Court File No.: CV-17-11846-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SEARS CANADA INC., CORBEIL ÉLECTRIQUE INC., S.L.H. TRANSPORT INC., THE CUT INC., SEARS CONTACT SERVICES INC., INITIUM LOGISTICS SERVICES INC., INITIUM COMMERCE LABS INC., INITIUM TRADING AND SOURCING CORP., SEARS FLOOR COVERING CENTRES INC., 173470 CANADA INC., 2497089 ONTARIO INC., 6988741 CANADA INC., 10011711 CANADA INC., 1592580 ONTARIO LIMITED, 955041 ALBERTA LTD., 4201531 CANADA INC., 168886 CANADA INC., AND 3339611 CANADA INC.

Applicants

BOOK OF AUTHORITIES OF THE RESPONDENT, OXFORD PROPERTIES GROUP

(Response to Applicants' Motion Returnable July 13, 2017 re: Approval of SISP and Related Relief)

July 12, 2017

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TO: **THIS HONOURABLE COURT**

AND TO: **THE SERVICE LIST**

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Applicants

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Tab No.	Case Reference
8.	Wasserman, M. & Fell, C. "Credit Bidding in Canadian Insolvency Proceedings – A Useful Tool for Secured Creditors Requiring Checks and Balances" (2014) *3 Journal of the Insolvency Institute of Canada* 21
9.	Roderick J. Wood, *Bankruptcy and Insolvency Law*, 2nd ed. (Toronto: Irwin Law Inc., 2015)

Tab 1

2004 CarswellOnt 870
Ontario Superior Court of Justice [Commercial List]

Air Canada, Re

2004 CarswellOnt 870, [2004] O.J. No. 842, 129 A.C.W.S. (3d) 451, 47 C.B.R. (4th) 189

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

AND IN THE MATTER OF SECTION 191 OF THE CANADA BUSINESS CORPORATIONS ACT, R.S.C. 1985, C. C-44, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF AIR CANADA AND THOSE SUBSIDIARIES LISTED ON SCHEDULE "A"

APPLICATION UNDER THE COMPANIES CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Farley J.

Heard: February 19, 2004
Judgment: February 22, 2004
Docket: 03-CL-4932

Counsel: David R. Byers, Sean F. Dunphy, Katherine J. Menear for Air Canada
Joseph M. Steiner, Donald Hanna for Greater Toronto Airport Authority
Peter Griffin, Monique Jilesen for Monitor
James C. Tory for Board of Directors
Howard Gorman for Unsecured Creditors Committee
Robert Thornton, Greg Azeff for GECAS
Dan MacDonald, Q.C. for WestJet

Subject: Corporate and Commercial; Civil Practice and Procedure; Insolvency; Public; Contracts

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.3 Arrangements
XIX.3.d Effect of arrangement
XIX.3.d.iii Miscellaneous

Transportation

II Aviation and aeronautics
II.10 Miscellaneous

Headnote

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Arrangements — Effect of arrangement — General principles

Greater Toronto Airport Authority was ordered to comply with initial order dated April 1, 2003, not to interfere with Air Canada's right to relocate its domestic operations to Terminal 1 New.

Aviation and aeronautics --- Miscellaneous issues

Greater Toronto Airport Authority was ordered to comply with initial order dated April 1, 2003, not to interfere with Air Canada's right to relocate its domestic operations to Terminal 1 New.

Table of Authorities

Cases considered by *Farley J.*:

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

Skydome Corp., Re (1999), 1999 CarswellOnt 208 (Ont. Gen. Div. [Commercial List]) — referred to

Statutes considered:

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

Generally — referred to

s. 11.1 [en. 1997, c. 12, s. 124] — referred to

MOTION by Air Canada against Greater Toronto Airport Authority to enforce terms of earlier order involving terminal access.

***Farley J.*:**

1 As argued, this was a motion by Air Canada (AC) for an Order enforcing paragraphs 6 and 7 of the Amended and Restated Initial Order dated April 1, 2003 (Initial Order) requiring the Greater Toronto Airports' Authority (Authority) not to discontinue, alter or interfere with the right, contract, arrangement, agreement, license or permit to allow AC to relocate its domestic operations (including baggage handling and gating) to Terminal 1 New (NT) and in doing so to have fixed preferential use of all 14 contact gates (bridge gates) in the domestic area of NT during the initial development phase of NT, subject to the terms and conditions of the Memorandum of Understanding between AC and Authority made as of the 31st day of January, 2001 (MOU) and the Terminal Facilities Allocation Protocol (Protocol) as such may evolve from time to time. Apparently the 9 hard stand commuter gates (tarmac gates) are no longer an issue for AC.

2 Paragraphs 6 and 7 of the Initial Order provide:

> 6. **THIS COURT ORDERS** that during the Stay Period, no person, firm, corporation, governmental authority, or other entity shall, without leave, discontinue, fail to renew, alter, interfere with or terminate any right, contract, arrangement, agreement, licence or permit in favour of an Applicant or the Applicants' Property or held by or on behalf of an Applicant, including as a result of any default or non-performance by an Applicant, the making or filing of these proceedings or any allegation contained in these proceedings.
>
> 7. **THIS COURT ORDERS** that, during the Stay Period, (a) all persons, firms, corporations, governmental authorities, airports, airport authority or air navigation authorities or any other entity (including, without limitation, NAV Canada, Office of the Superintendent of Financial Institutions ("OSFI"), IBM Canada Limited and BCE Nexxia Inc.) having written or oral agreements with an Applicant (including, without

limitation, leases, pooling or consignment agreements, multilateral interline traffic agreements, codeshare agreements, Tier III Commercial Agreements, gate access agreements, frequent flyer programs or statutory or regulatory mandates) for the supply of goods and/or services (including, without limitation, real property, computer software and hardware, aircraft parts, aircraft maintenance services and related equipment, ground handling services and equipment, catering, office supplies and equipment, reservations, employee uniforms, crew accommodations, meals and commissary, communication and other data services, accounting and payroll servicing, insurance or indemnity, clearing, banking, cash management, credit cards or credit card processing, transportation, utility or other required services), by or to an Applicant or any of the Applicants' Property are hereby restrained until further order of this Court from discontinuing, failing to renew on terms no more onerous than those existing prior to these proceedings, altering, interfering with or terminating the supply of such goods or services so long as the normal prices or charges for such goods and services received after the date of this order are paid in accordance with present payment practices (for greater certainty and notwithstanding the terms of any federal or provincial statute or the terms of any lease or any present payment practices, lessors cannot alter, reconcile or recalculate the amount of any rent, operating, maintenance or other expenses payable by any Applicant so as to recover in whole or in part any amount payable by an Applicant in respect of any period of time prior to April 1, 2003 or to compensate it in whole or in part for not receiving amounts owing to it by any Applicant in respect of any period of time prior to April 1, 2003), or as may be hereafter negotiated from time to time, and (b) subject to Section 11.1 of the CCAA, all persons being party to fuel consortia agreements, or agreements or arrangements for hedging the price of, or forward purchasing of fuel, are hereby restrained from terminating, suspending, modifying, cancelling, or otherwise interfering with such hedging agreements or arrangements, notwithstanding any provisions in such agreements or arrangements to the contrary, provided that nothing herein shall require any bank to accept bankers acceptances issued after April 1, 2003. For greater certainty, any reference to "airport authority" made in this order shall include both authorities and any other types of legal entity operating an airport.

3 I have frequently observed in these CCAA proceedings that what is needed amongst all stakeholders and AC in all their various relationships is trust and respect flowing in every direction. I regret to say that I think it a fair observation here that trust and respect does not flow in either direction between AC and Authority. That is unfortunate and in my view completely unnecessary and inappropriate; especially when one considers that AC traffic made up 60% of the traffic which went through the Authority in 2003, and it recognized that AC is building a hub at the Toronto airport so that both sides should recognize the importance of one to the other and considering that AC is attempting to do significant restructuring in these CCAA proceedings. For whatever reasons, it appears that both sides of this equation were content to try to get an edge, even a little edge, on the other in their dealings. Each wishes its own slant on their relationship, but particularly as to how the written word should be interpreted. Suffice it to say that the agreement between AC and Authority is to be interpreted on a common sense, business efficacy/avoidance of commercial absurdity basis and is not to be restricted to the terms of any formal written agreement (as is the case of the settlement documentation as to Terminal One (T1) and Terminal Two (T2) executed between AC and Authority which agreements contain "entire agreement" clauses and which also provide that there is to be a separate agreement as to NT). There is no "entire agreement" clause in the subject documentation between AC and the Authority. Indeed there is no requirement that this relationship re NT be reduced to a written agreement as the T1 and T2 agreements provide that they:

> Shall not be construed as an agreement or understanding between [Authority] and [AC] with respect to any matters relating to [NT] which matters will be dealt with in separate arrangements between [Authority] and [A.C.]

4 John Kaldeway, the Vice President, Transition Programs of Authority wrote AC on May 29, 2003, two months into the CCAA proceedings (in dealing with an Initial Order which Authority has not come back on or as to this aspect appealed), stating in a most reasonable way its general concern that the Authority's operations and particularly its transition to NT would not be impacted adversely by AC's CCAA proceedings:

> The [Authority] assigns air carriers to the various terminals at the Airport in such a manner as to ensure the most efficient use of airport resources. It has been and continues to be our intent to have Air Canada, and its alliance and code-share (SA) partners, as the first occupants of the new terminal (NT). This, of course, assumes both that a successful restructuring by Air Canada has occurred or is continuing with an ongoing operational configuration which would warrant a transfer of operations to the new terminal, as well as the negotiation of the appropriate commercial arrangements.
>
> It is important through the process of [AC's] restructuring and the completion of the construction of the first phase of the new terminal that we maintain full and effective communications on how the restructuring and the final completion of the new terminal will impact and shape our mutual plans. In this regard, this letter will discuss important issues relating to the completion of the construction and the transition of air carrier operations into the new terminal.
>
> . . .
>
> AC and the Authority have entered into an Operating Agreement and Lease in respect of [T2] dated January 31, 2001. As you are aware, upon the completion of the first stage of [NT], the [Authority] must proceed immediately with the construction of Pier-F and the new international hammerhead. Until the opening of Pier-F, we expect that [AC's] domestic operations will be conducted from the terminal while international passenger processing will be conducted in the new terminal with boarding and deplaning to occur at the Infield Terminal to the extent these will not yet be able to be accommodated at the new terminal. Transborder [Transborder being interpreted as trans U.S. border] operations will remain at [T2]. In order to ensure the continued development of [NT] as planned, [AC] and the [Authority] will have to establish an operations protocol to provide for the transfer of operations from Gates 202, 203, 204, 205, 206, 208, 210, 212, 214, 216, 218, and 220 to [NT] in November [2003]. These gates serve domestic traffic only.
>
> . . .
>
> Finally, in view of the demands upon [AC's] as it proceeds with its restructuring and the critical phase of our development program, it is imperative that we establish an appropriate and effective line of communication between us that can respond in real time to emerging issues. Please confirm that John Segaert is the individual in Toronto who is able to bind [AC] with respect to these transitional issues. . . .

5 It is interesting to note that this question of the fixed preferential use of the 14 bridge gates being in issue only flared up in January, 2004 although the Authority indicates that there were rumours circulating in December, 2003 as to AC's major domestic competitor WestJet wanting to use NT. I note that apparently there are sufficient facilities in NT to allow for the checking in and baggage handling of SA international flights but that for these flights passengers would have to be bussed to the infield facility. It also appears that similarly domestic non-AC flights could be included at NT although bussing would be either to Terminal Three (T3) or (T2) in that event. Curiously, there seems to be somewhat of a mismatch of resources in that the Authority has built recently more bridge gates at T3 but has not companioned these new gates with check-in and baggage handling facilities.

6 AC filed its motion on February 5, 2004; the Authority responded with its material on February 12th, AC provided a reply affidavit of Monte Brewer (Brewer) on February 17th; the Authority responded with a further affidavit of Howard Bohan (Bohan) the same day; AC then provided a further affidavit of John Segaert (Segaert) on February 18th; and the Authority responded with the last word with a further Bohan affidavit of February 19th, the day of the hearing. The factum of AC is dated February 17, 2004; the factum of the Authority is dated February 18, 2004. There was no cross-examinations on any of the affidavits - either there was not enough time to do so (which is doubtful as to those in the February 5th and responding February 12th motion records or AC and the Authority were both content to live with

any statements of the other side (notwithstanding professed disagreement in the latter affidavits), in other words, they were content to live with the ambiguities, as it does not seem that either side had any appetite for cross-examination. It therefore falls to this court to deal with the morass of material and to attempt to determine what is the agreement between AC and the Authority as to the use of the 14 bridge gates in question based on an objective and reasonable view of matters including commercial reasonability and avoidance of absurdity. My conclusion is based upon the foregoing and the balance of probabilities in interpreting the evidence.

7 It is also curious to note that in many instances the affidavits referred to meetings, discussions and other contacts without specifying a precise date. The lack of precise dates for matters such as these would lead me to the reasonable conclusion that the active participants in these situations did not keep a written record of such, but are now only relying upon their memories as to dates. One would have thought that ordinarily matters of this nature would have been either documented in exchanges between the parties or in contemporaneous notes made at the time. That they were not would lead me to the reasonable conclusion that neither AC nor the Authority had the slightest expectation that as to the domestic use of NT during its first phase, the sole user would not be AC, absent unusual circumstances. Certainly AC was the only domestic carrier to be involved in discussions, liaison, planning, co-ordination and trial runs and testing. I would note that WestJet is a very recent new-comer to the NT scene (although it previously had some now existing operations out of T3) as discussions after WestJet's approach to the Authority about moving WestJet's Hamilton based flight operations to NT only happened in December, 2003; one might reasonably question whether WestJet would be able to get up to a co-ordinated speed for operations at NT for an April 18, 2004 start given that it has not been involved in any of this planning and testing over the past several years. WestJet claims that AC's motive in bringing this motion is to avoid the competition; one may similarly question whether WestJet's motives were "innocent".

8 That AC appeared to both AC and to the Authority as the only game in town up to at least December, 2003 would lead one (and it would appear both AC and the Authority as well) to consider that one need not dot all the "i"s and cross all the "t"s as to the 14 bridge gates. Further it is within that context that one must interpret the Authority's advice that AC and its SA partners would be the first occupants of NT as being that in respect of domestic carriers it was expected between AC and the Authority that AC would be the only domestic carrier in NT during phase one, subject to the "use it or lose it" provision of the Protocol and the provision that if other airline carriers could not be reasonably accommodated at T2 or T3 before phase two at NT came into play. It would be unreasonable to interpret the element of first occupant as being satisfied by AC domestic going in on April 6, 2004 and WestJet going in twelve days later on April 18, 2004, as per WestJet's January 14, 2004 press release. Curiously the Authority does not directly advise AC before its January 28, 2004 letter which indicates that AC gets not the 14 expected bridge gates on a fixed preferential basis, but rather only 8, with the requirement to share the other 6 with WestJet on a common usage basis. The Authority in my view is not the only one to play it cosy and coy; AC states that in late December it came up with a flight schedule that would allow it to have all of its domestic flights gated out of NT but it only advised the Authority of this on January 12, 2004, immediately after Calin Rovinescu of AC (second in command and the Chief Restructuring Officer in the CCAA proceedings) confirmed with Lou Turpen, the CEO of the Authority that the Authority was having discussions with WestJet, the nature of such discussions was not revealed.

9 I think it is fair to observe that one is disappointed with the lack of trust and respect flowing both ways as well as the lack of communication, co-operation and common sense. I say this notwithstanding that I appreciate how difficult running a major airline or a major airport is, particularly as to co-ordinating and accommodating ever changing scheduling. However, apparently the Authority is on record as not wishing to be bothered with interim scheduling advice but rather to be informed as to the schedule for the next season (the summer season) on a finalized basis in late January 2004 (January 31, 2004 being the last IATA date for such schedules). The Authority complains that usually changes made at such late date are only "tweaks", not the types of changes made by AC in mid-January and then as changed on a wholesale basis later in that month. However there does not appear to be any such restriction on magnitude or quality. One should also observe that the Authority during November and even into December 2003 was having meetings with AC at which the Authority was requesting AC to see if it could adjust its domestic schedule so that it would all be gated out of NT with no bussing to T2 (and therefore no bus terminal is to be built there). It may well be that AC

was incentivized to re-think its position once it heard rumours of WestJet's interest. I would not find that unusual. I have no doubt that AC thought that it had the luxury of keeping its options open as to having overflow (if any) as to its domestic flights in phase one of the NT accommodated by bussing to T2 (with a new bus terminal to be built by and at the expense of the Authority which would have the extra benefit of accommodating a swing flight plane from domestic to transborder use (or vice versa) at T2; that luxury would not "cost" AC anything so long as its expected position of being the only domestic carrier at NT during phase one was maintained).

10 In Segaert's February 5, 2004 affidavit he states at para. 43:

> 43. In or about September, 2003, I had discussions with Mr. Howard Bohan, General Manager, New Terminal 1 Client Task Force, GTAA, regarding the revisions to version 6 of the TFAP. At the time, we discussed the application of the fixed preferential use gates and common use gates provisions of the TFAP in connection with the opening of phase 1 of T1 New. Our discussions for some time had all been premised on Air Canada moving its domestic operations into T1 New from Terminal 2. Mr. Bohan at that time indicated to me that the 14 domestic contact gates would be designated as fixed preferential use gates including reserved facilities that Air Canada would be in a position to control in the manner prescribed by the TFAP. The 9 hard stand commuter gates in T1 New he indicated would be designated as common use gates with Air Canada Jazz being fully accommodated in these facilities with some potential surplus capacity available. At that time as at all other times up until January 28, 2004, there was never any suggestion or doubt expressed by GTAA in their discussions with me that there would be any other domestic carriers operating out of T1 New from the initial phase until completion of the construction of subsequent phases of the development.

11 Segaert was the liaison decision-maker of AC requested by the Authority in the May 29, 2003 letter.

12 Bohan in his February 12, 2004 affidavit does not deny that but attempts to explain away the impact of same at paragraphs 2-7:

> 2. I have reviewed the affidavit of John Segaert sworn February 5, 2004, and in particular paragraph 43 of that affidavit. Mr. Segaert implies that the GTAA has altered an agreement or arrangement that Air Canada would have the permanent use of all fourteen contact gates at T1New on a fixed preferential basis. This is untrue. The discussions described by Mr. Segaert in paragraph 43 are not accurately described and, taken in conjunction with the balance of Mr. Segaert's affidavit, distort the discussions we had concerning the application of the Terminal Facilities Allocation Protocol ("TFAP") for T1New.
>
> 3. The discussions referred to at paragraph 43 of Mr. Segaert's affidavit took place at a meeting late in May or early June, 2003. At that time, the scheduled opening date for T1New was October 2003. Our discussions centred on the application of the TFAP for the purpose of designating fixed preferential contact gates and common use contact gates, as well as fixed preferential check-in counters and common use counters, at the time of the proposed opening date for T1New.
>
> 4. Our discussions at that time were based on version 5 of the TFAP. A copy of the TFAP version 5 is attached as Exhibit "P" to John Kaldeway's affidavit.
>
> 5. Under the TFAP methodology, the first step is for the GTAA to determine the number of gates or check-in counters available for allocation on a fixed preferential use basis, under section 4.4.1(ii), which provided:.
>
> (ii) Based on the processing standards and the peak gate and Check-in Facility demand analysis, the GTAA will determine the number of Fixed Preferential gates and check-in positions to be allocated from the available gates and Check-in Facilities that have been designated by the GTAA as being available for allocation on a Fixed Preferential Use Basis. For greater certainty, such available gate and Check-in Facilities shall not include any gates and check-in positions that have been designated as GTAA Reserved or common Use Terminal Facilities.

6. Section 8 of the TFAP provides that 10% of the available facilities will be designated GTAA reserve facilities. (Sections 4.4.1(ii) and 8 are unchanged in the current version 7 of the TFAP.)

7. At that time, in late May or June, 2003, the GTAA anticipated Air Canada to be the only domestic carrier that would be operating from T1New at the time of opening. Accordingly, the GTAA then considered that all contact gates at T1New, including 2 GTAA reserved use gates, could be available for allocation on a fixed preferential basis.

13 One should also have regard to the November 23, 2001 Authority Map showing SA domestic (that is AC domestic) as using all gates - and no other carrier. The drawings presented by the Authority are Feb. 10, 11, 2004 and therefore produced only for the hearing.

14 It seems to me that the understanding between AC and the Authority which would have the status and equivalence of the type of agreement contemplated by the subject paragraphs 6 and 7 of the Initial Order under the CCAA was that in the prevailing circumstances and as these parties saw the Protocol (and MOU) playing out during phase one, AC was to have the fixed preferential use of the 14 bridge gates at NT subject to the use it or lose it proviso and the unable to accommodate elsewhere process.

15 Further given this understanding, then if the Authority wished to change course, it is constrained to do so in accord with the MOU and the Protocol in place from time to time. The Protocol is a work in progress and will continue to be so not only in phase one of the NT but during the complete functional life of the NT, unless otherwise replaced.

16 It does not seem to me that the Protocol (or the MOU) can be reasonably interpreted as advanced by the Authority that the Authority has the right and obligation to determine how many common use bridge gates it needs to accommodate carriers it wishes to place in the NT and that any being left over would be available for fixed preferential use (to a carrier which represented 60% of the traffic in the NT as to any type of flight - domestic, transborder and international collectively which at the present time could only be AC and at anytime could only be one carrier as simple mathematics dictate).

17 Given that Segaert was the AC liaison co-ordinating person as requested by the Authority, I do not see that any advice from anyone even in December, 2003 at the Authority to Rick Leach (Leach) or others at AC would have any legal impact. Given that understanding, I am not so surprised that Leach may not have focussed on what was being suggested to him that AC would only get a certain number of bridge gates on a fixed preferential basis. Further, since these suggestions were made at a time when it was understood that on a practical basis AC was the only domestic carrier for phase one of the NT - understood by both the Authority and AC until the approach to the Authority by WestJet in December and thereafter by AC alone, in permitted ignorance until otherwise advised in January, 2004.

18 I understand that the opening of NT was delayed from the expected date of October, 2003 to April 5, 2004, but that such delay was not occasioned by AC. If matters had progressed without such delay, then it would appear that AC would not only have been allocated all 14 bridge gates on a fixed preferential basis, as indicated and evidenced by the discussion between Bohan and Segaert, but that it would have been functionally operating same. I do not see that the delay or the lack of present functional use gives the Authority any flexibility to change its mind as to AC having these bridge gates on such basis. If the Authority wishes to accommodate WestJet at NT, then it would have to follow the Protocol until either AC loses some or all of the 14 gates on a fixed preferential basis for lack of use or additional gates are built in subsequent phases (it is perhaps curious that phase one of the NT has so few gates relatively speaking although subsequent phases will bring the total to over 100; apparently most of that results from NT being squeezed into a space between T2 and T3 and for the interim having to exist in conjunction with T1 before it is demolished and replaced by runway and new construction of piers at NT).

19 The Authority (and indeed WestJet) stressed that the Authority's mandate was to provide equitable access for all air carriers. However one would observe as has been observed frequently in other CCAA proceedings that equitable

treatment does not necessarily mean equal treatment. In these circumstances I do not see that there is anything truly inequitable about following the Protocol if WestJet wishes to be accommodated at the NT through use of any of the bridge gates. I pause to note that WestJet apparently could be accommodated at the NT for check-in and baggage handling if it were content to have its passengers bussed to either T2 or T3. The Authority downplayed to the maximum the inconvenience of such bussing, indicating that it would only involve the same amount of time as it would take a passenger to otherwise walk to the end of one of the piers of NT. One may be sceptical of that assertion but that is the official position of the Authority. I would also be of the view that the Authority has not in any material respect satisfied its obligations to show that it cannot otherwise accommodate WestJet at either T2 or T3, there were no figures as to usage of the check-in and baggage facilities being overloaded at T3 and there are "surplus" gates there; similarly there was no explanation as to the need to "rewire" the computer system as it would seem that under ordinary circumstances the existing cabling could remain intact and only the peripherals of computers would need to be replaced (with their own compatible software programs) and the baggage handling question was not explained as to why it needed to be replaced (or indeed why WestJet could not contract AC to handle this aspect for it at T2). One would also observe that apparently the Authority might be able to accommodate WestJet at NT by using the tarmac gates on a common use basis.

20 I note that AC was willing to accommodate WestJet as to all or part of the computer facilities at T2. Additionally AC indicated that as opposed to leaving the Protocol (as it now exists in version 7) for review after a year of experience to see what, if any, adjustments should be made, it was content to do this after 6 months.

21 I should also note that the Protocol is written without limiting its effect to AC alone. This is appropriate since AC even at the initial stage was not to be the only user as there were to be other international users. But additionally, the Protocol was being developed for use throughout all phases of the NT to and including the end of its functional life.

22 The Authority does not dispute that the usage by AC for its domestic flights as per the last schedule would give the highest use rate of all the terminals at the airport. Having done what the Authority asked it to do up to and including less than a month before WestJet came on the scene, namely put all its domestic flights gated out of NT without the necessity for bussing, I find it passing strange that the Authority would then do its calculations to bring AC below 60% usage as to certain gates by the device of the Authority - not AC - indicating that certain of AC's domestic flights would be bussed to T2.

23 The Authority submits that if I decide in AC's favour on this issue, it will have an impact beyond AC's proposed emergence from CCAA proceedings. All that is required of the Authority is that it respect the MOU and the Protocol in accordance with the internal processing of these documents at least until emergence (one way or the other) from the CCAA proceedings. What the Authority does after that time is up to it, although it would continue to be governed by those documents (in other words I suppose the Authority could decide to breach their provisions, in which case AC could, if it desired, proceed in the ordinary course with litigation, including going for injunctive relief at that time).

24 Bohan notes that the Authority and WestJet negotiated without disclosing same to the public, including carriers at the airport including AC. He observed that the same confidential arrangements were in place as were for AC moving its Tango operations to T3. However he did not comment on the magnitude of that or its relative impact on the other carriers at T3 which is an acknowledged common use facility - with no exclusive gate, check-in or baggage arrangement or anything "in between" as is the fixed preferential use subject to the various aforesaid provisions in place for NT. I note what Brewer states in his February 17th affidavit at paras. 11 and 2 respectively:

> 11. With respect to paragraph 31, I am advised by Mr. Dave Robinson, Senior Director, Corporate Real Estate, Air Canada, and do verily believe that as part of the Settlement in 2001, Air Canada agreed to give up its exclusive use of Terminal 2 despite the fact that Air Canada had made significant investments therein. While the GTAA would not agree to exclusive use of T1 New, the GTAA and Air Canada came up with a business solution and agreed to the concept of "Fixed Preferential Use" of facilities for domestic and transborder operations at T1 New. I am advised by Mr. Robinson and do verily believe that the concept of Fixed Preferential Use was agreed upon to give Air Canada comfort that it would be able to accommodate its entire domestic and transborder operations in T1 New with Fixed

Preferential Use of the domestic and transborder facilities in relation to other carriers during the initial phase of T1 New, subject to the "use it or lose it" principle and subject to the GTAA maximizing facilities throughout Pearson Airport before accommodating another carrier at T1 New. I am advised by Mr. Robinson and do verily believe that Air Canada believed that it was protected by the provision in the MOU requiring the GTAA prove that Air Canada wasn't using its gates efficiently and therefore ought to "lose" them and that the GTAA was protected because Air Canada would lose its Fixed Preferential gates if not using them efficiently. I am advised by Mr. Robinson and do verily believe that Fixed Preferential Use of the T1 New was one of the critical components of the Settlement.

2. The GTAA Affidavits misconstrue statements and concepts from the First A.C. Affidavits. The GTAA Affidavits suggest that Air Canada's position is that it is entitled to "exclusive" use of all gates at T1 New. This is not the position set out in the First A.C. Affidavits. The position of Air Canada is that it was agreed that Air Canada would be the first tenant of the initial phase of the development of T1 New and that it would have the use of all gates in this first phase on a Fixed Preferential Use basis. As set out in the First A.C. Affidavits, all planning for the development and opening of the initial phase of T1 New was based on and consistent with this agreement. Air Canada's position is that it has always been agreed that the allocation of Fixed Preferential Use gates to Air Canada would ensure that it would have first call on as many gates as would reasonably be required to accommodate its operations in T1 New at a reasonable intensity of use subject only to (a) the "use it or lose it" principle enshrined in the MOU; and (b) the provisions enabling new carriers to be introduced to T1 New only when the use of other terminals have been maximized. It was always understood that at the completion of the development of T1 New, there would be sufficient terminal facilities available to accommodate other carriers.

25 It seems to me reasonable in the circumstances prevailing that the contractual relationship between AC and the Authority as to the fixed preferential use of the 14 bridge gates should be interpreted in the overall context of the above.

26 I find that the Authority has committed the 14 bridge gates to AC on a fixed preferential basis pursuant to the Protocol as established and the MOU and that such commitment should be honoured in regard to paragraphs 6 and 7 of the Initial Order.

27 The purpose of the CCAA has been characterized by many courts as involving a broad balancing of a plurality of stakeholder interests, recognizing that the interest of most parties will be best served by the survival of the applicant debtor corporation: see *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (Ont. C.A.), at pp. 306-7 (Doherty, J.A. dissenting on unrelated grounds). I see no reason why the Authority should not be held to the understanding and agreement which I have found it had with AC in this regard. Where an affected party is in breach of an initial order (which in this case remains intact as to the paragraphs in question and unappealed or otherwise dealt with on a comeback basis by the Authority in this regard), the court may order the breaching entity to comply with the initial order: see *Skydome Corp., Re*, [1999] O.J. No. 221 (Ont. Gen. Div. [Commercial List]) at paras. 2 and 20. In that regard I order the Authority to live up to its commitment to provide AC with the fixed preferential use of the 14 bridge gates at the NT, subject only to the provisos in the Protocol (and MOU). As offered by AC, the Protocol may be revisited after six months' experience.

28 I note that all concerned (including AC, WestJet and the Authority) wanted me to release this decision as quickly as possible with a view to stabilizing the situation and getting on with implementation.

29 Order accordingly.

Motion granted.

End of Document

Tab 2

Most Negative Treatment: Distinguished
Most Recent Distinguished: Vesnaver, Re | 2015 QCCS 3357, 2015 CarswellQue 11729, 2015 CarswellQue 6930, J.E. 2015-1261, EYB 2015-254595, 258 A.C.W.S. (3d) 666 | (C.S. Qué., Jul 16, 2015)

2010 SCC 60
Supreme Court of Canada

Ted Leroy Trucking [Century Services] Ltd., Re

2010 CarswellBC 3419, 2010 CarswellBC 3420, 2010 SCC 60, [2010] 3 S.C.R. 379, [2010] G.S.T.C. 186, [2011] 2 W.W.R. 383, [2011] B.C.W.L.D. 533, [2011] B.C.W.L.D. 534, 12 B.C.L.R. (5th) 1, 196 A.C.W.S. (3d) 27, 2011 D.T.C. 5006 (Eng.), 2011 G.T.C. 2006 (Eng.), 296 B.C.A.C. 1, 326 D.L.R. (4th) 577, 409 N.R. 201, 503 W.A.C. 1, 72 C.B.R. (5th) 170, J.E. 2011-5

Century Services Inc. (Appellant) and Attorney General of Canada on behalf of Her Majesty The Queen in Right of Canada (Respondent)

Deschamps J., McLachlin C.J.C., Binnie, LeBel, Fish, Abella, Charron, Rothstein, Cromwell JJ.

Heard: May 11, 2010
Judgment: December 16, 2010
Docket: 33239

Proceedings: reversing *Ted Leroy Trucking Ltd., Re* (2009), 2009 CarswellBC 1195, 2009 G.T.C. 2020 (Eng.), 2009 BCCA 205, 270 B.C.A.C. 167, 454 W.A.C. 167, [2009] 12 W.W.R. 684, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.); reversing *Ted Leroy Trucking Ltd., Re* (2008), 2008 CarswellBC 2895, 2008 BCSC 1805, [2008] G.S.T.C. 221, 2009 G.T.C. 2011 (Eng.) (B.C. S.C. [In Chambers])

Counsel: Mary I.A. Buttery, Owen J. James, Matthew J.G. Curtis for Appellant
Gordon Bourgard, David Jacyk, Michael J. Lema for Respondent

Subject: Estates and Trusts; Goods and Services Tax (GST); Tax — Miscellaneous; Insolvency

Related Abridgment Classifications

Tax

I General principles
I.5 Priority of tax claims in bankruptcy proceedings

Tax

III Goods and Services Tax
III.14 Collection and remittance
III.14.b GST held in trust

Headnote

Tax --- Goods and Services Tax — Collection and remittance — GST held in trust

Debtor owed Crown under Excise Tax Act (ETA) for unremitted GST — Debtor sought relief under Companies' Creditors Arrangement Act (CCAA) — Under order of BC Supreme Court, amount of GST debt was placed in trust account and remaining proceeds of sale of assets paid to major secured creditor — Debtor's application for partial lifting of stay of proceedings to assign itself into bankruptcy was granted, while Crown's application for payment of tax debt was dismissed — Crown's appeal to BC Court of Appeal was allowed — Creditor appealed to Supreme Court of Canada — Appeal allowed — Analysis of ETA and CCAA yielded conclusion that CCAA provides that statutory deemed trusts do not apply, and that Parliament did not intend to restore Crown's deemed trust priority in GST claims under CCAA when it amended ETA in 2000 — Parliament had moved away from asserting priority for Crown claims under both CCAA and Bankruptcy and Insolvency Act (BIA), and neither statute provided for preferred treatment of GST claims — Giving Crown priority over GST claims during CCAA proceedings but not in bankruptcy would reduce use of more flexible and responsive CCAA regime — Parliament likely inadvertently succumbed to drafting anomaly — Section 222(3) of ETA could not be seen as having impliedly repealed s. 18.3 of CCAA by its subsequent passage, given recent amendments to CCAA — Court had discretion under CCAA to construct bridge to liquidation under BIA, and partially lift stay of proceedings to allow entry into liquidation — No "gap" should exist when moving from CCAA to BIA — Court order segregating funds did not have certainty that Crown rather than creditor would be beneficiary sufficient to support express trust — Amount held in respect of GST debt was not subject to deemed trust, priority or express trust in favour of Crown — Excise Tax Act, R.S.C. 1985, c. E-15, ss. 222(1), (1.1).

Tax --- General principles — Priority of tax claims in bankruptcy proceedings

Debtor owed Crown under Excise Tax Act (ETA) for unremitted GST — Debtor sought relief under Companies' Creditors Arrangement Act (CCAA) — Under order of BC Supreme Court, amount of GST debt was placed in trust account and remaining proceeds of sale of assets paid to major secured creditor — Debtor's application for partial lifting of stay of proceedings to assign itself into bankruptcy was granted, while Crown's application for payment of tax debt was dismissed — Crown's appeal to BC Court of Appeal was allowed — Creditor appealed to Supreme Court of Canada — Appeal allowed — Analysis of ETA and CCAA yielded conclusion that CCAA provides that statutory deemed trusts do not apply, and that Parliament did not intend to restore Crown's deemed trust priority in GST claims under CCAA when it amended ETA in 2000 — Parliament had moved away from asserting priority for Crown claims under both CCAA and Bankruptcy and Insolvency Act (BIA), and neither statute provided for preferred treatment of GST claims — Giving Crown priority over GST claims during CCAA proceedings but not in bankruptcy would reduce use of more flexible and responsive CCAA regime — Parliament likely inadvertently succumbed to drafting anomaly — Section 222(3) of ETA could not be seen as having impliedly repealed s. 18.3 of CCAA by its subsequent passage, given recent amendments to CCAA — Court had discretion under CCAA to construct bridge to liquidation under BIA, and partially lift stay of proceedings to allow entry into liquidation — No "gap" should exist when moving from CCAA to BIA — Court order segregating funds did not have certainty that Crown rather than creditor would be beneficiary sufficient to support express trust — Amount held in respect of GST debt was not subject to deemed trust, priority or express trust in favour of Crown.

Taxation --- Taxe sur les produits et services — Perception et versement — Montant de TPS détenu en fiducie

Débitrice devait à la Couronne des montants de TPS qu'elle n'avait pas remis, en vertu de la Loi sur la taxe d'accise (LTA) — Débitrice a entamé des procédures judiciaires en vertu de la Loi sur les arrangements avec les créanciers des compagnies (LACC) — En vertu d'une ordonnance du tribunal, le montant de la créance fiscale a été déposé dans un compte en fiducie et la balance du produit de la vente des actifs a servi à payer le créancier garanti principal — Demande de la débitrice visant à obtenir la levée partielle de la suspension de procédures afin qu'elle puisse faire cession de ses biens a été accordée, alors que la demande de la Couronne visant à obtenir le paiement des montants de TPS non remis a été rejetée — Appel interjeté par la Couronne a été accueilli — Créancier a formé un pourvoi — Pourvoi accueilli — Analyse de la LTA et de la LACC conduisait à la conclusion que le législateur ne saurait avoir eu l'intention de redonner la priorité, dans le cadre de la LACC, à la fiducie réputée de la Couronne à l'égard de ses créances relatives à la TPS quand il a modifié la LTA, en 2000 — Législateur avait mis un terme à la priorité accordée aux créances de la Couronne sous les régimes de la LACC et de la Loi sur la faillite et l'insolvabilité (LFI), et ni l'une ni l'autre de ces lois ne prévoyaient que les créances relatives à la TPS bénéficiaient d'un traitement préférentiel — Fait de faire primer la priorité de la Couronne sur les créances découlant de la TPS dans le cadre de procédures fondées sur la LACC mais pas en cas de faillite aurait pour effet de restreindre le recours à la possibilité de se restructurer sous le régime plus souple et mieux adapté de la LACC — Il semblait probable que le législateur avait par inadvertance commis une anomalie rédactionnelle — On ne pourrait pas considérer l'art. 222(3) de la LTA comme ayant implicitement abrogé l'art. 18.3 de la LACC, compte tenu des modifications récemment apportées à la LACC — Sous le régime de la LACC, le tribunal avait discrétion pour établir une passerelle vers une liquidation opérée sous le régime de la LFI et de lever la suspension partielle des procédures afin de permettre à la débitrice de procéder à la transition au régime de liquidation — Il n'y avait aucune certitude, en vertu de l'ordonnance du tribunal, que la Couronne était le bénéficiaire véritable de la fiducie ni de fondement pour donner naissance à une fiducie expresse — Montant perçu au titre de la TPS ne faisait l'objet d'aucune fiducie présumée, priorité ou fiducie expresse en faveur de la Couronne.

Taxation --- Principes généraux — Priorité des créances fiscales dans le cadre de procédures en faillite

Débitrice devait à la Couronne des montants de TPS qu'elle n'avait pas remis, en vertu de la Loi sur la taxe d'accise (LTA) — Débitrice a entamé des procédures judiciaires en vertu de la Loi sur les arrangements avec les créanciers des compagnies (LACC) — En vertu d'une ordonnance du tribunal, le montant de la créance fiscale a été déposé dans un compte en fiducie et la balance du produit de la vente des actifs a servi à payer le créancier garanti principal — Demande de la débitrice visant à obtenir la levée partielle de la suspension de procédures afin qu'elle puisse faire cession de ses biens a été accordée, alors que la demande de la Couronne visant à obtenir le paiement des montants de TPS non remis a été rejetée — Appel interjeté par la Couronne a été accueilli — Créancier a formé un pourvoi — Pourvoi accueilli — Analyse de la LTA et de la LACC conduisait à la conclusion que le législateur ne saurait avoir eu l'intention de redonner la priorité, dans le cadre de la LACC, à la fiducie réputée de la Couronne à l'égard de ses créances relatives à la TPS quand il a modifié la LTA, en 2000 — Législateur avait mis un terme à la priorité accordée aux créances de la Couronne sous les régimes de la LACC et de la Loi sur la faillite et l'insolvabilité (LFI), et ni l'une ni l'autre de ces lois ne prévoyaient que les créances relatives à la TPS bénéficiaient d'un traitement préférentiel — Fait de faire primer la priorité de la Couronne sur les créances découlant de la TPS dans le cadre de procédures fondées sur la LACC mais pas en cas de faillite aurait pour effet de restreindre le recours à la possibilité de se restructurer sous le régime plus souple et mieux adapté de la LACC — Il semblait probable que le législateur avait par inadvertance commis une anomalie rédactionnelle — On ne pourrait pas considérer l'art. 222(3) de la LTA comme ayant implicitement abrogé l'art. 18.3 de la LACC, compte tenu des modifications récemment apportées à la LACC — Sous le régime de la LACC, le tribunal avait discrétion pour établir une passerelle vers une liquidation opérée sous le régime de la LFI et de lever la suspension partielle des procédures afin de permettre à la débitrice de procéder à la transition au régime de liquidation — Il n'y avait aucune certitude, en vertu de l'ordonnance du tribunal, que la Couronne était le bénéficiaire véritable de la fiducie ni de fondement pour donner naissance à une fiducie expresse — Montant perçu au titre de la TPS ne faisait l'objet d'aucune fiducie présumée, priorité ou fiducie expresse en faveur de la Couronne.

