to secure another contract for the upcoming winter. As Callow explained at the hearing, "since this dishonesty caused Callow a loss by inducing it not to bid on other contracts during the summer of 2013 for the winter of 2013 to 2014, the condos are liable to it for damages" (transcript, at p. 5), which reflect its lost opportunity arising out of its abuse of clause 9.

115 It may be true that the trial judge could have explained her rationale for awarding damages more plainly. But even if the trial judge fell into the same error that the trial judge in *Bhasin* committed, so as to award damages as though the contract had carried on, it was one of no consequence.

116 As the trial judge found, Baycrest "failed to provide a fair opportunity for [Callow] to protect its interests" (para. 67). Had Baycrest acted honestly in exercising its right of termination, and thus corrected Mr. Callow's false impression, Callow would have taken proactive steps to bid on other contracts for the upcoming winter (A.F., at paras. 91-95). Indeed, there was ample evidence before the trial judge that Callow had opportunities to bid on other winter maintenance contracts in the summer of 2013, but chose to forego those opportunities due to Mr. Callow's misapprehension as to the status of the contract with Baycrest. In any event, even if I were to conclude that the trial judge did not make an explicit finding as to whether Callow lost an opportunity, it may be presumed as a matter of law that it did, since it was Baycrest's own dishonesty that now precludes Callow from conclusively proving what would have happened if Baycrest had been honest (see *Lamb v. Kincaid* *(1907), 38 S.C.R. 516*, at pp. 539-40).

117 In the result, I see no palpable and overriding error. I am satisfied that, if Baycrest's dishonesty had not deprived Callow of the opportunity to bid on other contracts, then Callow would have made an amount that was at least equal to the profit it lost under the winter maintenance agreement. The trial judge found that, once expenses are deducted, that award amounts to $64,306.96. I see no reason to interfere with her fact finding as to the estimation of expenses. Consequently, I see no basis for overturning this portion of the trial judge's award of damages.

118 The trial judge also awarded Callow $14,835.14, representing the cost of leasing a piece of machinery for one year. Mr. Callow testified that he had leased the machinery specifically for the winter maintenance agreement, but would not have had he known the contract would be terminated (para. 81). Baycrest submits that the trial judge erred by awarding these expenses because it amounts to double recovery.

119 I see no issue of double recovery in this case. The trial judge awarded the $64,306.96 as lost profit, not lost revenue. This is appropriate because Callow was not actually hired for the other contract on which it did not bid and therefore did not necessarily have to undertake all the expenses that would have been required to fulfill that contract. However, as Callow had already committed to this expense, the lease of the machinery, it too should be compensated for along with the lost profit. The trial judge was entitled to decide this point as she did, having the advantage of measuring losses first hand. I see no reviewable error in the trial judge's approach on this issue.

V. Disposition

120 I would allow the appeal, set aside the order of the Court of Appeal and reinstate the judgment of the trial judge, with costs throughout.

The reasons of Moldaver, Brown and Rowe JJ. were delivered by

R. BROWN J.

I. Introduction

121 This appeal invites us to affirm the scope and operation of the duty of honest performance, recognized in *Bhasin v. Hrynew*, *2014 SCC 71*, *[2014] 3 S.C.R. 494*, by clarifying the distinction between actively misleading conduct and innocent non-disclosure. Applying that distinction to the facts of this appeal, is a straightforward matter. As the trial judge found, the respondents (collectively, "Baycrest") represented to Callow (referring interchangeably in these reasons to the appellant and its principal) that its contract would not be terminated (*2017 ONSC 7095*). By relying on Baycrest's representations, Callow lost the opportunity to secure other work for the contract's term. Callow's complaint therefore does not relate to Baycrest's *silence* but rather to its positive representations, which can clearly ground a claim based on the duty of honest performance.

122 Given that Baycrest did not identify any palpable and overriding errors in the trial judge's findings, I agree with the majority that the appeal should be allowed and the trial judge's award restored. Regrettably, however, I am compelled to express my respectful objection to the majority's view that the doctrine of abuse of right in the civil law of Quebec is "useful" and "helpful" in understanding the application of *Bhasin* to this appeal (para. 57). Again respectfully, I see this digression as neither "useful" nor "helpful" to the judges and lawyers who must try to understand the common law principles of good faith as developed in this judgment. Indeed, it will only inject uncertainty and confusion into the law.

123 This is not to suggest that comparative legal analysis is not an important tool or that its use should somehow be unduly limited at this Court. As the majority's reasons amply document, the Court has a longstanding tradition of looking to Quebec's civil law in developing the common law ? whether to answer a question that the common law does not answer (that is, to fill a "gap") or where it is necessary to modify or otherwise develop existing rules. In addition, where concerns are raised about the effects of moving the common law in one direction or another, this Court has considered the experience in Quebec and elsewhere, often for reassurance that the posited concerns are unfounded or overstated. What this Court has refrained from doing, however, is deploying comparative legal analysis that serves none of these purposes or, even worse, renders the law obscure to those who must know and

apply it. But by invoking the civilian abuse of right framework to clarify when "[d]ishonesty is directly linked to the performance of a given contract" (para. 73) -- a question requiring no "clarification" -- the majority does exactly that.

124 While, therefore, my objection is fundamentally methodological, it also speaks to the substantive consequences that follow. As the majority acknowledges, this appeal concerns the duty of honest performance, not the duty to exercise discretionary powers in good faith. And yet, its digression into the notion of "wrongful exercise of a right", in substance, pulls it into that very territory, since it ties *dishonesty* to *the manner in which contractual discretion is exercised*. Effectively, then, the majority's reliance on a civil law concept leads it to conflate, or at least obscure the distinction between what are distinct common law concepts. This is both unnecessary and undesirable, since the exercise of discretion ? apart from being a matter of performance that may be misrepresented ? has little to do with the duty of honest performance. Rather, the duty to exercise discretionary powers in good faith ? or, expressed with the civilian terminology the majority adds, in a manner that is not "abusive" or "wrongful" ? is a distinct concept that has no application to this appeal.

125 Our aim in deciding this appeal should be to develop the common law's organizing principle of good faith carefully, and in a coherent manner, and more particularly in a manner that gives clear guidance by taking care to distinguish among the distinct doctrines identified by this Court in *Bhasin*. Respectfully, I say that the majority has not done so here.

II. Background

126 Baycrest comprises ten condominium corporations with shared assets, for which decisions are made by a Joint Use Committee. In April 2012, Baycrest entered into two separate two-year agreements with Callow to provide summer landscaping and winter snow removal services. The terms of the winter service agreement stipulated that Baycrest could terminate the agreement, without cause, upon giving 10 days' notice.

127 In March or April 2013, the Joint Use Committee voted to terminate the winter service agreement earlier than its scheduled expiry in April 2014. Baycrest opted not to tell Callow about its decision until September 2013, however, so as not to jeopardize his performance under the summer service agreement. Unaware of Baycrest's decision, Callow performed free work for Baycrest in the spring and summer of 2013 in the hope that Baycrest would renew both agreements. Callow also discussed the prospect of renewal with two Baycrest representatives, one of whom had negotiated Callow's existing agreements in 2012. These discussions led him to believe that he was likely to receive a two-year contract renewal in 2014 and, therefore, that the winter service agreement was not in danger. Knowing that Callow was operating under this misapprehension, Baycrest nevertheless continued to withhold information about its termination decision.

128 On September 12, 2013, Baycrest gave Callow notice that it was terminating the winter service agreement. Callow sued, claiming that Baycrest failed to perform the winter service agreement in good faith and was therefore liable for breach of contract. The trial judge held that Baycrest breached the duty of honest performance. She found that Baycrest's statements and conduct actively deceived Callow and led him to believe that the winter service contract would not be terminated. As a result, she awarded damages to place Callow in the position that it would have been in had the contract not been terminated. The Court of Appeal for Ontario reversed, stating that the duty of honest performance does not impose a requirement of disclosure (*2018 ONCA 896*, *429 D.L.R. (4th) 704*). In its view, even if Baycrest had misled Callow, Callow bargained only for 10 days' notice of termination and that was the extent of its entitlement.

III. Analysis

A. *This Case Can Be Readily Decided by Applying the Common Law Principle of Good Faith*

129 Disposing of this case is really a simple matter of applying this Court's decision in *Bhasin*. The first step in deciding a common law good faith claim is to consider whether any established good faith doctrines apply. Callow bases its claim on two established doctrines: the duty of honest performance and the duty to exercise discretionary

powers in good faith. As I will explain, however, Callow's claim should be resolved by applying only the duty of honest performance.

(1) The Duty of Honest Performance

130 As a universally applicable minimum standard, all contracts must be performed honestly. Contracting parties may therefore not lie to, or otherwise knowingly mislead, each other about matters directly linked to performance (*Bhasin*, at paras. 73-74). If a plaintiff suffers loss in reliance on its counterparty's misleading conduct, the duty of honest performance serves to make the plaintiff whole. The duty of honest performance does not, however, "impose a duty of loyalty or of disclosure or require a party to forego advantages flowing from the contract" (*Bhasin*, at para. 73).

131 The dividing line between (1) actively misleading conduct, and (2) permissible non-disclosure, is the central issue in this appeal. As that line has been clearly demarcated by cases addressing misrepresentation in other contexts, it is in my view worth affirming here that the same settled principles apply to the duty of honest performance. The duty of honest performance is, after all, broadly comparable to the doctrine of fraudulent misrepresentation, although it applies (unlike misrepresentation) to representations made *after* contract formation (B. MacDougall, *Misrepresentation* (2016), at pp. 63-64). It follows that those representations sufficient to ground a claim for misrepresentation are analogous to the representations that will support a claim based on the duty of honest performance.