The debtor company owed the Crown under the Excise Tax Act (ETA) for GST that was not remitted. The debtor commenced proceedings under the Companies' Creditors Arrangement Act (CCAA). Under an order by the B.C. Supreme Court, the amount of the tax debt was placed in a trust account, and the remaining proceeds from the sale of the debtor's assets were paid to the major secured creditor. The debtor's application for a partial lifting of the stay of proceedings in order to assign itself into bankruptcy was granted, while the Crown's application for the immediate payment of the unremitted GST was dismissed.

The Crown's appeal to the B.C. Court of Appeal was allowed. The Court of Appeal found that the lower court was bound by the ETA to give the Crown priority once bankruptcy was inevitable. The Court of Appeal ruled that there was a deemed trust under s. 222 of the ETA or that an express trust was created in the Crown's favour by the court order segregating the GST funds in the trust account.

The creditor appealed to the Supreme Court of Canada.

Held: The appeal was allowed.

Per Deschamps J. (McLachlin C.J.C., Binnie, LeBel, Charron, Rothstein, Cromwell JJ. concurring): A purposive and contextual analysis of the ETA and CCAA yielded the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the CCAA when it amended the ETA in 2000. Parliament had moved away from asserting priority for Crown claims in insolvency law under both the CCAA and Bankruptcy and Insolvency Act (BIA). Unlike for source deductions, there was no express statutory basis in the CCAA or BIA for concluding that GST claims enjoyed any preferential treatment. The internal logic of the CCAA also militated against upholding a deemed trust for GST claims.

Giving the Crown priority over GST claims during CCAA proceedings but not in bankruptcy would, in practice, deprive companies of the option to restructure under the more flexible and responsive CCAA regime. It seemed likely that Parliament had inadvertently succumbed to a drafting anomaly, which could be resolved by giving precedence to s. 18.3 of the CCAA. Section 222(3) of the ETA could no longer be seen as having impliedly repealed s. 18.3 of the CCAA by being passed subsequently to the CCAA, given the recent amendments to the CCAA. The legislative context supported the conclusion that s. 222(3) of the ETA was not intended to narrow the scope of s. 18.3 of the CCAA.

The breadth of the court's discretion under the CCAA was sufficient to construct a bridge to liquidation under the BIA, so there was authority under the CCAA to partially lift the stay of proceedings to allow the debtor's entry into liquidation. There should be no gap between the CCAA and BIA proceedings that would invite a race to the courthouse to assert priorities.

The court order did not have the certainty that the Crown would actually be the beneficiary of the funds sufficient to support an express trust, as the funds were segregated until the dispute between the creditor and the Crown could be resolved. The amount collected in respect of GST but not yet remitted to the Receiver General of Canada was not subject to a deemed trust, priority or express trust in favour of the Crown.

Per Fish J. (concurring): Parliament had declined to amend the provisions at issue after detailed consideration of the insolvency regime, so the apparent conflict between s. 18.3 of the CCAA and s. 222 of the ETA should not be treated as a drafting anomaly. In the insolvency context, a deemed trust would exist only when two complementary elements co-existed: first, a statutory provision creating the trust; and second, a CCAA or BIA provision confirming its effective operation. Parliament had created the Crown's deemed trust in the Income Tax Act, Canada Pension Plan and Employment Insurance Act and then confirmed in clear and unmistakable terms its continued operation under both the CCAA and the BIA regimes. In contrast, the ETA created a deemed trust in favour of the Crown, purportedly notwithstanding any contrary legislation, but Parliament did not expressly provide for its continued operation in either the BIA or the CCAA. The absence of this confirmation reflected Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings. Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings, and so s. 222 of the ETA mentioned the BIA so as to exclude it from its ambit, rather than include it as the other statutes did. As none of these statutes mentioned the CCAA expressly, the specific reference to the BIA had no bearing on the interaction with the CCAA. It was the confirmatory provisions in the insolvency statutes that would determine whether a given deemed trust would subsist during insolvency proceedings.

Per Abella J. (dissenting): The appellate court properly found that s. 222(3) of the ETA gave priority during CCAA proceedings to the Crown's deemed trust in unremitted GST. The failure to exempt the CCAA from the operation of this provision was a reflection of clear legislative intent. Despite the requests of various constituencies and case law confirming that the ETA took precedence over the CCAA, there was no responsive legislative revision and the

BIA remained the only exempted statute. There was no policy justification for interfering, through interpretation, with this clarity of legislative intention and, in any event, the application of other principles of interpretation reinforced this conclusion. Contrary to the majority's view, the "later in time" principle did not favour the precedence of the CCAA, as the CCAA was merely re-enacted without significant substantive changes. According to the Interpretation Act, in such circumstances, s. 222(3) of the ETA remained the later provision. The chambers judge was required to respect the priority regime set out in s. 222(3) of the ETA and so did not have the authority to deny the Crown's request for payment of the GST funds during the CCAA proceedings.

La compagnie débitrice devait à la Couronne des montants de TPS qu'elle n'avait pas remis, en vertu de la Loi sur la taxe d'accise (LTA). La débitrice a entamé des procédures judiciaires en vertu de la Loi sur les arrangements avec les créanciers des compagnies (LACC). En vertu d'une ordonnance du tribunal, le montant de la créance fiscale a été déposé dans un compte en fiducie et la balance du produit de la vente des actifs de la débitrice a servi à payer le créancier garanti principal. La demande de la débitrice visant à obtenir la levée partielle de la suspension de procédures afin qu'elle puisse faire cession de ses biens a été accordée, alors que la demande de la Couronne visant à obtenir le paiement immédiat des montants de TPS non remis a été rejetée.

L'appel interjeté par la Couronne a été accueilli. La Cour d'appel a conclu que le tribunal se devait, en vertu de la LTA, de donner priorité à la Couronne une fois la faillite inévitable. La Cour d'appel a estimé que l'art. 222 de la LTA établissait une fiducie présumée ou bien que l'ordonnance du tribunal à l'effet que les montants de TPS soient détenus dans un compte en fiducie créait une fiducie expresse en faveur de la Couronne.

Le créancier a formé un pourvoi.

Arrêt: Le pourvoi a été accueilli.

Deschamps, J. (McLachlin, J.C.C., Binnie, LeBel, Charron, Rothstein, Cromwell, JJ., souscrivant à son opinion) : Une analyse téléologique et contextuelle de la LTA et de la LACC conduisait à la conclusion que le législateur ne saurait avoir eu l'intention de redonner la priorité, dans le cadre de la LACC, à la fiducie réputée de la Couronne à l'égard de ses créances relatives à la TPS quand il a modifié la LTA, en 2000. Le législateur avait mis un terme à la priorité accordée aux créances de la Couronne dans le cadre du droit de l'insolvabilité, sous le régime de la LACC et celui de la Loi sur la faillite et l'insolvabilité (LFI). Contrairement aux retenues à la source, aucune disposition législative expresse ne permettait de conclure que les créances relatives à la TPS bénéficiaient d'un traitement préférentiel sous le régime de la LACC ou celui de la LFI. La logique interne de la LACC allait également à l'encontre du maintien de la fiducie réputée à l'égard des créances découlant de la TPS.

Le fait de faire primer la priorité de la Couronne sur les créances découlant de la TPS dans le cadre de procédures fondées sur la LACC mais pas en cas de faillite aurait pour effet, dans les faits, de priver les compagnies de la possibilité de se restructurer sous le régime plus souple et mieux adapté de la LACC. Il semblait probable que le législateur avait par inadvertance commis une anomalie rédactionnelle, laquelle pouvait être corrigée en donnant préséance à l'art. 18.3 de la LACC. On ne pouvait plus considérer l'art. 222(3) de la LTA comme ayant implicitement abrogé l'art. 18.3 de la LACC parce qu'il avait été adopté après la LACC, compte tenu des modifications récemment apportées à la LACC. Le contexte législatif étayait la conclusion suivant laquelle l'art. 222(3) de la LTA n'avait pas pour but de restreindre la portée de l'art. 18.3 de la LACC.

L'ampleur du pouvoir discrétionnaire conféré au tribunal par la LACC était suffisant pour établir une passerelle vers une liquidation opérée sous le régime de la LFI, de sorte qu'il avait, en vertu de la LACC, le pouvoir de lever la suspension partielle des procédures afin de permettre à la débitrice de procéder à la transition au régime de liquidation. Il n'y avait aucune certitude, en vertu de l'ordonnance du tribunal, que la Couronne était le bénéficiaire véritable de la fiducie ni de fondement pour donner naissance à une fiducie expresse, puisque les fonds étaient détenus à part jusqu'à ce que le litige entre le créancier et la Couronne soit résolu. Le montant perçu au titre de la TPS mais non encore versé au receveur général du Canada ne faisait l'objet d'aucune fiducie présumée, priorité ou fiducie expresse en faveur de la Couronne.

Fish, J. (souscrivant aux motifs des juges majoritaires) : Le législateur a refusé de modifier les dispositions en question suivant un examen approfondi du régime d'insolvabilité, de sorte qu'on ne devrait pas qualifier l'apparente contradiction entre l'art. 18.3 de la LACC et l'art. 222 de la LTA d'anomalie rédactionnelle. Dans un contexte d'insolvabilité, on ne pourrait conclure à l'existence d'une fiducie présumée que lorsque deux éléments complémentaires étaient réunis : en premier lieu, une disposition législative qui crée la fiducie et, en second lieu, une disposition de la LACC ou de la LFI qui confirme l'existence de la fiducie. Le législateur a établi une fiducie présumée en faveur de la Couronne dans la Loi de l'impôt sur le revenu, le Régime de pensions du Canada et la Loi sur l'assurance-emploi puis, il a confirmé en termes clairs et explicites sa volonté de voir cette fiducie présumée produire ses effets sous le régime de la LACC et de la LFI. Dans le cas de la LTA, il a établi une fiducie présumée en faveur de la Couronne, sciemment et sans égard pour toute législation à l'effet contraire, mais n'a pas expressément prévu le maintien en vigueur de celle-ci sous le régime de la LFI ou celui de la LACC. L'absence d'une telle confirmation témoignait de l'intention du législateur de laisser la fiducie présumée devenir caduque au moment de l'introduction de la procédure d'insolvabilité. L'intention du législateur était manifestement de rendre inopérantes les fiducies présumées visant la TPS dès l'introduction d'une procédure d'insolvabilité et, par conséquent, l'art. 222 de la LTA mentionnait la LFI de manière à l'exclure de son champ d'application, et non de l'y inclure, comme le faisaient les autres lois. Puisqu'aucune de ces lois ne mentionnait spécifiquement la LACC, la mention explicite de la LFI n'avait aucune incidence sur l'interaction avec la LACC. C'était les dispositions confirmatoires que l'on trouvait dans les lois sur l'insolvabilité qui déterminaient si une fiducie présumée continuerait d'exister durant une procédure d'insolvabilité.

Abella, J. (dissidente) : La Cour d'appel a conclu à bon droit que l'art. 222(3) de la LTA donnait préséance à la fiducie présumée qui est établie en faveur de la Couronne à l'égard de la TPS non versée. Le fait que la LACC n'ait pas été soustraite à l'application de cette disposition témoignait d'une intention claire du législateur. Malgré les demandes répétées de divers groupes et la jurisprudence ayant confirmé que la LTA l'emportait sur la LACC, le législateur n'est pas intervenu et la LFI est demeurée la seule loi soustraite à l'application de cette disposition. Il n'y avait pas de considération de politique générale qui justifierait d'aller à l'encontre, par voie d'interprétation législative, de l'intention aussi clairement exprimée par le législateur et, de toutes manières, cette conclusion était renforcée par l'application d'autres principes d'interprétation. Contrairement à l'opinion des juges majoritaires, le principe de la préséance de la « loi postérieure » ne militait pas en faveur de la présance de la LACC, celle-ci ayant été simplement adoptée à nouveau sans que l'on ne lui ait apporté de modifications importantes. En vertu de la Loi d'interprétation, dans ces circonstances, l'art. 222(3) de la LTA demeurait la disposition postérieure. Le juge siégeant en son cabinet était tenu de respecter le régime de priorités établi à l'art. 222(3) de la LTA, et il ne pouvait pas refuser la demande présentée par la Couronne en vue de se faire payer la TPS dans le cadre de la procédure introduite en vertu de la LACC.

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***Deschamps J.*:**

1 For the first time this Court is called upon to directly interpret the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). In that respect, two questions are raised. The first requires reconciliation of provisions of the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*"), which lower courts have held to be in conflict with one another. The second concerns the scope of a court's discretion when supervising reorganization. The relevant statutory provisions are reproduced in the Appendix. On the first question, having considered the evolution of Crown priorities in the context of insolvency and the wording of the various statutes creating Crown priorities, I conclude that it is the *CCAA* and not the *ETA* that provides the rule. On the second question, I conclude that the broad discretionary jurisdiction conferred on the supervising judge must be interpreted having regard to the remedial nature of the *CCAA* and insolvency legislation generally. Consequently, the court had the discretion to partially lift a stay of proceedings to allow the debtor to make an assignment under the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*"). I would allow the appeal.

1. Facts and Decisions of the Courts Below

2 Ted LeRoy Trucking Ltd. ("LeRoy Trucking") commenced proceedings under the *CCAA* in the Supreme Court of British Columbia on December 13, 2007, obtaining a stay of proceedings with a view to reorganizing its financial affairs. LeRoy Trucking sold certain redundant assets as authorized by the order.

3 Amongst the debts owed by LeRoy Trucking was an amount for Goods and Services Tax ("GST") collected but unremitted to the Crown. The *ETA* creates a deemed trust in favour of the Crown for amounts collected in respect of

GST. The deemed trust extends to any property or proceeds held by the person collecting GST and any property of that person held by a secured creditor, requiring that property to be paid to the Crown in priority to all security interests. The *ETA* provides that the deemed trust operates despite any other enactment of Canada except the *BIA.* However, the *CCAA* also provides that subject to certain exceptions, none of which mentions GST, deemed trusts in favour of the Crown do not operate under the *CCAA.* Accordingly, under the *CCAA* the Crown ranks as an unsecured creditor in respect of GST. Nonetheless, at the time LeRoy Trucking commenced *CCAA* proceedings the leading line of jurisprudence held that the *ETA* took precedence over the *CCAA* such that the Crown enjoyed priority for GST claims under the *CCAA*, even though it would have lost that same priority under the *BIA.* The *CCAA* underwent substantial amendments in 2005 in which some of the provisions at issue in this appeal were renumbered and reformulated (S.C. 2005, c. 47). However, these amendments only came into force on September 18, 2009. I will refer to the amended provisions only where relevant.

4 On April 29, 2008, Brenner C.J.S.C., in the context of the *CCAA* proceedings, approved a payment not exceeding $5 million, the proceeds of redundant asset sales, to Century Services, the debtor's major secured creditor. LeRoy Trucking proposed to hold back an amount equal to the GST monies collected but unremitted to the Crown and place it in the Monitor's trust account until the outcome of the reorganization was known. In order to maintain the *status quo* while the success of the reorganization was uncertain, Brenner C.J.S.C. agreed to the proposal and ordered that an amount of $305,202.30 be held by the Monitor in its trust account.

5 On September 3, 2008, having concluded that reorganization was not possible, LeRoy Trucking sought leave to make an assignment in bankruptcy under the *BIA.* The Crown sought an order that the GST monies held by the Monitor be paid to the Receiver General of Canada. Brenner C.J.S.C. dismissed the latter application. Reasoning that the purpose of segregating the funds with the Monitor was "to facilitate an ultimate payment of the GST monies which were owed pre-filing, but only if a viable plan emerged", the failure of such a reorganization, followed by an assignment in bankruptcy, meant the Crown would lose priority under the *BIA* (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

6 The Crown's appeal was allowed by the British Columbia Court of Appeal (2009 BCCA 205, [2009] G.S.T.C. 79, 270 B.C.A.C. 167 (B.C. C.A.)). Tysoe J.A. for a unanimous court found two independent bases for allowing the Crown's appeal.

7 First, the court's authority under s. 11 of the *CCAA* was held not to extend to staying the Crown's application for immediate payment of the GST funds subject to the deemed trust after it was clear that reorganization efforts had failed and that bankruptcy was inevitable. As restructuring was no longer a possibility, staying the Crown's claim to the GST funds no longer served a purpose under the *CCAA* and the court was bound under the priority scheme provided by the *ETA* to allow payment to the Crown. In so holding, Tysoe J.A. adopted the reasoning in *Ottawa Senators Hockey Club Corp. (Re)*, [2005] G.S.T.C. 1, 73 O.R. (3d) 737 (Ont. C.A.), which found that the *ETA* deemed trust for GST established Crown priority over secured creditors under the *CCAA.*

8 Second, Tysoe J.A. concluded that by ordering the GST funds segregated in the Monitor's trust account on April 29, 2008, the judge had created an express trust in favour of the Crown from which the monies in question could not be diverted for any other purposes. The Court of Appeal therefore ordered that the money held by the Monitor in trust be paid to the Receiver General.

2. Issues

9 This appeal raises three broad issues which are addressed in turn:

(1) Did s. 222(3) of the *ETA* displace s. 18.3(1) of the *CCAA* and give priority to the Crown's *ETA* deemed trust during *CCAA* proceedings as held in *Ottawa Senators*?

(2) Did the court exceed its *CCAA* authority by lifting the stay to allow the debtor to make an assignment in bankruptcy?

(3) Did the court's order of April 29, 2008 requiring segregation of the Crown's GST claim in the Monitor's trust account create an express trust in favour of the Crown in respect of those funds?

3. Analysis

10 The first issue concerns Crown priorities in the context of insolvency. As will be seen, the *ETA* provides for a deemed trust in favour of the Crown in respect of GST owed by a debtor "[d]espite ... any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)" (s. 222(3)), while the *CCAA* stated at the relevant time that "notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be [so] regarded" (s. 18.3(1)). It is difficult to imagine two statutory provisions more apparently in conflict. However, as is often the case, the apparent conflict can be resolved through interpretation.

11 In order to properly interpret the provisions, it is necessary to examine the history of the *CCAA*, its function amidst the body of insolvency legislation enacted by Parliament, and the principles that have been recognized in the jurisprudence. It will be seen that Crown priorities in the insolvency context have been significantly pared down. The resolution of the second issue is also rooted in the context of the *CCAA*, but its purpose and the manner in which it has been interpreted in the case law are also key. After examining the first two issues in this case, I will address Tysoe J.A.'s conclusion that an express trust in favour of the Crown was created by the court's order of April 29, 2008.

3.1 Purpose and Scope of Insolvency Law

12 Insolvency is the factual situation that arises when a debtor is unable to pay creditors (see generally, R. J. Wood, *Bankruptcy and Insolvency Law* (2009), at p. 16). Certain legal proceedings become available upon insolvency, which typically allow a debtor to obtain a court order staying its creditors' enforcement actions and attempt to obtain a binding compromise with creditors to adjust the payment conditions to something more realistic. Alternatively, the debtor's assets may be liquidated and debts paid from the proceeds according to statutory priority rules. The former is usually referred to as reorganization or restructuring while the latter is termed liquidation.

13 Canadian commercial insolvency law is not codified in one exhaustive statute. Instead, Parliament has enacted multiple insolvency statutes, the main one being the *BIA*. The *BIA* offers a self-contained legal regime providing for both reorganization and liquidation. Although bankruptcy legislation has a long history, the *BIA* itself is a fairly recent statute — it was enacted in 1992. It is characterized by a rules-based approach to proceedings. The *BIA* is available to insolvent debtors owing $1000 or more, regardless of whether they are natural or legal persons. It contains mechanisms for debtors to make proposals to their creditors for the adjustment of debts. If a proposal fails, the *BIA* contains a bridge to bankruptcy whereby the debtor's assets are liquidated and the proceeds paid to creditors in accordance with the statutory scheme of distribution.

14 Access to the *CCAA* is more restrictive. A debtor must be a company with liabilities in excess of $5 million. Unlike the *BIA*, the *CCAA* contains no provisions for liquidation of a debtor's assets if reorganization fails. There are three ways of exiting *CCAA* proceedings. The best outcome is achieved when the stay of proceedings provides the debtor with some breathing space during which solvency is restored and the *CCAA* process terminates without reorganization being needed. The second most desirable outcome occurs when the debtor's compromise or arrangement is accepted by its creditors and the reorganized company emerges from the *CCAA* proceedings as a going concern. Lastly, if the compromise or arrangement fails, either the company or its creditors usually seek to have the debtor's assets liquidated under the applicable provisions of the *BIA* or to place the debtor into receivership. As discussed in greater detail below, the key difference between the reorganization regimes under the *BIA* and the *CCAA* is that the latter offers a more flexible mechanism with greater judicial discretion, making it more responsive to complex reorganizations.

15 As I will discuss at greater length below, the purpose of the *CCAA* — Canada's first reorganization statute — is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose, though this is achieved through a rules-

based mechanism that offers less flexibility. Where reorganization is impossible, the *BIA* may be employed to provide an orderly mechanism for the distribution of a debtor's assets to satisfy creditor claims according to predetermined priority rules.

16 Prior to the enactment of the *CCAA* in 1933 (S.C. 1932-33, c. 36), practice under existing commercial insolvency legislation tended heavily towards the liquidation of a debtor company (J. Sarra, *Creditor Rights and the Public Interest: Restructuring Insolvent Corporations* (2003), at p. 12). The battering visited upon Canadian businesses by the Great Depression and the absence of an effective mechanism for reaching a compromise between debtors and creditors to avoid liquidation required a legislative response. The *CCAA* was innovative as it allowed the insolvent debtor to attempt reorganization under judicial supervision outside the existing insolvency legislation which, once engaged, almost invariably resulted in liquidation (*Reference re Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659 (S.C.C.), at pp. 660-61; Sarra, *Creditor Rights*, at pp. 12-13).

17 Parliament understood when adopting the *CCAA* that liquidation of an insolvent company was harmful for most of those it affected — notably creditors and employees — and that a workout which allowed the company to survive was optimal (Sarra, *Creditor Rights*, at pp. 13-15).

18 Early commentary and jurisprudence also endorsed the *CCAA's* remedial objectives. It recognized that companies retain more value as going concerns while underscoring that intangible losses, such as the evaporation of the companies' goodwill, result from liquidation (S. E. Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act" (1947), 25 *Can. Bar Rev.* 587, at p. 592). Reorganization serves the public interest by facilitating the survival of companies supplying goods or services crucial to the health of the economy or saving large numbers of jobs (*ibid.*, at p. 593). Insolvency could be so widely felt as to impact stakeholders other than creditors and employees. Variants of these views resonate today, with reorganization justified in terms of rehabilitating companies that are key elements in a complex web of interdependent economic relationships in order to avoid the negative consequences of liquidation.

19 The *CCAA* fell into disuse during the next several decades, likely because amendments to the Act in 1953 restricted its use to companies issuing bonds (S.C. 1952-53, c. 3). During the economic downturn of the early 1980s, insolvency lawyers and courts adapting to the resulting wave of insolvencies resurrected the statute and deployed it in response to new economic challenges. Participants in insolvency proceedings grew to recognize and appreciate the statute's distinguishing feature: a grant of broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA's* objectives. The manner in which courts have used *CCAA* jurisdiction in increasingly creative and flexible ways is explored in greater detail below.

20 Efforts to evolve insolvency law were not restricted to the courts during this period. In 1970, a government-commissioned panel produced an extensive study recommending sweeping reform but Parliament failed to act (see *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (1970)). Another panel of experts produced more limited recommendations in 1986 which eventually resulted in enactment of the *Bankruptcy and Insolvency Act* of 1992 (S.C. 1992, c. 27) (see *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)). Broader provisions for reorganizing insolvent debtors were then included in Canada's bankruptcy statute. Although the 1970 and 1986 reports made no specific recommendations with respect to the *CCAA*, the House of Commons committee studying the *BIA*'s predecessor bill, C-22, seemed to accept expert testimony that the *BIA*'s new reorganization scheme would shortly supplant the *CCAA*, which could then be repealed, with commercial insolvency and bankruptcy being governed by a single statute (*Minutes of Proceedings and Evidence of the Standing Committee on Consumer and Corporate Affairs and Government Operations*, Issue No. 15, October 3, 1991, at pp. 15:15-15:16).

21 In retrospect, this conclusion by the House of Commons committee was out of step with reality. It overlooked the renewed vitality the *CCAA* enjoyed in contemporary practice and the advantage that a flexible judicially supervised reorganization process presented in the face of increasingly complex reorganizations, when compared to the stricter rules-based scheme contained in the *BIA*. The "flexibility of the *CCAA* [was seen as] a great benefit, allowing for

creative and effective decisions" (Industry Canada, Marketplace Framework Policy Branch, *Report on the Operation and Administration of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (2002), at p. 41). Over the past three decades, resurrection of the *CCAA* has thus been the mainspring of a process through which, one author concludes, "the legal setting for Canadian insolvency restructuring has evolved from a rather blunt instrument to one of the most sophisticated systems in the developed world" (R. B. Jones, "The Evolution of Canadian Restructuring: Challenges for the Rule of Law", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2005* (2006), 481, at p. 481).

22 While insolvency proceedings may be governed by different statutory schemes, they share some commonalities. The most prominent of these is the single proceeding model. The nature and purpose of the single proceeding model are described by Professor Wood in *Bankruptcy and Insolvency Law*:

> They all provide a collective proceeding that supersedes the usual civil process available to creditors to enforce their claims. The creditors' remedies are collectivized in order to prevent the free-for-all that would otherwise prevail if creditors were permitted to exercise their remedies. In the absence of a collective process, each creditor is armed with the knowledge that if they do not strike hard and swift to seize the debtor's assets, they will be beat out by other creditors. [pp. 2-3]

The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiation with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt a compromise. With a view to achieving that purpose, both the *CCAA* and the *BIA* allow a court to order all actions against a debtor to be stayed while a compromise is sought.

23 Another point of convergence of the *CCAA* and the *BIA* relates to priorities. Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful. In addition, one of the important features of legislative reform of both statutes since the enactment of the *BIA* in 1992 has been a cutback in Crown priorities (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, ss. 73 and 125; S.C. 2000, c. 30, s. 148; S.C. 2005, c. 47, ss. 69 and 131; S.C. 2009, c. 33, ss. 25 and 29; see also *Alternative granite & marbre inc., Re*, 2009 SCC 49, [2009] 3 S.C.R. 286, [2009] G.S.T.C. 154 (S.C.C.); *Quebec (Deputy Minister of Revenue) c. Rainville* (1979), [1980] 1 S.C.R. 35 (S.C.C.); *Proposed Bankruptcy Act Amendments: Report of the Advisory Committee on Bankruptcy and Insolvency* (1986)).

24 With parallel *CCAA* and *BIA* restructuring schemes now an accepted feature of the insolvency law landscape, the contemporary thrust of legislative reform has been towards harmonizing aspects of insolvency law common to the two statutory schemes to the extent possible and encouraging reorganization over liquidation (see *An Act to establish the Wage Earner Protection Program Act, to amend the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act and to make consequential amendments to other Acts*, S.C. 2005, c. 47; *Gauntlet Energy Corp., Re*, 2003 ABQB 894, [2003] G.S.T.C. 193, 30 Alta. L.R. (4th) 192 (Alta. Q.B.), at para. 19).

25 Mindful of the historical background of the *CCAA* and *BIA*, I now turn to the first question at issue.

3.2 GST Deemed Trust Under the CCAA

26 The Court of Appeal proceeded on the basis that the *ETA* precluded the court from staying the Crown's enforcement of the GST deemed trust when partially lifting the stay to allow the debtor to enter bankruptcy. In so doing, it adopted the reasoning in a line of cases culminating in *Ottawa Senators*, which held that an *ETA* deemed trust remains enforceable during *CCAA* reorganization despite language in the *CCAA* that suggests otherwise.

27 The Crown relies heavily on the decision of the Ontario Court of Appeal in *Ottawa Senators* and argues that the later in time provision of the *ETA* creating the GST deemed trust trumps the provision of the *CCAA* purporting to nullify most statutory deemed trusts. The Court of Appeal in this case accepted this reasoning but not all provincial courts

follow it (see, e.g., *Komunik Corp., Re*, 2009 QCCS 6332 (C.S. Que.), leave to appeal granted, 2010 QCCA 183 (C.A. Que.)). Century Services relied, in its written submissions to this Court, on the argument that the court had authority under the *CCAA* to continue the stay against the Crown's claim for unremitted GST. In oral argument, the question of whether *Ottawa Senators* was correctly decided nonetheless arose. After the hearing, the parties were asked to make further written submissions on this point. As appears evident from the reasons of my colleague Abella J., this issue has become prominent before this Court. In those circumstances, this Court needs to determine the correctness of the reasoning in *Ottawa Senators*.

28 The policy backdrop to this question involves the Crown's priority as a creditor in insolvency situations which, as I mentioned above, has evolved considerably. Prior to the 1990s, Crown claims largely enjoyed priority in insolvency. This was widely seen as unsatisfactory as shown by both the 1970 and 1986 insolvency reform proposals, which recommended that Crown claims receive no preferential treatment. A closely related matter was whether the *CCAA* was binding at all upon the Crown. Amendments to the *CCAA* in 1997 confirmed that it did indeed bind the Crown (see *CCAA*, s. 21, as am. by S.C. 1997, c. 12, s. 126).

29 Claims of priority by the state in insolvency situations receive different treatment across jurisdictions worldwide. For example, in Germany and Australia, the state is given no priority at all, while the state enjoys wide priority in the United States and France (see B. K. Morgan, "Should the Sovereign be Paid First? A Comparative International Analysis of the Priority for Tax Claims in Bankruptcy" (2000), 74 *Am. Bank. L.J.* 461, at p. 500). Canada adopted a middle course through legislative reform of Crown priority initiated in 1992. The Crown retained priority for source deductions of income tax, Employment Insurance ("EI") and Canada Pension Plan ("CPP") premiums, but ranks as an ordinary unsecured creditor for most other claims.

30 Parliament has frequently enacted statutory mechanisms to secure Crown claims and permit their enforcement. The two most common are statutory deemed trusts and powers to garnish funds third parties owe the debtor (see F. L. Lamer, *Priority of Crown Claims in Insolvency* (loose-leaf), at § 2).

31 With respect to GST collected, Parliament has enacted a deemed trust. The *ETA* states that every person who collects an amount on account of GST is deemed to hold that amount in trust for the Crown (s. 222(1)). The deemed trust extends to other property of the person collecting the tax equal in value to the amount deemed to be in trust if that amount has not been remitted in accordance with the *ETA*. The deemed trust also extends to property held by a secured creditor that, but for the security interest, would be property of the person collecting the tax (s. 222(3)).

32 Parliament has created similar deemed trusts using almost identical language in respect of source deductions of income tax, EI premiums and CPP premiums (see s. 227(4) of the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*"), ss. 86(2) and (2.1) of the *Employment Insurance Act*, S.C. 1996, c. 23, and ss. 23(3) and (4) of the *Canada Pension Plan*, R.S.C. 1985, c. C-8). I will refer to income tax, EI and CPP deductions as "source deductions".

33 In *Royal Bank v. Sparrow Electric Corp.*, [1997] 1 S.C.R. 411 (S.C.C.), this Court addressed a priority dispute between a deemed trust for source deductions under the *ITA* and security interests taken under both the *Bank Act*, S.C. 1991, c. 46, and the Alberta *Personal Property Security Act*, S.A. 1988, c. P-4.05 ("*PPSA*"). As then worded, an *ITA* deemed trust over the debtor's property equivalent to the amount owing in respect of income tax became effective at the time of liquidation, receivership, or assignment in bankruptcy. *Sparrow Electric* held that the *ITA* deemed trust could not prevail over the security interests because, being fixed charges, the latter attached as soon as the debtor acquired rights in the property such that the *ITA* deemed trust had no property on which to attach when it subsequently arose. Later, in *First Vancouver Finance v. Minister of National Revenue*, 2002 SCC 49, [2002] G.S.T.C. 23, [2002] 2 S.C.R. 720 (S.C.C.), this Court observed that Parliament had legislated to strengthen the statutory deemed trust in the *ITA* by deeming it to operate from the moment the deductions were not paid to the Crown as required by the *ITA*, and by granting the Crown priority over all security interests (paras. 27-29) (the "*Sparrow Electric* amendment").

34 The amended text of s. 227(4.1) of the *ITA* and concordant source deductions deemed trusts in the *Canada Pension Plan* and the *Employment Insurance Act* state that the deemed trust operates notwithstanding any other enactment of Canada, except ss. 81.1 and 81.2 of the *BIA.* The *ETA* deemed trust at issue in this case is similarly worded, but it excepts the *BIA* in its entirety. The provision reads as follows:

> **222.** (3) Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed ....

35 The Crown submits that the *Sparrow Electric* amendment, added by Parliament to the *ETA* in 2000, was intended to preserve the Crown's priority over collected GST under the *CCAA* while subordinating the Crown to the status of an unsecured creditor in respect of GST only under the *BIA.* This is because the *ETA* provides that the GST deemed trust is effective "despite" any other enactment except the *BIA.*

36 The language used in the *ETA* for the GST deemed trust creates an apparent conflict with the *CCAA*, which provides that subject to certain exceptions, property deemed by statute to be held in trust for the Crown shall not be so regarded.

37 Through a 1997 amendment to the *CCAA* (S.C. 1997, c. 12, s. 125), Parliament appears to have, subject to specific exceptions, nullified deemed trusts in favour of the Crown once reorganization proceedings are commenced under the Act. The relevant provision reads:

> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

This nullification of deemed trusts was continued in further amendments to the *CCAA* (S.C. 2005, c. 47), where s. 18.3(1) was renumbered and reformulated as s. 37(1):

> **37.** (1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

38 An analogous provision exists in the *BIA*, which, subject to the same specific exceptions, nullifies statutory deemed trusts and makes property of the bankrupt that would otherwise be subject to a deemed trust part of the debtor's estate and available to creditors (S.C. 1992, c. 27, s. 39; S.C. 1997, c. 12, s. 73; *BIA*, s. 67(2)). It is noteworthy that in both the *CCAA* and the *BIA*, the exceptions concern source deductions (*CCAA*, s. 18.3(2); *BIA*, s. 67(3)). The relevant provision of the *CCAA* reads:

> **18.3** (2) Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

Thus, the Crown's deemed trust and corresponding priority in source deductions remain effective both in reorganization and in bankruptcy.

39 Meanwhile, in both s. 18.4(1) of the *CCAA* and s. 86(1) of the *BIA*, other Crown claims are treated as unsecured. These provisions, establishing the Crown's status as an unsecured creditor, explicitly exempt statutory deemed trusts in source deductions *(CCAA*, s. 18.4(3); *BIA*, s. 86(3)). The *CCAA* provision reads as follows:

> **18.4** (3) Subsection (1) [Crown ranking as unsecured creditor] does not affect the operation of
>
> > (a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,
> >
> > (b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution ....

Therefore, not only does the *CCAA* provide that Crown claims do not enjoy priority over the claims of other creditors (s. 18.3(1)), but the exceptions to this rule (i.e., that Crown priority is maintained for source deductions) are repeatedly stated in the statute.

40 The apparent conflict in this case is whether the rule in the *CCAA* first enacted as s. 18.3 in 1997, which provides that subject to certain explicit exceptions, statutory deemed trusts are ineffective under the *CCAA*, is overridden by the one in the *ETA* enacted in 2000 stating that GST deemed trusts operate despite any enactment of Canada except the *BIA*. With respect for my colleague Fish J., I do not think the apparent conflict can be resolved by denying it and creating a rule requiring both a statutory provision enacting the deemed trust, and a second statutory provision confirming it. Such a rule is unknown to the law. Courts must recognize conflicts, apparent or real, and resolve them when possible.

41 A line of jurisprudence across Canada has resolved the apparent conflict in favour of the *ETA*, thereby maintaining GST deemed trusts under the *CCAA*. *Ottawa Senators*, the leading case, decided the matter by invoking the doctrine of implied repeal to hold that the later in time provision of the *ETA* should take precedence over the *CCAA* (see also *Solid Resources Ltd., Re* (2002), 40 C.B.R. (4th) 219, [2003] G.S.T.C. 21 (Alta. Q.B.); *Gauntlet*

42 The Ontario Court of Appeal in *Ottawa Senators* rested its conclusion on two considerations. First, it was persuaded that by explicitly mentioning the *BIA* in *ETA* s. 222(3), but not the *CCAA*, Parliament made a deliberate choice. In the words of MacPherson J.A.:

> The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

43 Second, the Ontario Court of Appeal compared the conflict between the *ETA* and the *CCAA* to that before this Court in *Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.), and found them to be "identical" (para. 46). It therefore considered *Doré* binding (para. 49). In *Doré*, a limitations provision in the more general and recently enacted *Civil Code of Québec*, S.Q. 1991, c. 64 ("*C.C.Q.*"), was held to have repealed a more specific provision of the earlier Quebec *Cities and Towns Act*, R.S.Q., c. C-19, with which it conflicted. By analogy, the Ontario Court of Appeal held that the later in time and more general provision, s. 222(3) of the *ETA*, impliedly repealed the more specific and earlier in time provision, s. 18.3(1) of the *CCAA* (paras. 47-49).

44 Viewing this issue in its entire context, several considerations lead me to conclude that neither the reasoning nor the result in *Ottawa Senators* can stand. While a conflict may exist at the level of the statutes' wording, a purposive and contextual analysis to determine Parliament's true intent yields the conclusion that Parliament could not have intended to restore the Crown's deemed trust priority in GST claims under the *CCAA* when it amended the *ETA* in 2000 with the *Sparrow Electric* amendment.

45 I begin by recalling that Parliament has shown its willingness to move away from asserting priority for Crown claims in insolvency law. Section 18.3(1) of the *CCAA* (subject to the s. 18.3(2) exceptions) provides that the Crown's deemed trusts have no effect under the *CCAA*. Where Parliament has sought to protect certain Crown claims through statutory deemed trusts and intended that these deemed trusts continue in insolvency, it has legislated so explicitly and elaborately. For example, s. 18.3(2) of the *CCAA* and s. 67(3) of the *BIA* expressly provide that deemed trusts for source deductions remain effective in insolvency. Parliament has, therefore, clearly carved out exceptions from the general rule that deemed

trusts are ineffective in insolvency. The *CCAA* and *BIA* are in harmony, preserving deemed trusts and asserting Crown priority only in respect of source deductions. Meanwhile, there is no express statutory basis for concluding that GST claims enjoy a preferred treatment under the *CCAA* or the *BIA.* Unlike source deductions, which are clearly and expressly dealt with under both these insolvency statutes, no such clear and express language exists in those Acts carving out an exception for GST claims.

46 The internal logic of the *CCAA* also militates against upholding the *ETA* deemed trust for GST. The *CCAA* imposes limits on a suspension by the court of the Crown's rights in respect of source deductions but does not mention the *ETA* (s. 11.4). Since source deductions deemed trusts are granted explicit protection under the *CCAA*, it would be inconsistent to afford a better protection to the *ETA* deemed trust absent explicit language in the *CCAA.* Thus, the logic of the *CCAA* appears to subject the *ETA* deemed trust to the waiver by Parliament of its priority (s. 18.4).

47 Moreover, a strange asymmetry would arise if the interpretation giving the *ETA* priority over the *CCAA* urged by the Crown is adopted here: the Crown would retain priority over GST claims during *CCAA* proceedings but not in bankruptcy. As courts have reflected, this can only encourage statute shopping by secured creditors in cases such as this one where the debtor's assets cannot satisfy both the secured creditors' and the Crown's claims (*Gauntlet*, at para. 21). If creditors' claims were better protected by liquidation under the *BIA*, creditors' incentives would lie overwhelmingly with avoiding proceedings under the *CCAA* and not risking a failed reorganization. Giving a key player in any insolvency such skewed incentives against reorganizing under the *CCAA* can only undermine that statute's remedial objectives and risk inviting the very social ills that it was enacted to avert.

48 Arguably, the effect of *Ottawa Senators* is mitigated if restructuring is attempted under the *BIA* instead of the *CCAA*, but it is not cured. If *Ottawa Senators* were to be followed, Crown priority over GST would differ depending on whether restructuring took place under the *CCAA* or the *BIA.* The anomaly of this result is made manifest by the fact that it would deprive companies of the option to restructure under the more flexible and responsive *CCAA* regime, which has been the statute of choice for complex reorganizations.

49 Evidence that Parliament intended different treatments for GST claims in reorganization and bankruptcy is scant, if it exists at all. Section 222(3) of the *ETA* was enacted as part of a wide-ranging budget implementation bill in 2000. The summary accompanying that bill does not indicate that Parliament intended to elevate Crown priority over GST claims under the *CCAA* to the same or a higher level than source deductions claims. Indeed, the summary for deemed trusts states only that amendments to existing provisions are aimed at "ensuring that employment insurance premiums and Canada Pension Plan contributions that are required to be remitted by an employer are fully recoverable by the Crown in the case of the bankruptcy of the employer" (Summary to S.C. 2000, c. 30, at p. 4a). The wording of GST deemed trusts resembles that of statutory deemed trusts for source deductions and incorporates the same overriding language and reference to the *BIA.* However, as noted above, Parliament's express intent is that only source deductions deemed trusts remain operative. An exception for the *BIA* in the statutory language establishing the source deductions deemed trusts accomplishes very little, because the explicit language of the *BIA* itself (and the *CCAA*) carves out these source deductions deemed trusts and maintains their effect. It is however noteworthy that no equivalent language maintaining GST deemed trusts exists under either the *BIA* or the *CCAA.*

50 It seems more likely that by adopting the same language for creating GST deemed trusts in the *ETA* as it did for deemed trusts for source deductions, and by overlooking the inclusion of an exception for the *CCAA* alongside the *BIA* in s. 222(3) of the *ETA*, Parliament may have inadvertently succumbed to a drafting anomaly. Because of a statutory lacuna in the *ETA*, the GST deemed trust could be seen as remaining effective in the *CCAA*, while ceasing to have any effect under the *BIA*, thus creating an apparent conflict with the wording of the *CCAA.* However, it should be seen for what it is: a facial conflict only, capable of resolution by looking at the broader approach taken to Crown priorities and by giving precedence to the statutory language of s. 18.3 of the *CCAA* in a manner that does not produce an anomalous outcome.

51 Section 222(3) of the *ETA* evinces no explicit intention of Parliament to repeal *CCAA* s. 18.3. It merely creates an apparent conflict that must be resolved by statutory interpretation. Parliament's intent when it enacted *ETA* s. 222(3)

was therefore far from unambiguous. Had it sought to give the Crown a priority for GST claims, it could have done so explicitly as it did for source deductions. Instead, one is left to infer from the language of *ETA* s. 222(3) that the GST deemed trust was intended to be effective under the *CCAA.*

52 I am not persuaded that the reasoning in *Doré* requires the application of the doctrine of implied repeal in the circumstances of this case. The main issue in *Doré* concerned the impact of the adoption of the *C.C.Q.* on the administrative law rules with respect to municipalities. While Gonthier J. concluded in that case that the limitation provision in art. 2930 *C.C.Q.* had repealed by implication a limitation provision in the *Cities and Towns Act*, he did so on the basis of more than a textual analysis. The conclusion in *Doré* was reached after thorough contextual analysis of both pieces of legislation, including an extensive review of the relevant legislative history (paras. 31-41). Consequently, the circumstances before this Court in *Doré* are far from "identical" to those in the present case, in terms of text, context and legislative history. Accordingly, *Doré* cannot be said to require the automatic application of the rule of repeal by implication.

53 A noteworthy indicator of Parliament's overall intent is the fact that in subsequent amendments it has not displaced the rule set out in the *CCAA.* Indeed, as indicated above, the recent amendments to the *CCAA* in 2005 resulted in the rule previously found in s. 18.3 being renumbered and reformulated as s. 37. Thus, to the extent the interpretation allowing the GST deemed trust to remain effective under the *CCAA* depends on *ETA* s. 222(3) having impliedly repealed *CCAA* s. 18.3(1) because it is later in time, we have come full circle. Parliament has renumbered and reformulated the provision of the *CCAA* stating that, subject to exceptions for source deductions, deemed trusts do not survive the *CCAA* proceedings and thus the *CCAA* is now the later in time statute. This confirms that Parliament's intent with respect to GST deemed trusts is to be found in the *CCAA.*

54 I do not agree with my colleague Abella J. that s. 44(*f*) of the *Interpretation Act*, R.S.C. 1985, c. I-21, can be used to interpret the 2005 amendments as having no effect. The new statute can hardly be said to be a mere re-enactment of the former statute. Indeed, the *CCAA* underwent a substantial review in 2005. Notably, acting consistently with its goal of treating both the *BIA* and the *CCAA* as sharing the same approach to insolvency, Parliament made parallel amendments to both statutes with respect to corporate proposals. In addition, new provisions were introduced regarding the treatment of contracts, collective agreements, interim financing and governance agreements. The appointment and role of the Monitor was also clarified. Noteworthy are the limits imposed by *CCAA* s. 11.09 on the court's discretion to make an order staying the Crown's source deductions deemed trusts, which were formerly found in s. 11.4. No mention whatsoever is made of GST deemed trusts (see Summary to S.C. 2005, c. 47). The review went as far as looking at the very expression used to describe the statutory override of deemed trusts. The comments cited by my colleague only emphasize the clear intent of Parliament to maintain its policy that only source deductions deemed trusts survive in *CCAA* proceedings.

55 In the case at bar, the legislative context informs the determination of Parliament's legislative intent and supports the conclusion that *ETA* s. 222(3) was not intended to narrow the scope of the *CCAA's* override provision. Viewed in its entire context, the conflict between the *ETA* and the *CCAA* is more apparent than real. I would therefore not follow the reasoning in *Ottawa Senators* and affirm that *CCAA* s. 18.3 remained effective.

56 My conclusion is reinforced by the purpose of the *CCAA* as part of Canadian remedial insolvency legislation. As this aspect is particularly relevant to the second issue, I will now discuss how courts have interpreted the scope of their discretionary powers in supervising a *CCAA* reorganization and how Parliament has largely endorsed this interpretation. Indeed, the interpretation courts have given to the *CCAA* helps in understanding how the *CCAA* grew to occupy such a prominent role in Canadian insolvency law.

3.3 Discretionary Power of a Court Supervising a CCAA Reorganization

57 Courts frequently observe that "[t]he *CCAA* is skeletal in nature" and does not "contain a comprehensive code that lays out all that is permitted or barred" (*ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*,

2008 ONCA 587, 92 O.R. (3d) 513 (Ont. C.A.), at para. 44, *per* Blair J.A.). Accordingly, "[t]he history of CCAA law has been an evolution of judicial interpretation" (*Dylex Ltd., Re* (1995), 31 C.B.R. (3d) 106 (Ont. Gen. Div. [Commercial List])), at para. 10, *per* Farley J.).

58 *CCAA* decisions are often based on discretionary grants of jurisdiction. The incremental exercise of judicial discretion in commercial courts under conditions one practitioner aptly describes as "the hothouse of real-time litigation" has been the primary method by which the *CCAA* has been adapted and has evolved to meet contemporary business and social needs (see Jones, at p. 484).

59 Judicial discretion must of course be exercised in furtherance of the *CCAA's* purposes. The remedial purpose I referred to in the historical overview of the Act is recognized over and over again in the jurisprudence. To cite one early example:

> The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.
>
> (*Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 41 O.A.C. 282 (Ont. C.A.), at para. 57, *per* Doherty J.A., dissenting)

60 Judicial decision making under the *CCAA* takes many forms. A court must first of all provide the conditions under which the debtor can attempt to reorganize. This can be achieved by staying enforcement actions by creditors to allow the debtor's business to continue, preserving the *status quo* while the debtor plans the compromise or arrangement to be presented to creditors, and supervising the process and advancing it to the point where it can be determined whether it will succeed (see, e.g., *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (B.C. C.A.), at pp. 88-89; *Pacific National Lease Holding Corp., Re* (1992), 19 B.C.A.C. 134 (B.C. C.A. [In Chambers]), at para. 27). In doing so, the court must often be cognizant of the various interests at stake in the reorganization, which can extend beyond those of the debtor and creditors to include employees, directors, shareholders, and even other parties doing business with the insolvent company (see, e.g., *Canadian Airlines Corp., Re*, 2000 ABQB 442, 84 Alta. L.R. (3d) 9 (Alta. Q.B.), at para. 144, *per* Paperny J. (as she then was); *Air Canada, Re* (2003), 42 C.B.R. (4th) 173 (Ont. S.C.J. [Commercial List]), at para. 3; *Air Canada, Re* [2003 CarswellOnt 4967 (Ont. S.C.J. [Commercial List])], 2003 CanLII 49366, at para. 13, *per* Farley J.; Sarra, *Creditor Rights*, at pp. 181-92 and 217-26). In addition, courts must recognize that on occasion the broader public interest will be engaged by aspects of the reorganization and may be a factor against which the decision of whether to allow a particular action will be weighed (see, e.g., *Canadian Red Cross Society / Société Canadienne de la Croix Rouge, Re* (2000), 19 C.B.R. (4th) 158 (Ont. S.C.J.), at para. 2, *per* Blair J. (as he then was); Sarra, *Creditor Rights*, at pp. 195-214).

61 When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow breathing room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA.* Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

62 Perhaps the most creative use of *CCAA* authority has been the increasing willingness of courts to authorize post-filing security for debtor in possession financing or super-priority charges on the debtor's assets when necessary for the continuation of the debtor's business during the reorganization (see, e.g., *Skydome Corp., Re* (1998), 16 C.B.R. (4th) 118 (Ont. Gen. Div. [Commercial List]); *United Used Auto & Truck Parts Ltd., Re*, 2000 BCCA 146, 135 B.C.A.C. 96 (B.C. C.A.), aff'g (1999), 12 C.B.R. (4th) 144 (B.C. S.C. [In Chambers]); and generally, J. P. Sarra, *Rescue! The Companies' Creditors Arrangement Act* (2007), at pp. 93-115). The *CCAA* has also been used to release claims against third parties as part of approving a comprehensive plan of arrangement and compromise, even over the objections of some dissenting creditors (see Metcalfe & Mansfield). As well, the appointment of a Monitor to oversee the reorganization was

originally a measure taken pursuant to the *CCAA's* supervisory authority; Parliament responded, making the mechanism mandatory by legislative amendment.

63 Judicial innovation during *CCAA* proceedings has not been without controversy. At least two questions it raises are directly relevant to the case at bar: (1) what are the sources of a court's authority during *CCAA* proceedings? (2) what are the limits of this authority?

64 The first question concerns the boundary between a court's statutory authority under the *CCAA* and a court's residual authority under its inherent and equitable jurisdiction when supervising a reorganization. In authorizing measures during *CCAA* proceedings, courts have on occasion purported to rely upon their equitable jurisdiction to advance the purposes of the Act or their inherent jurisdiction to fill gaps in the statute. Recent appellate decisions have counselled against purporting to rely on inherent jurisdiction, holding that the better view is that courts are in most cases simply construing the authority supplied by the *CCAA* itself (see, e.g., *Skeena Cellulose Inc., Re*, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (B.C. C.A.), at paras. 45-47, *per* Newbury J.A.; *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5 (Ont. C.A.), paras. 31-33, *per* Blair J.A.).

65 I agree with Justice Georgina R. Jackson and Professor Janis Sarra that the most appropriate approach is a hierarchical one in which courts rely first on an interpretation of the provisions of the *CCAA* text before turning to inherent or equitable jurisdiction to anchor measures taken in a *CCAA* proceeding (see G. R. Jackson and J. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters", in J. P. Sarra, ed., *Annual Review of Insolvency Law 2007* (2008), 41, at p. 42). The authors conclude that when given an appropriately purposive and liberal interpretation, the *CCAA* will be sufficient in most instances to ground measures necessary to achieve its objectives (p. 94).

66 Having examined the pertinent parts of the *CCAA* and the recent history of the legislation, I accept that in most instances the issuance of an order during *CCAA* proceedings should be considered an exercise in statutory interpretation. Particularly noteworthy in this regard is the expansive interpretation the language of the statute at issue is capable of supporting.

67 The initial grant of authority under the *CCAA* empowered a court "where an application is made under this Act in respect of a company ... on the application of any person interested in the matter ..., subject to this Act, [to] make an order under this section" (*CCAA*, s. 11(1)). The plain language of the statute was very broad.

68 In this regard, though not strictly applicable to the case at bar, I note that Parliament has in recent amendments changed the wording contained in s. 11(1), making explicit the discretionary authority of the court under the *CCAA.* Thus in s. 11 of the *CCAA* as currently enacted, a court may, "subject to the restrictions set out in this Act, ... make any order that it considers appropriate in the circumstances" (S.C. 2005, c. 47, s. 128). Parliament appears to have endorsed the broad reading of *CCAA* authority developed by the jurisprudence.

69 The *CCAA* also explicitly provides for certain orders. Both an order made on an initial application and an order on subsequent applications may stay, restrain, or prohibit existing or new proceedings against the debtor. The burden is on the applicant to satisfy the court that the order is appropriate in the circumstances and that the applicant has been acting in good faith and with due diligence (*CCAA*, ss. 11(3), (4) and (6)).

70 The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA.* The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* — avoiding the social and economic losses resulting from liquidation of an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are

enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.

71 It is well-established that efforts to reorganize under the *CCAA* can be terminated and the stay of proceedings against the debtor lifted if the reorganization is "doomed to failure" (see *Chef Ready*, at p. 88; *Philip's Manufacturing Ltd., Re* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.), at paras. 6-7). However, when an order is sought that does realistically advance the *CCAA's* purposes, the ability to make it is within the discretion of a *CCAA* court.

72 The preceding discussion assists in determining whether the court had authority under the *CCAA* to continue the stay of proceedings against the Crown once it was apparent that reorganization would fail and bankruptcy was the inevitable next step.

73 In the Court of Appeal, Tysoe J.A. held that no authority existed under the *CCAA* to continue staying the Crown's enforcement of the GST deemed trust once efforts at reorganization had come to an end. The appellant submits that in so holding, Tysoe J.A. failed to consider the underlying purpose of the *CCAA* and give the statute an appropriately purposive and liberal interpretation under which the order was permissible. The Crown submits that Tysoe J.A. correctly held that the mandatory language of the *ETA* gave the court no option but to permit enforcement of the GST deemed trust when lifting the *CCAA* stay to permit the debtor to make an assignment under the *BIA*. Whether the *ETA* has a mandatory effect in the context of a *CCAA* proceeding has already been discussed. I will now address the question of whether the order was authorized by the *CCAA*.

74 It is beyond dispute that the *CCAA* imposes no explicit temporal limitations upon proceedings commenced under the Act that would prohibit ordering a continuation of the stay of the Crown's GST claims while lifting the general stay of proceedings temporarily to allow the debtor to make an assignment in bankruptcy.

75 The question remains whether the order advanced the underlying purpose of the *CCAA*. The Court of Appeal held that it did not because the reorganization efforts had come to an end and the *CCAA* was accordingly spent. I disagree.

76 There is no doubt that had reorganization been commenced under the *BIA* instead of the *CCAA*, the Crown's deemed trust priority for the GST funds would have been lost. Similarly, the Crown does not dispute that under the scheme of distribution in bankruptcy under the *BIA*, the deemed trust for GST ceases to have effect. Thus, after reorganization under the *CCAA* failed, creditors would have had a strong incentive to seek immediate bankruptcy and distribution of the debtor's assets under the *BIA*. In order to conclude that the discretion does not extend to partially lifting the stay in order to allow for an assignment in bankruptcy, one would have to assume a gap between the *CCAA* and the *BIA* proceedings. Brenner C.J.S.C.'s order staying Crown enforcement of the GST claim ensured that creditors would not be disadvantaged by the attempted reorganization under the *CCAA*. The effect of his order was to blunt any impulse of creditors to interfere in an orderly liquidation. His order was thus in furtherance of the *CCAA's* objectives to the extent that it allowed a bridge between the *CCAA* and *BIA* proceedings. This interpretation of the tribunal's discretionary power is buttressed by s. 20 of the *CCAA*. That section provides that the *CCAA* "may be applied together with the provisions of any Act of Parliament... that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them", such as the *BIA*. Section 20 clearly indicates the intention of Parliament for the *CCAA* to operate *in tandem* with other insolvency legislation, such as the *BIA*.

77 The *CCAA* creates conditions for preserving the *status quo* while attempts are made to find common ground amongst stakeholders for a reorganization that is fair to all. Because the alternative to reorganization is often bankruptcy, participants will measure the impact of a reorganization against the position they would enjoy in liquidation. In the case at bar, the order fostered a harmonious transition between reorganization and liquidation while meeting the objective of a single collective proceeding that is common to both statutes.

78 Tysoe J.A. therefore erred in my view by treating the *CCAA* and the *BIA* as distinct regimes subject to a temporal gap between the two, rather than as forming part of an integrated body of insolvency law. Parliament's decision to

maintain two statutory schemes for reorganization, the *BIA* and the *CCAA*, reflects the reality that reorganizations of differing complexity require different legal mechanisms. By contrast, only one statutory scheme has been found to be needed to liquidate a bankrupt debtor's estate. The transition from the *CCAA* to the *BIA* may require the partial lifting of a stay of proceedings under the *CCAA* to allow commencement of the *BIA* proceedings. However, as Laskin J.A. for the Ontario Court of Appeal noted in a similar competition between secured creditors and the Ontario Superintendent of Financial Services seeking to enforce a deemed trust, "[t]he two statutes are related" and no "gap" exists between the two statutes which would allow the enforcement of property interests at the conclusion of *CCAA* proceedings that would be lost in bankruptcy *Ivaco Inc. (Re)* (2006), 83 O.R. (3d) 108 (Ont. C.A.), at paras. 62-63).

79 The Crown's priority in claims pursuant to source deductions deemed trusts does not undermine this conclusion. Source deductions deemed trusts survive under both the *CCAA* and the *BIA*. Accordingly, creditors' incentives to prefer one Act over another will not be affected. While a court has a broad discretion to stay source deductions deemed trusts in the *CCAA* context, this discretion is nevertheless subject to specific limitations applicable only to source deductions deemed trusts (*CCAA*, s. 11.4). Thus, if *CCAA* reorganization fails (e.g., either the creditors or the court refuse a proposed reorganization), the Crown can immediately assert its claim in unremitted source deductions. But this should not be understood to affect a seamless transition into bankruptcy or create any "gap" between the *CCAA* and the *BIA* for the simple reason that, regardless of what statute the reorganization had been commenced under, creditors' claims in both instances would have been subject to the priority of the Crown's source deductions deemed trust.

80 Source deductions deemed trusts aside, the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable. Indeed, an orderly transition to liquidation is mandatory under the *BIA* where a proposal is rejected by creditors. The *CCAA* is silent on the transition into liquidation but the breadth of the court's discretion under the Act is sufficient to construct a bridge to liquidation under the *BIA*. The court must do so in a manner that does not subvert the scheme of distribution under the *BIA*. Transition to liquidation requires partially lifting the *CCAA* stay to commence proceedings under the *BIA*. This necessary partial lifting of the stay should not trigger a race to the courthouse in an effort to obtain priority unavailable under the *BIA*.

81 I therefore conclude that Brenner C.J.S.C. had the authority under the *CCAA* to lift the stay to allow entry into liquidation.

3.4 Express Trust

82 The last issue in this case is whether Brenner C.J.S.C. created an express trust in favour of the Crown when he ordered on April 29, 2008, that proceeds from the sale of LeRoy Trucking's assets equal to the amount of unremitted GST be held back in the Monitor's trust account until the results of the reorganization were known. Tysoe J.A. in the Court of Appeal concluded as an alternative ground for allowing the Crown's appeal that it was the beneficiary of an express trust. I disagree.

83 Creation of an express trust requires the presence of three certainties: intention, subject matter, and object. Express or "true trusts" arise from the acts and intentions of the settlor and are distinguishable from other trusts arising by operation of law (see D. W. M. Waters, M. R. Gillen and L. D. Smith, eds., *Waters' Law of Trusts in Canada* (3rd ed. 2005), at pp. 28-29 especially fn. 42).

84 Here, there is no certainty to the object (i.e. the beneficiary) inferrable from the court's order of April 29, 2008, sufficient to support an express trust.

85 At the time of the order, there was a dispute between Century Services and the Crown over part of the proceeds from the sale of the debtor's assets. The court's solution was to accept LeRoy Trucking's proposal to segregate those monies until that dispute could be resolved. Thus there was no certainty that the Crown would actually be the beneficiary, or object, of the trust.

86 The fact that the location chosen to segregate those monies was the Monitor's trust account has no independent effect such that it would overcome the lack of a clear beneficiary. In any event, under the interpretation of *CCAA* s. 18.3(1) established above, no such priority dispute would even arise because the Crown's deemed trust priority over GST claims would be lost under the *CCAA* and the Crown would rank as an unsecured creditor for this amount. However, Brenner C.J.S.C. may well have been proceeding on the basis that, in accordance with *Ottawa Senators*, the Crown's GST claim would remain effective if reorganization was successful, which would not be the case if transition to the liquidation process of the *BIA* was allowed. An amount equivalent to that claim would accordingly be set aside pending the outcome of reorganization.

87 Thus, uncertainty surrounding the outcome of the *CCAA* restructuring eliminates the existence of any certainty to permanently vest in the Crown a beneficial interest in the funds. That much is clear from the oral reasons of Brenner C.J.S.C. on April 29, 2008, when he said: "Given the fact that [*CCAA* proceedings] are known to fail and filings in bankruptcy result, it seems to me that maintaining the status quo in the case at bar supports the proposal to have the monitor hold these funds in trust." Exactly who might take the money in the final result was therefore evidently in doubt. Brenner C.J.S.C.'s subsequent order of September 3, 2008, denying the Crown's application to enforce the trust once it was clear that bankruptcy was inevitable, confirms the absence of a clear beneficiary required to ground an express trust.

4. Conclusion

88 I conclude that Brenner C.J.S.C. had the discretion under the *CCAA* to continue the stay of the Crown's claim for enforcement of the GST deemed trust while otherwise lifting it to permit LeRoy Trucking to make an assignment in bankruptcy. My conclusion that s. 18.3(1) of the *CCAA* nullified the GST deemed trust while proceedings under that Act were pending confirms that the discretionary jurisdiction under s. 11 utilized by the court was not limited by the Crown's asserted GST priority, because there is no such priority under the *CCAA*.

89 For these reasons, I would allow the appeal and declare that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada is not subject to deemed trust or priority in favour of the Crown. Nor is this amount subject to an express trust. Costs are awarded for this appeal and the appeal in the court below.

***Fish J. (concurring)*:**

I

90 I am in general agreement with the reasons of Justice Deschamps and would dispose of the appeal as she suggests.

91 More particularly, I share my colleague's interpretation of the scope of the judge's discretion under s. 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). And I share my colleague's conclusion that Brenner C.J.S.C. did not create an express trust in favour of the Crown when he segregated GST funds into the Monitor's trust account (2008 BCSC 1805, [2008] G.S.T.C. 221 (B.C. S.C. [In Chambers])).

92 I nonetheless feel bound to add brief reasons of my own regarding the interaction between the *CCAA* and the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*ETA*").

93 In upholding deemed trusts created by the *ETA* notwithstanding insolvency proceedings, *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), and its progeny have been unduly protective of Crown interests which Parliament itself has chosen to subordinate to competing prioritized claims. In my respectful view, a clearly marked departure from that jurisprudential approach is warranted in this case.

94 Justice Deschamps develops important historical and policy reasons in support of this position and I have nothing to add in that regard. I do wish, however, to explain why a comparative analysis of related statutory provisions adds support to our shared conclusion.

95 Parliament has in recent years given detailed consideration to the Canadian insolvency scheme. It has declined to amend the provisions at issue in this case. Ours is not to wonder why, but rather to treat Parliament's preservation of the relevant provisions as a deliberate exercise of the legislative discretion that is Parliament's alone. With respect, I reject any suggestion that we should instead characterize the apparent conflict between s. 18.3(1) (now s. 37(1)) of the *CCAA* and s. 222 of the *ETA* as a drafting anomaly or statutory lacuna properly subject to judicial correction or repair.

II

96 In the context of the Canadian insolvency regime, a deemed trust will be found to exist only where two complementary elements co-exist: first, a statutory provision *creating* the trust; and second, a *CCAA* or *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*") provision *confirming* — or explicitly preserving — its effective operation.

97 This interpretation is reflected in three federal statutes. Each contains a deemed trust provision framed in terms strikingly similar to the wording of s. 222 of the *ETA*.

98 The first is the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("*ITA*") where s. 227(4) *creates* a deemed trust:

> **227 (4) Trust for moneys deducted** — Every person who deducts or withholds an amount under this Act <u>is deemed</u>, notwithstanding any security interest (as defined in subsection 224(1.3)) in the amount so deducted or withheld, <u>to hold the amount separate and apart</u> from the property of the person and from property held by any secured creditor (as defined in subsection 224(1.3)) of that person that but for the security interest would be property of the person, <u>in trust for Her Majesty and for payment to Her Majesty in the manner and at the time provided under this Act</u>. [Here and below, the emphasis is of course my own.]

99 In the next subsection, Parliament has taken care to make clear that this trust is unaffected by federal or provincial legislation to the contrary:

> **(4.1) Extension of trust** — <u>Notwithstanding</u> any other provision of this Act, <u>the *Bankruptcy and Insolvency Act*</u> (except sections 81.1 and 81.2 of that Act), <u>any other enactment of Canada</u>, any enactment of a province or any other law, <u>where</u> at any time <u>an amount deemed by subsection 227(4) to be held by a person in trust for Her Majesty is not paid to Her Majesty</u> in the manner and at the time provided under this Act, <u>property of the person</u> ... equal in value to the amount so deemed to be held in trust <u>is deemed</u>
>
>> (a) <u>to be held</u>, from the time the amount was deducted or withheld by the person, separate and apart from the property of the person, <u>in trust for Her Majesty</u> whether or not the property is subject to such a security interest, ...
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>> ...
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> ... and the proceeds of such property shall be paid to the Receiver General in priority to all such security interests.

100 The continued operation of this deemed trust is expressly *confirmed* in s. 18.3 of the *CCAA*:

> **18.3** (1) <u>Subject to subsection (2)</u>, notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> (2) <u>Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*</u>, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

101 The operation of the *ITA* deemed trust is also confirmed in s. 67 of the *BIA*:

> **67** (2) Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.
>
> (3) Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act*....

102 Thus, Parliament has first *created* and then *confirmed the continued operation of* the Crown's *ITA* deemed trust under *both* the *CCAA* and the *BIA* regimes.

103 The second federal statute for which this scheme holds true is the *Canada Pension Plan*, R.S.C. 1985, c. C-8 ("*CPP*"). At s. 23, Parliament creates a deemed trust in favour of the Crown and specifies that it exists despite all contrary provisions in any other Canadian statute. Finally, and in almost identical terms, the *Employment Insurance Act*, S.C. 1996, c. 23 ("*EIA*"), creates a deemed trust in favour of the Crown: see ss. 86(2) and (2.1).

104 As we have seen, the survival of the deemed trusts created under these provisions of the *ITA*, the *CPP* and the *EIA* is confirmed in s. 18.3(2) the *CCAA* and in s. 67(3) the *BIA*. In all three cases, Parliament's intent to enforce the Crown's deemed trust through insolvency proceedings is expressed in clear and unmistakable terms.

105 The same is not true with regard to the deemed trust created under the *ETA*. Although Parliament creates a deemed trust in favour of the Crown to hold unremitted GST monies, and although it purports to maintain this trust notwithstanding any contrary federal or provincial legislation, it does not *confirm* the trust — or expressly provide for its continued operation — in either the *BIA* or the *CCAA*. The second of the two mandatory elements I have mentioned is thus absent reflecting Parliament's intention to allow the deemed trust to lapse with the commencement of insolvency proceedings.

106 The language of the relevant *ETA* provisions is identical in substance to that of the *ITA*, *CPP*, and *EIA* provisions:

> **222. (1) [Deemed] Trust for amounts collected** — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).
>
> ...
>
> **(3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act*), any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
>
>> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, ...
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>> ...
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> ... and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

107 Yet no provision of the *CCAA* provides for the continuation of this deemed trust after the *CCAA* is brought into play.

108 In short, Parliament has imposed *two* explicit conditions, or "building blocks", for survival under the *CCAA* of deemed trusts created by the *ITA*, *CPP*, and *EIA.* Had Parliament intended to likewise preserve under the *CCAA* deemed trusts created by the *ETA*, it would have included in the *CCAA* the sort of confirmatory provision that explicitly preserves other deemed trusts.

109 With respect, unlike Tysoe J.A., I do not find it "inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception" (2009 BCCA 205, 98 B.C.L.R. (4th) 242, [2009] G.S.T.C. 79 (B.C. C.A.), at para. 37). *All* of the deemed trust provisions excerpted above make explicit reference to the *BIA.* Section 222 of the *ETA* does not break the pattern. Given the near-identical wording of the four deemed trust provisions, it would have been surprising indeed had Parliament not addressed the *BIA* at all in the *ETA.*

110 Parliament's evident intent was to render GST deemed trusts inoperative upon the institution of insolvency proceedings. Accordingly, s. 222 mentions the *BIA* so as to *exclude* it from its ambit — rather than to *include* it, as do the *ITA*, the *CPP*, and the *EIA.*

111 Conversely, I note that *none* of these statutes mentions the *CCAA* expressly. Their specific reference to the *BIA* has no bearing on their interaction with the *CCAA.* Again, it is the confirmatory provisions *in the insolvency statutes* that determine whether a given deemed trust will subsist during insolvency proceedings.

112 Finally, I believe that chambers judges should not segregate GST monies into the Monitor's trust account during *CCAA* proceedings, as was done in this case. The result of Justice Deschamps's reasoning is that GST claims become unsecured under the *CCAA.* Parliament has deliberately chosen to nullify certain Crown super-priorities during insolvency; this is one such instance.

III

113 For these reasons, like Justice Deschamps, I would allow the appeal with costs in this Court and in the courts below and order that the $305,202.30 collected by LeRoy Trucking in respect of GST but not yet remitted to the Receiver General of Canada be subject to no deemed trust or priority in favour of the Crown.

***Abella J. (dissenting)*:**

114 The central issue in this appeal is whether s. 222 of the *Excise Tax Act*, R.S.C. 1985, c. E-15 ("*EIA*"), and specifically s. 222(3), gives priority during *Companies*' *Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"), proceedings to the Crown's deemed trust in unremitted GST. I agree with Tysoe J.A. that it does. It follows, in my respectful view, that a court's discretion under s. 11 of the *CCAA* is circumscribed accordingly.

115 Section 11 [1] of the *CCAA* stated:

> **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.

To decide the scope of the court's discretion under s. 11, it is necessary to first determine the priority issue. Section 222(3), the provision of the *ETA* at issue in this case, states:

> **222 (3) Extension of trust** — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed
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> (a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and
>
> (b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest
>
> and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

116 Century Services argued that the *CCAA's* general override provision, s. 18.3(1), prevailed, and that the deeming provisions in s. 222 of the *ETA* were, accordingly, inapplicable during *CCAA* proceedings. Section 18.3(1) states:

> **18.3** (1) ... [N]otwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

117 As MacPherson J.A. correctly observed in *Ottawa Senators Hockey Club Corp. (Re)* (2005), 73 O.R. (3d) 737, [2005] G.S.T.C. 1 (Ont. C.A.), s. 222(3) of the *ETA* is in "clear conflict" with s. 18.3(1) of the *CCAA* (para. 31). Resolving the conflict between the two provisions is, essentially, what seems to me to be a relatively uncomplicated exercise in statutory interpretation: does the language reflect a clear legislative intention? In my view it does. The deemed trust provision, s. 222(3) of the *ETA*, has unambiguous language stating that it operates notwithstanding any law except the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("*BIA*").

118 By expressly excluding only one statute from its legislative grasp, and by unequivocally stating that it applies despite any other law anywhere in Canada *except* the *BIA*, s. 222(3) has defined its boundaries in the clearest possible terms. I am in complete agreement with the following comments of MacPherson J.A. in *Ottawa Senators*:

> The legislative intent of s. 222(3) of the *ETA* is clear. If there is a conflict with "any other enactment of Canada (except the *Bankruptcy and Insolvency Act*)", s. 222(3) prevails. In these words Parliament did two things: it decided that s. 222(3) should trump all other federal laws and, importantly, it addressed the topic of exceptions to its trumping decision and identified a single exception, the *Bankruptcy and Insolvency Act* .... The *BIA* and the *CCAA* are closely related federal statutes. I cannot conceive that Parliament would specifically identify the *BIA* as an exception, but accidentally fail to consider the *CCAA* as a possible second exception. In my view, the omission of the *CCAA* from s. 222(3) of the *ETA* was almost certainly a considered omission. [para. 43]

119 MacPherson J.A.'s view that the failure to exempt the *CCAA* from the operation of the *ETA* is a reflection of a clear legislative intention, is borne out by how the *CCAA* was subsequently changed after s. 18.3(1) was enacted in 1997. In 2000, when s. 222(3) of the *ETA* came into force, amendments were also introduced to the *CCAA*. Section 18.3(1) was not amended.

120 The failure to amend s. 18.3(1) is notable because its effect was to protect the legislative *status quo*, notwithstanding repeated requests from various constituencies that s. 18.3(1) be amended to make the priorities in the *CCAA* consistent

with those in the *BIA*. In 2002, for example, when Industry Canada conducted a review of the *BIA* and the *CCAA*, the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals recommended that the priority regime under the *BIA* be extended to the *CCAA* (Joint Task Force on Business Insolvency Law Reform, *Report* (March 15, 2002), Sch. B, proposal 71, at pp. 37-38). The same recommendations were made by the Standing Senate Committee on Banking, Trade and Commerce in its 2003 report, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act*; by the Legislative Review Task Force (Commercial) of the Insolvency Institute of Canada and the Canadian Association of Insolvency and Restructuring Professionals in its 2005 *Report on the Commercial Provisions of Bill C-55*; and in 2007 by the Insolvency Institute of Canada in a submission to the Standing Senate Committee on Banking, Trade and Commerce commenting on reforms then under consideration.

121 Yet the *BIA* remains the only exempted statute under s. 222(3) of the *ETA*. Even after the 2005 decision in *Ottawa Senators* which confirmed that the *ETA* took precedence over the *CCAA*, there was no responsive legislative revision. I see this lack of response as relevant in this case, as it was in *R. v. Tele-Mobile Co.*, 2008 SCC 12, [2008] 1 S.C.R. 305 (S.C.C.), where this Court stated:

> While it cannot be said that legislative silence is necessarily determinative of legislative intention, in this case the silence is Parliament's answer to the consistent urging of Telus and other affected businesses and organizations that there be express language in the legislation to ensure that businesses can be reimbursed for the reasonable costs of complying with evidence-gathering orders. I see the legislative history as reflecting Parliament's intention that compensation not be paid for compliance with production orders. [para. 42]

122 All this leads to a clear inference of a deliberate legislative choice to protect the deemed trust in s. 222(3) from the reach of s. 18.3(1) of the *CCAA*.

123 Nor do I see any "policy" justification for interfering, through interpretation, with this clarity of legislative intention. I can do no better by way of explaining why I think the policy argument cannot succeed in this case, than to repeat the words of Tysoe J.A. who said:

> I do not dispute that there are valid policy reasons for encouraging insolvent companies to attempt to restructure their affairs so that their business can continue with as little disruption to employees and other stakeholders as possible. It is appropriate for the courts to take such policy considerations into account, but only if it is in connection with a matter that has not been considered by Parliament. Here, Parliament must be taken to have weighed policy considerations when it enacted the amendments to the *CCAA* and *ETA* described above. As Mr. Justice MacPherson observed at para. 43 of *Ottawa Senators*, it is inconceivable that Parliament would specifically identify the *BIA* as an exception when enacting the current version of s. 222(3) of the *ETA* without considering the *CCAA* as a possible second exception. I also make the observation that the 1992 set of amendments to the *BIA* enabled proposals to be binding on secured creditors and, while there is more flexibility under the *CCAA*, it is possible for an insolvent company to attempt to restructure under the auspices of the *BIA*. [para. 37]

124 Despite my view that the clarity of the language in s. 222(3) is dispositive, it is also my view that even the application of other principles of interpretation reinforces this conclusion. In their submissions, the parties raised the following as being particularly relevant: the Crown relied on the principle that the statute which is "later in time" prevails; and Century Services based its argument on the principle that the general provision gives way to the specific (*generalia specialibus non derogant*).

125 The "later in time" principle gives priority to a more recent statute, based on the theory that the legislature is presumed to be aware of the content of existing legislation. If a new enactment is inconsistent with a prior one, therefore, the legislature is presumed to have intended to derogate from the earlier provisions (Ruth Sullivan, *Sullivan on the Construction of Statutes* (5th ed. 2008), at pp. 346-47; Pierre-André Côté, *The Interpretation of Legislation in Canada* (3rd ed. 2000), at p. 358).

126 The exception to this presumptive displacement of pre-existing inconsistent legislation, is the *generalia specialibus non derogant* principle that "[a] more recent, general provision will not be construed as affecting an earlier, special provision" (Côté, at p. 359). Like a Russian Doll, there is also an exception within this exception, namely, that an earlier, specific provision may in fact be "overruled" by a subsequent general statute if the legislature indicates, through its language, an intention that the general provision prevails (*Doré c. Verdun (Municipalité)*, [1997] 2 S.C.R. 862 (S.C.C.)).

127 The primary purpose of these interpretive principles is to assist in the performance of the task of determining the intention of the legislature. This was confirmed by MacPherson J.A. in *Ottawa Senators*, at para. 42:

> [T]he overarching rule of statutory interpretation is that statutory provisions should be interpreted to give effect to the intention of the legislature in enacting the law. This primary rule takes precedence over all maxims or canons or aids relating to statutory interpretation, including the maxim that the specific prevails over the general (*generalia specialibus non derogant*). As expressed by Hudson J. in *Canada v. Williams*, [1944] S.C.R. 226, ... at p. 239 ...:
>
>> The maxim *generalia specialibus non derogant* is relied on as a rule which should dispose of the question, but the maxim is not a rule of law but a rule of construction and bows to the intention of the legislature, if such intention can reasonably be gathered from all of the relevant legislation.

(See also Côté, at p. 358, and Pierre-Andre Côté, with the collaboration of S. Beaulac and M. Devinat, *Interprétation des lois* (4th ed. 2009), at para. 1335.)

128 I accept the Crown's argument that the "later in time" principle is conclusive in this case. Since s. 222(3) of the *ETA* was enacted in 2000 and s. 18.3(1) of the *CCAA* was introduced in 1997, s. 222(3) is, on its face, the later provision. This chronological victory can be displaced, as Century Services argues, if it is shown that the more recent provision, s. 222(3) of the *ETA*, is a general one, in which case the earlier, specific provision, s. 18.3(1), prevails (*generalia specialibus non derogant)*. But, as previously explained, the prior specific provision does not take precedence if the subsequent general provision appears to "overrule" it. This, it seems to me, is precisely what s. 222(3) achieves through the use of language stating that it prevails despite any law of Canada, of a province, or "any other law" *other than the BIA.* Section 18.3(1) of the *CCAA*, is thereby rendered inoperative for purposes of s. 222(3).