132 The general rule, applicable to contracts other than those requiring utmost good faith, is that contracting parties have no duty to disclose material information (*Bhasin*, at paras. 73 and 86). Mere silence therefore cannot be considered actively misleading conduct (*Alevizos v. Nirula*, *2003 MBCA 148*, *180 Man. R. (2d) 186*, at para. 19). In some cases, however, silence on a particular topic is misleading in light of what *has* been said (*Xerex Exploration Ltd. v. Petro-Canada*, *2005 ABCA 224*, *47 Alta. L.R. (4th) 6*, at para. 56, citing *Opron Construction Co. v. Alberta (1994), 151 A.R. 241* (Q.B.)). Again, no wheels need re-inventing here. There is, in the context of misrepresentation, "a rich law accepting that sometimes silence or half-truths amount to a statement" (MacDougall, at p. 67; see also A. Swan, "The Obligation to Perform in Good Faith: Comment on *Bhasin v. Hrynew*" (2015), 56 *Can. Bus. L.J.* 395, at p. 402). A contracting party therefore may not create a misleading picture about its contractual performance by relying on half-truths or partial disclosure (*Peek v. Gurney* (1873), L.R. 6 H.L. 377; *Alevizos*, at paras. 24-25; *Xerex*, at paras. 56-57). And contracting parties are required to correct representations that are subsequently rendered false, or which the representor later discovers were erroneous (*Xerex*, at para. 58; MacDougall, at pp. 118-19).

133 Further, the representation need not take the form of an express statement. So long as it is clearly communicated, it may comprise other acts or conduct on the part of the defendant (MacDougall, at p. 87). The question is whether the defendant's active conduct contributed to a misapprehension that could be corrected only by disclosing additional information. If so, the defendant must make that disclosure. Conversely, a contracting party is not required to correct a misapprehension to which it has not contributed (T. Buckwold, "The Enforceability of Agreements to Negotiate in Good Faith: The Impact of *Bhasin v. Hrynew* and the Organizing Principle of Good Faith in Common Law Canada" (2016), 58 *Can. Bus. L.J.* 1, at p. 13). The entire context, which includes the nature of the parties' relationship, is to be considered in determining, objectively, whether the defendant made a misrepresentation to the plaintiff (MacDougall, at p. 102; see, e.g., *Outaouais Synergest Inc. v. Lang Michener LLP*, *2013 ONCA 526*, *116 O.R. (3d) 742*, at paras. 84-87; *C.R.F. Holdings Ltd. v. Fundy Chemical International Ltd. (1981), 33 B.C.L.R. 291* (C.A.), at p. 296). It follows that the question of whether a misrepresentation has been made is a question of mixed fact and law, subject to appellate review only for palpable and overriding error.

134 In light of these principles ? which, again, are well established and require nothing more than a statement by this Court of their application to the duty of honest performance ? I cannot accept Baycrest's argument that its conduct fell on the side of innocent non-disclosure. Indeed, the trial judge found that "active communications between the parties between March/April and September 12, 2013 ... deceived Callow" (para. 66 (CanLII)). Based

on Baycrest's conduct and express statements, the trial judge found that Baycrest had represented that the winter service agreement was not in danger of termination (paras. 65 and 76). Further, the trial judge found that Baycrest knew that its representations were misleading and nonetheless expressed its intention of keeping Callow in the dark (paras. 48 and 69). These findings are sufficient to support the conclusion that Baycrest breached the duty of honest performance. And Baycrest identifies no palpable and overriding error to justify overturning them.

135 Nor do I accept Baycrest's argument that its representations related only to the renewal of a new winter agreement and not to the termination of Callow's existing agreement. As I have explained, whether Baycrest made an actionable representation about its performance must be determined in context, which included its conduct as I have described it. And it was open to the trial judge to conclude from that conduct that Callow reasonably inferred that the winter service agreement would not be terminated (see, e.g., *Queen v. Cognos Inc.*, [1993] 1 S.C.R. 87, at pp. 128-32). Again, I see no basis for disturbing the trial judge's conclusion.

(2) The Duty to Exercise Discretionary Powers in Good Faith

136 Callow also argues that Baycrest's decision to terminate the winter service agreement was a discretionary decision that it was required to make in good faith. He relies on the good faith duty that arises "where one party exercises a discretionary power under the contract", and which was affirmed by this Court in *Bhasin* (para. 47). As a preliminary matter, I note that not every decision that involves a degree of discretion is subject to this duty (*Bhasin*, at para. 72; J. T. Robertson, "Good Faith as an Organizing Principle in Contract Law: *Bhasin v Hrynew* ? Two Steps Forward and One Look Back" (2015), 93 *Can. Bar Rev.* 809, at p. 859). The extent to which it applies to unfettered termination rights remains unsettled, and I do not purport to resolve that controversy here (*Styles v. Alberta Investment Management Corp.*, 2017 ABCA 1, 44 Alta. L.R. (6th) 214, at para. 41; *Mohamed v. Information Systems Architects Inc.*, 2018 ONCA 428, 423 D.L.R. (4th) 174, at para. 19).

137 This duty limits the exercise of certain contractual powers that may appear to grant one party unfettered discretion. For the purposes of this appeal, it is unnecessary to express a firm view on the standard that applies to a breach of this duty. It is sufficient to note that where a plaintiff relies on this duty, its complaint is *not* about dishonesty; rather, it is that the defendant was not entitled to make the decision that it made. The wrongful behavior is the very exercise of discretion, and the plaintiff therefore basis its claim on the *effect* of that decision (see, e.g., *Greenberg v. Meffert* (1985), 50 O.R. (2d) 755 (C.A.); *Mesa Operating Ltd. Partnership v. Amoco Canada Resources Ltd.* (1994), 19 Alta. L.R. (3d) 38 (C.A.)). Damages are awarded based on the difference between the outcome that occurred and the outcome that would have occurred if the defendant had exercised its discretion in the least onerous, yet lawfully acceptable, manner.

138 Callow, however, does not dispute that Baycrest was entitled to terminate the winter service agreement, as it did, without cause and by providing only 10 days' notice. Rather, Callow impugns *the dishonesty* that *preceded* Baycrest's exercise of discretion. Callow therefore seeks damages measured by considering what would have happened had Baycrest made the same decision, albeit without misrepresenting its intentions. The applicable duty is therefore the duty of honest performance. In sum, the appeal at bar presents a case about dishonesty in the performance of a contract, and nothing more. Indeed, it represents *precisely* the sort of instance contemplated by Cromwell J.'s reference for this Court in *Bhasin*, at para. 73, to circumstances where a party "lie[s] or mislead[s] the other party about one's contractual performance". Conversely, it is *not* a case about the exercise of a discretionary power.

(3) Damages

139 Having concluded that Baycrest breached the duty of honest performance, the remaining issue is whether the trial judge awarded the appropriate quantum of damages. While I reach the same result as the majority, I approach this question somewhat differently than it does. The majority would retain the expectation measure of damages for breach of the duty of honest performance. I say, however, that it follows from recognizing Baycrest's misleading conduct as a wrong independent of the termination provision that the proper measure of damages represents the

loss Callow suffered in reliance on Baycrest's misleading representations (which I accept will often coincide with the expectation measure).

140 The majority relies on Cromwell J.'s statement in *Bhasin* that a breach of the duty of honest contractual performance "supports a claim for damages according to the contractual rather than the tortious measure" (para. 88). But when the purpose of the expectation measure of damages for breach of contract is examined and contrasted with the legal framework developed in *Bhasin*, the actual claim in *Bhasin* and the damages actually received, it becomes readily apparent that the reliance measure is precisely the measure that the *Bhasin* framework contemplates should be awarded. On this point, the majority's reasons represent *not* fidelity to *Bhasin*, but a regrettable departure that undermines the coherence between the interests sought to be protected in *Bhasin* and the remedy to be awarded.

141 It has "long been settled and [is] indeed axiomatic" that the legal aim in remedying a breach of contract is to give the innocent party the full benefit of the bargain by placing it in the position it would have occupied had the contract been performed (P. Benson, *Justice in Transactions* (2019), at p. 5; see also *Fidler v. Sun Life Assurance Co. of Canada*, 2006 SCC 30, [2006] 2 S.C.R. 3, at para. 27). Awarding a reliance measure ? that is, compensating for losses sustained by the innocent party in reliance on the contract ? would ignore the innocent party's right to performance that flows from its having pledged consideration therefor, thereby potentially depriving it of the benefit of the contract. Indeed, confining recovery to losses sustained in reliance on the agreement would create an incentive to breach agreements where the cost of performance outweighs the reliance measure of damage (S. M. Waddams, *The Law of Contracts* (7th ed. 2017), at para. 704; see also L. L. Fuller and W. R. Perdue Jr., "The Reliance Interest in Contract Damages" (1936), 46 Yale L.J. 52, at pp. 57-66).

142 But the justification for awarding expectation damages does not apply to breach of the duty of honest performance. In such cases, the issue is *not* that the defendant has failed to perform the contract, thereby defeating the plaintiff's expectations. It is, rather, that the defendant *has* performed the contract, but has also caused the plaintiff loss by making dishonest extra-contractual misrepresentations concerning that performance, *upon which the plaintiff relied* to its detriment. In short, the plaintiff's complaint is not lost value of performance, but detrimental reliance on dishonest misrepresentations. The interest being protected is not an expectation interest, but a reliance interest. And just as these are unrelated interests, an expectation measure of damage is unrelated to the breach of the duty of honest performance.