129 It is true that when the *CCAA* was amended in 2005,[2] s. 18.3(1) was re-enacted as s. 37(1) (S.C. 2005, c. 47, s. 131). Deschamps J. suggests that this makes s. 37(1) the new, "later in time" provision. With respect, her observation is refuted by the operation of s. 44(f) of the *Interpretation Act*, R.S.C. 1985, c. I-21, which expressly deals with the (non) effect of re-enacting, without significant substantive changes, a repealed provision (see *Canada (Attorney General) v. Canada (Public Service Staff Relations Board)*, [1977] 2 F.C. 663 (Fed. C.A.), dealing with the predecessor provision to s. 44(f)). It directs that new enactments not be construed as "new law" unless they differ in substance from the repealed provision:

> **44.** Where an enactment, in this section called the "former enactment", is repealed and another enactment, in this section called the "new enactment", is substituted therefor,
>
>> ...
>>
>> (f) <u>except to the extent that the provisions of the new enactment are not in substance the same as those of the former enactment, the new enactment shall not be held to operate as new law</u>, but shall be construed and have effect as a consolidation and as declaratory of the law as contained in the former enactment;

Section 2 of the *Interpretation Act* defines an enactment as "an Act or regulation or *any portion of an Act or regulation*".

130 Section 37(1) of the current *CCAA* is almost identical to s. 18.3(1). These provisions are set out for ease of comparison, with the differences between them underlined:

> **37.**(1) Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.
>
> **18.3** (1) Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

131 The application of s. 44(*f*) of the *Interpretation Act* simply confirms the government's clearly expressed intent, found in Industry Canada's clause-by-clause review of Bill C-55, where s. 37(1) was identified as "a technical amendment to reorder the provisions of this Act". During second reading, the Hon. Bill Rompkey, then the Deputy Leader of the Government in the Senate, confirmed that s. 37(1) represented only a technical change:

> On a technical note relating to the treatment of deemed trusts for taxes, the bill [*sic*] makes no changes to the underlying policy intent, despite the fact that in the case of a restructuring under the CCAA, sections of the act [*sic*] were repealed and substituted with renumbered versions due to the extensive reworking of the CCAA.
>
> (*Debates of the Senate*, vol. 142, 1st Sess., 38th Parl., November 23, 2005, at p. 2147)

132 Had the substance of s. 18.3(1) altered in any material way when it was replaced by s. 37(1), I would share Deschamps J.'s view that it should be considered a new provision. But since s. 18.3(1) and s. 37(1) are the same in substance, the transformation of s. 18.3(1) into s. 37(1) has no effect on the interpretive queue, and s. 222(3) of the *ETA* remains the "later in time" provision (Sullivan, at p. 347).

133 This means that the deemed trust provision in s. 222(3) of the *ETA* takes precedence over s. 18.3(1) during *CCAA* proceedings. The question then is how that priority affects the discretion of a court under s. 11 of the *CCAA.*

134 While s. 11 gives a court discretion to make orders notwithstanding the *BIA* and the *Winding-up Act*, R.S.C. 1985, c. W-11, that discretion is not liberated from the operation of any other federal statute. Any exercise of discretion is therefore circumscribed by whatever limits are imposed by statutes *other* than the *BIA* and the *Winding-up Act.* That includes the *ETA.* The chambers judge in this case was, therefore, required to respect the priority regime set out in s. 222(3) of the *ETA.* Neither s. 18.3(1) nor s. 11 of the *CCAA* gave him the authority to ignore it. He could not, as a result, deny the Crown's request for payment of the GST funds during the *CCAA* proceedings.

135 Given this conclusion, it is unnecessary to consider whether there was an express trust.

136 I would dismiss the appeal.

Appeal allowed.

Pourvoi accueilli.

Appendix

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (as at December 13, 2007)

> **11. (1) Powers of court** — 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.
>
> ...

(3) Initial application court orders — 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 (i);

(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) Other than initial application court orders — 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) Burden of proof on application — 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.

11.4 (1) Her Majesty affected — An order made under section 11 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for such period as the court considers appropriate but ending not later than

(i) the expiration of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or arrangement,

(iv) the default by the company on any term of a compromise or arrangement, or

(v) the performance of a compromise or arrangement in respect of the company; and\

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company where the company is a debtor under that legislation and the provision has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for such period as the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) may apply.

(2) When order ceases to be in effect — An order referred to in subsection (1) ceases to be in effect if

(a) the company defaults on payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) under any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11, other than an order referred to in subsection (1) of this section, does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

18.3 (1) Deemed trusts — Subject to subsection (2), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*, and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

18.4 (1) Status of Crown claims — In relation to a proceeding under this Act, all claims, including secured claims, of Her Majesty in right of Canada or a province or any body under an enactment respecting workers' compensation, in this section and in section 18.5 called a "workers' compensation body", rank as unsecured claims.

...

(3) Operation of similar legislation — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

...

20. [Act to be applied conjointly with other Acts] — The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province, that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

***Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (as at September 18, 2009)**

11. General power of court — Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

...

11.02 (1) Stays, etc. — initial application — A court may, on an initial application in respect of a debtor company, make an order on any terms that it may impose, effective for the period that the court considers necessary, which period may not be more than 30 days,

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*;

(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 any action, suit or proceeding against the company.

(2) Stays, etc. — other than initial application — A court may, on an application in respect of a debtor company other than an initial application, make an order, on any terms that it may impose,

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

(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 any action, suit or proceeding against the company.

(3) Burden of proof on application — The court shall not make the order unless

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

(b) in the case of an order under subsection (2), the applicant also satisfies the court that the applicant has acted, and is acting, in good faith and with due diligence.

...

11.09 (1) Stay — Her Majesty — An order made under section 11.02 may provide that

(a) Her Majesty in right of Canada may not exercise rights under subsection 224(1.2) of the *Income Tax Act* or any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, in respect of the company if the company is a tax debtor under that subsection or provision, for the period that the court considers appropriate but ending not later than

(i) the expiry of the order,

(ii) the refusal of a proposed compromise by the creditors or the court,

(iii) six months following the court sanction of a compromise or an arrangement,

(iv) the default by the company on any term of a compromise or an arrangement, or

(v) the performance of a compromise or an arrangement in respect of the company; and

(b) Her Majesty in right of a province may not exercise rights under any provision of provincial legislation in respect of the company if the company is a debtor under that legislation and the provision has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

for the period that the court considers appropriate but ending not later than the occurrence or time referred to in whichever of subparagraphs (*a*)(i) to (v) that may apply.

(2) When order ceases to be in effect — The portions of an order made under section 11.02 that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*) cease to be in effect if

(a) the company defaults on the payment of any amount that becomes due to Her Majesty after the order is made and could be subject to a demand under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection; or

(b) any other creditor is or becomes entitled to realize a security on any property that could be claimed by Her Majesty in exercising rights under

(i) subsection 224(1.2) of the *Income Tax Act*,

(ii) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(iii) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(A) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(B) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection.

(3) Operation of similar legislation — An order made under section 11.02, other than the portions of that order that affect the exercise of rights of Her Majesty referred to in paragraph (1)(*a*) or (*b*), does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*,

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts, or

(c) any provision of provincial legislation that has a purpose similar to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, and the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

37. (1) Deemed trusts — Subject to subsection (2), despite any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a debtor company shall not be regarded as being held in trust for Her Majesty unless it would be so regarded in the absence of that statutory provision.

(2) Exceptions — Subsection (1) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision"), nor does it apply in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province if

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

***Excise Tax Act*, R.S.C. 1985, c. E-15 (as at December 13, 2007)**

222. (1) [Deemed] Trust for amounts collected — Subject to subsection (1.1), every person who collects an amount as or on account of tax under Division II is deemed, for all purposes and despite any security interest in the amount, to hold the amount in trust for Her Majesty in right of Canada, separate and apart from the property of the person and from property held by any secured creditor of the person that, but for a security interest, would be property of the person, until the amount is remitted to the Receiver General or withdrawn under subsection (2).

(1.1) Amounts collected before bankruptcy — Subsection (1) does not apply, at or after the time a person becomes a bankrupt (within the meaning of the *Bankruptcy and Insolvency Act)*, to any amounts that, before that time, were collected or became collectible by the person as or on account of tax under Division II.

...

(3) Extension of trust — Despite any other provision of this Act (except subsection (4)), any other enactment of Canada (except the *Bankruptcy and Insolvency Act)*, any enactment of a province or any other law, if at any time an amount deemed by subsection (1) to be held by a person in trust for Her Majesty is not remitted to the Receiver General or withdrawn in the manner and at the time provided under this Part, property of the person and property held by any secured creditor of the person that, but for a security interest, would be property of the person, equal in value to the amount so deemed to be held in trust, is deemed

(a) to be held, from the time the amount was collected by the person, in trust for Her Majesty, separate and apart from the property of the person, whether or not the property is subject to a security interest, and

(b) to form no part of the estate or property of the person from the time the amount was collected, whether or not the property has in fact been kept separate and apart from the estate or property of the person and whether or not the property is subject to a security interest

and is property beneficially owned by Her Majesty in right of Canada despite any security interest in the property or in the proceeds thereof and the proceeds of the property shall be paid to the Receiver General in priority to all security interests.

***Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (as at December 13, 2007)**

67. (1) Property of bankrupt — The property of a bankrupt divisible among his creditors shall not comprise

(a) property held by the bankrupt in trust for any other person,

(b) any property that as against the bankrupt is exempt from execution or seizure under any laws applicable in the province within which the property is situated and within which the bankrupt resides, or

(b.1) such goods and services tax credit payments and prescribed payments relating to the essential needs of an individual as are made in prescribed circumstances and are not property referred to in paragraph (*a*) or (*b*),

but it shall comprise

(c) all property wherever situated of the bankrupt at the date of his bankruptcy or that may be acquired by or devolve on him before his discharge, and

(d) such powers in or over or in respect of the property as might have been exercised by the bankrupt for his own benefit.

(2) Deemed trusts — Subject to subsection (3), notwithstanding any provision in federal or provincial legislation that has the effect of deeming property to be held in trust for Her Majesty, property of a bankrupt shall not be regarded as held in trust for Her Majesty for the purpose of paragraph (1)(*a*) unless it would be so regarded in the absence of that statutory provision.

(3) Exceptions — Subsection (2) does not apply in respect of amounts deemed to be held in trust under subsection 227(4) or (4.1) of the *Income Tax Act*, subsection 23(3) or (4) of the *Canada Pension Plan* or subsection 86(2) or (2.1) of the *Employment Insurance Act* (each of which is in this subsection referred to as a "federal provision") nor in respect of amounts deemed to be held in trust under any law of a province that creates a deemed trust the sole purpose of which is to ensure remittance to Her Majesty in right of the province of amounts deducted or withheld under a law of the province where

(a) that law of the province imposes a tax similar in nature to the tax imposed under the *Income Tax Act* and the amounts deducted or withheld under that law of the province are of the same nature as the amounts referred to in subsection 227(4) or (4.1) of the *Income Tax Act*, or

(b) the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan*, that law of the province establishes a "provincial pension plan" as defined in that subsection and the amounts deducted or withheld under that law of the province are of the same nature as amounts referred to in subsection 23(3) or (4) of the *Canada Pension Plan*,

and for the purpose of this subsection, any provision of a law of a province that creates a deemed trust is, notwithstanding any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as the corresponding federal provision.

86. (1) Status of Crown claims — In relation to a bankruptcy or proposal, all provable claims, including secured claims, of Her Majesty in right of Canada or a province or of any body under an Act respecting workers' compensation, in this section and in section 87 called a "workers' compensation body", rank as unsecured claims.

...

(3) Exceptions — Subsection (1) does not affect the operation of

(a) subsections 224(1.2) and (1.3) of the *Income Tax Act*;

(b) any provision of the *Canada Pension Plan* or of the *Employment Insurance Act* that refers to subsection 224(1.2) of the *Income Tax Act* and provides for the collection of a contribution, as defined in the *Canada Pension Plan*, or an employee's premium, or employer's premium, as defined in the *Employment Insurance Act*, and of any related interest, penalties or other amounts; or

(c) any provision of provincial legislation that has a similar purpose to subsection 224(1.2) of the *Income Tax Act*, or that refers to that subsection, to the extent that it provides for the collection of a sum, and of any related interest, penalties or other amounts, where the sum

(i) has been withheld or deducted by a person from a payment to another person and is in respect of a tax similar in nature to the income tax imposed on individuals under the *Income Tax Act*, or

(ii) is of the same nature as a contribution under the *Canada Pension Plan* if the province is a "province providing a comprehensive pension plan" as defined in subsection 3(1) of the *Canada Pension Plan* and the provincial legislation establishes a "provincial pension plan" as defined in that subsection,

and for the purpose of paragraph (*c*), the provision of provincial legislation is, despite any Act of Canada or of a province or any other law, deemed to have the same effect and scope against any creditor, however secured, as subsection 224(1.2) of the *Income Tax Act* in respect of a sum referred to in subparagraph (*c*)(i), or as subsection 23(2) of the *Canada Pension Plan* in respect of a sum referred to in subparagraph (*c*)(ii), and in respect of any related interest, penalties or other amounts.

Footnotes

1 Section 11 was amended, effective September 18, 2009, and now states:
11. Despite anything in the *Bankruptcy and Insolvency Act* or the *Winding-up and Restructuring Act*, if an application is made under this Act in respect of a debtor company, the court, on the application of any person interested in the matter, may, subject to the restrictions set out in this Act, on notice to any other person or without notice as it may see fit, make any order that it considers appropriate in the circumstances.

2 The amendments did not come into force until September 18, 2009.

End of Document

Tab 3

2009 CarswellOnt 7627
Ontario Superior Court of Justice [Commercial List]

Brainhunter Inc., Re

2009 CarswellOnt 7627, [2009] O.J. No. 5207, 183 A.C.W.S. (3d) 28

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 Brainhunter Inc., TrekLogic Inc., Brainhunter Canada Inc., Brainhunter (Ottawa) Inc. and Protec Employment Services Limited (Applicants)

APPLICATION UNDER SECTION 18.6 OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED

Newbould J.

Heard: December 2, 2009
Judgment: December 4, 2009
Docket: 09-8483-00CL

Counsel: Jay A. Swartz, James D. Bunting for Applicants
Grant B. Moffat for Deloitte and Touche Inc.
Edmond Lamek for Toronto-Dominion Bank
Joseph Bellissimo for Roynat Capital Inc.
Daniel R. Dowdall for certain noteholders
Patrick F. Schindler for an unsecured judgment creditor

Subject: Insolvency

Related Abridgment Classifications
Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.3 Arrangements
XIX.3.b Approval by court
XIX.3.b.ii Discretion of court

Headnote
Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Arrangements — Approval by court — Discretion of court

Canadian Company, located in Toronto, provided human resources services to clients — Bank was secured creditor of Company and agreed to provide applicants with $7 million to meet working capital requirements during Companies' Creditors Arrangement Act (CCAA) proceedings — Company made application for protection under s. 18.6 of CCAA — Company intended to solicit going concern asset sale of business, which meant no plan of arrangement filed — Application allowed — Court can allow CCAA protection in cases where company does not file formal plan of compromise or arrangement.

Table of Authorities

Cases considered by *Newbould J.*:

Canwest Global Communications Corp., Re (2009), 2009 CarswellOnt 7169 (Ont. S.C.J. [Commercial List]) — considered

Consumers Packaging Inc., Re (2001), 150 O.A.C. 384, 27 C.B.R. (4th) 197, 2001 CarswellOnt 3482, 12 C.P.C. (5th) 208 (Ont. C.A.) — followed

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4467, 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) — followed

Statutes considered:

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

s. 3 — referred to

s. 9 — referred to

s. 11.2(1) [en. 2005, c. 47, s. 128] — considered

s. 11.4 [en. 2005, c. 47, s. 128] — considered

s. 11.4(1) [en. 1997, c. 12, s. 124] — considered

s. 11.4(2) [en. 1997, c. 12, s. 124] — considered

s. 11.4(3) [en. 1997, c. 12, s. 124] — considered

s. 11.4(4) [en. 1997, c. 12, s. 124] — considered

s. 11.51(1) [en. 2005, c. 47, s. 128] — considered

s. 11.52(1) [en. 2007, c. 36, s. 66] — considered

s. 36(1) — considered

APPLICATION by company for protection under s. 18.6 of *Companies' Creditors Arrangement Act*.

***Newbould J.*:**

1 On December 2, 2009 after hearing submissions from the parties present, I made an initial order granting CCAA protection to the applicants, with reasons to follow. These are my reasons.

2 There is no question that the Court has jurisdiction to hear the application pursuant to section 9 of the CCAA as the applicants' head offices are located in Toronto, Canada. At the time of the application, Brainhunter Inc. was listed on the TSX. The applicants qualify as debtor companies pursuant to section 3 of the CCAA as the applicants are affiliated companies with total claims against them of more than $5 million. The applicants are all insolvent.

3 The applicants are in the business of providing human resources with the skill sets to satisfy their clients' needs. The applicants' business operates in large part through umbrella agreements generally referred to as Master Service Agreements. These agreements are entered into by the applicable applicant and each of their respective contract staffing clients.

4 Each time a contract staffing client wishes to retain the services of an individual (each a "Contractor") pursuant to a Master Services Agreement, the client will enter into a sub-agreement referred to as a statement of work in respect of the specific Contractor. The applicable applicant subsequently enters into an agreement with the Contractor to fulfill the statement of work and the Contractor issues invoices to the applicant for the work he or she performs for the client. The applicant then pays the Contractor and bills the client. Because the applicants receive payment from their clients after they pay their Contractors, the applicants are dependent on having adequate credit facilities available to fund the payments to Contractors until the related invoices from the client can be collected.

5 TD Bank and Roynat are secured creditors with security over all of the assets of the applicants. As at October 31, 2009 there was principal outstanding of $18.7 million to TD Bank and principal and interest of $5.9 million owing to Roynat.

6 In addition there are secured subordinated promissory notes secured only on the assets of Brainhunter Inc. The principal and interest outstanding as at October 31, 2009 was $11.9 million. Most of the material assets of the applicants are not held in Brainhunter Inc., but by the other applicants.

7 TD Bank and the applicants have entered into a debtor-in-possession financing term sheet, pursuant to which the TD Bank has agreed to provide the applicants with $7 million of DIP financing to enable the applicants to meet their working capital requirements during the CCAA proceedings.

8 This application is in some respects unusual because the applicants state that they intend at the outset to solicit a going concern asset sale of the business, and that it is likely that there will be no plan of arrangement filed. The factum on their behalf states:

> 5. If protection is granted under the CCAA, the Applicants intend to bring a motion seeking approval of a bid process to solicit going concern asset purchase offers for the Applicants' business, as well as offers to sponsor a plan of arrangement (the "Bid Process"). The Applicants have entered into an agreement to sell substantially all of their assets as a going concern on the understanding that this agreement will serve as a stalking horse bid. The Bid Process will solicit competing offers from prospective investors to bid up the stalking horse bid.
>
> 24. Although the proposed Bid Process could result in the filing of a plan of arrangement or plan of compromise, it is more likely to result in the sale of the Applicants' business.

9 The applicants submit that this Court has the jurisdiction to provide them with protection under the CCAA in circumstances such as these where the applicants may not file a formal plan of compromise or arrangement.

10 I agree with the applicants that protection under the CCAA may be granted in these circumstances. I say that for the following reasons.

11 The initial protection is supported by TD Bank and Roynat. It is also supported by the secured noteholders represented by Mr. Dowdall, being a little more than 60% of the noteholders. Mr. Dowdall has other concerns that I will deal with.

12 It is well settled in Ontario that a court in a CCAA proceeding may approve a sale of all or substantially all of the assets of a debtor company as a going concern. In *Consumers Packaging Inc., Re*, 27 C.B.R. (4th) 197 (Ont. C.A.), the Court stated:

> The sale of Consumers' Canadian glass operations as a going concern pursuant to the Owens-Illinois bid allows the preservation of Consumers' business (albeit under new ownership), and is therefore consistent with the purposes of the CCAA.

13 Similarly, it is well settled in Ontario that a court in a CCAA proceeding may order the sale of a business in the absence of a plan of arrangement being put to stakeholders for a vote. In *Nortel Networks Corp., Re* (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) Morawetz J. came to this conclusion after analyzing a number of cases that had made such an order. See paras 35 to 40 of his reasons for judgment.

14 It seems to me that if at some point in time after an initial CCAA protection order has been made, it appears appropriate to undertake a sales process to sell the business without a plan of arrangement in place, there is no reason why CCAA protection should not initially be granted if at the outset it is thought appropriate to undertake a sales process without a plan of arrangement in place. It is simply a matter of timing as to when it appears appropriate to pursue a sale of the business without a plan of arrangement in place.

15 *Nortel Networks Corp., Re* was decided before the new CCAA provisions came into force on September 18, 2009. The new relevant provision does not, however, affect the principles accepted by Morawetz J. in that case. Section. 36(1) provides:

> 36.(1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.

16 In *Canwest Global Communications Corp., Re* [2009 CarswellOnt 7169 (Ont. S.C.J. [Commercial List])] released November 12, 2009, Pepall J. stated the following regarding s. 36:

> The CCAA is remedial legislation designed to enable insolvent companies to restructure. As mentioned by me before in this case, the amendments do not detract from this objective. In discussing section 36, the Industry Canada Briefing Book on the amendments states that "The reform is intended to provide the debtor company with greater flexibility in dealing with its property while limiting the possibility of abuse."

17 The applicants have not yet brought their motion for approval of a sales process, and consideration as to whether such a sales process is appropriate will take place when the motion is heard. [1] The fact that the motion was anticipated at the time of the initial order with no plan of arrangement in sight does not mean however that the initial order should not be made.

18 The applicants seek an order declaring that the Contractors are "critical suppliers", permitting the payment of pre-filing amounts to the contractors and creating a charge that secures the obligations owed to the Contractors.

19 The authorization to pay pre-filing amounts is now codified in section 11.4 of the CCAA. Pursuant to this section, the Court has the discretion to:

> (a) declare a person to be a critical supplier, if it is satisfied the person is a supplier of goods or services to the company and the goods or services are critical to the company's continued operations (s. 11.4(1));
>
> (b) make an order requiring the "critical supplier" to supply any goods or services specified by the Court to the company on any terms and conditions that are consistent with the supply relationship or the Court considers appropriate (s. 11.4(2));
>
> (c) grant a charge in favour of a person declared to be a critical supplier, in an amount equal to the value of the goods or services supplied under the terms of the order (s. 11.4(3)); and

(d) order the security or charge to rank in priority over the claim of any secured creditor of the company (s. 11.4(4)).

20 The rationale for the enactment of section 11.4 is explained in the Industry Canada Clause by Clause Briefing Book as follows:

> Companies undergoing a restructuring must be able to continue to operate during the period. On the other hand, suppliers will attempt to restrict their exposure to credit risk by denying credit or refusing services to those debtor companies. To balance the conflicting interests, the court will be given the authority to designate certain key suppliers as "critical suppliers". The designation will mean that the supplier will be required to continue its business relationship with the debtor company but, in return, the critical supplier will be given security for payment.

21 The applicants submit, and I accept, that an order permitting the payment of pre-filing amounts is necessary to ensure the continued provision of personal services from the Contractors to the applicants and to prevent the potentially significant harm that could follow if such payments are not made. If the Contractors are not paid for services provided before the filing of the application, there is a substantial risk they will not continue to perform services under the current statements of work. This would result in a default by the applicants to their clients and impact the ability of the applicants to continue as a going concern.

22 As the Contractors are individuals, the applicants did not seek an order requiring the continued supply of personal services. However, they requested a charge to secure payment to the Contractors in order to provide assurances to the Contractors that their relationship will be unaffected during the CCAA proceedings. The amount of the Contractors' charge requested is $15 million which represents an estimated average of the amount owing to Contractors. The applicants requested that the Contractors' charge rank in priority to all secured lenders other than the TD Bank. Roynat is agreeable to that and the notesholders represented here do not oppose it. Deloitte & Touche Inc, in their capacity as the proposed monitor, in their pre-filing report support the charge as reasonable.

23 I am satisfied that it is appropriate to provide in the initial order that the Contractors are declared to be critical suppliers, that the applicants shall be entitled to pay outstanding and future amounts owing to Contractors and that a Contractors' charge as requested be provided.

24 The applicants also requested other charges, being (i) an administration charge of $1 million: (ii) a KERP charge of $290,000 under which the CEO is to be paid a retention bonus of $50,000 for two months in addition to his salary and 10 key employees will be paid up to $190,000 if they remain with the company for four months from the date of filing: (iii) a directors and officers charge of $1.7 million; and (iv) a DIP charge to secure the $7 million DIP facility being provided by TD Bank.

25 TD Bank and Roynat support these charges and their priority provided for in the initial order. Deloitte & Touche Inc. expressed the view that the proposed charges are necessary and reasonable and will provide the applicants with the opportunity to successfully complete a restructuring.

26 Mr. Dowdall for the noteholders raised a concern with some of these charges. He said that while counsel for the applicants discussed with him in advance the intention to file, he was not made aware of the details and his clients have not had an opportunity to review the information provided in the material filed with the Court. Thus he wishes to reserve his clients' rights with respect to these charges. He has a concern that while typically such concerns when raised at the initial application are met with the response that there is a come-back clause in the initial order, people start relying on the charges and it becomes difficult to oppose them as time passes. I think his concern is a fair one. In this case, however, not only is there a come-back clause with a 7 days notice requirement, but the matter will be before the Court shortly on December 8, 2009 when the motion to approve a sales process will be dealt with. Mr. Dowdall's clients will have had an opportunity to consider their position before then and be able to move to vary the initial order if they so desire.

27 In the circumstances, on the basis of the record before me, the charges appear appropriate and are approved. This is without prejudice, however, to the noteholders right to contest them. Any delay, however, in taking steps to contest them will obviously seriously affect any attack on them.

28 Mr. Schindler represents an unsecured judgment creditor owed approximately $250,000. His client of course had not seen the material before it was filed, and Mr. Schindler said that he had been intending to ask that the entire matter be adjourned for a week, and that he was asking that the charges not be made for at least a week to provide his client with time to consider whether they are warranted.

29 In exercising the balancing of interests required in a CCAA application, it would be risky indeed to delay the application or these charges at the request of one unsecured creditor. These are standard charges and deemed necessary by the proposed monitor. It should be noted that the sections of the CCAA under which the charges are authorized, being sections 11.2(1), 11.4(1), 11.51(1) and 11.52(1), provide that notice of a request for such charges is to be given to the secured creditors who are likely to be affected by the charge. Notice is not required to be given to unsecured creditors. In the circumstances, I declined the request to delay the charges.

Application allowed.

Footnotes

1 The motion is now scheduled for December 8, 2009

Tab 4

Most Negative Treatment: Distinguished
Most Recent Distinguished: Richmond-John Centre Inc. v. Dover Corp. (Canada) Ltd. | 1991 CarswellOnt 618, [1991] O.J. No. 2034, 22 R.P.R. (2d) 243, 30 A.C.W.S. (3d) 262 | (Ont. Gen. Div., Nov 19, 1991)

1983 CarswellOnt 732
Ontario Supreme Court, Court of Appeal

G. Ford Homes Ltd. v. Draft Masonry (York) Co.

1983 CarswellOnt 732, [1983] O.J. No. 150, [1983] O.J. No. 3181, 1 D.L.R. (4th) 262, 22 A.C.W.S. (2d) 232, 2 O.A.C. 231, 2 C.L.R. 210, 43 O.R. (2d) 401

G. FORD HOMES LTD. v. DRAFT MASONRY (YORK) CO. LTD.

Blair, Morden and Cory JJ.A.

Judgment: October 21, 1983

Counsel: *D.J. McGhee*, for plaintiff-respondent.
D.H. Creighton, for defendant-appellant.

Subject: Contracts

Related Abridgment Classifications
Construction law

II Contracts
II.6 Breach of terms of contract
II.6.c Breach of warranty
II.6.c.i Implied contractual warranty
II.6.c.i.B By contractor

Headnote
Construction Law --- Breach of terms of contract — Breach of warranty — Implied contractual warranty — By contractor

Building contracts — Supply and installation of staircase — Failure to comply with Ontario Building Code — Term requiring compliance with Ontario Building Code to be implied into contract.

The defendant was the builder of two two-storey homes and the plaintiff was the fabricator and installer of residential staircases. The plaintiff orally agreed to supply and install two circular staircases for the two homes being built. The staircases were installed but did not meet the minumum headroom requirement specified in the Ontario Building Code. The architect's plans, which indicated that the required headroom was to comply with the Code, were available on site and were offered to the plaintiff who chose to ignore them. The houses were framed in so that measurements could be taken.

At trial, the plaintiff's claim for the cost of the supply and installation of the staircases was dismissed. An appeal to the Divisional Court was allowed. The defendant further appealed to the Court of Appeal.

Held:

The appeal was allowed.

The plaintiff was an "expert" in the manufacture and installation of stairs and it would be natural and reasonable in the circumstances of the case for the defendant to rely upon the plaintiff to supply and install staircases in compliance with the Ontario Building Code. Accordingly, there must be an implied term that the staircases could be and would be installed so as to comply with the Code. Alternatively, or additionally, a term should be implied that both the work and materials would be reasonably fit for the purpose for which they were required.

Table of Authorities

Cases considered:

CCH Can. Ltd. v. Mollenhauer Contr. Co., [1976] 1 S.C.R. 49, 51 D.L.R. (3d) 638 — *distinguished*

Hart v. Bell Telephone Co. of Can. (1979), 26 O.R. (2d) 218, 10 C.C.L.T. 335, 102 D.L.R. (3d) 465 (C.A.)*followed*

Independent Broadcasting Authority v. EMI Elec. Ltd. (1980), 14 Build. L.R. 1 (H.L.) — *followed*

Laliberté v. Blanchard (1980), 31 N.B.R. (2d) 275, 75 A.P.R. 275 (C.A.) — *followed*

Lewis v. Todd, [1980] 2 S.C.R. 694, 14 C.C.L.T. 294, 34 N.R. 1 — *followed*

Moorcock, The (1889), 14 P.D. 64 — *followed*

Myers (G.H.) Co. v. Brent Cross Service Co., [1934] 1 K.B. 46 — *followed*

Young & Marten Ltd. v. McManus Childs Ltd., [1969] 1 A.C. 454, [1968] 2 All E.R. 1169 (H.L.) — *followed*

Authorities considered:

Hudson's Building and Engineering Contracts (10th ed., 1979), pp. 274-75.

APPEAL to the Court of Appeal from a decision of the Divisional Court which reversed a trial decision dismissing the plaintiff's claim for the cost of the supply and installation of a staircase.

The judgment of the Court was delivered by *Cory J.A.* (orally):

1 The respondent, G. Ford Homes, orally agreed to supply and install two circular staircases for two homes which the appellant, Draft Masonry, was building. The point in issue on this appeal is whether there was an implied term of the contract for the supply and installation of the staircases that they would comply with the requirements of the Ontario Building Code.

Factual background

2 Something must be said of the facts of this case to understand the problem.

3 The appellant was building two single family two-storey homes on adjacent lots in the Township of Scugog. These were large homes having a floor area of approximately 3,000 square feet; they were priced at $239,900 and they were described by both parties as luxury homes. The appellant contractor had earlier built a number of homes following the same plans. In none of these homes had there been any problem with the stairs. The architect's plans for the home were available on the site.

4 The respondent fabricates and installs residential staircases. Mr. Di Donato, an officer of the appellant company, called Mr. Ford, an officer of the respondent (Ford) to see if it could provide and install circular staircases in the homes. Mr. Ford attended at the homes. At that time they had reached a stage of the construction where they were framed in. Di Donato offered to show the architectural plans for the homes to Ford. He declined to see those plans. It is significant that the plans clearly indicate the required headroom at the top of the stairs, which would comply with the Ontario Building Code requirements. Mr. Ford did, however, make some measurements. He offered a selection of three types of staircases to Mr. Di Donato. Mr. Di Donato selected one of the three. The price was agreed upon as were certain minor structural changes necessary to permit the stairs to be installed.

5 The stairs were, in due course, delivered and installed. There is no fault found with the material used in the stairways. Unfortunately they did not comply with the Ontario Building Code regulation for the headroom was 1-1/2 inches short of the specified minimum. As a result, the appellant was required by the building inspector to take out the staircases and install others which complied with the Ontario Building Code. The removal of the staircases and the installation of new ones gave rise to this claim.

Result at trial and in the Divisional Court

6 Ford brought an action to recover the cost for the supply and installation of the services. At trial the Ford claim for the two circular staircases was dismissed.

7 Ford then appealed the result to the Divisional Court. That Court gave effect to Ford's contentions and allowed it the full amount of its claim together with interest. It held that there could be no obligation upon the respondent Ford unless the appellant placed reliance upon it with regard to the staircases and made Ford aware of that reliance. On the facts the Divisional Court found that "there was no vestige of such a reliance on the record of the case".

8 With deference, we cannot agree with either of the conclusions of the Divisional Court.

Implied terms of contracts

9 When may a term be applied on a contract? A Court faced with that question must first take cognizance of some important and time-honoured cautions. For example, the Courts will be cautious in their approach to implying terms to contracts. Certainly a Court will not rewrite a contract for the parties. As well, no term will be implied that is inconsistent with the contract. Implied terms are as a rule based upon the presumed intention of the parties and should be founded upon reason. The circumstances and background of the contract, together with its precise terms, should all be carefully regarded before a term is implied. As a result, it is clear that every case must be determined on its own particular facts. With these principles firmly in mind it is appropriate to consider some texts and recent cases dealing with the issue.

10 For almost a century it has been recognized that a term will be implied in a contract in order to give it business efficacy: see The Moorcock (1889), 14 P.D. 64. The basis upon which a term of a contract will be implied has been extended by decisions of the English Court of Appeal and the House of Lords. Hudson's Building and Engineering Contracts (10th ed., 1979), pp. 274-5, gives us a useful summary of the law pertaining to when terms will be implied in a contract:

> It is submitted that a contractor undertaking to do work and supply materials impliedly undertakes:
>
> (a) to do the work undertaken with care and skill or, as sometimes expressed, in a workmanlike manner;

> (b) to use materials of good quality. In the case of materials described expressly this will mean good of their expressed kind. (In the case of goods not described, or not described in sufficient detail, it is submitted that there will be reliance on the contractor to that extent, and the warranty in (c) below will apply);
>
> (c) *that both the work and materials will be reasonably fit for the purpose for which they are required, unless the circumstances of the contract are such as to exclude any such obligation* (this obligation is additional to that in (a) and (b), and only becomes relevant, for practical purposes, if the contractor has fulfilled his obligations under (a) and (b)).

(Emphasis added.)

11 Young & Marten Ltd. v. McManus Childs Ltd., [1969] 1 A.C. 454, [1968] 2 All E.R. 1169, is a decision of the House of Lords. Two principles emerge from the speeches given in the course of that case. The first is that the common law principles codified in the Sale of Goods Act apply to contracts for the provision of work and materials sometimes referred to as contracts for work and services. Thus, the provisions pertaining to the Sale of Goods Act and codified in that Act are equally applicable to contracts for the provision of work and materials. Secondly, it is determined that unless the cirumstances of a particular case are sufficient to specifically exclude it, there will be implied into a contract for the supply of work and materials a term that the materials used will be of merchantable quality and that those materials will be reasonably fit for the purposes for which they were intended.

12 Independent Broadcasting Authority v. EMI Electronics Ltd. (1980), 14 Build. L.R. 1, was a further decision of the House of Lords. That decision followed Young & Marten, supra, and added something further. It was to the effect that in the absence of any term (express or implied) negativing the obligation, one who contracts to design an article for a purpose made known to him undertakes that the design is reasonably fit for the purpose. Such a design obligation was said to be consistent with the statutory law regulating the sale of goods.

13 The principle enunciated in Young & Marten Ltd. has been considered and adopted in appellate courts in Canada. In Ontario, in Hart v. Bell Telephone Co. of Can. (1979), 26 O.R. (2d) 218, 10 C.C.L.T. 335, 102 D.L.R. (3d) 465 (C.A.) (on the general issue of when warranties will be implied). In Laliberté v. Blanchard (1980), 31 N.B.R. (2d) 275, 75 A.P.R. 275 (C.A.), Chief Justice Hughes specifically followed Young & Marten Ltd. and relied upon a quotation from Lord Justice DuParcq, which was favourably referred to in that case. The words of Lord Justice DuParcq appear in Myers (G.H.) Co. v. Brent Cross Service Co., [1934] 1 K.B. 46:

> ... the true view is that a person contracting to do work and supply materials warrants that the materials which he uses will be of good quality and reasonably fit for the purpose for which he is using them, unless the circumstances of the contract are such as to exclude any such warranty.

The foregoing principles are most attractive and compelling.

14 On behalf of the appellant reliance was placed on CCH Can. Ltd. v. Mollenhauer Contr. Co., [1976] 1 S.C.R. 49, 51 D.L.R. (3d) 638. The reasons given by the Supreme Court of Canada do not include a reference to the Young & Marten decision. In our view, the scope of the decision in the CCH case is narrow. It determined that the contract under consideration by the Court, by its terms and its reference to the use of a specific type of brick, excluded an implied term that those bricks would be fit for the purposes intended. In the case before us it cannot be said that the appellant specified a particular staircase, but rather, he was simply offered a choice of three by the respondent, one of which he chose. In our opinion, the CCH case is not applicable to the facts presently before us.

Application of principles to this case

15 In applying the principles to this case it is important to bear in mind the following. In this case the appellant contractor acquired material and services from Ford, the respondent subcontractor. It was the subcontractor that was

"expert" in the manufacture and installation of stairs. When the contract was negotiated the house plans were offered to Ford who chose to ignore them. The houses were framed in so that measurements could be taken to ensure that the stairs complied with the provisions of the Ontario Building Code. The respondent was, as it should have been, fully aware of the requirements of the Building Code. No one would have a better knowledge of the dimensions of its products than Ford. No one else could better appreciate whether they could be installed in the house and comply with the Code. It would be natural and reasonable in the circumstances of this case for the appellant to rely upon Ford to supply and install the staircases in compliance with the Ontario Building Code. It would be unrealistic to come to any other conclusion. The trial Judge inferentially found that there was such a reliance. That can be ascertained from the following excerpts from his reasons. At p. 230 he said:

> It is a most unfortunate situation but I place the fault on the plaintiff [Ford] for failing to have the stairs installed in such a manner that they do not contravene the Building Code.

Further, the following appears at p. 231:

> The houses in question were luxury type homes of approximately 3,000 square feet and the selling price was $239,000 odd if I recollect correctly; $239,900. This being so I am of the opinion that the defendants were entitled to have the staircase installed which was satisfactory and which would not interfere or would not contravene the structural requirements of the Building Code and also that any structural change that was required might interfere with the proper installation of a railing or bannister on the upper floor and over all the visual or cosmetic effect of this defect.

And lastly, at p. 231:

> ... in my view the defendants were entitled to insist on strict compliance ... that is their entitlement ...

16 These findings were well substantiated by the evidence. In those circumstances the Divisional Court, sitting as an appellate Court, was not justified in ignoring those findings; rather, it was bound to accept them: see, for example, Lewis v. Todd, [1980] 2 S.C.R. 694, 14 C.C.L.T. 294, 34 N.R. 1.

17 On the facts of this case there must of necessity be an implied term that the staircase could be and would be installed so as to comply with the Ontario Building Code. There could be no business efficacy to the contract without such a term. It is no contract to have stairs installed that must, by requirements of the law, be taken out for failure to comply with the Code. To sanction the installation of such a staircase in contravention of the Code would be tantamount to sanctioning an illegal contract. On the basis of the principle enunciated in the Moorcock case, supra, the term should be implied in the contract that the stairs would comply with the Code.

18 Alternatively or additionally a term should be implied that both the work and materials will be reasonably fit for the purpose for which they were required. Such a term must be implied unless the circumstances of the contract are such as to exclude any such obligation: see Young & Marten, supra. No such exclusion appears, from the circumstances of the contract, in this case. The work and materials supplied could not be reasonably fit for the purpose for which they were required unless they complied with the provisions of the Ontario Building Code.

19 In the circumstances, the appeal will be allowed with costs here and in the Divisional Court. The order of the Divisional Court will be set aside and the judgment at trial restored.

Appeal allowed.

Tab 5

2005 CarswellOnt 5985
Ontario Superior Court of Justice

Terastar Realty Corp., Re

2005 CarswellOnt 5985, [2005] O.J. No. 4742, 143 A.C.W.S. (3d) 621, 16 C.B.R. (5th) 111, 39 R.P.R. (4th) 1

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S. 1985, c. C-36, as amended

AND IN THE MATTER OF a Proposed Plan of Compromise or Arrangement with Respect to Terastar Realty Corporation, Terastar Realty Growth Limited Partnership, Terastar Investments Holdings Inc., Pioneer SportsWorld Inc., SportsWorld Limited Partnership, 1345020 Ontario Limited and SportsWorld Twin Pads Inc. (Applicants)

Hoy J.

Heard: October 31, 2005
Judgment: November 3, 2005
Docket: 05-CL-005815

Counsel: David R. Wingfield, Paul D. Guy for Applicants
Peter J. Osborne for Respondent, McDonald's Restaurants of Canada Limited
L. Joseph Latham for Intermarket MMK Inc.
David Ward for Bank of Montreal
John Contini for Lochan Ora Investments Limited
Derrick Tay for Civil Services Co-operative Credit Society Limited
James C. Davies for Oakville Investment Corporation (DIP Lender)
Mark Laugesen for Monitor, BDO Dunwoody Limited
Philip Horgan for Ball Construction
Jack Nanson for Kearsley Electric

Subject: Property; Insolvency; Contracts

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Real property

I Interests in real property
I.4 Restrictive covenants
I.4.g Enforcement
I.4.g.iii Miscellaneous

Headnote

Real property --- Restrictive covenants — Enforcement — Subsequent purchasers — General

One of applicants entered into 40-year restrictive covenant in 1985 in connection with sale to M Ltd. of lands adjacent to subject property for price of $345,000 — Covenant restricted lands from being used for certain restaurant uses without express written consent of M Ltd. — Applicants were granted protection from their creditors under Companies' Creditors Arrangement Act ("CCAA") — Applicants sought approval to sell sports-oriented family entertainment centre to third party — It was condition of sale transaction for benefit of third party that order be granted vesting title in entertainment centre's assets in third party free and clear of restrictive covenant, and applicants were required to seek this order — On liquidation following sale, there would be insufficient funds to fully pay out all of secured creditors and lien holders — Motion was brought to determine whether court should vest title to property proposed to be sold as part of sale by applicants, under CCAA, free and clear of restrictive covenant in favour of company registered on title to property — Court declined to grant requested vesting order — Cases under Conveyancing and Law of Property Act suggest that in CCAA proceedings court has to act with greater caution in discharging covenant running with land than in dealing with executory contracts — There was no evidence as to what restaurant uses were proposed by third party, and therefore finding of lack of prejudice to M Ltd. could not be made — This was not case where court order terminating executory contract was sought to permit continued operation of petitioner's business as going concern, to facilitate restructuring — It was before court as liquidating sale for benefit of secured creditors — There was no evidence from third party that it would be unwilling to complete sale transaction at reduced price, with restrictive covenant left in place — Deletion of restrictive covenant would secure higher price for benefit of secured creditors, at expense of M Ltd. — There was no evidence of failed or unreasonable negotiations.

Bankruptcy and insolvency --- Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues

One of applicants entered into 40-year restrictive covenant in 1985 in connection with sale to M Ltd. of lands adjacent to subject property for price of $345,000 — Covenant restricted lands from being used for certain restaurant uses without express written consent of M Ltd. — Applicants were granted protection from their creditors under Companies' Creditors Arrangement Act ("CCAA") — Applicants sought approval to sell sports-oriented family entertainment centre to third party — It was condition of sale transaction for benefit of third party that order be granted vesting title in entertainment centre's assets in third party free and clear of restrictive covenant, and applicants were required to seek this order — On liquidation following sale, there would be insufficient funds to fully pay out all of secured creditors and lien holders — Motion was brought to determine whether court should vest title to property proposed to be sold as part of sale by applicants, under CCAA, free and clear of restrictive covenant in favour of company registered on title to property — Court declined to grant requested vesting order — Cases under Conveyancing and Law of Property Act suggest that in CCAA proceedings court has to act with greater caution in discharging covenant running with land than in dealing with executory contracts — There was no evidence as to what restaurant uses were proposed by third party, and therefore finding of lack of prejudice to M Ltd. could not be made — This was not case where court order terminating executory contract was sought to permit continued operation of petitioner's business as going concern, to facilitate restructuring — It was before court as liquidating sale for benefit of secured creditors — There was no evidence from third party that it would be unwilling to complete sale transaction at reduced price, with restrictive covenant left in place — Deletion of restrictive covenant would secure higher price for benefit of secured creditors, at expense of M Ltd. — There was no evidence of failed or unreasonable negotiations.

Annotation

This is a fascinating case that cries out for annotation. It is particularly fascinating because the facts arise out of the confluence of real property law and insolvency law, always a fertile intersection for interesting case law. It never fails to amaze this annotator, whose own practice tends to straddle these two sub-disciplines of commercial law, the curious lack of mutual understanding between practitioners in the two sub-disciplines, notwithstanding that they interact all too often with each other in real life.

The facts are simple. An insolvent owns real property that is the servient tenement subject to a restrictive covenant in favour of an adjoining dominant tenement. The insolvent servient tenement owner seeks court protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, s.1 (the "CCAA"). While under court protection, the insolvent finds an opportunity to sell the real property to a third party purchaser, so long as the property can be sold free and clear of the restrictive covenant. The one true question before the Court was whether or not the Court could, in the exercise of its jurisdiction under the CCAA, override the legitimate property rights of the neighbouring dominant tenement owner in and to the insolvent's real property.

One cannot emphasize enough how disparate the views of the real property bar and the insolvency bar generally are on this relatively straightforward issue. To most of the insolvency bar, the restrictive covenant represents little more than yet another executory contract that had been entered into by the insolvent that could be compromised in order to permit the insolvent to re-structure. The dominant tenement owner, to the extent that it suffers damages as a result of the loss of the benefit of having the insolvent's property bound by such restrictive covenant, can then submit a claim in the insolvency proceedings (albeit often at less than 100 cents on the dollar, as would have been the case in *Terastar*) had the Court not upheld the immunity of the restrictive covenant.

The real estate bar, on the other hand, would (or at least should), if they even fully appreciated that cases like *Terastar* were regularly being adjudicated, react apoplectically over the thought that real property rights over adjoining lands acquired and paid for years ago, may be forfeited upon the insolvency of the current servient tenement owner. There are certain historical and practical justifications for treating leases more like executory contracts instead of as the property conveyances that they actually are (even long before *Highway Properties Ltd. v. Kelly, Douglas & Co.* (1971), [1971] S.C.R. 562, [1972] 2 W.W.R. 28, 17 D.L.R. (3d) 710, 1971 CarswellBC 239, 1971 CarswellBC 274 (S.C.C.), the courts have treated leases as "quasi-realty" and, besides, the general practice of reserving rent and having it paid in regular instalments over time lends itself to an executory contract characterization for leases). However, restrictive covenants and easements really do not share these features in common with leases and these incorporeal hereditaments are far more easily characterized as true property rights. Certainly this annotator is absolutely unaware of any real property title opinion currently being issued by a major Canadian law firm that even tries to qualify for the risk of compromise in insolvency. Indeed, the very fact that this matter even came before the Court is giving this annotator some cause for pause as to whether some sort of express qualification might some day have to be included in this annotator's own title opinions, but the decision of Hoy J. of the Ontario Superior Court of Justice in *Terastar* renders that consideration moot for the time being.

The *Terastar* decision itself consists of a preliminary discussion of Section 61 of the *Conveyancing and Law of Property Act* (the "CLPA"). This obscure provision of an otherwise arcane act is the general authority of a court to modify or cancel otherwise valid restrictive covenants which have since become obsolete (for an interesting application of the corresponding British Columbia statutory regime for the judicial modification or cancellation of restrictive covenants, see *Mountain Development Corp. v. McCrodan* (1995), 50 R.P.R. (2d) 9, 15 B.C.L.R. (3d) 309, 1995 CarswellBC 1034 (B.C. S.C.), but see also *Moody, Re* (1941), [1941] O.W.N. 167, 1941 CarswellOnt 125 (Ont. C.A.) and *Toronto (City), Re* (1945), [1945] O.W.N. 723, 1945 CarswellOnt 297 (Ont. H.C.) for similar Ontario applications). The discussion about Section 61 of the CLPA in *Terastar* was largely unhelpful since statutory provisions like Section 61 of the CLPA were always intended to simply quiet modern titles otherwise subject to ancient and clearly obsolete restrictions on title with little, if any, credible loss of value for the dominant tenement owner that is vested out pursuant to court orders issued under the authority of such statutes. The Court in *Terastar* wisely gave little credence to the application of a Section 61 CLPA remedy to a modern dispute with valuable and timely interests at stake for the dominant tenement owner (see, generally, *Ontario Lime Co., Re* (1926), 59 O.L.R. 646, [1927] 1 D.L.R. 765, 1926 CarswellOnt 79 (Ont. C.A.) cited with approval in *Terastar*).

The "true" issue in *Terastar* was the boundaries, if any, that the Court was prepared to impose upon its own heretofore "broad and unrefined discretion" to use the general compromise power in the CCAA to achieve the remedy denied under Section 61 of the CLPA. In addressing this issue, Hoy J. applied the reasoning of the Ontario Court of Appeal in *2022177 Ontario Inc. v. Toronto Hanna Properties Ltd.* (2005), 37 R.P.R. (4th) 1, 2005 CarswellOnt 5194, 203 O.A.C. 220 (Ont. C.A.), a case involving contractual density allocation rights. In *Toronto*

Hanna, the insolvent had previously sold its density rights in and to the subject property pursuant to a density transfer agreement in favour of a neighbouring owner. The Ontario Court of Appeal refused to allow the insolvent to sell the real property free and clear of the burden that had been assumed by the insolvent under the density transfer agreement. The Court's reasoning in *Toronto Hanna* was illuminating. The Court held that: (i) these density rights were property rights and, having effectively sold such rights much earlier pursuant to the density rights agreement, the insolvent really no longer had those density rights to sell; (ii) the deprived density owner in *Toronto Hanna* was not a "creditor" in any true sense vis-à-vis the insolvent; and (iii) the deprived density owner in *Toronto Hanna* did not have notice of vendor *cum* debtor's CCAA proceedings. Real property lawyers certainly will have no difficulties sympathizing with the holding in *Toronto Hanna* and seeing the ready parallels between the facts in *Toronto Hanna* and the facts in *Terastar*.

In fairness, the dominant tenement holder in *Terastar* did get some notice of the CCAA proceedings, but only after it became clear that the Court was going to be requested to vest-out the restrictive covenant interest. Typically, the holders of such interests rarely get any notice of such proceedings, and often lose their rights before even knowing that such rights were in jeopardy. Ironically, this chronic lack of notice to holders of ancillary real estate encumbrances in CCAA and BIA proceedings simply proves that such holders are never really considered true "creditors" of the insolvent, and merely giving these dominant tenement owners notice of the CCAA proceedings does not then convert such relationships into debtor-creditor relationships subject to the authority of the CCAA.

In the end, wearing this annotator's real property lawyer hat, one cannot possibly argue with the correctness of the Court's position in *Terastar* on the scope of its own CCAA powers. Presumably, wearing this annotator's insolvency lawyer hat and making the corresponding annotation in, say, the *Bankruptcy Law Reports*, this annotator would have to lament the courts' reluctance to invoke its own broad powers under the CCAA (and, presumably, corresponding powers under the *Bankruptcy and Insolvency Act*) to vest out the property interests of contractual counterparties under executory contracts. Even if not real or immoveable in nature, the benefits of executory contracts to the counterparties thereof also presumably have value to such counterparties, yet such parties must nonetheless endure sometimes material compromise for the benefit of the restructuring. Also, landlords, who also hold real property interests, already face such risk of compromise at both the proposal and the bankruptcy stages in a BIA insolvency and it may not be entirely intuitive to an insolvency lawyer why a landlord and other executory contract creditors may be compromised whilst dominant tenement holders under restrictive covenants (presumably under easements and other incorporeal hereditaments as well) and density rights holders under density transfer agreements should somehow enjoy more favourable jurisprudential immunity from compromise.

Ironically, many existing CCAA orders already issued to date actually purport to vest out many otherwise immune ancillary real property rights (presumably inadvertently) through their use (abuse) of broad, sweeping vesting language. Only recently has this annotator seen an increased sensitivity to the concept of "permitted encumbrances", reflected in CCAA orders. Correspondingly, it has only been recently where this annotator has seen insolvency counsel and judges sensitive to the fact that CCAA orders, notwithstanding their potential breadth, are not always appropriate venues for "cleaning-up" title anomalies against parties who are not true creditors in the proceedings. Ironically, insolvency counsel and judges have some excuse in their general unfamiliarity with the nuances of conveyancing. The real culprits in this abuse of vesting orders are actually purchasers' counsel, all too often real property veterans, who have seized upon the seemingly limitless authority of CCAA court orders as a convenient means of "back-door" quieting of titles.

Finally, while this annotator supports the principles enunciated in *Terastar*, this annotator is actually quite surprised at the outcome of the case. This annotator was certain that the so-called "dominant tenement" owner in *Terastar* would easily have lost, but for reasons altogether unaddressed in *Terastar*. A hint as to this annotator's thinking can be found in the Ontario Superior Court of Justice decision in *Philip Analytical Services Inc., Re* (2005), 2005 CarswellOnt 2988 (Ont. S.C.J. [Commercial List]) which, on fairly similar facts, permitted the vesting-out of certain covenants relating to the insolvent's lands to facilitate a proposed restructuring of the insolvent. In *Phillip Analytical*

Services, the Court found that the covenants at issue were not enforceable against successors in any event as a matter of real property law (they were in the nature of positive covenants which, thanks to the Court of Appeal's decision in *Amberwood Investments Ltd. v. Durham Condominium Corp. No. 123* (2002), 50 R.P.R. (3d) 1, 211 D.L.R. (4th) 1, 157 O.A.C. 135, 58 O.R. (3d) 481, 2002 CarswellOnt 850 (Ont. C.A.), cannot run with the land in Ontario). What *Phillip Analystical Services* teaches the bar is that a CCAA order can be used to vest-out unwanted rights where, as a matter of property law, the restrictive covenants are defective in the first place.

Although the covenants in *Terastar* were not positive in nature, it is interesting to note what they in fact were. The dominant tenement owner in *Terastar* was an internationally renowned fast- food restaurant chain and the restrictive covenant encumbering the insolvent's land was a covenant not to permit a competing fast-food operation. As such, one might have thought that the covenant was immediately unenforceable (certainly against successors in title and quite possibly even against the instant parties thereto) as being a restriction in the nature of commerce only and not one that went to the benefit of the putative dominant tenement *qua* land. This annotator remains sceptical about the enforceability of restrictive covenants that are given blatantly (and sometimes not so blatantly, but equally deliberately) to restrict commerce on the servient tenement for the benefit of the business conducted on the dominant tenement (but not necessarily to benefit the intrinsic value of the land itself). Although a number of leading cases (starting with *Russo v. Field* (1973), [1973] S.C.R. 466, 34 D.L.R. (3d) 704, 1973 CarswellOnt 223, 1973 CarswellOnt 223F (S.C.C.) and, more recently, *Canada Safeway Ltd. v. Thompson (City)* (1996), 5 R.P.R. (3d) 1, [1996] 10 W.W.R. 252, 112 Man. R. (2d) 94, 1996 CarswellMan 401 (Man. Q.B.)) have gone a long way in relaxing the proscription against "commercial-only" restrictive covenants in the context of shopping centre and plaza commercial leasing, one of the basic tenets of the law of freehold covenants remains the proposition that the putative restriction must benefit the dominant tenement generally, not just the person or persons who from time to time may run a business from the dominant tenement. For instance, presumably a restriction against selling hamburgers would generally benefit abutting dominant tenements in upscale residential areas of town (which neighbour would want a fast food hamburger restaurant on a quiet residential street in the expensive residential part of town?), but query whether the same restrictive covenant would benefit lands in the commercial core already zoned to permit restaurants and otherwise situated in an area where restaurants are common and desirable. If the court finds that such a restriction against fast food hamburgers was intended only to create a competitive commercial advantage for the then current fast food hamburger vendor on the dominant tenement, but the same covenant would not generally enhance the value of the dominant tenement had it been held by anyone other than the fast food hamburger vendor, then such a restrictive covenant should probably be unenforceable *abinitio*. Frankly, the covenant at issue in *Terastar* was precisely the type of "commercial restriction" that the courts will not generally, as a matter of policy, enforce. It is unclear whether or not the Court in *Terastar* suspected that it did not have to consider the CCAA jurisdiction at all because the issue could be disposed of on real property law principles alone as was the case in *Phillip Analytical Services*. The analysis is, of course, moot in the long run since the ultimate outcome would have been the same, but discussion on the limits of the CCAA vesting power may very well have been diluted amidst the other *obiter dicta* had the Court in *Terastar* truncated any extended discussion on its CCAA powers in favour of a "commercial restriction" analysis. What is fairly clear to this annotator is that the Court was mindful not to set a precedent against the "commercial restriction" bar to availment by declaring early in the Court's reasons, "it is undisputed that the restrictive covenant is a negative covenant that runs with the land". By establishing that it has not been compelled to explore the validity of the negative covenant as one that runs with land, the Court leaves itself free to consider the "commercial restriction" at some other juncture without *Terastar* being set-up as some sort of same-level *stare decisis*.

Jeffrey W. Lem

Davies Ward Phillips & Vineberg LLP

Table of Authorities

Cases considered by *Hoy J.*:

Beardmore, Re (1935), [1935] O.R. 526, [1935] 4 D.L.R. 562, 1935 CarswellOnt 57 (Ont. C.A.) — considered

Citibank Canada v. Chase Manhattan Bank of Canada (1991), 5 C.B.R. (3d) 165, 2 P.P.S.A.C. (2d) 21, 4 B.L.R. (2d) 147, 1991 CarswellOnt 182 (Ont. Gen. Div.) — considered

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

National Capital Commission v. Bélanger (2002), 2002 CarswellOnt 1678, 2 R.P.R. (4th) 130 (Ont. S.C.J.) — considered

Ontario Lime Co., Re (1926), 59 O.L.R. 646, [1927] 1 D.L.R. 765 (Ont. C.A.) — followed

Philip Analytical Services Inc., Re (2005), 2005 CarswellOnt 2988 (Ont. S.C.J. [Commercial List]) — not followed

Stelco Inc., Re (2005), 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2005 CarswellOnt 1188, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 196 O.A.C. 142 (Ont. C.A.) — considered

T. Eaton Co., Re (1999), 1999 CarswellOnt 3542, 14 C.B.R. (4th) 288 (Ont. S.C.J. [Commercial List]) — considered

Van Bork v. William Carson Holdings Ltd. (1998), 1998 CarswellOnt 4300 (Ont. Gen. Div.) — considered

2022177 Ontario Inc. v. Toronto Hanna Properties Ltd. (2005), 2005 CarswellOnt 5194 (Ont. C.A.) — considered

Statutes considered:

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

s. 1 — considered

s. 11 — considered

s. 11(4) — referred to

s. 11(6) — referred to

Conveyancing and Law of Property Act, R.S.O. 1990, c. C.34
Generally — referred to

s. 61 — referred to

s. 61(1) — considered

MOTION to determine whether court should vest title to real property proposed to be sold as part of sale by applicants, under *Companies' Creditors Arrangement Act*, free and clear of restrictive covenant in favour of company registered on title to property.

***Hoy J.*:**

1 The issue before me on this motion is whether this Court should vest title to real property (the "Property") proposed to be sold as part of the sale by the Applicants, under the *Companies' Creditors Arrangement Act*, R.S. 1985 c. C-36, s. 1 (the "*CCAA*"), of their business to a third party purchaser, Intermarket MMK Inc. ("Intermarket"), free and clear of a restrictive covenant in favour of McDonald's Restaurants of Canada Limited ("McDonald's") registered on title to the Property.

Background

2 One of the Applicants entered into the restrictive covenant in 1985, in connection with the sale to McDonald's of lands adjacent to the Property for a price of $345,000. No portion of the purchase price was specifically allocated to the restrictive covenant. The restrictive covenant has a term of 40 years from the date of registration, and expires on April 15, 2026. It restricts the lands from being used for certain restaurant uses without the express written consent of McDonald's. It is undisputed that the restrictive covenant is a negative covenant that runs with the land.

3 The Applicants, Terastar Realty Corporation, Terastar Realty Growth Limited Partnership, Pioneer SportsWorld Inc., Terastar Investment Holdings Inc., Sports World Limited Partnership, 1345020 Ontario Limited and SportsWorld Twin Pads Inc., were granted protection from their creditors under the *CCAA*, by initial order dated March 24, 2005.

4 The Applicants own SportsWorld, a sports-oriented family entertainment center in the Kitchener area whose attractions include a golf dome, batting cage complex, twin pad arena, arcade, water park, wave park, miniature golf courses, go-cart track, midway, rock climbing center, picnic grounds, children's day camps and two restaurants.

5 The Applicants seek approval to sell SportsWorld to Intermarketet. The Monitor is of the view that the proposed transaction is the highest and best offer and recommends the transaction. The transaction is supported by the Applicants' secured lenders, their DIP lender, Bank of Montreal ("BMO") and Lochan Ora, and various construction lien holders.

6 It is a condition of the sale transaction for the benefit of Intermarketet that this Court grant an order vesting title in the SportsWorld assets in Intermarketet free and clear of the restrictive covenant and the Applicants are required to seek this order.

7 On the liquidation following the sale, there will be insufficient funds to fully pay out all of the secured creditors and the lien holders. Accordingly, if the Court vested title in the assets in Intermarket free and clear of the restrictive covenant, and McDonald's simply advanced a claim under the plan, as some of the secured creditors suggest it might, McDonald's would receive no compensation.

8 The parties supporting the requested vesting order (the "Supporting Parties"), namely the Applicants, Intermarketet, BMO, Lochan Ora and the construction lien claimants, and McDonald's agree that *CCAA* judges have broad discretionary powers under s. 11 of the *CCAA*.

9 The Applicants and McDonald's referred me to *Stelco Inc., Re* (Ont. C.A.) at paras. 58 and 51, in which Blair J.A. held that where another applicable statute confers jurisdiction with respect to a matter, the broad and unrefined discretion provided for in the *CCAA* cannot be used to supplant or override the other applicable statute.

10 The parties agree that in the case before me, the *Conveyancing and Law of Property Act*, R.S.O. 1990, c. C.34 (the "*CLPA*") specifically addresses the circumstances in which restrictive covenants may be discharged by the court.

11 Section 61 of the *CLPA* provides:

> 61. (1) Where there is annexed to land a condition or covenant that the land or a specified part of it is not to be built on or is to be or not to be used in a particular manner, or any other condition or covenant running with or capable of being legally annexed to land, any such condition or covenant may be modified or discharged by order of the [Superior Court of Justice].

12 The parties' positions differ as to how I should exercise my discretionary powers under the *CCAA*.

The Supporting Parties' Position

13 The position of the Supporting Parties is that the Court has the power under the *CCAA* to remove a restrictive covenant as part of a sale and approval of a vesting order. They cite the recent decision of the Court of Appeal in *2022177 Ontario Inc. v. Toronto Hanna Properties Ltd.*, [2005] O.J. No. 4527 (Ont. C.A.), released October 26, 2005 as authority for the ability of the Court to remove a restrictive covenant in approving a sale and granting a vesting order. They say *Toronto Hanna Properties Ltd.* only requires that notice or compensation be provided, and that notice has been given to McDonald's.

14 The Supporting Parties also rely on *Philip Analytical Services Inc., Re*, [2005] O.J. No. 2915 (Ont. S.C.J. [Commercial List]) in which Cameron J., in considering the effect of a vesting order, concluded that certain covenants relating to land were positive covenants, therefore did not run with the land and were discharged by a vesting order in a restructuring, and that even if they were negative covenants, they were discharged by the vesting order. They do not dispute that Cameron J. relied on the decision of the applications judge in *Toronto Hanna Properties Ltd.*, which was reversed by the Court of Appeal.

15 The Supporting Parties also point to this Court's finding in *T. Eaton Co., Re*, [1999] O.J. No. 4216 (Ont. S.C.J. [Commercial List]), in which Farley J. noted that it is clear that under *CCAA* proceedings, debtor companies are permitted to unilaterally terminate leases and contracts, even if the contracting parties may, like other creditors, be paid off at less than 100 cents on the dollar when they advance claims arising out of the repudiation.

16 The Supporting Parties argue that the Court's discretion under s. 11 of the *CCAA* must be exercised in conformity with the overall purpose of the *CCAA*. They referred me to *Citibank Canada v. Chase Manhattan Bank of Canada*, [1991] O.J. No. 944 (Ont. Gen. Div.) in which Rosenberg J., as he then was, wrote that, "The jurisdiction of the Court under the *CCAA* should be given a large and liberal interpretation consistent with the remedial nature of the legislation. ... The purpose of the *CCAA* is to facilitate arrangements that might avoid liquidation of the company and allow it to continue in business to the benefit of the whole economic community, including the shareholders, the creditors (both secured and unsecured) and the employees."

17 The Supporting Parties also refer me to statements of Farley J. in *Lehndorff General Partner Ltd., Re* (Ont. Gen. Div. [Commercial List]):

> 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.
>
> . . . . .
>
> The *CCAA* is intended to provide a structured environment for the negotiation of compromises between a debtor company and is creditors for the benefit of both.
>
> . . . . .
>
> The court's primary concerns under the *CCAA* must be for the debtor and all of the creditors.

18 The Applicants agree with McDonald's that the test to be applied in determining whether or not to remove the restrictive covenants under s. 61 of the *Conveyancing and Law of Property Act* is articulated in *Ontario Lime Co., Re* (1926), 59 O.L.R. 646 (Ont. C.A.)):

> ... The Court should not sanction the making of an order which would substantially depreciate the adjacent land. It has been more than once pointed out that under this statute there is no power to make compensation to a land owner who is prejudicially affected, and that jurisdiction is one to be exercised with the greatest caution, and an order should seldom, if ever be made which will in truth operate to the prejudice of the adjacent landowner who has any real rights. The true function of the statute is to enable the Court to get rid of the condition or restriction which is spent or so unsuitable as to be of no value and under circumstances when its assertion would be clearly vexatious.

19 The Supporting Parties submit that the restrictive covenant is no longer of value, because three direct competitors (Harvey's, Wendy's and Tim Horton's) already have locations within approximately 0.5 km. of the SportsWorld property, and that maintaining the covenant is therefore vexatious. They also submit that the restrictive covenant is "spent", because McDonald's has already had the benefit of it for twenty years.

20 They refer me to *Van Bork v. William Carson Holdings Ltd.*, [1998] O.J. No. 4523 (Ont. Gen. Div.). In that case, a homeowner opposed a developer's motion to have a restrictive covenant removed to permit a residential development because the homeowner alleged he would be negatively affected by the removal of the restrictive covenant. He led no expert evidence on the impact of the removal of the negative covenant and asserted such things as that he would be adversely impacted by increased noise and smells from a residential development, that would not result from commercial buildings permitted by the restrictive covenant. Gans J. considered evidence from the developer that another residential development was poised to take place below the homeowner's property, and contiguous to the developer's land, and that it was much larger than the development objected to by the homeowner. Gans J. concluded that the homeowner would not derive any real benefit from the enforcement of the covenant; the planning concerns about which he complained had been dealt with by municipal authorities. The homeowner had declined to participate in the planning process. Gans J. concluded that the homeowner's opposition was vexatious and the restrictive covenant was deleted.

21 The Supporting Parties acknowledge the evidence of Mr. McKinley, National Director of Real Estate with McDonald's, that the location of McDonald's restaurants in relation to its competitors is critical to its business viability and success at this location and that removal of the restrictive covenant would, *depending on what other restaurant uses were introduced*, have a material financial impact on its restaurant adjacent to the Sports World lands. The Supporting Parties say that this evidence is comparable to the evidence of the homeowner discounted by Gans J. in the *Van Bork* case, *supra*, and should therefore be discounted.

22 The Supporting Parties also cite *Van Bork* and *National Capital Commission v. Bélanger*, [2002] O.J. No. 1844 (Ont. S.C.J.) for the proposition that in applying the test in *Ontario Lime Co., Re*, *supra*, the court must consider the balance of convenience and interests of all those concerned.

23 In *National Capital Commission*, Chilcott J. applied *Ontario Lime Co., Re* and concluded there was no evidence that the restrictive covenant was expendable and of no value. In that case, the homeowner was unaware of the restrictive covenant and built part of his home on lands protected by a restrictive covenant in favour of the National Capital Commission. The purpose of the restrictive covenant was to ensure that the houses would be less visible from the National Capital Commission parkway and pathways. The homeowner was required to modify his property to comply with the restrictive covenant.

24 The Supporting Creditors argue that because the removal of the restrictive covenant is a condition of the sale to Intermarket, the sale to Intermarket will be frustrated unless the requested vesting order is granted. They point to the Monitor's Seventh Report which indicates that if the Intermarket sale is aborted because the restrictive covenant is not deleted, it appears that the Applicants will not have sufficient financial resources on hand to fund operations for

an extended further period while negotiations with other prospective purchasers are started or the sales and marketing process is resumed. The Monitor also indicates that it doubts that the secured creditors would support an extension of a stay if the proposed purchase transaction is aborted. The evidence of the Applicants is that all of the "top tier purchasers" required that, at a minimum, the McDonald's restrictive covenant be modified, or there would be "no deal". They say the balance of convenience favours the Applicants.

McDonald's Position

25 McDonald's says the Applicants seek to sell more than they own. The Applicants own land subject to a restrictive covenant and they seek to sell the land free from the restrictive covenant. McDonald's argues that the *Toronto Hanna Properties Ltd.* case, *supra*, says petitioners cannot do this in the context of the *CCAA*.

26 As to the relative impact on the parties, McDonald's also points out that there is no evidence from Intermarket, which appeared on this motion, that it would not consider completing the transaction at a reduced price, and points to the evidence that on two prior occasions McDonald's has agreed to amend the restrictive covenant. McDonald's says that a restrictive covenant that runs with the land is not like an executory contract or lease. It also says that it is not a creditor that can participate in the *CCAA* process. McDonald's submits that except for the *Philip Analytical Services Inc., Re* case, *supra*, which was decided before the Court of Appeal released its decision in *Toronto Hanna Properties Ltd.* and which it submits must be viewed in light of the *Toronto Hanna Properties Ltd.* decision, the Supporting Parties are unable to refer me to any case where the Court has "vested out" a restrictive covenant that runs with the land on a liquidating sale under the *CCAA*.

27 McDonald's says the restriction has value despite the location of its competitors: as the Confidential Information Memorandum, dated May 2005 with respect to SportsWorld, notes the McDonald's restaurant offers park visitors a fast food alternative. The addition of fast food concessions on the SportsWorld property would undoubtedly impact on McDonald's.

28 While McDonald's concedes that it was given notice of the vesting order sought, it submits that the Court should take into account that McDonald's was intentionally excluded from the process until after the Agreement of Purchase and Sale with Intermarket was executed, even though the Applicants were aware several months before that the McDonald's restrictive covenant would likely be an issue.

29 McDonald's points to ss. 11(6) of the *CCAA* which, among other things, provides that the Court shall not make an order under s. 11(4) unless the Applicant satisfies the Court that the Applicant has acted and is acting in good faith. McDonald's submits that the Applicants' delay in involving McDonald's in the process, whether or not on the instructions of Intermarket, based on its view that McDonald's would not be reasonable, is an indication of lack of good faith.

30 McDonald's also submits the requested order is inherently unfair. Only secured lenders will be paid as a consequence of the liquidating sale and all debts to the secured lenders were incurred after the restrictive covenant in favour of McDonald's was registered.

Discussion and Conclusion

31 The Supporting Parties and McDonald's cite *Toronto Hanna Properties Ltd.* for different propositions.

32 In *Toronto Hanna Properties Ltd.*, Toronto Hanna sold a property to Carrier Centres (Canada) Ltd., a company in the 360 Network Group of Companies (the "360 Group"). As part of the sale transaction, Toronto Hanna and Carrier agreed to work together to allocate any surplus density on the purchased property to Toronto Hanna's land to the east of the purchased property. Cronk J.A. characterized this so-called Density Agreement as "an independent contractual right in the nature of a restriction on the permitted future use of designated lands".

33 Notice of the Density Agreement was registered on title. The 360 Group subsequently sought protection under the *CCAA* in British Columbia. Orders of the British Columbia Supreme Court approving the sale of the property, and vesting title in the purchaser, and the final *CCAA* order contained language vesting title in assets sold pursuant to the restructuring free and clear of any and all liens, interests, encumbrances or other claims whatsoever.

34 Toronto Hanna was not involved in the *CCAA* proceedings. It was unaware that its interest in the Density Agreement was, or could be, affected by the *CCAA* orders until litigation ensued after the 360 Group emerged from *CCAA* protection.

35 The ultimate purchaser of the property, LEDCOR, an affiliate of the 360 Group, took the position that it acquired the property free from the Density Agreement. However, the same party had enforced and derived benefit from other terms of the sale agreement, which incorporated the Density Agreement at issue.

36 Cronk J.A. concluded that the *CCAA* orders did not affect Toronto Hanna's interests under the Density Agreement for three reasons.

37 First, she noted that the *CCAA* orders extinguished claims "against the Transferred Assets". "Transferred Assets" were defined as meaning "all estate right, title and interest of the [360 Group] in, to or against ... real property ... and all other assets" that LEDCOR was to receive from the 360 Group. Cronk J.A. concluded that the effect of the Density Agreement was to reserve to Toronto Hanna an interest in the surplus density. She wrote, at paragraphs 48 and 49:

> Simply put, the surplus density on the Toronto property formed no part of the property sold by Toronto Hanna to Carrier. ... Although Carrier was a "Petitioner" in the *CCAA* proceedings an could dispose of its "estate, right, title and interest" in the Toronto Property to LEDCOR, it could dispose of no more than it held. Nor could a vesting order in the CCAA proceedings purport to vest in LEDCOR assets in which the 360 Group had no interest and which it was in no legal position to convey. Consequently, Carrier could not agree with LEDCOR under the LEDCOR Settlement to sell LEDCOR any asset or interest associated with land to which it had no colour right nor a controlling claim.

38 Second, Cronk J.A. rejected the position that Toronto Hanna's required recourse was to make a claim for compensation in the *CCAA* proceedings. She held Toronto Hanna was not a creditor; it had no claim unless and until the owner of the property attempted to utilize the surplus density in a manner contrary to the Density Agreement. This had not occurred.

39 Third, she did not accept that the *CCAA* orders had the effect of eliminating substantive rights of persons who did not have notice that their interest could be potentially affected by the *CCAA* proceedings. She wrote at paragraph 56, "*CCAA* proceedings do not license the permanent abrogation of substantive contractual rights or property interests of strangers to the proceedings without notice or compensation."

40 Cronk J.A. also noted that it would be unfair to deny the benefit of the Density Agreement to Toronto Hanna when Carrier had enforced and derived benefits from the terms of the agreement incorporating the density rights at issue.

41 McDonald's position focuses on the first and second of Cronk J.A.'s reasons. McDonald's says that the Applicants own property subject to a restrictive covenant in their favour, and they cannot dispose of a greater interest in the property than they have. McDonald's says that, like Toronto Hanna, it is not a creditor and its recourse is not making a claim in the *CCAA* proceedings.

42 The Supporting Parties argue that the *Toronto Hanna Properties Ltd.* decision really turns on the fact that Toronto Hanna was not given notice of its right to participate in the *CCAA* proceedings. Here, they say, McDonald's has notice of the proposed vesting order, and that it is open to me, in my discretion, to permit them to make a claim, as an unsecured creditor, in the *CCAA* proceeding to compensate them for the loss of their restrictive covenant. They say that the third

reason of Cronk J.A. is an endorsement that substantive contractual rights and property interests can be abrogated in *CCAA* proceedings as long as there is notice *or* compensation. Hence, they say, as McDonald's has had notice it does not matter that it would, in effect, receive no compensation, if treated as an unsecured creditor.

43 I do not accept that *Toronto Hanna Properties Ltd.* stands for the proposition that, as long as notice is given, a *CCAA* judge should permit a petitioner in *CCAA* proceedings to dispose of a greater interest in property than it is in a legal position to convey. Factors other than simply giving notice affect whether the making of an order is appropriate. A significant factor must be the extent of good faith negotiations before seeking relief from the Court. In considering whether the extent of the negotiations was reasonable, the Court would have regard to the circumstances and the overall purpose of the *CCAA*.

44 I agree with counsel for McDonald's that *Philip Analytical Services Inc., Re*, *supra*, must be discounted in light of the Court of Appeal's subsequent decision in *Toronto Hanna Properties Ltd.*.

45 As noted above, the Supporting Parties cite *Van Bork* and *National Capital Commission* as authority for the proposition that in applying the test in *Ontario Lime Co., Re*, the Court must consider the balance of convenience and interest of all those concerned. In fact, *National Capital Commission*, in referring to *Beardmore, Re*, [1935] O.R. 526 (Ont. C.A.), makes clear that the test in relieving a party from a restrictive covenant is more than simply balance of convenience. *Beardmore, Re* explains that the words "balance of convenience" arose in an earlier version of the statute which incorporated those words, and that the elimination of those words from the statute increased the burden resting on the applicant. *Beardmore, Re* indicates that the resulting injury to the beneficiary of the covenant must be negligible, and Chilcott J. in *National Capital Commission* indicates that the benefit of the parties seeking relief must greatly exceed any possible detriment to the beneficiaries of the restrictive covenant.

46 There may be a difference between an applicant repudiating an executory contract and a court discharging a restrictive covenant. In the former case, the contracting party would have a claim against the applicant. As noted by Farley J. in *T. Eaton Co., Re*, *supra*, in that claim they would rank with the other unsecured creditors of the petitioner. The Applicants have not breached the restrictive covenant, and there is therefore no claim against the Applicants for breach of the restrictive covenant. The beneficiary of the restrictive covenant might not have a claim under the plan unless the Court made provision for such a claim in its vesting order. I say "might not" because in the context of this real-time litigation the right of a third party to make a claim against an applicant for obtaining an order expunging the third party's rights have not been fully explored. While the Supporting Parties say that the Court in its discretion might permit the beneficiary of the restrictive covenant to advance a claim under the plan as an unsecured creditor, they say that discretion does not permit the Court to grant the beneficiary of the covenant a super-priority status. I am not sure that I agree, but I do not need to decide, and do not decide the point.

47 I decline to grant the requested vesting order for the following reasons:

(1) The cases under the *CLPA* suggest to me that in a *CCAA* proceeding the Court has to act with greater caution in discharging a covenant running with the land than in dealing with executory contracts.

(2) In *Ontario Lime Co., Re*, Middleton J.A. in declining to delete a restrictive covenant, noted that when an order is sought to discharge a restrictive covenant it is incumbent upon the Court to ascertain exactly what is proposed by the applicant. In the case before me, there is no evidence as to what restaurant uses are proposed by Intermarket. I cannot make a finding of lack of prejudice to McDonald's in the absence of such evidence.