143 The claim in *Bhasin* itself is illustrative. Bhasin contracted to sell financial products for Can-Am. The contract would renew automatically at the end of the initial term unless one of the parties gave six months' notice of non-renewal. Can-Am intended to force a takeover of Bhasin's business by his competitor, Hrynew, but misled him about its intention to do so. Can-Am also appointed Hrynew to audit Bhasin's business. When Bhasin protested this conflict of interest, Can-Am lied to him about the reason for Hrynew's appointment as auditor and the terms that would govern his access to Bhasin's confidential information. Ultimately, when Can-Am gave notice of non-renewal, Bhasin lost the value of his business. This Court found that, but for Can-Am's dishonesty in the period leading up to the non-renewal, he "would have been able to retain the value of his business rather than see it, in effect, expropriated and turned over to Mr. Hrynew" (para. 109). It awarded damages to compensate for the lost value of the business.

144 Neither the claim, then, nor the damage award, related to Can-Am's failure to perform the contract with Bhasin. The theory of the judgment was that Bhasin lost the value of his business by relying on Can-Am's dishonest representations. The relief actually awarded was therefore measured by the difference between Bhasin's position and the position he would have occupied had Can-Am not been dishonest about its intention to force a takeover by way of cancelling his contract. Had Bhasin not relied on Can-Am's dishonesty, no damages could have been awarded on this basis, because the dishonesty would not have altered his position.

145 The measure applied in *Bhasin* was, therefore, clearly not based on expected performance, and indeed it appears to have had nothing to do with placing Bhasin in the position he would have occupied had the contract been performed (K. Maharaj, "An Action on the Equities: Re-Characterizing *Bhasin* as Equitable Estoppel" (2017),

55 Alta. L. Rev. 199, at p. 215). Rather, it was directed solely towards making good the detriment that flowed from Bhasin's reliance on a dishonest misrepresentation -- a measure characterized by one scholar as "very tort-like" (MacDougall, at p. 65). Much like estoppel and civil fraud, therefore, the duty of honest performance vindicates the plaintiff's *reliance* interest (Robertson, at p. 861; Maharaj, at pp. 215-18). A contracting party that breaches this duty will be liable to compensate its counterparty for any foreseeable losses suffered *in reliance* on the misleading representations.

146 This is not to suggest that the duty of honest performance is "subsumed" by estoppel and civil fraud (Kasirer J.'s reasons, at para. 50). Rather, it is merely to observe that each of these legal devices protects the same interest. Indeed, far from being "subsumed" into estoppel and civil fraud, the duty of honest performance protects the reliance interest in a distinct and broader manner since, as this Court observed in *Bhasin*, the defendant may be held liable even where it does not *intend* for the plaintiff to rely on the misleading representation (para. 88). Irrespective of the defendant's intention, all a plaintiff need show is that, but for its reliance on the misleading representation, it would not have sustained the loss.

147 Baycrest advances three arguments for reducing the trial award. First, it says that the ten day notice period defines its maximum exposure for damages because, irrespective of its dishonesty, its least onerous means of performance was to terminate the agreement. The trial judge therefore incorrectly awarded damages as if the winter contract had not been terminated.

148 While Baycrest is correct to say that damages for breach of contract are measured against the defendant's least onerous means of performance (*Hamilton v. Open Window Bakery Ltd.*, 2004 SCC 9, [2004] 1 S.C.R. 303, at para. 20), that principle does not assist Baycrest here. To perform the contract *honestly* (that is, without breaching the duty of honest performance), Baycrest was required *not to mislead* Callow about whether the contract would be terminated. It could have accomplished this by keeping silent about termination or, having misled Callow as to the true state of affairs, by correcting Callow's misapprehension before he relied on the misleading conduct to his detriment. Had either of these possibilities occurred, Callow would have been able to seek other work for the 2013-14 winter season.

149 Of course, we cannot say with certainty that Callow *would have secured* other work. He might have sat idle in any event, assuming that the winter service contract was in good standing. But this evidentiary difficulty is the product of Baycrest's dishonesty, and Baycrest should not be relieved from liability simply because Callow cannot definitively prove what would have occurred had it not been misled (*Wood v. Grand Valley Rway. Co.* (1915), 51 S.C.R. 283, at pp. 288-91; see also *Lamb v. Kincaid* (1907), 38 S.C.R. 516, at pp. 539-40). Callow gave evidence that it typically bid on winter contracts during the summer months and that it was too late to find replacement work by the time it was notified of termination. I agree with the majority that, based on the record, we can reasonably presume that Callow would have been able to replace the winter service agreement with a contract of similar value. While the trial judge erred by awarding damages as if the winter service agreement had not been terminated, I would, based on this presumption, award the same quantum of damages.

150 Secondly, Baycrest says that the trial judge's award led to double recovery for Callow's expenses. But this is simply incorrect. The trial judge awarded Callow the *net* value of the winter service agreement ($64,306.96) ? representing the gross contract value ($80,383.70) less Callow's expenses, which the trial judge approximated at 20 percent ($16,076.74). She then added back the cost of an equipment lease, which Callow had already entered into in reliance on Baycrest's misleading representations. Though the trial judge did not say so expressly, the record shows that Callow's approximated expenses included the cost of leasing equipment. If Callow is not reimbursed for the leasing expenses that he incurred in reliance on Baycrest's misleading representations, those expenses would therefore be counted against him twice. Absent Baycrest's breach of contract, Callow would have obtained a similarly valued contract and ended the 2013-14 winter season with $64,306.96 in profit. The trial judge's approach ensured that Callow was restored to this position, and, accordingly, I see no basis for overturning this aspect of her award.

151 Finally, Baycrest argues that the trial judge misapprehended the evidence relating to Callow's expenses. I am

not convinced, however, that the trial judge did anything other than estimate Callow's expenses at 20 percent of the winter service contract's value, based on evidence that Callow gave regarding its expenses in previous years. Estimating the expenses was a decision that fell within the trial judge's remit as a fact-finder and should not be disturbed on appeal. Indeed, it is difficult to imagine how the trial judge could have proceeded differently, given that the winter services agreement was never performed and that we therefore cannot say with certainty what Callow's expenses would have been.

B. *"Abuse of Right", "Wrongful Exercise of a Right", and Comparative Analysis of Good Faith in the Law of Contract*

152 With the exception of my discussion regarding damages, most of the foregoing is consistent, or at least not inconsistent, with the majority's reasons, and is sufficient to dispose of this appeal. But while acknowledging this (at para. 44: "the duty to act honestly about matters directly linked to the performance of the contract ... is sufficient to dispose of this appeal"; "[n]o expansion of the law set forth in *Bhasin* is necessary to find in favour of Callow"), the majority nonetheless proceeds to delve into matters beyond the duty to act honestly. And in so doing, it does indeed expand upon (and, I say, confuse) the law set forth in *Bhasin*.

153 More particularly, the majority says that this appeal presents an opportunity to resolve two issues: first, "what constitutes a breach of the duty of honest performance where it manifests itself in connection with the exercise of a seemingly unfettered, unilateral termination clause" (para. 30); and secondly, "when dishonesty is directly linked to the performance of a contract" (para. 64). These questions lead the majority to focus on whether the exercise of the termination provision was *itself* dishonest. It explains:

> ... the duty of honesty as contractual doctrine has a limiting function on the exercise of an otherwise complete and clear right ... . This means, simply, that instead of constraining the decision to terminate in and of itself, the duty of honest performance attracts damages where the manner in which the right was exercised was dishonest. [para. 53]

The majority finds support for this approach in Quebec civil law. Specifically, it contends that the "required direct link between dishonesty and performance" is "made plain" by considering "how the framework for abuse of rights in Quebec connects the manner in which a contractual right is exercised to the requirements of good faith" (para. 67). It states that arts. 6, 7 and 1375 of the *Civil Code of Québec* "point to this connection by providing that no contractual right may be exercised abusively without violating the requirements of good faith" (para. 67).

154 Both as a substantive and methodological matter, I cannot endorse this. First, in the circumstances of this particular appeal, the majority's resort to the civil law as a "source of inspiration" (para. 60) is inappropriate. As the majority acknowledges, the issues to which its analysis responds are fully addressed by *Bhasin* itself, and there is no indication that the principles outlined therein require further elaboration. Secondly, and relatedly, the majority's focus on the wrongful exercise of a right distorts the analysis mandated by *Bhasin* and undermines the independent character of the various common law good faith duties identified therein.

(1) Comparative Analysis

155 The majority draws on the civilian concept of abuse of rights "as a framework to understand the common law duty of honest performance" (para. 73). Specifically, it finds that this framework "helps to focus the analysis of whether the common law duty of honest performance has been breached on what might be called the wrongful exercise of a contractual right" (para. 63).

156 In considering the utility of the comparative exercise that the majority proposes, it must be borne in mind that the common law principles applicable to this appeal are both determinative and settled. Drawing from civil law in these circumstances departs from this Court's accepted practice in respect of comparative legal analysis. Rather than permissibly drawing inspiration or comfort from the civil law in filling a gap in the common law or in modifying it,

the majority's approach, I say respectfully, risks subsuming the common law's already-established and distinct conception of good faith into the civil law's conception. And to the extent it does so, it confuses matters significantly, the majority's assurances to the contrary notwithstanding.

157 As Moldaver J. observed (in dissent, but not on this point) in *Reference re Supreme Court Act, ss. 5 and 6*, *2014 SCC 21*, *[2014] 1 S.C.R. 433*, at para. 113 (emphasis added), "[t]he coexistence of two distinct legal systems in Canada -- the civil law system in Quebec and the common law system elsewhere -- is a unique and defining characteristic of our country." The distinct common law and civil law traditions represent an integral component of Canadian legal heritage and identity (Hon. M. Bastarache, "Bijuralism in Canada", in *Bijuralism and Harmonization: Genesis* (2001), at p. 26; see also M. Samson, "Le droit civil québécois: exemple d'un droit à porosité variable" (2018-19), 50 Ottawa L. Rev. 257, at p. 257).

158 Preserving this unique aspect of Canada's identity requires maintaining the distinct features of both the common law and civil law traditions. Indeed, this Court has gone so far as to describe its own composition as having been designed to ensure "that the common law and the civil law would evolve side by side, while each maintained its distinctive character" (*Reference re Supreme Court Act*, at para. 85 (emphasis added)). It follows that, just as this Court decided in *Reference re Supreme Court Act* that the presence on this Court of at least three judges from Quebec "ensur[es] civil law expertise and the representation of Quebec's legal traditions", the integrity and distinct character of the common law is also ensured by the presence of judges from Canada's common law jurisdictions.

159 It also follows from the distinct nature of Canada's two legal traditions that drawing from one tradition to influence the other is simply an exercise in comparative legal analysis (*Caisse populaire des Deux Rives v. Société mutuelle d'assurance contre l'incendie de la Vallée du Richelieu*, *[1990] 2 S.C.R. 995*, at p. 1016). As I have already recounted, this is what the majority claims it is doing here. But while comparison is an important tool, its uses are not unlimited. In particular, comparative analysis, in the sense of using law from another legal system to elucidate or develop the domestic legal system, is generally appropriate only where domestic law does not provide an answer to the problem facing the court, or where it is necessary to otherwise develop that law. Using law from other systems in other circumstances would either be superfluous, or would (to the extent of its use) have the undesirable effect of displacing established domestic jurisprudence (J.-L. Baudouin, "L'interprétation du Code civil québécois par la Cour suprême du Canada" (1975), 53 *Can. Bar Rev.* 715, at pp. 725-27; see also K. Zweigert and H. Kötz, *Introduction to Comparative Law* (3rd rev. ed. 1998), at pp. 17-18; T. Lundmark, *Charting the Divide between Common and Civil Law* (2012), at pp. 8-10). As Justice Sharpe writes extra-judicially about the use of authority generally, which applies equally to comparative legal analysis, "[i]t is only where the case cannot readily be decided on the basis of binding authority that non-binding sources will have a material effect on the decision" (*Good Judgment: Making Judicial Decisions* (2018), at p. 171).

160 These sources are not expressions of jurisdictional chauvinism. Rather, they express a posture of prudence and disciplined restraint in the deployment of comparative analysis in judgments. And for good reason. Seeking inspiration from external sources when it is unnecessary to do so may simply complicate a straightforward subject, thereby introducing uncertainty to a previously settled area of law (*Gilles E. Néron Communication Marketing Inc. v. Chambre des notaires du Québec*, *2004 SCC 53*, *[2004] 3 S.C.R. 95*, at para. 56, citing J.-L. Baudouin and P. Deslauriers, *La responsabilité civile* (6th ed. 2003), at p. 193). Even something as seemingly innocuous as changing the terminology used to describe a concept ? for example, the majority's reliance on the civil law device of abuse of right and references to the wrongful exercise of a right ? can have substantive legal implications, affecting the coherence and stability of the resulting modified legal system. Language itself, after all, plays "a crucial role in the evolution of the law" (Bastarache, at p. 20; see also Lundmark, at pp. 74-86).

161 This is not mere conjecture. The seemingly benign injection of civil law terminology into common law judgments has previously generated precisely that kind of instability. Substantial confusion in the common law of unjust enrichment arose in Canada in the 1970s from the introduction of civil law terminology of "absence of juristic reasons for an enrichment" as if it were synonymous with the traditional requirement of "unjust factors" that had been "deeply ingrained" since Lord Mansfield's judgment in *Moses v. Macferlan* (1760), 2 Burr. 1005, 97 E.R. 676

(K.B.) (M. McInnes, "The Reason to Reverse: Unjust Factors and Juristic Reasons" (2012), 92 B.U.L. Rev. 1049, at pp. 1052 and 1054). As Professor McInnes explains:

> ... without discussion or explanation, the Supreme Court of Canada began to use the civilian terminology (i.e., "absence of juristic reason for the enrichment") while continuing to apply the traditional unjust factors. Predictably, the Canadian law of unjust enrichment grew ever more confused as the court said one thing and did another. [Footnotes omitted; p. 1056.]

162 The result was, to put it mildly, destabilizing. And predictably so. While Western legal systems are called upon to address the same kinds of disputes, each has developed different ways over the centuries to resolve them. The result is like two massive jigsaw puzzles that cover the same amount of ground. From a distance, each looks much the same as the other, but up close, it becomes apparent that the pieces are cut differently so that pieces from one cannot fit (or at least fit easily) into the other. And so it was when "juristic reasons" began to be spoken of in the Canadian common law of unjust enrichment. Conflicting lines of authorities continued to apply the common law requirement of unjust factors, while in other decisions courts ascribed legal significance to the introduction of civilian language ? that is, they "took the civilian language at face value and ordered restoration when defendants could not justify the retention of their enrichments" (McInnes, at p. 1056 (footnote omitted)). In the end, this Court had to settle the question in *Garland v. Consumers' Gas Co.*, 2004 SCC 25, [2004] 1 S.C.R. 629, which it did by clarifying that the civilian terminology of "juristic reasons" applies. But coming even several decades after the uncertainty arose, we must acknowledge that this confirmation of the civil law terminological shift *itself* also effected substantive instability in the administration of the common law:

> In a stroke, lawyers and judges were required to alter fundamentally their conception of injustice. Liability now responds to the *absence* of any reason for the defendant's *retention*, rather than to the *presence* of some reason for the plaintiff's *recovery*. The transition has not been seamless, and it will be many years before practice settles into the level of consistency and certainty that litigants have the right to expect from a mature system of law. [Emphasis in original.]
>
> (McInnes, at p. 1057)

163 This is not to suggest that *Garland* is wrongly decided, or that its authority in the common law of unjust enrichment is somehow undermined by its civilian inclination. Rather, it is simply to point out that there can be a heavy price to pay ? typically, by unijural lawyers and their clients ? when external legal concepts are introduced via a judgment on a purely domestic legal issue. Hence the restraint which this Court has (until now) shown, by introducing external legal concepts to a judgment only where it is necessary to do so ? that is, to fill a gap where domestic law *does not* provide an answer, or where it is necessary to modify or otherwise develop an existing legal rule. In such circumstances, other legal systems may well reveal potential solutions that would not have been apparent from a narrow domestic focus (Zweigert and Kötz, at pp. 17-20; see also *Canadian National Railway Co. v. Norsk Pacific Steamship Co.*, [1992] 1 S.C.R. 1021, at pp. 1140-47 (per McLachlin J., as she then was)). This is what we mean when we say that Canada's two legal systems can serve as sources of "inspiration" (*Bou Malhab v. Diffusion Métromédia CMR inc.*, 2011 SCC 9, [2011] 1 S.C.R. 214, at para. 38).

164 We can also draw on the experience of other legal systems to assist our deliberations about whether an identified potential solution to a legal problem will result in negative consequences. Indeed, that was the limited use this Court made of Quebec law (and, for that matter, U.S. law) in *Bhasin*, at paras. 83-85, *Saadati v. Moorhead*, 2017 SCC 28, [2017] 1 S.C.R. 543, at para. 34, and *Norsk*, at pp. 1174-75 (per Stevenson J., concurring). Similarly, this Court will sometimes observe that a legal concept developed within one system, using domestic sources, mirrors a concept found in another system (*Deloitte & Touche v. Livent Inc. (Receiver of)*, *2017 SCC 63*, [2017] 2 S.C.R. 855, at para. 138 (per McLachlin C.J., dissenting in part); *Kingstreet Investments Ltd. v. New Brunswick (Finance)*, 2007 SCC 1, [2007] 1 S.C.R. 3, at para. 41; *St. Lawrence Cement Inc. v. Barrette*, 2008 SCC 64, [2008] 3 S.C.R. 392, at paras. 76-79; see also *Sport Maska Inc. v. Zittrer*, [1988] 1 S.C.R. 564, at p. 570 (per Beetz J., concurring)). When used in these ways, comparative sources are relied on to provide comfort that other legal systems have arrived at similar conclusions.

165 But that is not this case. Here, no gaps are to be filled, and no domestic common law requires development (or even "clarification"). Rather, in service of what the majority describes as a "dialogue" between the civil law and common law, it uses the civil law device of abuse of right to drive an analysis which, I repeat, is neither necessary to decide this appeal, nor helpful in its obscuring of the law. Further, this case engages an issue ? the place of good faith in contract law ? on which the Canadian common law and civil law systems have adopted very different approaches ? each autonomous, and neither inherently superior to the other (see, generally, R. Jukier, "Good Faith in Contract: A Judicial Dialogue Between Common Law Canada and Québec" (2019), 1 *Journal of Commonwealth Law* 83). As the Hon. Louis LeBel observed:

> [TRANSLATION] The fact that the Court has maintained the specificity of the two legal traditions with respect to good faith shows the importance it attaches to respect for their conceptual autonomy. The dialogue between the two systems remains circumscribed by a judicial stance that, in general today, understands the importance and characteristics of the major legal traditions that make up Canadian bijuralism.
>
> ("Les cultures de la Cour suprême du Canada: vers l'émergence d'une culture dialogique?", in J.-F. Gaudreault-DesBiens et al., eds., *Convergence, concurrence et harmonisation des systèmes juridiques* (2009), 1, at p. 15)

166 Indeed, there are principled reasons for the distinct treatment of good faith as between the common law and civil law systems. As Professor Valcke observes, the common law also relies on other concepts, including the equitable doctrine of estoppel, to achieve similar outcomes as the doctrine of good faith ("*Bhasin v Hrynew*: Why a General Duty of Good Faith Would Be Out of Place in English Canadian Contract Law" (2019), 1 *Journal of Commonwealth Law* 65, at p. 77). At a more general level, the common law and civil law are premised on different understandings of legal rights (H. Dedek, "From Norms to Facts: The Realization of Rights in Common and Civil Private Law" *(2010), 56 McGill L.J. 77*, at pp. 79-81) and of the role of the state in mitigating the effects of harsh bargains (M. Pargendler, "The Role of the State in Contract Law: The Common-Civil Law Divide" (2018), 43 *Yale J. Intl L.* 143, at p. 179).