(3) This is not a case where a court order terminating an executory contract is sought to permit continued operation of the petitioner's business as a going concern, to facilitate restructuring. It is before me as a liquidating sale for the benefit of the secured creditors. There is no evidence before me from Intermarket that it would be unwilling to complete the sale transaction at a reduced price, with the restrictive covenant left in place. Essentially, the deletion of the restrictive covenant would secure a higher price for the benefit of the secured

creditors, at the expense of McDonald's. In saying this, I do not discount the adverse effect of SportsWorld's insolvency on lien holders in the community. Nor do I discount the fact that Intermarket will assume the employment of 6 to 8 people if the transaction is completed. However, McDonald's also operates a business, and a down-turn in sales at the location in issue would presumably affect employment at that location.

It is open to Intermarket or the Applicants to negotiate directly with McDonald's the terms on which the restrictive covenant could be deleted or modified, and for Intermarket to seek an abatement of the purchase price in an amount equal to the amount required to be paid to McDonald's. Satisfactory resolution of the issue prior to closing could be a condition for the benefit of Intermarket. McDonald's is a sophisticated party: it must appreciate the need to act reasonably and expeditiously in the circumstances.

(4) There was no evidence before me of failed or unreasonable negotiations.

Order accordingly.

Tab 6

2010 QCCS 4915
Cour supérieure du Québec

White Birch Paper Holding Co., Re

2010 CarswellQue 10954, 2010 QCCS 4915, [2010] Q.J. No. 10469, 193 A.C.W.S. (3d) 1067, 72 C.B.R. (5th) 49, J.E. 2010-2002, EYB 2010-180748

In the Matter of the Plan of Arrangement and Compromise of : White Birch Paper Holding Company, White Birch Paper Company, Stadacona General Partner Inc., Black Spruce Paper Inc., F. F. Soucy General Partner Inc., 3120772 Nova Scotia Company, Arrimage de gros Cacouna inc. and Papier Masson ltée (Petitioners) v. Ernst & Young Inc. (Monitor) and Stadacona Limited Partnership, F. F. Soucy Limited Partnership and F. F. Soucy Inc. & Partners, Limited Partnership (Mises en cause) and Service d'impartition Industriel Inc., KSH Solutions Inc. and BD White Birch Investement LLC (Intervenant) and Sixth Avenue Investment Co. LLC, Dune Capital LLC and Dune Capital International Ltd. (Opposing parties)

Robert Mongeon, J.C.S.

Heard: 24 september 2010

Oral reasons: 24 september 2010 *
Written reasons: 15 october 2010
Docket: C.S. Montréal 500-11-038474-108

Proceedings: refused leave to appeal *White Birch Paper Holding Co., Re* (2010), 2010 QCCA 1950 (C.A. Que.)

Counsel: None given.

Subject: Insolvency; Corporate and Commercial

Related Abridgment Classifications
Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Headnote
Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Miscellaneous

Corporation experienced financial difficulties and placed itself under protection of Companies' Creditors Arrangement Act — In context of its restructuring, corporation contemplated sale of all its assets — Bidding process was launched and several investors filed offers — Corporation entered into asset sale agreement with winning bidder — US bankruptcy court approved process without modifications — Court approved process with some modifications and set date of September 17, 2010, as limit to submit bid — On September 17, unsuccessful bidder filed new bid — At outcome of bidding process, corporation decided to sell its assets once again to winning bidder — On September 24, corporation brought motion seeking court's approval of sale — Motion granted — Evidence showed that no stakeholder objected to sale and that all parties agreed to participate in bidding process — Once bidding process was started, there was no turning back unless process was defective — Court was not convinced that winning bid should be set aside just because unsuccessful bidder lost — Court was of view that bidding process met criteria established by jurisprudence — In addition, monitor supported position of winning bidder — Therefore, sale should be approved as is.

Faillite et insolvabilité --- Loi sur les arrangements avec les créanciers des compagnies — Divers

Société a connu des difficultés financières et s'est mise sous la protection de la Loi sur les arrangements avec les créanciers des compagnies — Dans le cadre de sa restructuration, la société a considéré vendre tous ses actifs — Processus d'appel d'offres a été lancé et plusieurs investisseurs ont déposé leurs offres — Société a signé une entente de vente d'actifs avec le soumissionnaire gagnant — Tribunal américain de faillite a approuvé le processus sans modifications — Tribunal a approuvé le processus avec quelques modifications et a fixé la date du 17 septembre 2010 comme étant la date limite pour soumettre une soumission — Soumissionnaire déçu a déposé une nouvelle offre le 17 septembre — Au terme du processus d'appel d'offres, la société a décidé de vendre ses actifs une fois de plus au soumissionnaire gagnant — Société a déposé, le 24 septembre, une requête visant à obtenir l'approbation de la vente par le tribunal — Requête accueillie — Preuve démontrait qu'aucune partie intéressée ne s'était opposée à la vente et que toutes les parties avaient convenu de participer au processus d'appel d'offres — Une fois le processus d'appel d'offres lancé, il n'était pas question de l'interrompre à moins que le processus ne s'avère déficient — Tribunal n'était pas convaincu que le soumissionnaire gagnant devrait être exclu simplement parce que le soumissionnaire déçu avait perdu — Tribunal était d'avis que le processus d'appel d'offres satisfaisait aux critères établis par la jurisprudence — De plus, le contrôleur était en faveur de la position défendue par le soumissionnaire gagnant — Par conséquent, la vente devrait être approuvée telle quelle.

Table of Authorities

Cases considered by *Robert Mongeon, J.C.S.*:

AbitibiBowater inc., Re (2010), 2010 QCCS 1742, 2010 CarswellQue 4082 (C.S. Que.) — considered

Canwest Publishing Inc./Publications Canwest Inc., Re (2010), 68 C.B.R. (5th) 233, 2010 CarswellOnt 3509, 2010 ONSC 2870 (Ont. S.C.J. [Commercial List]) — considered

Cie Montréal Trust c. Jori Investments Inc. (1980), 1980 CarswellQue 85, 13 R.P.R. 116 (C.S. Que.) — referred to

Eugène Marcoux Inc. c. Côté (1990), [1990] R.D.I. 551, [1990] R.J.Q. 1221 (C.A. Que.) — referred to

Maax Corporation, Re (July 10, 2008), Doc. 500-11-033561-081 (C.S. Que.) — referred to

Nortel Networks Corp., Re (2009), 56 C.B.R. (5th) 224, 2009 CarswellOnt 4838 (Ont. S.C.J. [Commercial List]) — followed

Statutes considered:

Code de procédure civile, L.R.Q., c. C-25

art. 689 — referred to

art. 730 — referred to

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

Generally — referred to

s. 36 — considered

s. 36(1) — considered

s. 36(3) — considered

s. 36(3)(a) — considered

s. 36(3)(b) — considered

s. 36(3)(c) — considered

s. 36(3)(d) — considered

s. 36(3)(f) — considered

s. 36(6) — considered

MOTION by corporation seeking court's approval of sale.

***Robert Mongeon, J.C.S.*:**

BACKGROUND

1 On 24 February 2010, I issued an Initial Order under the CCAA protecting the assets of the Debtors and Mis-en-cause (the WB Group). Ernst & Young was appointed Monitor.

2 On the same date, Bear Island Paper Company LLC (Bear Island) filed for protection of Chapter 11 of the US Bankruptcy code before the US Bankruptcy Court for the Eastern District of Virginia.

3 On April 28, 2010, the US Bankruptcy Court issued an order approving a Sale and Investor Solicitation Process (« SISP ») for the sale of substantially all of the WB Group's assets. I issued a similar order on April 29, 2010. No one objected to the issuance of the April 29, 2010 order. No appeal was lodged in either jurisdiction.

4 The SISP caused several third parties to show some interest in the assets of the WG Group and led to the execution of an Asset Sale Agreement (ASA) between the WB Group and BD White Birch Investment LLC (« BDWB »). The ASA is dated August 10, 2010. Under the ASA, BDWB would acquire all of the assets of the Group and would:

a) assume from the Sellers and become obligated to pay the Assumed Liabilities (as defined in the ASA);

b) pay US$90 million in cash;

c) pay the Reserve Payment Amount (as defined);

d) pay all fees and disbursements necessary or incidental for the closing of the transaction; and

e) deliver the Wind Down Amount (as defined).

the whole for a consideration estimated between $150 and $178 million dollars.

5 BDWB was to acquire the Assets through a Stalking Horse Bid process. Accordingly, Motions were brought before the US Bankruptcy Court and before this Court for orders approving:

a) the ASA

b) BDWB as the stalking horse bidder

c) The Bidding Procedures

6 On September 1, 2010, the US Bankruptcy Court issued an order approving the foregoing without modifications.

7 On September 10, 2010, I issued an order approving the foregoing with some modifications (mainly reducing the Break-Up Fee and Expense Reimbursement clauses from an aggregate total sought of US$5 million, down to an aggregate total not to exceed US$3 million).

8 My order also modified the various key dates of implementation of the above. The date of September 17 was set as the limit to submit a qualified bid under stalking horse bidding procedures, approved by both Courts and the date of September 21st was set as the auction date. Finally, the approval of the outcome of the process was set for September 24, 2010 [1].

9 No appeal was lodged with respect to my decision of September 10, 2010.

10 On September 17, 2010, Sixth Avenue Investment Co. LLC (« Sixth Avenue ») submitted a qualified bid.

11 On September 21, 2010, the WB Group and the Monitor commenced the auction for the sale of the assets of the group. The winning bid was the bid of BDWB at US$236,052,825.00.

12 BDWB's bid consists of:

i) US$90 million in cash allocated to the current assets of the WB Group;

ii) $4.5 million of cash allocated to the fixed assets;

iii) $78 million in the form of a credit bid under the First Lien Credit Agreement allocated to the WB Group's Canadian fixed assets which are collateral to the First Lien Debt affecting the WB Group;

iv) miscellaneous additional charges to be assumed by the purchaser.

13 Sixth Avenue's bid was equivalent to the BDWB winning bid less US$500,000.00, that is to say US$235,552,825.00. The major difference between the two bids being that BDWB used credit bidding to the extent of $78 million whilst Sixth Avenue offered an additional $78 million in cash. For a full description of the components of each bid, see the Monitor's Report of September 23, 2010.

14 The Sixth Avenue bidder and the BDWB bidder are both former lenders of the WB Group regrouped in new entities.

15 On April 8, 2005, the WB Group entered into a First Lien Credit Agreement with Credit Suisse AG Cayman Islands and Credit Suisse AG Toronto acting as agents for a number of lenders.

16 As of February 24, 2010, the WB Group was indebted towards the First Lien Lenders under the First Lien Credit Agreement in the approximate amount of $438 million (including interest). This amount was secured by all of the Sellers' fixed assets. The contemplated sale following the auction includes the WB Group's fixed assets and unencumbered assets.

17 BDWB is comprised of a group of lenders under the First Lien Credit Agreement and hold, in aggregate approximately 65% of the First Lien Debt. They are also « Majority Lenders » under the First Lien Credit Agreement and, as such, are entitled to make certain decisions with respect to t he First Lien Debt including the right to use the security under the First Lien Credit Agreement as tool for credit bidding.

18 Sixth Avenue is comprised of a group of First Lien Lenders holding a minority position in the First Lien Debt (approximately 10%). They are not « Majority Lenders » and accordingly, they do not benefit from the same advantages

as the BDWB group of First Lien Lenders, with respect to the use of the security on the fixed assets of the WB Group, in a credit bidding process [2].

19 The bidding process took place in New York on September 21, 2010. Only two bidders were involved: the winning bidder (BDWB) and the losing bidder [3] (Sixth Avenue).

20 In its Intervention, BDWB has analysed all of the rather complex mechanics allowing it to use the system of credit bidding as well as developing reasons why Sixth Avenue could not benefit from the same privilege. In addition to certain arguments developed in the reasons which follow, I also accept as my own BDWB's submissions developed in section (e), paragraphs [40] to [53] of its Intervention as well as the arguments brought forward in paragraphs [54] to [60] validating BDWB's specific right to credit bid in the present circumstances.

21 Essentially, BDWB establishes its right to credit bid by referring not only to the September 10 Court Order but also by referring to the debt and security documents themselves, namely the First Lien Credit Agreement, the US First Lien Credit Agreement and under the Canadian Security Agreements whereby the « Majority Lender » may direct the « Agents » to support such credit bid in favour of such « Majority Lenders ». Conversely, this position is not available to the « Minority Lenders ». This reasoning has not been seriously challenged before me.

22 The Debtors and Mis-en-cause are now asking me to approve the sale of all and/or substantially all the assets of the WB Group to BDWB. The disgruntled bidder asks me to not only dismiss this application but also to declare it the winning bidder or, alternatively, to order a new auction.

23 On September 24, 2010, I delivered oral reasons in support of the Debtors' Motion to approve the sale. Here is a transcript of these reasons.

REASONS (delivered orally on September 24, 2010)

24 I am asked by the Petitioners to approve the sale of substantially all the WB Group's assets following a bid process in the form of a « Stalking Horse » bid process which was not only announced in the originating proceedings in this file, I believe back in early 2010, but more specifically as from May/June 2010 when I was asked to authorise the Sale and Investors Solicitation Process (SISP). The SISP order led to the canvassing of proposed bidders, qualified bidders and the eventual submission of a « Stalking Horse » bidder. In this context, a Motion to approve the « Stalking Horse » Bid process to approve the assets sale agreement and to approve a bidding procedure for the sale of substantially all of the assets of the WB Group was submitted and sanctioned by my decision of September 10, 2010.

25 I note that throughout the implementation of this sale process, all of its various preliminary steps were put in place and approved without any contestation whatsoever by any of the interested stakeholders except for the two construction lien holders KSH [4] and SIII [5] who, for very specific reasons, took a strong position towards the process itself (not that much with the bidding process but with the consequences of this process upon their respective claims.

26 The various arguments of KSH and SIII against the entire Stalking Horse bid process have now become moot, considering that both BDWB and Sixth Avenue have agreed to honour the construction liens and to assume the value of same (to be later determined).

27 Today, the Motion of the Debtors is principally contested by a group which was identified as the « Sixth Avenue » bidders and more particularly, identified in paragraph 20 of the Motion now before me. The « Stalking Horse » bidder, of course, is the Black Diamond group identified as « BD White Birch Investment LLC ». The Dune Group of companies who are also secured creditors of the WB Group are joining in, supporting the position of Sixth Avenue. Their contestation rests on the argument that the best and highest bid at the auction, which took place in New York on September 21, should not have been identified as the Black Diamond bid. To the contrary, the winning bid should have

been, according to the contestants, the « Sixth Avenue » bid which was for a lesser dollar amount ($500,000.00), for a larger cash amount (approximately $78,000,000.00 more cash) and for a different allocation of the purchase price.

28 Notwithstanding the foregoing, the Monitor, in its report of August 23, supports the « Black Diamond » winning bid and the Monitor recommends to the Court that the sale of the assets of the WB Group be made on that basis.

29 The main argument of « Sixth Avenue » as averred, sometimes referred to as the « bitter bidder », comes from the fact that the winning bid relied upon the tool of credit bidding to the extent of $78,000,000.00 in arriving at its total offer of $236,052,825.00.

30 If I take the comments of « Sixth Avenue », the use of credit bidding was not only a surprise, but a rather bad surprise, in that they did not really expect that this would be the way the « Black Diamond » bid would be ultimately constructed. However, the possibility of reverting to credit bidding was something which was always part of the process. I quote from paragraph 7 of the Motion to Approve the Sale of the Assets, which itself quotes paragraph 24 of the SISP Order, stating that:

> 24. Notwithstanding anything herein to the contrary, including without limitation, the bidding requirements herein, the agent under the White Birch DIP Facility (the « DIP Agent ») and the agent to the WB Group's first lien term loan lenders (the First Lien Term Agent »), on behalf of the lenders under White Birch DIP Facility and the WB Group's first lien term loan lenders, respectively, shall be deemed Qualified Bidders and any bid submitted by such agent on behalf of the respective lenders in respect of all or a portion of the Assets shall be deemed both Phase 1 Qualified Bids and Phase 2 Qualified Bids. The DIP Agent and First Lien Term Agent, on behalf of the lenders under the White Birch DIP Facility and the WB Group's first lien term loan lenders, respectively, shall be permitted in their sole discretion, to credit bid up to the full amount of any allowed secure claims under the White Birch DIP Facility and the first lien term loan agreement, respectively, to the extent permitted under Section 363(k) of the Bankruptcy Code and other applicable law.

31 The words « and other applicable law » could, in my view, tolerate the inclusion of similar rules of procedure in the province of Quebec. [6]

32 The possibility of reverting to credit bidding was also mentioned in the bidding procedure sanctioned by my decision of September 10, 2010 as follows and I now quote from paragraph 13 of the Debtors' Motion:

> 13. « Notwithstanding anything herein to the contrary, the applicable agent under the DIP Credit Agreement and the application agent under the First Lien Credit Agreement shall each be entitled to credit bid pursuant to Section 363(k) of the Bankruptcy Code and other applicable law.

33 I draw from these excerpts that when the « Stalking Horse » bid process was put in place, those bidders able to benefit from a credit bidding situation could very well revert to the use of this lever or tool in order to arrive at a better bid [7]

34 Furthermore, many comments were made today with respect to the dollar value of a credit bid versus the dollar value of a cash bid. I think that it is appropriate to conclude that if credit bidding is to take place, it goes without saying that the amount of the credit bid should not exceed, but should be allowed to go as, high as the face value amount of the credit instrument upon which the credit bidder is allowed to rely. The credit bid should not be limited to the fair market value of the corresponding encumbered assets. It would then be just impossible to function otherwise because it would require an evaluation of such encumbered assets, a difficult, complex and costly exercise.

35 Our Courts have always accepted the dollar value appearing on the face of the instrument as the basis for credit bidding. Rightly or wrongly, this is the situation which prevails.

36 Many arguments were brought forward, for and against the respective position of the two opposing bidders. At the end of the day, it is my considered opinion that the « Black Diamond » winning bid should prevail and the « Sixth Avenue » bid, the bitter bidder, should fail.

37 I have dealt briefly with the process. I don't wish to go through every single step of the process but I reiterate that this process was put in place without any opposition whatsoever. It is not enough to appear before a Court and say: « Well, we've got nothing to say now. We may have something to say later » and then, use this argument to reopen the entire process once the result is known and the result turns out to be not as satisfactory as it may have been expected. In other words, silence sometimes may be equivalent to acquiescence. All stakeholders knew what to expect before walking into the auction room.

38 Once the process is put in place, once the various stakeholders accept the rules, and once the accepted rules call for the possibility of credit bidding, I do not think that, at the end of the day, the fact that credit bidding was used as a tool, may be raised as an argument to set aside a valid bidding and auction process.

39 Today, the process is completed and to allow "Sixth Avenue" to come before the Court and say: "My bid is essentially better than the other bid and Court ratify my bid as the highest and best bid as opposed to the winning bid" is the equivalent to a complete eradication of all proceedings and judgments rendered to this date with respect to the Sale of Assets authorized in this file since May/June 2010 and I am not prepared to accept this as a valid argument. Sixth Avenue should have expected that BDWB would want to revert to credit bidding and should have sought a modification of the bidding procedure in due time.

40 The parties have agreed to go through the bidding process. Once the bidding process is started, then there is no coming back. Or if there is coming back, it is because the process is vitiated by an illegality or non-compliance of proper procedures and not because a bidder has decided to credit bid in accordance with the bidding procedures previously adopted by the Court.

41 The Court cannot take position today which would have the effect of annihilating the auction which took place last week. The Court has to take the result of this auction and then apply the necessary test to approve or not to approve that result. But this is not what the contestants before me ask me to do. They are asking me to make them win a bid which they have lost.

42 It should be remembered that "Sixth Avenue" agreed to continue to bid even after the credit bidding tool was used in the bidding process during the auction. If that process was improper, then "Sixth Avenue" should have withdrawn or should have addressed the Court for directions but nothing of the sort was done. The process was allowed to continue and it appears evident that it is only because of the end result which is not satisfactory that we now have a contestation of the results.

43 The arguments which were put before me with a view to setting aside the winning bid (leaving aside those under Section 36 of the CCAA to which I will come to a minute) have not convinced me to set it aside. The winning bid certainly satisfies a great number of interested parties in this file, including the winning bidders, including the Monitor and several other creditors.

44 I have adverse representations from two specific groups of creditors who are secured creditors of the White Birch Group prior to the issue of the Initial Order which have, from the beginning, taken strong exceptions to the whole process but nevertheless, they constitute a limited group of stakeholders. I cannot say that they speak for more interests than those of their own. I do not think that these creditors speak necessarily for the mass of unsecured creditors which they allege to be speaking for. I see no benefit to the mass of creditors in accepting their submissions, other than the fact that the Monitor will dispose of US$500,000.00 less than it will if the winning bid is allowed to stand.

45 I now wish to address the question of Section 36 CCAA.

46 In order to approve the sale, the Court must take into account the provisions of Section 36 CCAA and in my respectful view, these conditions are respected.

47 Section 36 CCAA reads as follows:

> 36. (1) A debtor company in respect of which an order has been made under this Act <u>may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court</u>. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.
>
> (2) A company that applies to the court for an authorization is to give notice of the application to the secured creditors who are likely to be affected by the proposed sale or disposition.
>
> (3) In deciding whether to grant the authorization, the court is to <u>consider, among other things,</u>
>
> (a) whether the process leading to the proposed sale or disposition was <u>reasonable in the circumstances</u>;
>
> (b) whether the <u>monitor approved the proc</u>ess leading to the proposed sale or disposition;
>
> (c) whether the monitor <u>filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;</u>
>
> (d) the <u>extent to which the creditors were consulted</u>;
>
> (e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
>
> (f) whether the <u>consideration to be received for the assets is reasonable and fair</u>, taking into account their market value.
>
> (4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that
>
> (a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and
>
> (b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.
>
> (5) For the purpose of subsection (4), a person who is related to the company includes
>
> (a) a director or officer of the company;
>
> (b) a person who has or has had, directly or indirectly, control in fact of the company; and
>
> (c) a person who is related to a person described in paragraph (*a*) or (*b*).
>
> (6) The court may authorize a sale or <u>disposition free and clear of any security, charge or other restriction</u> and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.
>
> (7) The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(4)(*a*) and (5)(*a*) if the court had sanctioned the compromise or arrangement.

2005, c. 47, s. 131; 2007, c. 36, s. 78.

(added underlining)

48 The elements which can be found in Section 36 CCAA are, first of all, not limitative and secondly they need not to be all fulfilled in order to grant or not grant an order under this section.

49 The Court has to look at the transaction as a whole and essentially decide whether or not the sale is appropriate, fair and reasonable. In other words, the Court could grant the process for reasons others than those mentioned in Section 36 CCAA or refuse to grant it for reasons which are not mentioned in Section 36 CCAA.

50 Nevertheless, I was given two authorities as to what should guide the Court in similar circumstances, I refer firstly to the comments of Madame Justice Sarah Peppall in *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 CarswellOnt 3509 (Ont. S.C.J. [Commercial List]), and she writes at paragraph 13:

> The proposed disposition of assets meets the Section 36 CCAA criteria and those set forth in the *Royal Bank v. Soundair Corp.* decision. Indeed, to a large degree, the criteria overlap. The process was reasonable as the Monitor was content with it (and this is the case here). Sufficient efforts were made to attract the best possible bid (this was done here through the process, I don't have to review this in detail); the SISP was widely publicized (I am given to understand that, in this present instance, the SISP was publicized enough to generate the interest of many interested bidders and then a smaller group of Qualified Bidders which ended up in the choice of one « Stalking Horse » bidder); ample time was given to prepare offers; and there was integrity and no unfairness in the process. The Monitor was intimately involved in supervising the SISP and also made the Superior Cash Offer recommendation. The Monitor had previously advised the Court that in its opinion, the Support Transaction was preferable to a bankruptcy (this was all done in the present case.) The logical extension of that conclusion is that the AHC Transaction is as well (and, of course, understand that the words « preferable to a bankruptcy » must be added to this last sentence). The effect of the proposed sale on other interested parties is very positive. (It doesn't mean by saying that, that it is positive upon all the creditors and that no creditor will not suffer from the process but given the representations made before me, I have to conclude that the proposed sale is the better solution for the creditors taken as a whole and not taken specifically one by one) Amongst other things, it provides for a going concern outcome and significant recoveries for both the secured and unsecured creditors.

51 Here, we may have an argument that the sale will not provide significant recoveries for unsecured creditors but the question which needs to be asked is the following: "Is it absolutely necessary to provide interest for all classes of creditors in order to approve or to set aside a "Stalking Horse bid process"?

52 In my respectful view, it is not necessary. It is, of course, always better to expect that it will happen but unfortunately, in any restructuring venture, some creditors do better than others and sometimes, some creditors do very badly. That is quite unfortunate but it is also true in the bankruptcy alternative. In any event, in similar circumstances, the Court must rely upon the final recommendation of the Monitor which, in the present instance, supports the position of the winning bidder.

53 In *Nortel Networks Corp., Re*, Mister Justice Morawetz, in the context of a Motion for the Approval of an Assets Sale Agreement, Vesting Order of approval of an intellectual Property Licence Agreement, etc. basically took a similar position (2009 CarswellOnt 4838 (Ont. S.C.J. [Commercial List]), at paragraph 35):

> The duties of the Court in reviewing a proposed sale of assets are as follows:
>
> > 1) It should consider whether sufficient effort has been made to obtain the best price and that the debtor has not acted improvidently;
> >
> > 2) It should consider the interests of all parties;

3) It should consider the efficacy and integrity of the process by which offers have been obtained;

4) and it should consider whether there has been unfairness in the working out of the process.

54 I agree with this statement and it is my belief that the process applied to the present case meets these criteria.

55 I will make no comment as to the standing of the « bitter bidder ». Sixth Avenue mayo have standing as a stakeholder while it may not have any, as a disgruntled bidder.

56 I am, however, impressed by the comments of my colleague Clément Gascon, j.s.c. in *Abitibi Bowater*, in his decision of May 3rd, 2010 where, in no unclear terms he did not think that as such, a bitter bidder should be allowed a second strike at the proverbial can.

57 There may be other arguments that could need to be addressed in order to give satisfaction to all the arguments provided to me by counsel. Again, this has been a long day, this has been a very important and very interesting debate but at the end of the whole process, I am satisfied that the integrity of the « Stalking Horse » bid process in this file, as it was put forth and as it was conducted, meets the criteria of the case law and the CCAA. I do not think that it would be in the interest of any of the parties before me today to conclude otherwise. If I were to conclude otherwise, I would certainly not be able to grant the suggestion of « Sixth Avenue », to qualify its bid as the winning bid; I would have to eradicate the entire process and cause a new auction to be held. I am not prepared to do that.

58 I believe that the price which will be paid by the winning bidder is satisfactory given the whole circumstances of this file. The terms and conditions of the winning bid are also acceptable so as a result, I am prepared to grant the Motion. I do not know whether the Order which you would like me to sign is available and I know that some wording was to be reviewed by some of the parties and attorneys in this room. I don't know if this has been done. Has it been done? Are KSH and SIII satisfied or content with the wording?

Attorney:

I believe, Mister Justice, that KSH and SIII have.........their satisfaction with the wording. I believe also that Dow Jones, who's present, ...their satisfaction. However, AT&T has communicated that they wish to have some minor adjustments.

The Court:

Are you prepared to deal with this now or do you wish to deal with it during the week-end and submit an Order for signature once you will have ironed out the difficulties, unless there is a major difficulty that will require further hearing?

Attorney:

I think that the second option you suggested is probably the better one. So, we'd be happy to reach an agreement and then submit it to you and we'll recirculate everyone the wording.

The Court:

Very well.

The Motion to Approve the Sale of substantially all of the WB Group assets (no. 87) is *granted,* in accordance with the terms of an Order which will be completed and circulated and which will be submitted to me for signature as of Monday, next at the convenience of the parties;

The Motion of Dow Jones Company Inc. (no. 79) will be continued sine die;

The Amended Contestation of the Motion to Approve the Sale (no. 84) on behalf of « Sixth Avenue » is *dismissed* without costs (I believe that the debate was worth the effort and it will serve no purpose to impose any cost upon the contestant);

Also for the position taken by Dunes, there is no formal Motion before me but Mr. Ferland's position was important to the whole debate but I don't think that costs should be imposed upon his client as well;

The Motion to Stay the Assignment of a Contract from AT&T (no. 86) will be continued sine die;

The Intervention and Memorandum of arguments of BD White Birch Investment LLC is *granted*, without costs.

Motion granted.

Footnotes

* Leave to appeal refused at *White Birch Paper Holding Co., Re* (2010), 2010 CarswellQue 11534, 2010 QCCA 1950 (C.A. Que.).

1 See my Order of September 10, 2010.

2 For a more comprehensive analysis of the relationship of BDWB members and Sixth Avenue members as lenders under the original First Lien Credit Agreement of April 8, 2005, see paragraphs 15 to 19 of BDWB's Intervention.

3 Sometimes referred to as the « bitter bidder » or « disgruntled bidder » See *AbitibiBowater inc., Re*, 2010 QCCS 1742 (C.S. Que.) (Gascon J.)

4 KSH Solutions Inc.

5 Service d'Impartition Industriel Inc.

6 The concept of credit bidding is not foreign to Quebec civil law and procedure. See for example articles 689 and 730 of the Quebec code of Civil Procedure which read as follows:
689. The purchase price must be paid within five days, at the expiry of which time interest begins to run.

Nevertheless, when the immovable is adjudged to the seizing creditor or any hypothecary creditor who has filed an opposition or whose claim is mentioned in the statement certified by the registrar, he may retain the purchase-money to the extent of the claim until the judgment of distribution is served upon him.

730. A purchaser who has not paid the purchase price must, within ten days after the judgment of homologation is transmitted to him, pay the sheriff the amounts necessary to satisfy the claims which have priority over his own; if he fails to do so, any interested party may demand the resale of the immovable upon him for false bidding.

When the purchaser has fulfilled his obligation, the sheriff must give him a certificate that the purchase price has been paid in full.
See also Denis Ferland and Benoit Emery, 4ème edition, volume 2 (Éditions Yvon Blais (2003)):
La loi prévoit donc que, lorsque l'immeuble est adjugé au saisissant ou à un créancier hypothécaire qui a fait opposition, ou dont la créance est portée à l'état certifié par l'officier de la publicité des droits, l'adjudicataire peut retenir le prix, y compris le prix minimum annoncé dans l'avis de vente (art. 670, al. 1, e), 688.1 C.p.c.), jusqu'à concurrence de sa créance et tant que ne lui a pas été signifié le jugement de distribution prévu à l'article 730 C.p.c. (art. 689, al 2 C.p.c.). Il n'aura alors à payer, dans les cinq jours suivant la signification de ce jugement, que la différence entre le prix d'adjudication et le montant de sa créance pour satisfaire aux créances préférées à la sienne (art. 730, al. 1 C.p.c.). La Cour d'appel a déclaré, à ce sujet, que puisque le deuxième alinéa de l'article 689 C.p.c. est une exception à la règle du paiement lors de la vente par l'adjudicataire du prix minimal d'adjudication (art. 688.1, al. 1 C.p.c.) et à celle du paiement du solde du prix d'adjudication dans les cinq jours suivants (art. 689, al. 1 C.p.c.), il doit être interprété de façon restrictive. Le sens du mot « créance », contenu dans cet article, ne permet alors à l'adjudicataire de retenir que la partie de sa créance qui est colloquée ou susceptible de l'être, tout en tenant compte des priorités établies par la loi.

See, finally, *Cie Montréal Trust c. Jori Investments Inc.*, J.E. 80-220 (C.S. Que.) [1980 CarswellQue 85 (C.S. Que.)], *Eugène Marcoux Inc. c. Côté*, [1990] R.J.Q. 1221 (C.A. Que.)

7 The SISP, the bidding procedure and corresponding orders recognize the principle of credit bidding at the auction and these orders were not the subject of any appeal procedure.

See paragraphs 24, 25 and 26 of BDWB's Intervention.

As for the right to credit bid in a sale by auction under the CCAA, see *Maax Corporation, Re* (July 10, 2008), Doc. 500-11-033561-081 (C.S. Que.) (Buffoni J.)

See also Re: *Brainhunter* (OSC Commercial List, no.09-8482-00CL, January 22, 2010)

Tab 7

2012 ANNREVINSOLV 7

Annual Review of Insolvency Law

Annual Review of Insolvency Law 2012 Editor: Janis P. Sarra

Martin P. Rosenthal

7 — Sales Process Dynamics The Monitor's Perspective

7 — Sales Process Dynamics The Monitor's Perspective

Martin P. Rosenthal[*]

There have been a variety of recent developments with regard to sales processes in the context of proceedings under the *Companies Creditors Arrangement Act*[2] ("*CCAA*") and the *Bankruptcy and Insolvency Act*[3] ("*BIA*"), including the advent of credit bids, stalking horses, an increase in the use of interim financing arrangements (DIP loans) as loan to own facilities and the management of cross-border filings; where any or all of these issues is front and centre.

Credit bidding and stalking horse bidding procedures are not specifically codified in the *BIA* or the *CCAA*. Accordingly, the Canadian courts have looked to the US *Bankruptcy Code*[4] in developing precedents that provide guidance as to how to deal with these matters. This article addresses some of the practical issues surrounding sales processes and the factors that the monitor, receiver, or trustee, as the case may be, must consider. These issues include the appropriate valuation of credit bids and the impact of DIP terms and conditions on sales processes. As all of these matters have recently been raised in the White Birch matter, many of the examples cited in the present article will draw on the recent experience in this ongoing case.

This article will demonstrate the importance of interested parties to a case being proactive and engaged from the outset. In so doing, they may be able to influence the direction of the process, participate in establishing the structure or rules of the game, and affect the outcome and their recovery.

I. — An Overview of the White Birch Sale and Investor Solicitation Process

On February 24, 2010, the Québec Superior Court (Commercial Division) ("Court") issued an initial order declaring that White Birch Paper Holding Company and certain of its affiliates ("White Birch" or the "companies") were debtor companies to which the *CCAA* applies and appointing Ernst & Young Inc as monitor.[5] Bear Island Paper Company, LLC ("Bear Island"), a US subsidiary of White Birch commenced a case under Chapter 11 of the US *Bankruptcy Code* on the same date.[6] As part of the initial application for relief, the companies sought approval of a senior secured, super-priority debtor-in-possession/interim financing term loan ("DIP"), which was granted by the courts in both Canada and the US.

The milestones set out in the DIP agreement were designed to ensure that the restructuring process progressed rapidly. The milestones imposed a finite timeline on the companies to achieve a settlement with the creditors, whereby the companies had to obtain a lock-up and plan support agreement with the first lien term loan lenders, and file a plan of arrangement under the *CCAA* and a plan of reorganization under Chapter 11 within a period of approximately four months following the granting of the initial order, failing which the companies were obligated to sell the business as a whole.

In view of the tight timeline, the milestones contemplated that a sale and investor solicitation process ("SISP") be undertaken in parallel with the efforts to negotiate and file a plan. The intent was to focus entirely on the sale process if and when White Birch determined that a settlement with the creditors would not be feasible within the permitted time frame.

Discussions were held between the senior management of the companies and representatives of Black Diamond Commercial Finance LLC ("Black Diamond"), which held a significant interest in both the DIP and the first lien term loan, regarding the possibility of filing a plan of reorganization and the general parameters of such a plan. However, Black Diamond indicated that it had no interest in exploring a restructuring plan at that time. In view of the voting power and financial leverage of Black Diamond, resulting from its holdings in respect of the DIP and the first lien term loan, the efforts of management of the companies were quickly focused on the sale process.

Management of White Birch, with the assistance of financial advisor Lazard Frères & Co LLC ("Lazard"), had sought interim financing from numerous potential lenders, and, at the end of the day, the sole party that was willing to provide a facility that met the anticipated requirements of the companies was Black Diamond. Black Diamond's strategy from the outset was clearly "loan to own," a strategy that has become a regular occurrence in recent proceedings. As long as the established rules are followed in a transparent manner, this strategy should not be questioned as less than honest or straight-forward. Any other party could have submitted an interim financing proposal and management would have eagerly considered it. Although management and Lazard actively solicited alternative financing proposals, none was forthcoming, including from other members of the first lien lending group or union sponsored investment funds, that met the anticipated requirements of the companies. The failure of the minority members of the first lien lending group to engage in the proceeding at this early stage, while not fatal, certainly had the effect of allowing competitive hurdles regarding the eventual outcome of the proceeding to be placed in their way. These hurdles included various matters set out in the DIP agreement, such as the requirement to engage in a rapid sale process early on subject to certain conditions and the lack of credit bidding limitations amongst others.

The sale process was initiated within two months after the initial order, with the preparation of SISP procedures, identification of potential purchasers, and the presentation of a motion to the Court to approve the SISP. The monitor reported to the Court on April 21, 2010, in respect of White Birch's Canadian motion, and recommended that the Court authorize White Birch to implement the SISP procedures, which included the selection of a stalking horse bid, as contemplated in the motion. The SISP and related procedures were approved by the Court by order made on April 29, 2010 ("SISP order"). A similar motion was filed by Bear Island in the US Court on April 19, 2010 and was granted by order of the US Court entered on April 28, 2010.

The sale process was managed by Lazard. Lazard suggested an appropriately targeted approach to identify prospective purchasers and invite them to participate in the SISP. Lazard contacted 52 prospective purchasers, chosen from strategic prospects and financial investors. The strategic prospects were comprised of direct competitors and businesses in the same industry, while the financial investors were comprised of investment funds, equity providers, and some members of the first lien term loan lender group who were thought to have an interest in investing in the companies' industry. This list of contacts was shared for review and comments with advisors to the first lien term loan lenders and advisors to the official committee of unsecured creditors of Bear Island. The prospects targeted by Lazard were provided with a background document setting out limited information on the companies and their market (a "teaser" document), and were invited to sign a confidentiality agreement to receive more detailed information. The execution of the confidentiality agreement, together with the delivery of various documents, entitled the interested party to be designated as a "phase 1 qualified bidder". As contemplated by the SISP, an exception to these rules was made with regards to the DIP and first term loan lenders, thus deeming them automatically to be phase 1 qualified bidders, the whole as authorized pursuant to the SISP order.

The SISP order required that the phase 1 qualified bidders provide Lazard with a non-binding expression of interest by June 15, 2010. The companies and Lazard were then required to analyze the expressions of interest to assess whether the expressions of interest could reasonably be expected to result in a sale. Where that was the case, the interested party would be designated as a "phase 2 qualified bidder," and would be invited to participate in a due diligence process, with a view to prepare a formal offer. By the June 15, 2010 deadline, Lazard had received four responses from the phase 1 qualified bidders, although two responses were discarded as they did not meet the criteria set out in the SISP, primarily because they lacked an adequate quantification of their offers. The discussions continued between the companies and the two remaining phase 2 qualified bidders, and additional information was provided to satisfy the preliminary due diligence requests of the prospective purchasers through management presentations, tours of the plants, and transmission of financial information. The SISP order required that the phase 2 qualified bidders provide Lazard with a formal binding offer by July 15, 2010. By that date, one of the phase 2 qualified bidders indicated that it would not present a formal offer, and the sole remaining phase 2 qualified bidder submitted an offer.

The offer received was formulated by BD White Birch Investments LLC ("BDWBI"), by letter dated July 15, 2010. This letter introduced BDWBI as an asset acquisition vehicle formed by Black Diamond Capital Management LLC, Credit Suisse Loan Funding LLC, and Caspian Capital Advisors LLC as well as their respective affiliates. The letter indicated that the sponsors of BDWBI also held the majority of the debt under the first lien term loan credit facility. The offer indicated a purchase price of US$90 million, plus an amount of cash to be set aside and held in trust by the monitor to pay certain disbursements anticipated to be necessary to wind down the companies' estates after the closing of the transaction, plus the assumption of certain selected liabilities of the companies.

The BDWBI offer specified those liabilities subject to assumption. In addition, the BDWBI offer specified the "excluded liabilities". Notably, amongst the excluded liabilities were obligations relating to pension or retirement liability of the companies to their then current and former employees.