167 I acknowledge that the majority refers to "special reasons" to be "cautious in undertaking the comparative exercise to which Callow invites us here" (para. 70). But ? and, again I stress, in an area of common law that admits of no lacuna or gap that needs filling, or that is in need of development ? by applying the civilian doctrine of "abuse of right" as it does, caution is thrown to the wind, the independent character of the existing good faith doctrine, which *Bhasin* carefully preserved, is undermined, and the generally applicable rule that this Court rejected in *Bhasin* is at least implicitly embraced.

168 To be clear, the majority's comparative methodology is not mere surplusage. Rather, its application is the only point of the exercise. As I have already recounted, the doctrine of abuse of rights is applied "to focus the analysis of whether the common law duty of honest performance has been breached on what might be called the wrongful exercise of a contractual right" (para. 63). Quebec civil law is cited as authority for the proposition that "no contractual right may be exercised abusively" (para. 67). This leads to another reason why comparative methodology is undesirable in this case, which requires me to speak plainly. The passages I have just cited from the majority's reasons, and indeed the very notion of "abuse of right", would not be familiar, meaningful or even comprehensible to the vast majority of common law lawyers and judges. And yet, many of them would reasonably assume ? as many did when the language of "juristic reasons" entered the common law lexicon of unjust enrichment ? that there is legal significance in their use here, and that they must therefore familiarize themselves with these concepts or retain bijural assistance in order to competently represent their clients or adjudicate their cases. At the very least, common law lawyers applying the common law concepts under discussion here will presumably need to have an eye, as the majority does, to the *Civil Code of Québec*. How they would acquire the necessary familiarity, and the extent to which they must acquire it, is left unexplained.

169 These are not idle concerns, and on this point there is a certain reality that we must bear in mind. Few

common law lawyers and judges in most provinces are sufficiently versed in French to read the sources of civil law concerning the abuse of right. And of those who are, fewer still will be trained in the civil law so as to understand their substance.

170 I confess that I am in no position to express a view on the correctness of the majority's proclamation that it, or this Court, is pursuing a "dialogue" between the civil and common legal systems. Indeed, it is not obvious to me what having such a "dialogue" means in the context of discharging our adjudicative responsibilities. But accepting that my colleagues understand themselves to be so engaged, I suggest with utmost respect that their dialogical pursuit should not occur at the expense of those who must know, understand and apply an aspect of one of those legal systems that the majority now renders opaque. It really comes down to this: the majority's unnecessary digression into external legal concepts will create practical difficulties on the ground by making the common law governing contractual relationships less comprehensible and therefore less accessible to those who need to know it, thereby increasing costs for all concerned. At a time when many are striving to remove old barriers that impede access to justice, I would not erect new barriers in the form of legal expression that bears little to no resemblance to the training and experience of those who help citizens navigate the legal system.

171 Even where a comparative analysis *is* appropriate, the analogy of the jigsaw puzzles must be borne in mind. It is simply not the case that "the common law and the civil law represent ... distinctive ways of knowing the law" (Kasirer J.'s reasons, at para. 71 (emphasis added)). They are not different *theories* of law. They are different *systems* of law. And because legal rules must originate from the system within which that rule will operate, comparative analysis must be undertaken with care and circumspection. This Court's statement in *Caisse populaire des Deux Rives*, at p. 1004, is apposite:

> ... apparent similarity of the fundamental rules should not cause us to forget that the courts have a duty to ensure that insurance law develops in a manner consistent with the rest of Quebec civil law, of which it forms a part. Accordingly, while the judgments of foreign jurisdictions, in particular Britain, the United States and France, may be of interest when the law there is based on similar principles, the fact remains that Quebec civil law is rooted in concepts peculiar to it, and while it may be necessary to refer to foreign law in some cases, the courts should only adopt what is consistent with the general scheme of Quebec law. [Emphasis added.]

172 The direction that civil law developments must be consistent with the overall civil law of Quebec applies with equal force when considering potential modifications to the common law. Maintaining the distinct character of each of Canada's legal traditions requires administering each system according to its own scheme of rules, and by reference to its own authorities (*Colonial Real Estate Co. v. La Communauté des Soeurs de la Charité de l'Hôpital Général de Montréal* *(1918), 57 S.C.R. 585*, at p. 603; see also J. Dainow, "The Civil Law and the Common Law: Some Points of Comparison" (1967), 15 Am. J. Comp. L. 419, at pp. 434-35). It follows that any enrichment from another legal system must be incorporated only insofar as it conforms to the internal structure and organizing principles of the adopting legal system (F. Allard, *The Supreme Court of Canada and its Impact on the Expression of Bijuralism* (2001), at p. 9). Ultimately, the golden rule in using concepts from one of Canada's legal systems to modify the other is that the proposed solution must be able to completely and coherently integrate into the adopting system's structure (J.-L. Baudouin, "Mixed Jurisdictions: A Model for the XXIst Century?" (2003), 63 *La. L. Rev.* 983, at pp. 990-91).

173 This is of practical concern here. Analytically jamming the civilian concept of abuse of right regarding the termination of a contract into the common law is not the tidy and discrete affair that the majority appears to suppose. This is because the obligation of good faith in civil law imposes more onerous duties on the party terminating the contract than it does at common law. The Quebec Court of Appeal has explained the notion of abuse of right in the context of termination of a contract in the following way:

> [TRANSLATION] Up until now, the courts have sometimes sanctioned abuse of right in cases of malice. However, they have also sanctioned unilateral resiliation by a distributor for reasons found not to be within the spirit of the discretionary resiliation clause, or where the resiliation was improper, that is,

> without any valid reason, or without prior notice or without any sign of what was to come. These cases clearly illustrate the "moralization" of contractual relations by the doctrine of abuse of right: for it is not enough to resiliate a contract in a strictly lawful manner (in accordance with the language of a resiliation clause), it is also necessary to do so in a legitimate way. [Emphasis added.]
>
> (*Birdair inc. v. Danny's Construction Co.*, *2013 QCCA 580*, at para. 131 (CanLII), citing J.- L. Baudouin and P.-G. Jobin, *Les obligations* (6th ed. 2005), by P.-G. Jobin with the collaboration of N. Vézina, at para. 125)

174 Even if we were to imagine that it *was* the exercise of the termination clause that led in this case to the breach of duty of honest contractual performance ? which, as I shall explain below, it was not ? *Bhasin* stipulates clearly that there is no duty to disclose information or intentions relevant to termination that flows from the common law duty of good faith. But under the civilian doctrine invoked by the majority, terminating a contract without disclosing intentions can constitute an abuse of right. While the majority acknowledges that it "do[es] not rely on the civil law here for the specific rules that would govern a similar claim in Quebec" (para. 73), this tends to affirm how inappropriate its comparative analysis is here. The majority either relies on a truncated and therefore distorted version of the civilian framework of abuse of right, or else opens the door to future "clarifications" (which would further undermine the integrity of the common law duty of honest performance as stated in *Bhasin*). Even on its own terms, then, the majority's invocation of abuse of right raises more questions than it claims to answer.

175 For all these reasons, I am of the respectful view that it is not appropriate to refer to, and rely upon, the doctrine of abuse of right in this case. This appeal calls upon this Court to straightforwardly apply the duty of honest performance, and nothing more. Transplanting the doctrine of abuse of right into the common law context is not only unnecessary here, doing so without reference to the broader context in which good faith operates in the common law will cause significant uncertainty.

(2) The Wrongful Exercise of a Right

176 The majority's reliance on the civilian doctrine of abuse of a right leads me to a final, substantive criticism: in focusing on the wrongful exercise of a right, it distorts the analysis described in *Bhasin* and elides the distinction between honest performance and good faith in the exercise of a contractual discretion.

177 The gravamen of a claim in honest performance is that a party made dishonest representations concerning contractual performance that caused its counterparty to suffer loss. It is *not* that a right was exercised in a way that was wrongful, abusive, or even dishonest. Here, for example, the complaint hinges on Baycrest's deceptive conduct *preceding* the exercise of the termination clause. By relying on Baycrest's misleading representations, Callow missed the opportunity to bid on other contracts. The exercise of the termination clause is relevant only in the sense that it was the subject of the misrepresentation.

178 I recognize that, in *Bhasin*, Cromwell J. stated that the defendant breached the duty of honest performance when it "failed to act honestly with [the plaintiff] in exercising the non-renewal clause" (para. 103). This phrasing, however, mirrored the trial judge's finding that the defendant "acted dishonestly toward Bhasin in exercising the non-renewal clause" (*Bhasin v. Hrynew*, *2011 ABQB 637*, *526 A.R. 1*, at para. 261, quoted in *Bhasin*, at para. 94). Elsewhere, Cromwell J. is clear that the breach "consisted of [the defendant's] failure to be honest with [the plaintiff] about its contractual performance and, in particular, with respect to its settled intentions with respect to renewal" (para. 108). This reflects the general framework that he describes, i.e., that the duty of honest performance "is a simple requirement not to lie or mislead the other party about one's contractual performance" (para. 73).

179 Maintaining analytical clarity about the source of the breach ? the dishonesty that preceded the termination, and not the termination itself ? is important for two reasons. First, a breach of the duty of honest performance may arise from many aspects of performance. The general rule enunciated in *Bhasin* provides a clear standard that can be applied across different contexts, including to the facts of this appeal. There is no benefit in developing a

separate analysis that responds narrowly to dishonesty concerning the exercise of a contractual right. Doing so will only make the law more confused and difficult to apply.

180 Secondly, the source of the breach distinguishes the duty of honest performance from the duty to exercise contractual discretion in good faith. As discussed above, where a breach of the latter duty is alleged, the focus of the analysis is whether the defendant was entitled to exercise its discretion in the way that it did. By shifting the focus of the honest performance analysis to the manner in which a right was exercised, the majority blurs the boundaries between these two distinct duties. Indeed, it contends that "the duty of honest performance shares a common methodology with the duty to exercise contractual discretionary powers in good faith by fixing, at least in circumstances like ours, on the wrongful exercise of a contractual prerogative" (para. 51).

181 We are bound by *Bhasin* to treat the duty of honest performance as conceptually distinct from the duty to exercise discretionary powers in good faith (*Atlantic Lottery Corp. Inc. v. Babstock*, *2020 SCC 19*, at para. 65). This is not simply a matter of *stare decisis* and incremental legal development (although it is at least those things); there is also the practical concern that blurred and ambiguous treatment of these two duties has a meaningful impact on the outcome for contracting parties. Contrary to the majority's suggestion, the wrong at issue in each category of cases is distinct, and the damages available differ accordingly. The award for a breach of the duty of honest performance addresses the effect of the *dishonesty*. In contrast, the award for a breach of the duty to exercise discretion in good faith addresses the effect of the *exercise of discretion itself*. Placing both duties under the umbrella of the "wrongful exercise of a contractual right" obscures these distinctions and thus represents an unfortunate departure from *Bhasin*.

IV. Conclusion

182 I would allow the appeal, set aside the Court of Appeal decision, and reinstate the judgment of the trial judge with costs in this Court and the courts below.

The following are the reasons delivered by

S. COTÉ J. (dissenting)

183 What constitutes actively misleading conduct in the context of a contractual right to terminate without cause? Where should the line be drawn between active dishonesty and permissible non-disclosure of information relevant to termination? Does a party to a contract have an obligation to dissuade his counterparty from entertaining hopes regarding the duration of their business relationship? These are the questions raised by this appeal.

184 In this case, the respondents ("Baycrest") bargained for a right to terminate *at any time* and *for any other reason than unsatisfactory services* upon giving 10 days' notice. Baycrest made the decision to terminate, but it chose to wait before sending the notice, as it did not want to jeopardize the performance of other work that was being done by the appellant ("Callow", referring interchangeably to C.M. Callow Inc. and to its principal, Mr. Christopher Callow). In the meantime, Baycrest became aware that its counterparty was entertaining hopes of a renewal, although it did not say or do anything that materially contributed to those hopes. Baycrest did nothing to discourage them; such conduct may not be laudable, but it does not fall within the category of "active dishonesty" prohibited by the contractual duty of honest performance.

I. Issue on Appeal

185 Both of my colleagues seem to agree on the following propositions.

186 First, this case concerns solely the duty of honest performance and not the duty to exercise discretionary powers in good faith (these two duties were distinguished in *Bhasin v. Hrynew*, *2014 SCC 71*, *[2014] 3 S.C.R. 494*, at paras. 47, 50 and 72-73).

187 Second, the duty of honest performance "means simply that parties must not lie or otherwise knowingly mislead each other about matters directly linked to the performance of the contract" (*Bhasin*, at para. 73).

188 Third, there is no duty to disclose information or one's intentions with respect to termination (*Bhasin*, at paras. 73 and 87).

189 Fourth, there is no need to extend the law by recognizing a new duty of good faith relating to "active non-disclosure".

190 I take it we all agree with these premises. Therefore, the issue, when properly framed, bears on the distinction referred to in *Bhasin* (at paras. 73 and 86-87) between actively misleading conduct and permissible non-disclosure. In the context of this case it comes down to this: did Baycrest lie or otherwise knowingly mislead Callow into thinking that there was no risk it would exercise its right to terminate the winter agreement for any other reason than unsatisfactory services? The answer to this question is no.

191 Before turning to my analysis, I wish to express my substantial agreement with Justice Brown's observations insofar as they pertain to the role of external legal concepts. Justice Kasirer states at paragraph 44 of his reasons that "[n]o expansion of the law set forth in *Bhasin* is necessary" to dispose of this appeal. However, he then embarks on, and I say this respectfully, an unnecessary comparative exercise between the civil law and the common law under the pretext of "dialogue". I am perplexed by the virtues of "dialogue" in a case like this one where no gaps in the common law need to be filled and no rules need to be modified. I do not see why we should adopt such an approach, one that provides no palpable benefits and that is also arbitrary and unpredictable.

192 That being said, I believe that the common law as it now stands does not support the result my colleagues arrive at. I am afraid that the unnecessary debate about comparative legal exercises may have diverted attention from the facts of this case as they are.

II. Ambit of the Duty of Honest Performance

A. *Context in Which the Duty Was Created*

193 In *Bhasin*, the Court unanimously introduced the contractual duty of honest performance as a "new common law duty under the broad umbrella of the organizing principle of good faith performance of contracts" (para. 72). Cromwell J. stressed that this was no more than a "modest, incremental step" (para. 73; see also paras. 82 and 89), with the duty of honest performance being a "minimum standard" (para. 74).

194 In Cromwell J.' opinion, the new duty would "interfer[e] very little with freedom of contract" (para. 76); so little that he thought such interference would be "more theoretical than real" (para. 81). On the subject of the organizing principle of good faith from which it grew, Cromwell J. stated:

> The principle of good faith must be applied in a manner that is consistent with the fundamental commitments of the common law of contract which generally places great weight on the freedom of contracting parties to pursue their individual self-interest. In commerce, a party may sometimes cause loss to another -- even intentionally -- in the legitimate pursuit of economic self-interest ... . The development of the principle of good faith must be clear not to veer into a form of *ad hoc* judicial moralism or "palm tree? justice. In particular, the organizing principle of good faith should not be used as a pretext for scrutinizing the motives of contracting parties. [para. 70]

195 Cromwell J. also expressed specific concerns relating to the clarity of the duty, its effect on commercial certainty and other practical implications (at paras. 59, 66, 70-71, 73, 79-80 and 86-87). He endeavoured to explain what the new duty was *not*:

> The duty of honest performance that I propose should not be confused with a duty of disclosure or of fiduciary loyalty. A party to a contract has no general duty to subordinate his or her interest to that of the other party. [Emphasis added; para. 86.]

196 Turning to a positive description, he stressed that the duty of honest performance *was* a "simple requirement" not to lie or knowingly mislead about matters directly linked to performance of the contract (para. 73).

197 The requirement that parties not lie is straightforward. But what kind of conduct is covered by the requirement that they not otherwise knowingly mislead each other? Absent a duty to disclose, it is far from obvious when exactly one's silence will "knowingly mislead" the other contracting party. Are we to draw sophisticated distinctions between "mere silence" and other types of silence, as Brown J. suggests? If that be so, I wonder how a contracting party -- on whom, I note, the law imposes *neither* "a duty of loyalty or of disclosure" *nor* a requirement "to forego advantages flowing from the contract" (*Bhasin*, at para. 73) -- is supposed to know at what point a permissible silence turns into a non-permissible silence that may constitute a breach of contract. With the greatest respect, I do not believe such casuistry is compatible with the "simple requirement" Cromwell J. meant to set out in *Bhasin*.

198 As Cromwell J. put it, "a clear distinction can be drawn between a failure to disclose a material fact, even a firm intention to end the contractual arrangement, and active dishonesty" (para. 86 (emphasis added)). He added that "*United Roasters* makes it clear that there is no unilateral duty to disclose information relevant to termination. But the situation is quite different, as I see it, when it comes to actively misleading or deceiving the other contracting party in relation to performance of the contract" (para. 87 (emphasis added)). These words should be taken at face value. The duty of honest performance should remain "clear and easy to apply" (para. 80).

B. *Permissible Non-disclosure*

199 It must be borne in mind that all obligations flowing from the duty of honest performance are "negative" obligations (P. Daly, "La bonne foi et la common law: l'arrêt *Bhasin c. Hrynew*", in J. Torres-Ceyte, G.-A. Berthold and C.-A. M. Péladeau, eds., *Le dialogue en droit civil* (2018), 89, at pp. 101-2; see also Kasirer J.'s reasons, at para. 86). Extending the duty beyond that scope would "detract from ... certainty in commercial dealings" (*Bhasin*, at para. 80).

200 Therefore, silence cannot be considered dishonest within the meaning of *Bhasin* unless there is a positive obligation to speak. Such an obligation does not arise simply because a party to a contract realizes that his counterparty is operating under a mistaken belief.

201 Absent a duty of disclosure, that is, absent any kind of free-standing positive obligation flowing from the duty of honest performance, a party to a contract has no obligation to correct his counterparty's mistaken belief unless the party's active conduct has *materially* contributed to it (see, in a different context, T. Buckwold, "The Enforceability of Agreements to Negotiate in Good Faith: The Impact of *Bhasin v. Hrynew* and the Organizing Principle of Good Faith in Common Law Canada" (2016), 58 *Can. Bus. L.J.* 1, at pp. 12-13).

202 What constitutes a material contribution will obviously depend upon the context, which includes the nature of the parties' relationship (see Brown J.'s reasons, at para. 133) as well as the relevant provisions of the contract. But the reason underlying this requirement is a practical one that is consistent with *Bhasin*'s emphasis on commercial expectations (at paras. 1, 34, 41, 60 and 62): parties that prefer not to disclose certain information -- which they are entitled not to do -- are not required to adopt a new line of conduct in their contractual relationship simply because they chose silence over speech.

203 It cannot be that the law, on the one hand, allows contracting parties not to disclose information but, on the other hand, negates that possibility by imposing a standard of conduct that is at odds with the spontaneous attitudes -- such as evasiveness and equivocation -- parties might have when their conversations bear precisely on what they wish not to disclose.