Based on its estimate of the assumed liabilities and wind-down expenses, the purchase price was calculated to be approximately US$150 to US$178 million in total. If the transaction were to be completed on the terms of the stalking horse bid without an increase in the purchase price at the auction, the funds available for distribution to the creditors were estimated to be less than US$124 million.

Given that the DIP facility was expected to approximate US$122 million at the predicted emergence date of the proceeding, it was anticipated that the stalking horse bid, unless the purchase price were to be enhanced at the auction, would yield an insignificant recovery, if any at all, for the general body of creditors. As such, the advantages that could be expected from the transaction, as it was then contemplated, were that: (i) specified liabilities would be assumed by BDWBI; (ii) the suppliers would have a continuing customer; and (iii) the employment of the workforce would continue, without a loss of arrears of salaries and vacation pay.

The monitor prepared a draft liquidation analysis to demonstrate the expected results of a theoretical liquidation carried out contemporaneously with the receipt of the offer from BDWBI. Based on the calculations made in estimating the value of the assets, in the event of an outright liquidation, the monitor considered that the purchase price as contemplated in the stalking horse bid represented, substantively, the liquidation value of the current assets, without any value allocated to the property, plant, and equipment. The analysis prepared by the monitor suggested that the liquidation value of the assets would have yielded an estimated dividend of between nil and 1.7% on average for the unsecured creditors.

On September 10, 2010, the court approved BDWBI as the stalking horse bidder and approved the proposed bidding procedures for an auction. The bidding procedures for an auction specifically permitted credit bidding of amounts due under the DIP and the first lien credit agreement.

Thereafter, on September 17, 2010, pursuant to the next stage in the SISP, an offer was received from Sixth Avenue Investment Co., LLC ("Sixth Avenue"). This entity was formed by a group of lenders holding approximately 10% of the first lien term loan debt. This bid was deemed to be a qualified bid and accordingly an auction was scheduled. No other offer was received.

The auction was held on September 21, 2010 and each of BDWBI and Sixth Avenue submitted multiple bids throughout the auction. Ultimately, the final bid submitted by BDWBI was determined to be the winning bid. The total consideration offered for White Birch's assets was approximately US $236.1 million, structured as follows:

• a cash amount of US$94.5 million of which US$90 million was allocated to current assets and US$4.5 million was allocated to repay debt related to certain legal hypothecs (the Québec equivalent of construction liens) affecting certain fixed assets located in Québec;

• a credit bid of US$78 million allocated to the Canadian fixed assets;

• US$36.7 million of assumed liabilities; and

• up to US$26.9 million of cure costs.

Under this bid, US$126.7 million was allocated to current assets and US$82.5 million was allocated to fixed assets (the whole excluding allocation of cure costs).

Sixth Avenue's last bid was US$500,000 less than the total winning bid submitted by BDWBI, but included US$175 million of cash, and allocated US$173.4 million to current assets and US$35.3 million to fixed assets (the whole excluding the allocation of cure costs).

II. — Appropriateness of Credit Bidding

In determining the appropriateness of the credit bidding process, certain precedents do exist in Canada. In the *CCAA* proceedings of *Maax Corporation*, the ability to credit bid at a *CCAA* auction was recognized by the court when it approved the stalking horse bid, which was a secured credit bid.[7] In addition, in the *CCAA* proceedings of *Brainhunter*, the Ontario Superior Court of Justice (Commercial List) ("Ontario Court") recognized the ability of the secured note holders to credit bid at an auction.[8] Furthermore, in the cross-border *CCAA* and Chapter 11 proceedings of *Eddie Bauer*, the Ontario Court had approved bidding procedures that explicitly provided for the right to credit bid.[9]

In the *White Birch* case, BDWBI noted, in its intervention and memorandum of arguments, that the concept of credit bidding was accepted under Québec law generally, and drew comparison to a hypothecary creditor in Québec who purchases hypothecated property and who is permitted to retain the purchase price to the extent of its secured claim on the property. The purchaser argued that this concept is regularly applied in judicial sales in Québec and is the functional equivalent of credit bidding.

Subsequent to the filing of the motion to approve the sale of substantially all the WB Group's assets,[10] Justice Mongeon found that "[t]he words 'and other applicable law' could, in my view, tolerate the inclusion of similar rules of procedure in the province of Québec."[11] Accordingly, the Court found that "those bidders able to benefit from a credit bidding situation could very well revert to the use of this lever or tool to arrive at a better bid" and that there was nothing in the *CCAA* or Québec law that prevented them from doing so, given the terms of their credit and security documents.[12] However, the possibility of reverting to credit bidding was something that was already contemplated in the SISP. Paragraph 7 of the motion to approve the sale of substantially all the WB Group's assets quotes paragraph 24 of the SISP order, stating that:

> Notwithstanding anything herein to the contrary, including without limitation, the bidding requirements herein, the agent under the White Birch DIP facility (the "DIP Agent") and the agent to the WB Group's first lien term loan lenders (the "First Lien Term Agent") on behalf of the lenders under White Birch DIP Facility and the WB Group's first lien term loan lenders, respectively, shall be deemed Qualified Bidders and any bid submitted by such agents on behalf of the respective lenders in respect of all or a portion of the Assets shall be deemed both Phase 1 Qualified Bids and Phase 2 Qualified Bids. The DIP Agent and First Lien Term Agent, on behalf of the lenders under the White Birch DIP Facility and the WB Group's first lien term loan lenders, respectively, shall be permitted, in their sole discretion, to credit bid up to the full amount of any allowed secured claims under the White Birch DIP Facility

> and the first lien term loan agreement, respectively, to the extent permitted under Section 363(k) of the *Bankruptcy Code* and other applicable law. [13]

The possibility of using credit bidding was also mentioned in the bidding procedures sanctioned by the Court in a decision rendered September 2, 2010 and the companies' motion clearly indicated the impact stating, "[n]otwithstanding anything herein to the contrary, the applicable agent under the DIP credit agreement and the applicable agent under the first lien creditor agreement shall each be entitled to credit bid pursuant to section 363(k) of the US *Bankruptcy Code* and other applicable law." [14]

When focusing on the issue of credit bidding, people tend to concentrate on an assessment of value, rather than on other factors. The analysis concentrates more on the value that should be ascribed to a dollar of credit used to acquire assets, rather than on whether or not it is appropriate for the lender to acquire the assets in the first place. While the issue of the assessment of value is important, there is another inherent risk to credit bidding that must be kept in the forefront in planning the sale process.

Given the popularity of "loan to own" arrangements, there is a possibility that the DIP lender or some or all of the secured creditors may become one of the prospective purchasers. There is certainly nothing wrong with the concept of a lender becoming the prospective purchaser, and indeed, the secured creditor's interest in the assets may protect value by eliminating the possibility of deep discount prices solely because there is temporarily limited interest in certain assets. It is important however to realize that the presence of lenders in the group of prospective purchasers may create an information imbalance within the group of prospective purchasers, that may act as a disincentive to the prospective purchasers.

It is likely that the lenders will seek to have access to privileged information in the context of the sale process, with a view to protect their interests. The receipt of information about the sales process by a lender, in its dual capacity as lender and as prospective purchaser, may give the lender a competitive advantage over other bidders that would discourage the competition.

In developing the rules relating to the sale process, it is therefore important to be mindful of the possible impact of access to privileged information, and to set up safeguards to limit this possibility.

III. — Valuation of Assets Where Credit Bidding is Allowed

In *White Birch*, the court held that if credit bidding was to take place, the amount of the credit bid should not exceed the face value of the credit instrument on which the credit bidder is allowed to rely and that the credit bid should not be limited to the fair market value of the corresponding encumbered assets. Justice Mongeon held that it would be impossible to function otherwise because it would require an evaluation of the encumbered assets, which could be impractical due to the complexity and cost. [15]

In applying section 36 of the *CCAA*, the Court held that all elements of section 36 need not be fulfilled in order to grant an order. The Court should look at the transaction as a whole and decide whether or not the sale is appropriate, fair, and reasonable. [16] Justice Mongeon further indicated that section 36 of the *CCAA* provides a list of criteria that the Court must consider, but does not impede the Court's judicial discretion by providing a list of conditions that must be met. The Court can approve the process for reasons other than those mentioned in section 36 or refuse to grant it for reasons not mentioned in section 36. The Court relied on *Re Canwest Publishing Inc* and *Re Nortel Networks Corp*, [17] and held that the process applied to the *White Birch* case met the criteria set out in those decisions; the price to be paid by the winning bidder was satisfactory given the circumstances and the terms and conditions of the winning bid were acceptable.

With regard to the valuation of a credit bid, the question as to whether a dollar for dollar of debt should be allowed or whether the credit should be limited to the value of the underlying asset has frequently been asked. Although the underlying value approach has been used in certain cases, it has been considered to be an incorrect application of credit bidding in other cases. A credit bid can be considered the same way as a foreclosure or taking in payment, where the secured creditor accepts ownership of the collateral in satisfaction of the entire indebtedness. In *Cohen v. KB Mezzanine Fund II LP*, [18] the US Court held that §363(k) "empowers creditors to bid the total face value of their claims — it does not limit bids to claims' economic value" and therefore supports the assertion that a dollar for dollar of debt should be allowed.

The approach and methodology to consider evaluation and sale proceeds allocation should be clear at the outset if the sale process proposes to sell both encumbered and unencumbered assets as a package.

In the *Cow Harbour Construction Ltd* matter, [19] the court authorized a global sale process that included encumbered assets; however, the encumbrances were held separately and not subject to inter-creditor agreements (leases, GSA and PMSI). In this case, the additional challenge that occurred was that some security holders wanted to take their security out of the global sale process, although ultimately, a deal was reached with these parties. This potential action by the secured lenders raised the question as to whether the secured lenders in a *CCAA* sale process need to bid or would they be allowed to watch the sale process unfold and if they were not satisfied with the result, attempt to exclude and repossess their security. From a practical perspective, this matter would have to be decided by the court prior to the commencement of the bidding process. If the secured creditor does not protest in advance and does not seek to have the assets subject to its security removed from the process prior to its commencement, it would be hard to argue at a later date that it reserved the right to do so.

In the *White Birch* case, the process adopted an approach whereby the debtor sold encumbered and unencumbered assets. In order to meet the requirements under the US *Bankruptcy Code* of allowing a secured creditor to protect its position through credit bidding, and recognizing the possibility that through this credit bid, the secured creditor could acquire unencumbered assets at a low value by skewing the allocation on a global bid, the debtor determined the minimum amount of cash that must be included and attributed to the unencumbered assets. Once that threshold was met, the credit bid was allowed on the dollar for dollar basis. [20] The minimum cash requirement was developed both with a view to avoid a "technical insolvency" of the estate, [21] and to ensure that adequate value would be allocated to the unencumbered assets, to protect the interests of the unsecured creditors, based on the estimated realizable value of the unencumbered assets.

Here, the asset sale agreement ("ASA") did not provide an allocation of value between the assets located in the US and Canada, or between the current assets, and in particular accounts receivable and inventories, and the capital assets. While these allocations were somewhat academic at the time that the stalking horse bid was approved, inasmuch as the value allocated to the assets did not exceed the amount due under the DIP agreement, the monitor had cautioned that these allocations could become relevant if the purchase price were to be enhanced at the auction.

The ASA stated that an allocation of the purchase price amongst the various entities comprising the White Birch group and between the various categories of assets would be provided by BDWBI prior to the auction, but after the hearing on the motion to approve the stalking horse, so that it would be available before the sale hearing. The monitor advised that it considered that the proposed timing was too late, and that a basis of allocation should be predetermined, in order to remove the possibility of a strategic allocation of value to benefit the first term loan lenders at the expense of the ordinary unsecured creditors; in view of the fact that the sponsors of BDWBI purported to hold the majority of the first term loan debt.

As stated above, the debtor established rules for the bidding at the auction that created a minimum allocation in cash to the unencumbered assets. The minimum amount of cash required can be established via valuation methods of either the forced or orderly liquidation value, net book value, or estimated market value. Other methods could also be applied to avoid a skewing of the allocation that would favour the secured creditor to the detriment of the unsecured creditors by allowing it to acquire the unencumbered assets at a discount. Such methods could include, for instance, bidding by step [22], or allocating less than full value to a credit bid, i.e. less than dollar for dollar, to compensate the fact that unencumbered assets are being acquired. This latter method, however, leads to complexities in the valuation of a credit bid that may be difficult to manage in the heat of the auction and that may lead to complicated valuation disputes with the secured creditor.

There is also the issue of the role of the monitor or receiver in terms of valuation, who must take a position as to whether the debtor or its advisors have properly valued the assets, including as to the principles that should be applied in valuing the assets. The process of the valuation should be fair and reasonable. The importance of ensuring adherence to sound valuation principles is further heightened because of the shortened timeline normally followed for the development and execution of the valuation process; the likely scrutiny underlying the probable and hypothetical assumptions associated with the valuation by stakeholders; and the lack of market comparables that typically exist for such distressed assets. In some cases, the monitor or receiver could suggest deferring the process; however, in other instances, when the market is unlikely to improve, it is difficult for the insolvency professional to say it will not accept the valuation, as it may be unclear where the bottom of the market will settle. In *CCAA* proceedings, management, the board of directors, or a chief restructuring officer are in place and they possess important information about the appropriate value of the assets, or what an appropriate floor value might be, on which a bidding process can be fashioned. To the extent that the process is equitable amongst stakeholders, business judgment and practical reality rules should apply.

The *White Birch* stalking horse process resulted in a stalking horse bidder being approved notwithstanding that the offer received represented close to the liquidation value of the assets. Given the low quantum of the offer that ultimately became the stalking horse bid, the barrier to entry to participate at this stage of the process was practically non-existent. Yet there was only one bid and that bid attributed no value to the fixed assets. Obtaining a valuation at this point would have provided a theoretical value to the assets, but it would have been difficult to argue that a theoretical value was a better assessment of market value than that obtainable in an open, transparent, and rigorous sales process that involved the marketing of the assets in question. In all circumstances, the best determination of fair market value is the actual price parties are willing to pay for the asset when offered through a competitive sale process.

IV. — Standing of the Losing Bidder

A recurring theme in Canadian sales processes in the context of formal proceedings is the contestation of the efficacy of the process and the results thereof by the losing bidder or "the bitter bidder". More and more, the losing bidder disputes the process and its results as a standard and logical next step in the competition to gain standing in the next phase of the sale process that leads to the conclusion of a transaction to acquire business assets. This phenomenon has been witnessed in the *Rail Power Technologies*, *Abitibi Bowater*, and *White Birch CCAA* cases, amongst others. This trend only reinforces the importance of having a transparent process, run by or in conjunction with, appropriate advisors, as well as a clear communication plan with regard to the rules of engagement.

Although the "bitter bidder" arguably has no standing before the court, Canadian courts are reluctant to exclude such party from a hearing based on this point alone. The losing bidder will customarily be given an opportunity to make representations to the court, if only for the fact that ultimately the court has to be satisfied that the sale process and its results are reasonable in the circumstances, and that the process was fair and transparent. [23] One of the stakeholders in addressing the adequacy of the sale process is the unsuccessful bidder, who will have a keen interest in raising all irregularities or shortcomings in the process, up to the motion seeking approval of a proposed transaction. However, in the cases where the court has been satisfied with the reasonableness of the process, the bitter bidder has been ultimately told that it has no interest in the proceedings, and can therefore not affect its outcome.

For example, at the sale hearing in the matter of White Birch, the argument was raised when Sixth Avenue, the losing bidder group, contested the motion seeking approval of the sale of the White Birch assets to BDWBI. Here, the losing bidder did not have standing to make any of the arguments as it was simply a party who had lost at an auction and did not like the results. This same losing party had not previously objected to any of the orders rendered earlier in the case that had approved the credit bidding process, and, in fact, participated in the process by credit bidding during the auction. In this matter, Justice Mongeon chose to address each of the arguments put forward by the minority lenders before the Court and ultimately overruled each of the arguments on its merits. However Justice Mongeon did specifically note in his reasons that:

> I will make no comment as to the standing of the "bitter bidder". Sixth Avenue [may] have standing as a stakeholder while it may not have any, as a disgruntled bidder.
>
> I am, however, impressed by the comments of my colleague Clément Gascon, j.s.c., in *Abitibi Bowater*, in his decision of May 3rd, 2010 where, in no unclear terms he did not think that as such, a bitter bidder should be allowed a second strike at the proverbial can. [24]

It should be noted that the minority lenders at no time presented themselves as creditors of White Birch, at the sale hearing or in any other context in this matter. Throughout, they relied on the agent of the first lien term loan syndicate to represent their interests as members of the syndicate, as would be expected.

In similar fashion to the *White Birch* and *Abitibi Bowater* matters, in the *Rail Power Technologies* [25] matter, the judgment rendered by Justice Alary also made it clear that notwithstanding any issues relating to the standing of the stakeholder before the court, the court will tend to allow the bitter bidder to make its representations and consider such in its deliberations, where appropriate. In her judgment, Justice Alary notes the following:

> Finally, the Court notices that Progress's reasons for complaining about the sale process have evolved, if not changed, between its initial contestation and its final argument.
>
> As a matter of fact, Progress failed to show that many of its initial criticisms were well founded. [26]

Notwithstanding the complete rejection by the Court of the criticisms of the sale process levied by the bitter bidder, and the scepticism expressed by the Court as to the bitter bidders' true motives, the Court tolerated a four-day hearing on the subject. Although, in this matter, the resultant delays to conclude the transaction, with the incurrence of significant professional fees and operating costs prior to closing, did not create a material adverse outcome, the concern lies with even greater delays that could be caused by way of a hearing on whether the bitter bidder has standing. The lapse of time for such a hearing, rendering a judgment, and potentially an appeal of the judgment could add to the delays of the hearing on the efficacy of the process and could be more damaging. In a worse case scenario, this delay could prove self-fulfilling for the bitter bidder where the resultant delay and cost demises the ability to close the proposed acceptable transaction. The courts therefore, logically, have tended towards putting this matter aside and dealing with the more practical issue at hand.

In *CCAA* matters, the courts have referred to jurisprudence relating to sales conducted by a court-appointed receiver. As set out in the judgment rendered by Justice Alary in the *Rail Power Technologies Corp* matter:

> When a sale occurs in the context of *CCAA* proceedings, the Court has to be satisfied that it is the result of the fair and transparent sale process. In considering the role of the Court, the jurisprudence has made an analogy with cases dealing with the approval of a sale by a Court-appointed receiver [*Royal Bank v. Soundair Corp.* (1991), 7 C.B.R. (3d) 1 p.6 (Ont. C.A).] It was decided that the Court's duties are: (i) to consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; (ii) to consider the interests of the parties; (iii) to consider the efficacy and integrity of the process by which offers are obtained; and, (iv) to consider whether there has been unfairness in the working out of the process. [27]

Notwithstanding the establishment of a process that clearly meets these goals and obtaining court approval thereof, it is still a frequent occurrence for the bitter bidder to criticize the sale process and its outcome, claiming that the process was not followed and/or that the recommendation of the monitor, or trustee, or receiver as the case may be, is flawed, as it is principled on unsound assumptions and facts. Such potential criticisms underpin the importance of adhering to the process in a rigorous manner, documenting the actions taken and even the conversations conducted throughout the process. Such documentation will serve to demonstrate adherence to process and the efforts expended by the professionals involved to secure the highest and best price for the associated assets. While the courts favour the recommendation of their appointed officer of the court, the delays caused by the intervention of a bitter bidder and the costs incurred in dealing with same can be unnecessarily disruptive to the sale and restructuring process. One could argue that exercising sound business judgement and foreseeing the criticism that may be levied by a bitter bidder in regard to the sale process will result in a better sales process. A sales process that is fully and effectually transparent and principled on equitable representation and participation by the varied stakeholders will achieve the objective of a sales process that withstands scrutiny by any stakeholder, including the bitter bidder. It will remain the role of the court to sift through the criticisms of the bitter bidder, or any other stakeholder, to determine the relative weight, if any, that should be applied against the criticisms in its deliberations; a role the court has effectively undertaken to date, and there is no reason to foresee any lesser effectiveness into the future.

Key terms of any sale process and the sale process procedures are often determined at the outset of the proceeding and subject to rules dictated by secured lenders and/or DIP lenders that reflect self-interest. The debtor, with the assistance of the professionals involved, must remain cognizant of stakeholder interests and devise a sales process that negates favouritism of one stakeholder over the other; avoiding an attempt by any party to "game" the process to their favour by introducing terms and conditions that would unduly favour their position.

V. — Conclusion and Lessons Learned

The importance of being proactive and establishing a strategy regarding the sale process from the outset of the process is made clear in the judgment and reasons rendered by Justice Mongeon in the *White Birch* matter:

> I have dealt briefly with the process. I don't wish to go through every single step of the process but I reiterate that this process was put in place without any opposition whatsoever. It is not enough to appear before Court and say: "Well, we've got nothing to say now. We may have something to say later" and then, use this argument to reopen the entire process once the result is known and the result turns out to be not as satisfactory as it may have been expected. In other words, silence sometimes may be the equivalent to acquiescence. All stakeholders knew what to expect before walking into the auction room.
>
> Once the process is put into place, once the various stakeholders accept the rules, and once the accepted rules call for the possibility of credit bidding, I do not think that, at the end of the day, the fact that credit bidding was used a tool, may be raised as an argument to set aside a valid bidding and auction process. [28]

DIP terms may be negotiated and approved well in advance of an application to approve a sales process. The court and practitioners need to be mindful of DIP lending terms that may restrict the sale process, such as rights of first refusal, a veto right in respect of the acceptance of an offer, or other restrictive condition.

Given the popularity of "loan to own" arrangements, there is a possibility that the DIP lender or some or all of the secured creditors may become one of the prospective purchasers. Their informational needs to protect their position as secured creditors throughout the tenure of the proceeding may cause an information imbalance between themselves and prospective purchasers. This information imbalance may create a disincentive for the prospective purchasers to participate in the sale process. Although one could also argue, at times, having too much information can be a disincentive to the party with knowledge. It is therefore important to establish safeguards to limit the possibility of an information imbalance from compromising the equity and effectiveness of the sale process.

The general consensus is that credit bidding is an accepted practice in Canada. The accepted principle is that a secured creditor can credit bid up to the full amount of its secured debt, in the purchase of its collateral, and that it will be valued on a dollar for dollar basis. Also, although a credit bid can only be applied against the purchase price of the collateral securing the debt, the credit bid can also be used as part of an overall bid for the purchase of encumbered and unencumbered assets. This strategy is acceptable so long as the consideration tendered for the fair market value of the unencumbered assets, when assessing the value of an overall bid, is offered as cash or cash equivalence. However, at the end of the day, in order to improve their chances of having a successful outcome in the process, participants in an auction or sale process that have concerns about the ability of a party to credit bid or the manner in which the process will be conducted, must raise these concerns early on in the process. Those potential bidders who come to the table at the outset will be able to influence the rules of the game and improve their opportunity for a successful outcome.

Footnotes

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2 *Companies' Creditors Arrangement Act*, RSC 1985, c C-36 [*CCAA*].

3 *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 [*BIA*].

4 USC title 11 [US *Bankruptcy Code*].

5 *Arrangement relatif à White Birch Paper Holding Company*, 2010 QCCS 764, [2010] QJ No 1723.

6 *In Re Bear Island Paper Company, LLC*, 2010 Bankr LEXIS 5777 (Bankr ED Va, 2010).

7 *Re Maax Corp*, 2008 CarswellQue 15021 (CS).

8 *Re Brainhunter*, 2010 ONSC 1035, 70 BLR (4th) 123 (Sup Ct J [Commercial List]).

9 *Re Eddie Bauer of Canada Inc*, 57 CBR (5th) 24, 2009 CarswellOnt 5450 (Sup Ct J [Commercial List]).

10 *Re White Birch Paper Holding Company*, 2010 QCCS 4915, ¶22, [2010] QJ No 10469 [*White Birch*].

11 *Ibid* at para 31.

12 *Ibid* at para 33.

13 *Ibid* at para 30.

14 "Amended Bidding Procedures" *White Birch Paper [CCAA Monitor]* (1 September 2010), online: Ernst & Young <http://documentcentre.eycan.com> at 8.

15 *White Birch*, *supra* note 9 at para 34.

16 *Ibid* at paras 48-49.

17 *Re Canwest Publishing Inc* (2010), 68 CBR (5th) 233, 2010 CarswellOnt 3509 (Sup Ct J [Commercial List]); *Re Nortel Networks Corp* (2009), 56 CBR (5th) 224, 2009 CarswellOnt 4838 (Sup Ct J [Commercial List]).

18 *Cohen v. KB Mezzanine Fund II LP*, 432 F 3d 448 at 459 (*sub nom In re SubMicron Sys Corp*) (3d Cir 2006).

19 *Royal Bank v. Cow Harbour Construction Ltd*, 2012 ABQB 59, 98 BLR (4th) 236.

20 US *Bankruptcy Code*, *supra* note 3, §363(k) ("[a]t a sale . . . of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and . . . may offset such claim against the purchase price or such property").

21 I.e., as a situation where the debtor is unable to pay the liabilities incurred after the commencement of the proceedings.

22 Bidding by step would occur where a bidder cannot step back from a previously bid value — in effect, an improved bid must meet a double requirement of having a greater overall value and an allocation that is no lower than the previously bid amount.

23 *Re Royal Bank v. Soundair, Corp*, 7 CBR (3d) 1 (Ont CA) (typically, the Court will try to assess whether the sale process meets the criteria developed by the Court).

24 *White Birch*, note 9 at paras 55-56.

25 *Re Rail Power Technologies Corp*, 2009 QCCS 2885, 71 CBR (5th) 258.

26 *Ibid* at paras 101-02.

27 *Ibid* at para 51.

28 *White Birch*, *supra* note 9 at paras 37-38.

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Tab 8

IIC-ART Vol. 3-2
Insolvency Institute of Canada (Articles)

— Credit Bidding in Canadian Insolvency Proceedings — A Useful Tool for Secured Creditors Requiring Checks and Balances

——*Marc Wasserman and Caitlin Fell* [*]

1. INTRODUCTION

In recent years and principally since the amendments to the *Companies' Creditors Arrangement Act (CCAA)* [2] in 2009, insolvency proceedings in Canada have seen the development and increasing use of credit bidding as a tool employed by secured creditors in the context of a sale of the property and assets of an insolvent debtor. While the *U.S. Bankruptcy Code* [3] specifically contemplates the right of a secured creditor to credit bid, Canadian insolvency legislation does not contain any specific provisions relating to credit bidding. Insolvency and restructuring professionals must therefore navigate the use and application of credit bidding within the confines of existing jurisprudence as well as within the backdrop of the relevant legal tests developed for the approval by the court of a sale process and for approval of a sale of a debtor's assets. This paper will provide a brief overview of the evolution of credit bidding in the U.S. and in Canada, examine certain key issues and concerns associated with credit bidding and provide consideration as to whether the Parliament of Canada should consider codifying boundaries, procedures and other aspects of credit bidding within Canadian insolvency law. Lastly, this paper will explore the role of court officers in the context of sales processes involving a credit bid.

2. CREDIT BIDDING

Credit bidding allows a secured creditor to bid some or all of the amount of the debt owed to it in order to acquire some or all of the assets to which its security attaches. Instead of a secured creditor paying cash to buy assets which would then be distributed back to the secured creditor, the secured creditor has the ability to bid some or all of the value of the debt. Simply put, if a secured creditor is owed $1,000, a credit bid would enable the secured creditor to bid up to $1,000 for assets that are subject to its security. In this respect, the secured creditor's bid can determine the value of the collateral. The logic behind credit bidding is that it avoids a redundant flow of funds from the secured creditor to the debtor and back to the secured creditor.

It is well established that creditors can bid up to the full face value of their secured claims, even if this amount exceeds the actual value of the underlying collateral. [4] Put differently, if the value of the collateral is less than the total amount of the indebtedness owing, a secured creditor can bid both the secured portion of the debt, representing an amount equal the value of the collateral, but also an amount over and above the value of the collateral. The rationale for not capping a credit bid at the value of the collateral is to avoid a situation where the secured creditor would be forced to pay an overbid of cash in order to outbid a third party despite having advanced funds in excess of the value ascribed to the collateral. The following hypothetical is illustrative:

> Assume that debtor has a single asset: a truck. The lender is a secured creditor that has loaned the debtor $15, taking a security interest in the truck. Debtor proposes to sell the truck to a bidder for $10. Debtor argues that the lender can only credit bid for $10 for the truck and must bid any excess in cash if it wishes to outbid the bidder. [5]

In essence, the rationale behind credit bidding is that a secured creditor would not look to outbid a cash bidder unless the secured creditor believed that it could generate a greater return on the collateral than a return from the amount of a bid submitted by a third-party bidder. Conversely, a third-party bidder, in theory, may bid more than the amount of the credit bid if it believed that the credit bid undervalued the collateral.

3. CREDIT BIDDING AS A TOOL FOR LENDERS

Secured creditors may consider credit bidding in order to: (i) protect the secured creditor's collateral from being undervalued by establishing a floor price for the asset; and (ii) as part of a "loan to own" investment strategy.

a) Undervaluation

Credit bidding is a method which enables secured creditors to ensure that they receive proper value for their collateral when it is sold. In this respect, credit bidding prevents a situation where a lender is forced to receive a reduced cash payment where assets are being sold in a depressed market or bids for the assets are being made at a material discount value. Absent a right to credit bid, a secured creditor may be forced to take less than full payment of the indebtedness owing while a third-party bidder is able to obtain any future upside for itself.

Credit bidding may be used by a secured creditor to protect against undervaluation in the context of a stalking horse bid. In a stalking horse sales process, typically the vendor enters into a binding agreement of purchase and sale with a specified initial bidder. Unless a superior bid is received, the vendor will be obligated to complete the sale transaction. The initial bidder, also referred to as the "stalking horse", sets the minimum baseline terms for the sale, including the price of the assets against which other submitted bids are to be measured and evaluated. A secured creditor may wish to be the stalking horse bidder or alternatively seek covenants in a stalking horse purchase agreement, in each case allowing the secured creditor to set a minimum price to be obtained for the assets, failing which the secured creditor will purchase the assets in exchange for all or a portion of the debt.

To protect against undervaluation, credit bidding may be employed by secured creditors to acquire a more meaningful "seat at the table" with respect to the restructuring of a debtor company. This was the case in *Canwest Publishing* [6] where the secured creditors offered a credit bid acquisition while the debtor pursued an alternative transaction. A credit bid can offer secured creditors greater influence in the outcome of the restructuring proceedings as a credit bid can force the resolution of an issue if a viable transaction or plan of arrangement is not approved by the court within a specified period of time.

b) Loan to Own

Secured creditors may also wish to credit bid as part of a greater "loan to own" investment strategy. A loan to own investment is one where a "lender's capital investment is turned into a controlling equity position in a reorganized debtor". [7] For example, the senior lenders used a credit bid to exercise a successful loan to own strategy in *Planet Organic Health Corp.* [8] and *Re Brainhunter Inc.* [9] Loan to own investors may acquire secured debt in the secondary market to obtain an advantage in the restructuring process and in order to gain control of the asset of the debtor.

4. EVOLUTION OF CREDIT BIDDING IN THE UNITED STATES

Credit bidding has been codified within U.S. bankruptcy law since 1978. [10] However, the use and application of credit bidding in the U.S. has undergone a tumultuous evolution principally due to ambiguity in the *U.S. Bankruptcy Code* as to if and when a secured creditor is entitled to credit bid.

Unless the court orders otherwise, under the *U.S. Bankruptcy Code*, the right of secured creditors to credit bid at a sale by a debtor of collateral arises in two circumstances in a Chapter 11 proceeding: (i) in a sale of collateral outside of a plan of arrangement under section 363(k) of the *U.S. Bankruptcy Code*; [11] and (ii) in a sale of collateral within a Chapter 11 plan under section 1129 of the *U.S. Bankruptcy Code*.

a) Credit Bidding in Sales Outside of Plan

Section 363(k) of the *U.S. Bankruptcy Code* codifies a secured creditor's right to credit bid in a sale of assets by a debtor that is being made free and clear of any liens and outside of the ordinary course of business. Section 363(k) of the *U.S. Bankruptcy Code* provides:

> (k) At a sale under subsection (b) of this section of property that is subject to a lien that secures an allowed claim, unless the court for cause orders otherwise the holder of such claim may bid at such sale, and, if the holder of such claim purchases such property, such holder may offset such claim against the purchase price of such property. [12]

b) Credit Bidding in Sales Pursuant to a Chapter 11 Plan

In addition to a section 363 asset sale, assets may also be sold outside of the ordinary course of business under a Chapter 11 plan. In this context, a secured creditor may be afforded the right to credit bid if a sale has not been accepted by a class of secured creditors. A debtor may seek to "cramdown" a plan on junior secured creditors provided that plan proponents demonstrate that the plan is "fair and equitable" with respect to such junior class of secured creditors. Section 1129(b)(2)(A) outlines what constitutes a "fair and equitable" plan in respect to a cramdown of dissenting secured creditors:

> (A) With respect to a class of secured claims, the plan provides —
>
> > (i)
> >
> > > (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
> > >
> > > (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totalling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;
> >
> > (ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
> >
> > (iii) for the realization by such holders of the indubitable equivalent of such claims. [13]

Thus, section 1129(b)(2)(A) outlines three alternative requirements a plan may provide for in order to meet the "fair and equitable" test to "cramdown" dissenting secured creditors: (i) the secured creditor, among other things, retains their liens on the collateral and receives deferred cash payments; (ii) the collateral is sold free and clear of the liens, subject to the right of the secured creditor to credit bid; and (iii) the secured creditor realizes the indubitable equivalent of its claims. It is the second prong of section 1129(b)(2)(A) which specifically imports the language of section 363(k) — the right of a secured creditor to credit bid in the context of a sale by the debtor of assets outside of the ordinary course of business in a proposed plan under Chapter 11.

A secured creditor's right to credit bid in a sale of assets of the debtor in the context of a "cramdown" under a plan appears to be a clear right afforded to secured creditors in the *U.S. Bankruptcy Code*. That is, a plan calling for the sale of assets and that is rejected by a secured creditor must provide the right to credit bid to such dissenting secured creditor. However, this right was challenged in a line of cases, beginning in 2009 with the decision of the Fifth Circuit Court in *Pacific Lumber Co.*, [14] which held that there is no inherent right to credit bid in a sale of assets by the debtor on the basis that, under the plan, the secured creditor was receiving, instead of the right to credit bid, their indubitable equivalent under section 1129(b)(2)(A)(iii) of the *U.S. Bankruptcy Code*.

Before delving into the Fifth Circuit Court's decision in *In re Pacific Lumber Co.*, it is first useful to understand the meaning of the "indubitable equivalent". The indubitable equivalent concept was first developed by the Court in *Murel Holding Corp*. [15] where the Court explained:

> . . . a creditor who fears the safety of his principal will scarcely be content with [interest payments alone]; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that . . . unless by a substitute of the most indubitable equivalence. [16]

In essence, dissenting secured creditors in a sale of assets under a Chapter 11 plan must be provided a substituted value to ensure that it receives the benefit of its bargain. [17] In *Pacific Lumber Co.*, the Fifth Circuit Court upheld a cramdown of a secured creditor. The Court reasoned that while the cash payment to the secured creditor was less than the total amount of the debt owed, it was judicially determined to be equal to the value of the secured creditor's collateral.

In *Pacific Lumber Co.*, six affiliated entities involved in the growing, harvesting and processing of redwood lumber filed separate Chapter 11 petitions which were then jointly administered by the bankruptcy court. The principal debtors were Pacific Lumber Company ("Palco") and Scotia Pacific LLC ("Scopac"). Palco was the owner and operator of a sawmill and Scopac was a special purpose entity that was owned by Palco. In 1998, Palco transferred more than 200,000 acres of redwood timber to Scopac to enable Scopac to issue approximately $867 million in notes secured by the redwood timber ("Timberlands") and other assets of Scopac. On the date of bankruptcy, Scopac owed the noteholders approximately $740 million in principal and accrued interest. Scopac also owed Bank of America approximately $36 million on a secured line of credit which ranked in priority to the noteholders. With respect to Palco, Palco owed Marathon Structured Finance ("Marathon") approximately $160 million, including amounts relating to DIP financing secured by Palco's assets. Marathon estimated that Palco's assets were worth approximately $110 million on the date of bankruptcy.

Under a plan filed by Marathon and Mendocino Redwood Company (MRC), a competitor of Palco (the "MRC Plan"), it was proposed that noteholders would be paid the value of their collateral in cash. The noteholders' claims were then bifurcated into a secured claim for the value of the collateral and an unsecured claim for the deficiency. The bankruptcy court determined that the value of the collateral was no more than $510 million. While two impaired classes voted in favour of the MRC Plan, MRC and Marathon still had to "cramdown" the MRC Plan on the dissenting classes, most notably the noteholders, in accordance with section 1129(b) of the *U.S. Bankruptcy Code*. In essence, the MRC Plan provided only $510 million to the noteholders as the indubitable equivalent of their secured claim with respect to the Timberlands collateral, despite their total claim being approximately $740 million.

The noteholders objected to the MRC Plan on the basis that they were denied their right to credit bid pursuant to section 1129(b)(2)(A)(ii) of the *U.S. Bankruptcy Code*. The noteholders argued that section 1129(b)(2)(A)(ii) entitled them to credit bid up to $740 million since the secured property was to be sold free and clear of all liens.

The Court in *Pacific Lumber Co.* held that because the three subsections of 1129(b)(2)(A) are joined by a disjunctive "or", they are separate and distinct alternatives. In this case, while the MRC Plan contemplated a sale free of all liens, and therefore falling within 1129(b)(2)(A)(ii), the MRC Plan offered the noteholders the "realization of its indubitable equivalent" under section 1129(b)(2)(A)(iii), which constituted repayment to the noteholders to the extent of the value of the collateral. The Court reasoned that "[w]hatever uncertainties exist about the indubitable equivalent, paying off secured creditors in cash can hardly be improper *if* the plan accurately reflected the value of the noteholders' collateral." [18] The "*if*" was precisely the issue, as the noteholders believed that the judicial valuation of the Timberlands did not accurately reflect the true value of the asset. While the noteholders were being paid a cash amount that was less than the total indebtedness, it was equal to the judicial valuation of the collateral and therefore, in the opinion of the court, the noteholders were being provided with the indubitable equivalent. As a result, the Court upheld the cramdown of the noteholders.

Six months after the Fifth Circuit's decision in *Pacific Lumber Co.*, the United States Court of Appeal for the Third Circuit came to a similar decision in *Philadelphia Newspapers, LLC.* [19] In *Philadelphia Newspapers, LLC* the Court also held that the right to credit bid could be dispensed with in a sale of the collateral as long as the secured creditor received the indubitable equivalent.

In *Philadelphia Newspapers, LLC* the debtors filed a motion to approve bidding procedures for the public auction. The bidding procedures expressly precluded secured creditors from credit bidding for the assets. The Bankruptcy Court denied the motion, holding that the plan provided for a sale of the assets of the debtors under section 1129(b)(2)(A)(ii) and thereby required that the lenders be provided with the right to credit bid. The District Court reversed the decision of the Bankruptcy Court, stating that because the three prongs of section 1129(b)(2)(A) were separated by the disjunctive "or", there were three potential independent alternative plan routes. While the plan did not provide the secured creditors with the right to credit bid, the plan did offer the secured creditors the "indubitable equivalent". On appeal, the Third Circuit Court affirmed the decision of the District Court, allowing the cramdown on the grounds that it provided the secured creditors with the indubitable equivalent. [20]

The majority of the Third Circuit Court reasoned that the plain language of section 1129(2)(A)(ii) is clear — the provision provides three distinct alternative arrangements for satisfaction of plan confirmation in the context of a cramdown of dissenting secured creditors and the right to credit bid was not incorporated into 1129(2)(A)(iii), where secured creditors receive the indubitable equivalent. While the standard means of providing for the indubitable equivalent to a secured creditor typically included surrendering collateral or substituting collateral, the cash from a sale representing the value of the collateral is another potential means of providing the indubitable equivalent.