204 Even though parties who make that choice must be careful with what they say or do, especially if they become aware that their counterparties are operating under a mistaken belief, they should not be asked to behave as if their actions were being scrutinized under a microscope to determine whether they have contributed to that mistaken belief. Such a requirement would be unacceptable.

205 In the context of a right to terminate a contract without cause, a party that intends to end an agreement does not have to convey hints in order to alert his counterparty that their business relationship is in danger. No duty of disclosure should mean no duty of disclosure.

206 A party's awareness of his counterparty's mistaken belief will therefore not, in itself, trigger an obligation to speak unless the party has taken positive action that materially contributed to that belief. The active conduct and the mistaken belief must both pertain to contractual performance; otherwise, it could hardly be said that one has "knowingly misle[d] [the] other about matters directly linked to the performance of the contract" (*Bhasin*, at para. 73).

207 In sum, the "minimum standard" of honesty imposed by the duty of honest performance has to be consistent with the other principles set out in *Bhasin*. It also has to be realistic and not overly formalistic. Absent a duty of disclosure, a party has no obligation to dissuade his counterparty from persisting in a mistaken belief. This does not mean that the party may induce or reinforce such a belief by significant positive actions or representations. There is an obligation to correct this mistaken belief if the party's active conduct has *materially* contributed to it.

III. Analysis

208 Callow and Baycrest entered into two two-year contracts: a winter agreement covering mostly snow removal services for the period from November 1, 2012 to April 30, 2014 and a summer maintenance services agreement for the period from May 1, 2012 to October 31, 2013. The winter agreement, which is at issue here, contained the following provision:

> 9. If the Contractor [i.e. Callow] fails to give satisfactory service to the Corporation [i.e. Baycrest] in accordance with the terms of this Agreement and the specifications and general conditions attached hereto or if for any other reason the Contractor's services are no longer required for the whole or part of the property covered by this Agreement, then the Corporation may terminate this contract upon giving ten (10) days' notice in writing to the Contractor, and upon such termination, all obligations of the Contractor shall cease and the Corporation shall pay to the Contractor any monies due to it up to the date of such terminations. [Emphasis added.]
>
> (A.R., vol. III, at p. 10)

209 In March or April 2013, Baycrest decided to terminate the winter agreement. On September 12, 2013, it gave Callow 10 days' notice that it was terminating the contract. In the meantime, Baycrest had learned that Callow was performing free extra landscaping work and that he was under the impression the winter agreement would not be terminated (trial reasons, *2017 ONSC 7095*, at para. 48 (CanLII)).

210 It can easily be understood from these circumstances that Callow was "shocked" by the termination. Callow believed that, "if there was a problem, he would have expected [Baycrest] to bring it to his attention like [it] had done in the past" (trial reasons, at para. 49). Baycrest's behaviour was certainly discourteous and cavalier. Yet, that is not the question here. The question is whether Baycrest materially contributed to Callow's mistaken belief that the contract would not be terminated. If Baycrest did, then it had an obligation to correct that mistaken belief in accordance with its duty of honest performance. Otherwise, it had no obligation to disclose anything.

211 Before our Court, Callow acknowledged that by entering into the winter agreement, he had taken the risk that Baycrest "may terminate [the contract], but only disclose the termination decision on 10 days' written notice"

(transcript, at p. 11; see also C.A. reasons, *2018 ONCA 896*, *429 D.L.R. (4th) 704*, at para. 14). I am of the view that according to the terms of the winter agreement, Callow could have found himself in the exact same situation regardless of Baycrest's behaviour during the spring and summer of 2013. Such a possibility was in fact inherent in the contract he had bargained for.

212 Callow essentially submits that Baycrest's active conduct led him to believe that the winter agreement was no longer at risk of being terminated despite the clear wording of the termination provision. He stresses the following points:

(1) Baycrest deliberately kept its decision secret because it did not want to jeopardize the performance of the summer agreement;

(2) Baycrest showed satisfaction with Callow's services;

(3) Callow had discussions with Mr. Peixoto and Mr. Campbell regarding the renewal of the winter agreement;

(4) Baycrest accepted Callow's "freebie" work; and

(5) Baycrest was aware of Callow's mistaken belief.

213 In my view, the appeal should be dismissed.

214 The trial judge's understanding of "active dishonesty" is tainted by an error of law. She did not consider the principle that, in order to amount to a breach of the duty of honest performance, any active dishonesty had to be "directly linked to the performance of the contract" (*Bhasin*, at para. 73). In assessing Baycrest's conduct, she did not inquire into whether Baycrest had "lie[d] or otherwise knowingly misle[d]" Callow about the exercise of its right to terminate the winter agreement for *any other reason* than unsatisfactory services. This explains why she wrongly insisted on, amongst other things, the need to "address the alleged performance issues" (para. 67) despite the fact that the winter agreement could be terminated even if Callow's services were satisfactory.

215 Furthermore, although the trial judge seems to have been aware that there was no duty of disclosure (para. 60), she nonetheless found that Baycrest had acted in bad faith by "withholding the information to ensure Callow performed the summer maintenance services contract" (para. 65; see also para. 76). She never asked herself whether Baycrest had explicitly or implicitly said or done anything that could have misled Callow into thinking that the contract was at no risk of being terminated for any other reason than unsatisfactory services. It is clear from reading the trial judge's reasons as a whole that the "representations" she found had been made by Baycrest (at paras. 65, 67 and 76) were not directly linked to the performance of the winter agreement. In sum, the trial judge's misunderstanding of the applicable legal principles vitiated the fact-finding process.

216 Baycrest had bargained for a right to terminate its winter agreement *for any reason* and *at any time* upon giving 10 days' notice. Its duty of honest performance did not require it to "forego" this undeniable "advantag[e] flowing from the contract" (*Bhasin*, at para. 73). It had no obligation to tell Callow about its decision to terminate the winter agreement until 10 days before the termination was to take effect, as the contract stipulated. Even after Baycrest became aware of Callow's mistaken belief, it had no obligation to refuse the "freebie" work Callow was performing on his own initiative or to correct this mistaken belief he was operating under. Such an obligation would have arisen only if Baycrest had contributed materially to that mistaken belief by inducing it or reinforcing it. In light of the evidence and the trial judge's findings, I am not convinced that Baycrest had done so.

217 I do not have the same reading as my colleague Kasirer J. about certain of the trial judge's findings of fact (para. 100). These findings expressed in very broad terms should not be insulated from the reasons as a whole and from the evidence that was before the trial judge. For instance, my colleague writes that "Mr. Peixoto made statements to Mr. Callow suggesting that a renewal of the winter maintenance agreement was likely" (para. 95), and he considers that to be a "key finding" (para. 96). However, the trial judge's finding pertained to *what Callow had thought*, not to *what Baycrest had said* (trial reasons, at para. 41), which is something quite different. Indeed,

as I demonstrate below, the evidence supporting this "key finding" shows that Callow's thoughts regarding a renewal of the winter agreement had nothing to do with what Baycrest said to him.

218 I now turn to the application of the foregoing legal principles to the facts of this case.

A. *Discussions About Renewal*

219 Callow argues that Baycrest materially contributed to his mistaken belief by discussing a possible renewal. Indeed, the renewal issue is central in this appeal. It is not disputed that unlike the contract at issue in *Bhasin*, the winter agreement did not contemplate any automatic renewal; it only contemplated termination. Since renewal was not a term of the winter agreement, it cannot be considered "performance of the contract" within the meaning of *Bhasin*. For Callow's claim to succeed, any breach of the duty of honest performance must pertain to termination.

220 Both of my colleagues accept Callow's submission that it can be inferred from the discussions about renewal that the winter agreement was not in danger of termination. I would agree with such a proposition in the following circumstances: if one party leads another to believe that their contract will be renewed, it follows that the other party can reasonably expect their business relationship to be extended rather than terminated. But an inference to that effect cannot be drawn in the abstract. In order to infer that one party, through discussions about renewal, led the other party to think that there was no risk their existing agreement would be terminated, the inference-drawing process must obviously take into account the nature of the risk at stake and what was actually communicated during those discussions. Otherwise, the inference would entail a palpable and overriding error that would be subject to appellate review (*Housen v. Nikolaisen*, *2002 SCC 33*, *[2002] 2 S.C.R. 235*, at paras. 22-23).

221 Here, s. 9 of the winter agreement contemplated that the agreement might be terminated (1) for unsatisfactory services, or (2) for any other reason than unsatisfactory services. Did Baycrest, by discussing renewal, communicate anything that might have led Callow to believe there was no risk the winter agreement would be terminated for *any other reason* than unsatisfactory services? The trial judge described the discussions between the parties as follows:

> During the spring and summer of 2013, Callow performed regular weekly grass cutting, garbage pick-up and was in discussions with the condominium corporations' board members to renew the contract for the following summer and also the winter maintenance services contract for a further two years. At this time, Callow had only completed year one of a two-year contract. The contract was supposed to remain in place for the winter of 2013-2014.
>
> After his discussions with Mr. Peixoto and Mr. Campbell, Mr. Callow thought that he was likely to get a two-year renewal of his winter maintenance services contract and they were satisfied with his services. [Emphasis added; paras. 40-41.]

222 The trial judge, who found Callow to be credible, relied on the following part of his testimony:

> **Q.** Now is probably a good time to -- well tell me about these discussions. Let's hear what discussions were you having.
>
> **A.** Mostly with Joe [Peixoto], we discussed it, and he said "yeah, it looks good, I'm sure they'll be up for it, let me talk to them".
>
> **Q.** Up for what?
>
> **A.** A two-year renewal.
>
> **Q.** All right. Anyone else?
>
> **A.** Kyle Campbell I ran into once or twice on site and we had discussions as well too.
>
> **Q.** Okay, and what was your impression of - - of -- I mean I suppose you already answered....

> **A.** That I was likely going to be getting a two-year renewal, there was no reason not to, they were satisfied with the service, they were happy with it. [Emphasis added.]
>
> (A.R., vol. II, at pp. 67-68)

223 Apparently not much importance was attached to the renewal issue at trial. The amended statement of claim did not even address this issue; it instead focused on Baycrest's knowledge, Callow's "freebie" work and the provision of satisfactory services. Even though the trial judge did consider renewal, I note that her findings in this regard bore on Callow's *mistaken belief* that the winter agreement was likely to be renewed (at para. 41); they did *not* bear on anything Baycrest actually did or said that would have misled Callow into that belief.

224 What Callow thought is one thing; what Baycrest said or did is another. According to Callow himself, Mr. Peixoto did not propose anything on behalf of Baycrest. Mr. Peixoto's statement that "I'm sure they'll be up for it, let me talk to them" (A.R., vol. II, at p. 67) clearly meant that despite his favorable opinion, he was not the one making the decision and that Baycrest had not even considered the mere possibility of a renewal at the time. It certainly could not be inferred from this statement that a renewal was likely. Callow's testimony does not suggest that he was misled into believing that Baycrest was actually contemplating a renewal -- Mr. Peixoto's response instead presupposes the contrary -- nor does it suggest that Baycrest did or said anything to negate the risk Callow took that his contract might be terminated for any other reason than unsatisfactory services. Indeed, Callow insisted that he had believed a renewal was likely because "there was no reason not to, they were satisfied with the service, they were happy with it" (A.R., vol. II, at p. 68).

225 In his examination for discovery, Callow had given the same reason for thinking his winter agreement would be renewed, that is, because "there was no reason not to" (A.R., vol. II, at p. 49). He did *not* refer to his discussions with Mr. Peixoto or Mr. Campbell. When asked if anyone had told him that his contract would be renewed, he said he could not recall. The evidence does *not* establish that Mr. Peixoto or Mr. Campbell initiated the discussions about renewal. On the contrary, it suggests that Callow did. When cross-examined about his "freebie" work, Callow admitted that, although he was under the mistaken belief that his contract was likely to be renewed, he was in fact only "*hopeful*" that it would be. *Nowhere* in his testimony did he suggest that he had been given *any* information that could mislead him into believing that Baycrest was seriously contemplating a two-year renewal instead of termination.

226 The trial judge referred to "active communications ... between March/April and September 12, 2013, which deceived Callow" (para. 66), and to "representations in anticipation of the notice period" (para. 67; see also paras. 65 and 76). But those references must be read in light of the evidence and the reasons as a whole. Even though the trial judge made credibility findings against Mr. Peixoto and Mr. Campbell and credibility findings in favour of Callow, the evidence pertaining to renewal supports only a very limited number of inferences regarding termination.

227 At most, it can be said that Mr. Peixoto and Mr. Campbell did not dissuade Callow from entertaining hopes when they had a chance to do so. But, and most importantly, they did not suggest that Baycrest was actually contemplating a continuation of their business relationship. If that had been the case, then I would agree that it might have been justifiable to infer that Callow had been led to believe there was no risk that his existing contract would be terminated before its term. But that was simply not the case here. In my view, the trial judge did not infer from the discussions about renewal that Baycrest had done or said anything to negate the risk that the winter agreement would be terminated for any other reason than unsatisfactory services. Had she made such an inference, it would be subject to appellate review, as it would not be supported by the evidence. Given the context discussed above, Mr. Peixoto's and Mr. Campbell's vague and evasive declarations did not materially contribute to Callow's mistaken belief that would have required Baycrest to disclose additional information.

B. *Baycrest's Satisfaction With Callow's Services*

228 The trial judge placed great importance on the fact that Callow's services had been satisfactory and that Baycrest's conduct had given him no reason to think otherwise (paras. 22, 27, 29-30, 34-36, 39, 41, 46-47 and 55).

I note there is no finding that Baycrest communicated any particular sign of satisfaction pertaining *to the performance of the winter agreement* past March 19, 2013. That being said, there is nothing dishonest about Baycrest terminating the winter agreement after showing its satisfaction with the quality of Callow's work.

229 Further, the parties had explicitly contemplated that Baycrest could terminate the winter agreement even if it was satisfied with Callow's performance, as the contract provided that Baycrest could exercise its termination right for any other reason than unsatisfactory services. Thus, positive feedback about Callow's services cannot justify Callow's mistaken belief that the contract would not be terminated.

C. *Callow's Mistaken Belief That the Winter Agreement Would Remain in Effect*

230 The trial judge found that Baycrest had "continu[ed] to represent that the contract was not in danger" (paras. 65 and 76; see also para. 13). This finding was essentially grounded on the overall signs of satisfaction communicated by Baycrest, on its acceptance of the "freebie" work and on Callow's mistaken belief following the discussions pertaining to renewal. As I have already explained, nothing here required Baycrest to disclose its intent to terminate the winter agreement.

231 What the trial judge *did not find* is also relevant. She did *not* find that Baycrest had decided to forego its right to terminate the winter agreement. She did *not* find that Baycrest had lied to Callow. She did *not* find that Baycrest had negated the risk taken by Callow that his contract would be terminated for any other reason than unsatisfactory services. Lastly, she did not clearly indicate why Callow so firmly believed "that his winter maintenance services contract would remain in place during the following winter" (para. 13).

232 Callow's belief that there was no risk Baycrest would exercise its termination right was based on two things. First, on the positive feedback he had received regarding his services. In his words, Baycrest was "happy with it". However, this is not very relevant in a context in which Baycrest could terminate the winter agreement for any other reason than unsatisfactory services. Second, and most importantly, Callow's mistaken belief was based on an erroneous interpretation of the winter agreement.

233 At trial, Callow testified that he was aware of the termination clause, but that he thought the two-year term made it unenforceable:

> **Q...** . So, in that letter, there is a -- a statement that the termination was in breach of the agreement. So, my question for you is, at that point in time what was your understanding, why was the termination in breach of the agreement?
>
> **A.** Because they asked me, and we entered into a two year agreement, to provide services both summer and winter; and I did so at a reduced rate. I upheld my end of the bargain which was to perform that work at that reduced rate. They -- and which I might add, I was not paid for, the landscaping and the final aspect of it, they were supposed to pay me. They didn't do it. And I continued to fulfill my contractual obligations. I expected nothing less than the same from them.
>
> **Q.** So -- so, when you -- because you talk -- but you knew that in the winter contract, there was that termination clause.
>
> **A.** They had a clause written in there. I didn't believe it be enforceable because we had a two year contract. That's the whole idea to a two year contract. You have contract for two years. I provide services for two years and they pay me for those services. [Emphasis added.]
>
> (A.R., vol. II, at p. 120; see also pp. 106-7.)

234 Even though that was not the position he took in this Court, Callow's uninformed interpretation of the termination provision casts an important light on the reason why he did not believe there was a risk the winter agreement would be terminated for any other reason than unsatisfactory services. The evidence does not suggest that Baycrest said or did anything that could have negated that risk, nor does it suggest that Baycrest had anything

to do with Callow's erroneous interpretation of the termination provision. I am therefore of the view that Baycrest was not required to correct Callow's mistaken belief by disclosing information it decided not to disclose.

IV. Conclusion

235 The trial judge erred in concluding that Baycrest had to address performance issues or provide prompt notice prior to termination (para. 67). She did not inquire into whether Baycrest had made any representations that had misled Callow into thinking Baycrest would not terminate the winter agreement for any other reason than unsatisfactory services. In my view, the trial judge extended the ambit of the duty of honest performance in a way that was not consistent with the other principles set out in *Bhasin*.

236 In sum, the narrow issue in this appeal comes down to this: Did Baycrest lie or otherwise knowingly mislead Callow into thinking that there was no risk it would exercise its right to terminate the winter agreement for any other reason than unsatisfactory services? There were no outright lies. Baycrest was aware of Callow's mistaken belief that his services would be required for the upcoming winter. But Baycrest never forewent the contractual advantage it had of being able to end the winter agreement at any time upon 10 days' notice. Nor did Baycrest say or do anything that materially contributed to Callow's mistaken belief that the winter agreement would not be terminated for any other reason than unsatisfactory services. Regardless of how its conduct is characterized, Baycrest had no obligation to correct Callow's mistaken belief.

237 To be clear, the result I arrive at should not be interpreted as meaning that Baycrest's behaviour was appropriate or that Callow has no recourse. It means that Callow's recourse cannot be based on a breach of the duty of honest performance. The trial judge did in fact find that Baycrest had been unjustly enriched by the "freebie" work (at para. 77), but she stated that Callow had not provided evidence of his expenses. That question exceeds the scope of this appeal, however.

238 I would therefore dismiss the appeal.

Appeal allowed with costs throughout, COTÉ J. *dissenting*.

Solicitors:

Solicitors for the appellant: McCarthy Tétrault, Toronto; KMH Lawyers, Ottawa.

Solicitors for the respondents: Gowling WLG (Canada), Ottawa.

Solicitors for the intervener the Canadian Federation of Independent Business: Blake, Cassels & Graydon, Toronto.

Solicitors for the intervener the Canadian Chamber of Commerce: Torys, Toronto.

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1 Professor Gutteridge pointed in particular to the influence of *Mayor of Bradford v. Pickles*, [1895] A.C. 587 (H.L.) and, in the contractual setting, *Allen v. Flood*, [1898] A.C. 1 (H.L.), quoting from p. 46 of the latter judgment: ". . . any right given by contract may be exercised as against the giver by the person to whom it is granted, no matter how wicked, cruel, or mean the motive may be which determines the enforcement of the right".