In a dissenting decision, Justice Ambro held that a plan providing for a sale of collateral, free and clear of liens, may cramdown secured creditors only if the plan provided for the right of secured creditors to credit bid the amount of their claims. [21] Judge Ambro found that while Congress intended that there be three distinct alternatives that may be used to cramdown secured creditors, these alternatives are to be determined based on the path chosen by the debtors within the plan, rather than leaving it up to the debtors to choose which alternative their plan fits into after the fact. For example, if a plan proposes a sale of the assets free and clear of all liens, then the plan falls within section 1129(b)(2)(A)(ii) which provides for the right of a secured creditor to credit bid. Conversely, if the plan does not contemplate a sale of assets free and clear and offers the indubitable equivalent to secured creditors, then the plan would fall within the meaning of 1129(b)(2)(A)(iii).

In 2010, the line of cases which rejected the right of a secured creditor to credit bid in the context of a sale of assets within a plan was overturned by the Seventh Circuit in *River Road Hotel Partners, LLC* [22] and in the Supreme Court's decision in *Radlax Gateway Hotel, LLC.* [23]

River Road Hotel Partners, LLC and *Radlax Gateway Hotel, LLC* involved similar facts. In *River Road Hotel Partners, LLC* the debtor obtained loans totalling $155 million from Longview Ultra Construction Loan Investment Fund. In *RadLAX Gateway Hotel, LLC*, the debtor borrowed $142 million to purchase a hotel from the Los Angeles airport. The debtors defaulted and filed for voluntary petitions under Chapter 11. Both debtors submitted plans of reorganization for court approval. In conjunction with the approval of each respective plan, both debtors sought approval of bidding procedures that would govern the proposed public auction of the debtors' assets. Each of the bidding procedures contemplated a stalking horse bidder and expressly provided that the senior creditors would be prohibited from credit bidding. In both cases, the secured creditors objected to the bidding procedures on the basis that the secured creditors were being denied the right to credit bid when the assets were being sold free and clear of all liens in a cramdown under section 1129(b)(2)(A)(ii). The debtors argued, consistent with *Pacific Lumber Co.* and *Philadelphia Newspapers, LLC*, that the cramdown of the lender's secured claims was fair and reasonable as it provided the lenders with the indubitable equivalent. The Bankruptcy Court, and the Seventh Circuit on direct appeal however, found in favour of the secured creditors and both of the debtors' proposals were rejected by the Court. The Bankruptcy Court and the Seventh Circuit Court relied heavily on the dissent of Justice Ambro in *Philadelphia Newspapers, LLC*.

In *River Road Hotel Partners, LLC*, the Seventh Circuit Court held that a plan that contained a sale of the assets free and clear of liens fell directly within the purview of section 1129(b)(2)(A)(ii). Allowing the debtors in such a sale to invoke the indubitable equivalent would render 1129(b)(2)(A)(ii) superfluous and inconsistent with other provisions of the *U.S. Bankruptcy Code* which offered protections to secured creditors. The Supreme Court in 2012 granted *certiorari* to decide the questions as to whether a "a debtor may pursue a Chapter 11 plan that proposes to sell assets free of liens without allowing the secured creditor to credit bid." [24] The Supreme Court answered this question in the negative, holding that debtors may not sell their property free of its liens without providing the right to credit bid.

As demonstrated, following the amendments to the *U.S. Bankruptcy Code* codifying the right to credit bid, the application of credit bidding in the United States went through a period of uncertainty. This uncertainty was largely the result of ambiguity in the *U.S. Bankruptcy Code* which facilitated differing interpretations of when a secured creditor could utilize a credit bid. Since the Supreme Court's clarification in 2012, it appears to be settled law that a debtor cannot cramdown a dissenting secured creditor in a plan which provides for a sale free and clear of liens, without giving the secured creditor the right to credit bid. Notwithstanding this right, it must be remembered that the court, pursuant to section 363(k), can deny a secured creditor the right to credit bid if there is cause warranting such denial.

c) Credit Bidding in Canada

A secured creditor's right to foreclose on its collateral, an analogous concept to credit bidding, has long been established in Canada within the provincial personal property security regimes. Under the *Personal Property Security Act* (Ontario), [25] upon default, a secured creditor is permitted to retain collateral in satisfaction of a debtor's obligation.

Notwithstanding provincial law, however, and unlike in the United States, there are no explicit statutory provisions in Canadian insolvency law which provide for a secured creditor's right to credit bid. In addition, relative to the United States, there is scant case law considering the use and application of credit bidding in Canada. Notwithstanding the foregoing, however, Canadian courts, beginning with cases such as *Re Maax Corp.*, [26] *Brainhunter Inc.* [27] and *Re Canwest Publishing Inc.*, [28] have appeared to accept, without issue or discussion as to jurisdiction or validity, the ability of a secured creditor to credit bid. Further, it was not until *White Birch Holding Company*, [29] a case where a purchaser (who was also the stalking horse bidder) acquired substantially all of a debtor's assets, in part by way of a significant and strongly opposed credit bid, that a Canadian court expressly considered the use and application of credit bidding in a contested hearing.

On February 24, 2010, White Birch Paper Holding Company and its subsidiaries (collectively "White Birch") filed for and obtained protection under the *CCAA*. White Birch had the second largest newsprint production capacity in North America with assets in Quebec consisting of three pulp and paper mills. In addition, White Birch also operated a fourth mill in Virginia through its U.S. affiliate, Bear Island Paper Company LLC ("Bear Island"). Concurrently with White Birch's *CCAA* filing, Bear Island filed for Chapter 11 protection in the United States. Prior to the filings, White Birch had debt obligations in the approximate amount of US$428 million in principal and US$9.77 million in interest pursuant to a First Lien Term Loan Agreement. The First Lien Term Loan Agreement was secured by White Birch's fixed assets.

In addition to the First Lien Term Loan, White Birch owed a further US$100 million in principal and US$4 million in interest pursuant to a Second Lien Term Loan Agreement. White Birch also owed US$50 million under a Revolving Asset Based Facility and an additional US$58 million under various interest rate swap agreements. Certain members of the syndicate under the First Term Lien Loan Agreement also provided DIP Financing in the amount of $140 million to be secured over all of White Birch's assets, in priority to existing security, subject to certain prior charges (the "DIP Loan").

On April 28, 2010, the U.S. Bankruptcy Court for the Eastern District of Virginia approved the Sales and Investor Solicitation Process (SISP) for White Birch's assets. The Quebec Superior Court issued a similar order on April 29, 2010. The SISP Orders in the U.S. and in Canada provided for, *inter alia*, credit bidding of amounts due under the DIP Loan and the First Lien Term Loan Agreement.

The SISP eventually led to the execution of an asset sale agreement (ASA) between White Birch and BD White Birch Investment LLC (BDWB) pursuant to which BDWB would acquire the assets of White Birch through a stalking horse bid process. BDWB held 65.5 percent of the First Lien Term Loan debt and therefore constituted "Majority Lenders" under the terms of the First Lien Term Loan Agreement and held 37 percent of the overall debt owed by White Birch. Pursuant to the ASA, BDWB would acquire substantially all of the assets of the debtors, including the encumbered fixed assets subject to its security interest as well as the unencumbered current assets for a total purchase price of approximately $90 million. At that time, the ASA did not include a credit bid.

The *CCAA* Court approved the ASA and the stalking horse bid process. In the Report of the Monitor dated August 10, 2010, the monitor indicated that the ASA, unless enhanced at the auction, would yield insignificant recovery, if any, for creditors in light of the fact that the amount owing to the DIP Lender was expected to amount to $122 million. In addition, the monitor noted that the purchase price of $90 million, in substance represented the liquidation value of the unencumbered current assets without any value allocated to the encumbered fixed assets. The monitor expressed concern to the *CCAA* Court that the ASA did not provide an allocation of value as between the fixed and current assets and that an allocation should be predetermined in order to remove the possibility of a strategic allocation of value to the benefit of BDWB, at the expense of ordinary unsecured creditors.

On completion of the auction, BDWB's final bid was declared to be the winning bid with a purchase price consisting of, *inter alia*, a credit bid of US$78 million of First Lien debt allocated to the encumbered fixed assets and US$90 million in cash allocated to the unencumbered current assets.

BDWB's winning bid was chosen over a competing bid submitted by Sixth Avenue Investment Co. ("Sixth Avenue"), a group of minority lenders holding approximately 10% of the First Lien Term Debt. Ultimately, Sixth Avenue's bid came in $500,000 lower than BDWB's bid. Under Sixth Avenue's bid, US$173.3 million was allocated to the unencumbered current assets and US$35.3 million was allocated to the encumbered fixed assets. The higher allocation provided by Sixth Avenue to the unencumbered current assets would have provided greater net recovery to White Birch's unsecured creditors, at the expense however to the secured creditors, whereas BDWB's bid was better for the secured creditors. The difference in allocation would prove to be central to the issue of the minority lenders.

After the auction, the debtors, with the support of the monitor, obtained approval of the selection of BDWB as the winning bid. However, Sixth Avenue contested the debtor's motion and requested that the Court dismiss the application and declare it to be the winning bidder, or alternatively, order a new auction. Sixth Avenue asserted several arguments in opposition to BDWB's bid, including, amongst others, that: (i) BDWB's bid unfairly prejudiced unsecured creditors; (ii) there was no authority for the right of a secured creditor to credit bid in Quebec or in Canada and in any event, a dollar of credit should not be considered to be equivalent to a dollar cash; and (iii) BDWB did not have rights under the security agreements to credit bid.

In its reasons, the Court held that the right to credit bid was always contemplated in the SISP which expressly provided for the right to credit bid up to the full amount of the secured claim under the First Lien Term Loan Agreement to the extent permitted under the *U.S. Bankruptcy Code* and other applicable law. The words "and other applicable law", in the Court's view, tolerated the inclusion of similar rules of procedure in the province of Quebec. In this regard, the Court cited prior Canadian cases in which credit bidding had been recognized in the context of a sale by auction under the *CCAA*, including *Maax* [30] and *Brainhunter*. [31] The *CCAA* Court also noted that all stakeholders were aware of what to expect before walking into the auction room and if Sixth Avenue had taken issue with the bidding process, the issue should have been raised when White Birch had sought approval of the auction process. With respect to the dollar value of a credit bid versus a dollar of a cash bid, the *CCAA* Court held that while the credit bid should not exceed the amount of indebtedness owed, a credit bid should not be limited to the fair market value of the collateral.

d) Benefits and Drawbacks of Credit Bidding

As mentioned above, a principal benefit of credit bidding is that it ensures that a secured creditor receives sufficient value for its collateral by avoiding circumstances where a debtor is attempting to sell the collateral at a discount or where there is a depressed market resulting in undervaluation of the collateral. Credit bidding therefore facilitates the preservation and maximization of value of the collateral by a secured creditor.

In addition, credit bidding may be a tool utilized by a secured creditor to indicate to the marketplace that there is a willing buyer for the collateral. A credit bid indicates that there is a buyer in place and that there will be a going concern enterprise at the end of the process. This can assist in providing stability and certainty to suppliers, employees and customers of a debtor company in an insolvency proceeding.

On the other hand, the utilization of credit bidding has been subject to criticism. A principal critique of credit bidding is that it has a potential "chilling effect" on other bidders. Credit bidding has been argued to discourage would-be cash bidders from bidding as bidders take note of the size of the secured debt and realize that a secured party would be able to easily outbid such bidder's reservation price.

This concern may be further heightened when a topping fee or break fee is included in a sale process. In essence, bidders may be disincentivized from spending time and money to engage in a sale process and to undertake the costs of due diligence to have the secured creditor unexpectedly submit a credit bid far in excess of the realistic value of the collateral. The incorporation of credit bidding in a sale process, in effect, provides a lender with absolute control over the bidding and the outcome of any auction simply by evoking a bid in the whole amount of their debt, potentially to the detriment of third-party bidders.

A similar criticism of credit bidding is that it has the potential to compromise the integrity of a sale process. Secured creditors who may be looking to implement a loan to own scenario may impose strict milestones in a DIP agreement and/or condensed timelines in the bid procedures. This can impact and limit the amount of time available to other bidders to conduct due diligence. In addition, secured creditors are likely more familiar with the debtor's business and assets relative to other potential bidders which may have the effect of dissuading other bidders from participating in the SISP if timelines are unreasonably condensed.

e) Credit Bidding Legislation in Canada — Do We Need It?

The fact that credit bidding has no statutory basis in Canadian insolvency legislation and, combined with the aforementioned criticisms of credit bidding, necessarily lead to the question of whether the ability or right of a secured creditor to credit bid should be codified in Canadian insolvency legislation. We would argue that it is not necessary to embed credit bidding in Canadian insolvency legislation.

The *CCAA* has been described by the courts as being skeletal in nature: it does not contain a comprehensive code outlining what is permissive or prohibited. [32] Rather, the events and actions taken in respect of a restructuring of a debtor company, and the court's approval thereof, are largely measured by whether the orders sought by the parties advance the objectives of the *CCAA*. [33] These objectives aim to avoid the negative consequences of the liquidation of an insolvent company and, if this is not achievable, attempt to ensure the fair distribution of the estate to the debtor's creditors in accordance with their relative priorities. [34]

Accordingly, while the courts will first rely on the provisions of the *CCAA*, they frequently turn to their inherent or equitable jurisdiction or judicial discretion to supervise restructurings. [35] In that respect, credit bidding has been generally accepted by the courts in Canada without issue, seemingly vitiating the need to embed a secured creditor's ability to credit bid within Canadian insolvency legislation. In addition, the criticisms of credit bidding noted above are not so much criticisms of the use, form or substance of credit bidding, but rather critiques of sale processes which employed the use of credit bidding by a secured creditor.

As a starting point, credit bidding is in form an acceptable strategy for secured creditors in the context of a restructuring or insolvency proceeding. However, it is the context and substance of how credit bidding is used in a particular factual circumstance which may bring to light the criticisms of credit bidding noted above. To address this concern, we would submit that the adoption of section 36 of the *CCAA*, the case law governing sales processes and the role of court officers in overseeing the restructuring provide the necessary parameters and checks and balances on a sale of assets outside of the ordinary course, and including within that, the use of credit bidding. The key to ensuring that credit bidding is used properly is to place emphasis on process.[36] This is precisely what is intended by the application of section 36 of the *CCAA*, the test for approving a sale procedure, the test for approval by the court of a sale of assets and the role of court officers within these frameworks — to ensure fairness and integrity of the process.

On September 18, 2009, Canadian parliament brought into force many amendments to the *Bankruptcy and Insolvency Act*[37] and *CCAA*, including the express authorization of a debtor to sell or otherwise dispose of assets outside of the ordinary course of business with court authorization. Section 36 of the *CCAA* introduced factors to be considered by a court in approving a sale of assets, including:

> a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
>
> b) whether the monitor approved the process leading to the proposed sale or disposition;
>
> c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition in a liquidation proceeding;
>
> d) the extent to which the creditors were consulted;
>
> e) the effects of the proposed sale or disposition on the creditors and other interested parties; and
>
> f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

In addition to the test to approve the sale of assets outside of the ordinary course, the courts have established a substantive test for the approval of a sale process. In approving a sale process, the test set out in *Nortel Networks Corp.*[38] states that:

> [t]he duties of the Court in reviewing a proposed sale of assets are as follows:
>
>> 1) It should consider whether sufficient effort has been made to obtain the best price and that the debtor has not acted improvidently;
>>
>> 2) It should consider the interests of all parties;
>>
>> 3) It should consider the efficacy and integrity of the process by which offers have been obtained;
>>
>> 4) whether there has been unfairness in the working out of the process.

[39]

The test to approve a sale of assets as well as the test to approve a sale process generally provides the appropriate mechanisms to evaluate the utilization of credit bidding and its effects on both the sale process and on all stakeholders. While the test for the sale of assets, as opposed to the test for approval of the sale itself, engages in different considerations, the factors used by the Court in approving a sale of assets are similar and form the basis of the approval by the Court of sale process.

i) Efficacy and Integrity of the Process

A sales process should be designed to encourage a fair, open and competitive sale of the debtors' assets. As noted above, credit bidding has been critiqued as a method which may have a chilling effect on potential bidders to submit a bid, especially where the amount of the credit bid is far greater than the market value of the assets. This potential chilling effect was apparently the basis upon which the U.S. Bankruptcy Court limited the right of a secured creditor to credit bid.

In *Re Fisker Automotive Holdings, Inc.*,[40] the Bankruptcy Court limited the right of a secured creditor to credit bid. The secured creditor purchased the debt at a significant discount to the amount advanced by the original secured lender. The purchaser paid approximately $25 million for $168.5 million of secured debt. The debtors, who filed for protection under Chapter 11 in November 2013, sought the approval by the Court of a private sale agreement with Hybrid Tech Holdings, LLC ("Hybrid") for purchase of the assets of the debtor for consideration of $75 million. At the sale motion, the debtors asserted that the cost and delay that would result from pursuing an auction process would unlikely increase value for the debtor's estate. A committee of unsecured creditors opposed the sale motion and proposed instead a competitive auction which included Wanxiang America Corporation ("Wanxiang"), a cash bidder who expressed genuine interest in purchasing the assets of the debtors. The unsecured creditors committee argued that Wanxiang's offer would promote competitive bidding for the assets.

In *Fisker*, the debtors and the unsecured creditors limited the areas of dispute and agreed upon, *inter alia*, the following statements: (i) if Hybrid's credit bid was capped or denied, there would be a strong likelihood of an auction that would create substantial value for the estate; (ii) the highest and best value for the estate would be achieved through a sale of all of the debtors' assets; (iii) material assets being sold were not subject to a properly perfected lien in favour of Hybrid or such lien was subject to a *bona fide* dispute.

The Bankruptcy Court ultimately limited Hybrid's right to credit bid in the amount paid for the debt — $25 million — and ordered an auction for the sale of the assets. Hybrid's credit bid was capped by the Bankruptcy Court principally on the basis that (i) if Hybrid's credit bid was not limited, the auction would not only be chilled but it would likely not occur as Wanxiang would have refused to participate; and (ii) a credit bid by Hybrid over and above $25 million would undermine a competitive auction process. In making its determination, the Bankruptcy Court noted that Hybrid's claim was partially unsecured. In addition, the judge criticized the timing of the proposed private sale motion as the debtors had provided less than 24 business days for parties with an interest to challenge the sale motion and even less time for the committee of unsecured creditors (given its late appointment). Within this context, the Court highlighted that neither the debtors nor Hybrid were able to provide satisfactory reasons for why the private sale needed to be rushed. Subsequent to the Bankruptcy Court's decision, after 19 rounds of bidding, the auction for the sale of the debtor's assets resulted in obtaining increased value for the collateral by more than 150 percent or $90 million more than Hybrid had proposed to pay.

It is not clear why the Court in *Fisker* thought it appropriate to deny the full face value of the debt held by Hybrid — presumably it remained a provable claim against the estate. However, it was clear that the secured lender either predicted that it would not receive consideration greater than its proposed purchase price or sought to implement a loan to own investment strategy. In either case, if the market value for the collateral was higher than the proposed purchase price offered by Hybrid, whether Hybrid's credit bid was capped or not, a third-party bidder theoretically should not be deterred by a credit bid submitted by a secured lender. However, the sale process, including timing and the proper and transparent canvassing of the market, was not carried out by the debtors with a view to maximizing the value of the collateral for all of the debtor's stakeholders, including its principal secured creditor. In addition, Hybrid's credit bid which included unencumbered and encumbered assets with no additional cash consideration provided, caused concern.

Any sales process, whether it includes bids by way of credit or cash, stalking horse or otherwise, may have the effect of chilling the market if not properly conducted in order to ensure fairness, transparency and the integrity of the process. These issues are not issues isolated to the utilization of credit bidding, but rather of sales processes generally.

A sale process must be fair, inclusive, transparent and competitive. In addition, any proposed sale of assets should take into consideration the interests of all stakeholders. In order to encourage other bidders to investigate a potential transaction, secured creditors should be required to declare whether they intend to credit bid at some point in the process. A security review should be undertaken by the court officer to ascertain the validity and enforceability of the secured creditor's security, and court approval should be obtained for the sales process and a potential credit bid. Consideration should be given if the secured creditors should be required to inform bidders as to the minimum consideration required to clear a credit bid.

Prior court approval and active involvement of the court officer in ensuring the implementation of a fair and reasonable sale process that is transparent and competitive is a preferred approach whether a sales process incorporates credit bidding or not. In addition, the court officer should, at the time for approval of any sale agreement, properly consider the effect and terms of a sale, including of the utilization of any credit bid, on the interests of all stakeholders prior to reporting on the process to the supervising court.

A successful, fair and transparent sales process was achieved in the *CCAA* proceedings of Arctic Glacier Income Fund and its various its related entities (collectively, "Arctic"). [41] In these proceedings, Arctic sought the approval of a SISP. The SISP specifically contemplated the right of the secured creditors, who were owed approximately $235 million of secured debt, to credit bid.

In Arctic, the timelines of the SISP, approximately 160 days in total for Phase I and Phase II, represented a fair balance between the interests of the secured creditor, the debtor intent on restructuring its business and affairs, and third parties in being afforded sufficient time to conduct due diligence on the proposed transaction. In addition, prior to Phase II of the sale process, which phase facilitated an opportunity for qualified bidders to conduct extensive due diligence, Arctic's secured creditor was required to declare whether it intended to submit a credit bid. This allowed prospective purchasers or investors to know whether the secured lender intended to credit bid prior to committing to extensive due diligence costs. Further, the secured creditor would be provided access to information about the sale process during Phase II, including receiving copies of bids, provided that the secured creditor declared that it would not be submitting a credit bid. This was to ensure that existing bidders would have comfort that the secured creditor would not be able to make a superior bid at the last minute after the secured creditor had access to the Phase II bids.

As of the Phase II bid deadline, Arctic had received three bids with the highest bid ultimately allowing Arctic to continue as a going concern, paying out the secured creditors in full, and leaving approximately $130 million to be distributed to Arctic's remaining stakeholders in accordance with their priorities. This balanced approach implemented in Arctic facilitated a competitive process which incorporated reasonable and fair timelines for due diligence and submission of bids by qualified bidders, and necessary conditions for any sale process, whether or not such sales process incorporates a right to credit bid.

ii) Allocation of Value

As was the case in *White Birch*, utilization of credit bidding may present issues as to the proper allocation of value to encumbered and unencumbered assets. When there are unencumbered assets, issues as to allocation of value between encumbered and unencumbered assets may arise. This was a central issue to the minority lenders in *White Birch*, but was not addressed in the Court's decision to approve the sale. The minority lenders in *White Birch* argued that the bid of the majority of First Lien Holders represented the liquidation value ascribed to the unencumbered assets, thereby allowing them to appropriate any upside in value at the unencumbered assets to itself to the detriment of the unsecured creditors. The issue in this case was not solely whether the First Lien Holders should be allowed to submit a credit bid, but rather the fact that it was determined to be the winning bid when an alternative bid offered significantly more for the unencumbered assets. However, had the minority lenders been declared as the successful bidder, its allocation of value to the encumbered assets would have been to the detriment of the secured creditors who would have received considerably less than total the value of their debt. A potential remedy might have been to include, as a condition of the sale process, that the winning bid must win on both its allocation to the encumbered and the unencumbered assets. This would have meant that the First Lien holders would have had to be successful on its bid over the unencumbered assets as well as the encumbered assets if it was going to be the overall successful bidder. Allocation of value is an issue for courts and court officers to be cognizant of.

iii) Notice of Motions to Approve Bidding Procedures

It is often said that to ensure fairness to all parties, sufficient notice should be given with respect to a motion to approve a sale process. This is especially important in light of the court's comments in *White Birch*, where the Court stated that if a bidder or other party has concerns about a sale process, including the ability or the manner in which secured creditors are able to credit bid, such parties must raise those concerns at the motion to approve the sale process.[42] However, notice of motion on a sales process rarely is given to potential bidders who are typically not on the service list, or if they are minority lenders, such information is typically served only on the agent for a syndicate of lenders. In this respect, it is not always possible for stakeholders or bidders to be informed of the sale process prior to its commencement, or to be afforded sufficient time to analyze the impact of credit bidding or the process in order to determine whether any challenge should be brought before the court.

As mentioned above, the provincial regime under the *PPSA* providing for a secured creditor's right to foreclose on its collateral is an analogous concept to credit bidding. Under the *PPSA*, there are various restraints on the ability of a secured party to acquire the collateral in satisfaction of the debt. Namely, under the *PPSA*, notice of the foreclosure must be given to the debtor, other secured creditors and every person with an interest in the collateral who has notified the secured creditor.[43] Once the notice has been received, a single valid objection that the foreclosure would be prejudicial to the objector's interest will terminate the foreclosure process. An effective objection might be that the market value of the collateral is greater than the total indebtedness. The right to make an objection, provided it is a valid objection, will force the secured party to sell the collateral. Within insolvency proceedings, the court, in approving a sale process or sale of the assets, as well as court officers, should consider importing these restraints where a credit bid is being made on the basis of fairness and integrity of the sale process.

In that regard, courts and court officers should turn their minds to the nature of the proposed sales process and the basis on which a secured party may be permitted to credit bid when considering any proposed sales process to ensure that issues with respect to credit bidding have been addressed prior to commencement of the process.

5. CONCLUSION

Canada's current insolvency regime applies checks and balances on the utilization of credit bidding by a secured creditor. Insolvency legislation, judicial oversight tests governing court approval of a sales process and approval for a sale of the assets of a debtor and the role of court officers in overseeing the integrity of the insolvency or restructuring process, provide an appropriate mechanism in which to assess the reasonableness and fairness of the use of credit bidding within a restructuring process. Codification of credit bidding in the same manner as within the *U.S. Bankruptcy Code* is not necessary. In that regard, one must be mindful of legislating proper checks and balances on the use of credit bidding that is without regard to the uniqueness of Canadian insolvency law: that is, law which is broad and sufficiently flexible in order to foster the building of consensus and creativity to meet the specific circumstances of each particular restructuring or insolvency proceeding.

Footnotes

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2 *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 [*CCAA*].

3 U.S. Code, Title 11 United States Code [*U.S. Bankruptcy Code*].

4 *In re SubMicron Systems Corp.*, 432 F.3d 448 (3d Cir., 2006) [*Submicron*]; *White Birch Paper Holding Co., Re*, 2010 CarswellQue 11534, [2010] Q.J. No. 11089 (C.A.); *White Birch Paper Holding Co., Re*, 2010 CarswellQue 10954, [2010] Q.J. No. 10469 (C.S.) [*White Birch*].

5 *Submicron*, *supra* note 3.

6 *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 CarswellOnt 3509, [2010] O.J. No. 2190 (S.C.J. [Commercial List]); *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 CarswellOnt 212, [2010] O.J. No. 188 (S.C.J. [Commercial List]) [*Canwest*].

7 John Rapisardi, "Bankruptcy Practice: Problems in Distressed Loan to Own Investments", 237 N.Y.L.J. 3d (col. 1).

8 *Planet Organic Holding Corp., Re*, Ontario Court File No.10j-8699-0CL.

9 *Brainhunter Inc., Re*, 2010 CarswellOnt 886, [2010] O.J. No. 632 (S.C.J.); *Brainhunter Inc., Re*, 2009 CarswellOnt 8207, [2009] O.J. No. 5578 (S.C.J. [Commercial List]) [*Brainhunter Inc.*].

10 *Bankruptcy Reform Act of 1978*, Pub. L. 95-598, Nov. 6, 1978, 92 Stat. 2549 (11 U.S.C. 101 et seq.).

11 *U.S. Bankruptcy Code*, *supra* note 2 at §363.

12 *Ibid.* at §363(k).

13 *U.S. Bankruptcy Code*, *supra* note 2 at § 1129(b)(2)(A).

14 *In re Pacific Lumber Co.*, 584 F.3d 229 (5th Cir., 2009) [*Pacific Lumber Co.*].

15 *In re Murel Holding Corp.*, 75 F.2d 941 at 942 (2d Cir., 1935) [*Murel Holding Corp*].

16 *Ibid.*

17 *Matter of Sandy Ridge Development Corp.*, 881 F.2d 1346 at 1350 (5th Cir., 1989).

18 *Pacific Lumber Co.*, *supra* note 13 at 247.

19 *In re Philadelphia Newspapers, LLC*, 599 F.3d 298 (3d Cir., 2010) at p. 310 [*Philadelphia Newspapers, LLC*].

20 *Ibid.* at 318.

21 *Ibid.* at 338.

22 *River Road Hotel Partners, LLC v. Amalgamated Bank*, 651 F.3d 642 (7th Cir., 2011) [*River Road Hotel Partners, LLC*].

23 *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S.Ct. 2065 (U.S. Sup. Ct., 2012) [*RadLAX Gateway Hotel, LLC*].

24 *Ibid.*

25 *Personal Property Security Act*, RSO 1990, c P.10 [*PPSA*].

26 *Maax Corp., Re*, 2008 CarswellQue 15021 (C.S. Que.) [*Maax*].

27 *Brainhunter Inc.*, *supra* note 8.

28 *Canwest*, *supra* note 5.

29 *White Birch*, *supra* note 3.

30 *Maax*, *supra* note 25.

31 *Brainhunter Inc.*, *supra* note 8.

32 *Nortel Networks Corp., Re*, 2009 CarswellOnt 4467 at para. 29, [2009] O.J. No. 3169 (S.C.J. [Commercial List]).

33 *Arnco Business Services Ltd., Re*, 1983 CarswellOnt 241, [1983] O.J. No. 974 (Bktcy.); *CCM Master Qualified Fund Ltd. v. blutip Power Technologies Ltd.*, 2012 CarswellOnt 3158, [2012] O.J. No. 1165 (S.C.J. [Commercial List]).

34 *Ibid.*

35 *Skeena Cellulose Inc., Re* (2003), 43 C.B.R. (4th) 187 (B.C. C.A.); *Royal Oak Mines Inc., Re*, 1999 CarswellOnt 792, [1999] O.J. No. 864 (Gen. Div. [Commercial List]).

36 Alan J. Hutchens, "Credit Bidding in Canadian Insolvency Proceedings: Additional Commentary from the Perspective of a Financial Advisor", in Janis P. Sarra, ed., *Annual Review of Insolvency Law 2013* (Toronto: Carswell, 2014) 16.

37 R.S.C. 1985, c. B-3 [*BIA*].

38 *Nortel Networks Corp., Re*, 2009 CarswellOnt 4838, [2009] O.J. No. 4487 (S.C.J. [Commercial List]).

39 *Ibid.* at para. 35.

40 *Fisker Auto. Holdings, Inc., Re*, 2014 Bankr. LEXIS 230 (Bankr. D. Del. Jan. 17, 2014).

41 *Arctic Glacier Income Fund, Re*, Winnipeg, Court File No. CI 12-01-76323 (Man. Q.B.).

42 *White Birch*, *supra* note 3 at para. 14.

43 *PPSA*, *supra* note 25, s. 65(2).

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Tab 9

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other counterparty. Often the parties enter into a master agreement that provides for a netting of all "in the money transactions" against all "out of the money" transactions.

The termination and netting out of financial obligations is considered to be of fundamental importance to the efficient operation of capital markets, and a failure to ensure that the legal framework governing derivatives is in accord with international standards would put Canadian financial markets at a competitive disadvantage. The global financial crisis in 2008 highlighted the need for regulation in order to reduce systemic risk — the danger that an insolvency of a counterparty will trigger the insolvency of another counterparty and set off a chain reaction. Insolvency legislation has been amended to ensure that parties are able to exercise their right to terminate and net out in respect of these obligations despite the fact that the counterparty is subject to insolvency proceedings.

In the absence of any special statutory provision, the principles governing executory contracts would apply to derivatives contracts and would interfere with a party's ability to terminate or net out financial obligations under derivatives contracts. The *CCAA* and *BIA* have been amended to ensure that this will not occur. The legislation creates a class of contracts referred to as "eligible financial contracts." The provisions in the *CCAA* and the *BIA* governing executory contracts do not apply to an eligible financial contract.[133] The statutes further provide that the stay of proceedings does not interfere with a party's ability to enforce a security interest against financial collateral that secures an obligation under an eligible financial contract.[134]

The definition of an eligible financial contract (EFC) is of crucial importance since it determines whether a contract will be exempt from the ordinary insolvency rules that limit a party's ability to assert their contractual rights and remedies. The definition was first added to the insolvency statutes in 1992 and produced some litigation. The issue was whether the reference to commodity contracts in the definition should be restricted to those that were financial in nature or whether it should also include contracts that were physically settled by delivery of the commodity. The courts rejected any distinction based on whether the contract was financially or physically settled. Instead they indicated that the definition should encompass contracts dealing with

133 *BIA*, ss 65.1(7) and 65.11(10); *CCAA*, ss 32(9) and 34(7).

134 *BIA*, s 65.1(9); *CCAA*, ss 34(8)–(9). And see Chapter 12, Section D(8).

fungible commodities that trade in a volatile market where the contracts are used as financial hedges and risk-management tools.[135]

The definition of an EFC was amended by the *Budget Implementation Act, 2007*.[136] The legislation did not enumerate the various types of contracts but simply provided that it means an agreement of a prescribed kind. Regulations promulgated under the various insolvency statutes set out the substantive provisions.[137] This permits the legislation to be more easily updated to encompass new financial products. In order to fall within the definition, the derivatives agreements must be traded on regulated markets or be subject to recurrent dealings in the markets. The definition of an EFC in the regulation also covers securities and commodities loans, securities repos, and margin loans in respect of securities accounts or future accounts held by a financial intermediary.

The appropriate treatment of EFCs continues to be controversial. There is presently a debate concerning the proper balance between the goal of reducing systemic risk and the goals of restructuring law.[138]

G. SALE OF THE ASSETS

1) The Statutory Framework

It has become increasingly common in restructurings for the debtor to sell some or all of its assets outside the ordinary course of business. In many cases, this has involved a going-concern sale of substantially all the assets of the debtor. In such instances, it is most often the case that a plan of arrangement is never developed or voted on by the creditors. The *CCAA* has also been used to effect a winding down of the business

135 *Re Blue Range Resource Corp* (2000), 20 CBR (4th) 187 (Alta CA); *Re Androscoggin Energy LLC* (2005), 8 CBR (5th) 11 (Ont.CA).

136 SC 2007, c 29.

137 *Eligible Financial Contract General Rules (Bankruptcy and Insolvency Act)*, SOR/2007-256.

138 See the competing views in the Insolvency Institute of Canada, *Task Force on Derivatives Report* (14 November 2013), online: www.insolvency.ca/en/iicresources/resources/IIC_Derivatives_Task_Force_Report_November_2013.pdf and the International Swaps and Derivatives Association, *Comment letter on the Industry Canada's discussion paper "Statutory Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act"* (15 July 2014), online: www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/International_Swaps_and_Derivatives_Association_July_15_2014.pdf/$FILE/International_Swaps_and_Derivatives_Association_July_15_2014.pdf.

operation through an orderly sale of the assets that does not involve a going-concern sale of the business. The sheer magnitude and complexity of the business and the number of stakeholder may weigh in favour of using the more flexible framework of the *CCAA*.[139] Courts have confirmed that the same holds true in respect of commercial proposals — a court may authorize a sale even if it is clear that the debtor is unable to present a proposal to its creditors.[140] The 2009 amendments to the *CCAA* and *BIA* provide for judicial supervision of such sales. They lay out a set of rules that must be followed when a debtor that is undergoing restructuring proceedings proposes to sell assets outside the ordinary course of its business. The provision does not address the broader policy question as to when it is appropriate to use restructuring proceedings rather than bankruptcy or receivership proceedings to effect a liquidation. This question may arise if the creditors challenge the restructuring proceedings and argue that alternative insolvency proceedings would better serve the interests of the parties.[141]

A debtor is not permitted to sell or otherwise dispose of its assets outside the ordinary course of its business unless a court approves the sale or other disposition.[142] Approval by the shareholders of a debtor corporation is not needed notwithstanding any federal or provincial legislation that requires shareholder approval. If the debtor is an individual, the rule only applies to his or her business assets.[143] Secured creditors who may be affected by the order must be given notice of the application.[144] A court may authorize a sale of the assets free and clear of any security, charge, or other restriction, but, if it does so, it must also impose a security, charge, or restriction on the other assets of the debtor or on the proceeds of the sale or other disposition.[145]

In determining whether to authorize the transaction, the court is directed to consider the following non-exhaustive set of factors:[146]

- whether the process leading to the proposed sale or disposition was reasonable in the circumstances;
- whether the monitor or trustee approved the process leading to the proposed sale or other disposition;

139 *Target Canada Co. (Re)*, above note 45.
140 *Komtech Inc (Re)*, 2011 ONSC 3230.
141 See Chapter 11, Section B(4).
142 *CCAA*, s 36(1); *BIA*, s 65.13(1).
143 *BIA*, s 65.13(2).
144 *CCAA*, s 36(2); *BIA*, s 65.13(3).
145 *CCAA*, s 36(6); *BIA*, s 65.13(7).
146 *CCAA*, s 36(3); *BIA*, s 65.13(4).

- whether the monitor or trustee filed with the court a report stating that, in their opinion, the sale or other disposition would be more beneficial than a sale or disposition under a bankruptcy;
- the extent to which the creditors were consulted;
- the effects of the proposed sale or disposition on the creditors or other interested parties; and
- whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

These factors would appear to encompass the principles set out in *Royal Bank of Canada v Soundair Corp*[147] that were developed to evaluate the reasonableness of a sale by a receiver, but which were subsequently used in connection with liquidations under the *CCAA*.[148]

Often the court is asked to approve the sale process in advance of obtaining any offers. Courts have applied a somewhat different set of factors in connection with the authorization of the sale process.[149] They will consider (a) Is a sale transaction warranted at this time? (b) Will the sale benefit the whole "economic community"? (c) Do any of the debtor's creditors have a *bona fide* reason to object to a sale of the business? (d) Is there a better viable alternative?[150]

If the proposed sale is to a related person, the court may authorize the transaction only if good faith efforts were made to sell the assets to someone other than a related party and the consideration that is received is superior to any other made in accordance with the process leading to the proposed sale or other disposition.[151] The court cannot authorize the transaction unless it is satisfied that the debtor can and will make the payments to employees in respect of unpaid wages or to pension funds that would have been required for court sanction of the plan or proposal.[152]

147 (1991), 7 CBR (3d) 1 (Ont CA). The court is to consider: (1) whether the receiver has made a sufficient effort to get the best price and has not acted improvidently; (2) the interests of all parties; (3) the efficacy and integrity of the process by which offers are obtained; and (4) whether there has been unfairness in the working out of the process.
148 *Re Canadian Red Cross Society* (1998), 5 CBR (4th) 299 (Ont Ct Gen Div).
149 *Re Brainhunter Inc* (2009), 62 CBR (5th) 41 (Ont SCJ) [*Brainhunter*].
150 These factors were originally developed in *Nortel Networks Corporation (Re)* (2009), 55 CBR (5th) 229 (Ont SCJ) before the 2009 amendments, but were subsequently applied in *Brainhunter*, above note 149.
151 *CCAA*, s 36(4); *BIA*, s 65.13(5). A related person includes (a) a director or officer of a debtor corporation, (b) a person who has or did have direct or indirect *de facto* control of the debtor, or (c) a person related to a person described in (a) or (b). See *CCAA*, s 36(5); *BIA*, s 65.13(6).
152 *CCAA*, s 36(7); *BIA*, s 65.13(8).

In *Canwest Global Communications Corp (Re)*,[153] the court considered the scope of these provisions. An internal corporate reorganization was proposed that would disentangle the shared services arrangements of two related companies. The difficulty was that if the transaction was regulated by section 36 of the *CCAA*, it would be necessary to demonstrate that good faith efforts were made to sell the assets to someone other than a related party.[154] The court held that certain types of internal reorganizations could qualify as transactions in the ordinary course of business of the company. It did not endorse the view that all internal reorganizations were exempt, and gave the example of a "phoenix corporation" as an example of a transaction that would fall within the scope of the provision.[155]

Section 36 covers going-concern sales of all or part of the business as well as non-ordinary course sales of redundant assets. Prior to the 2009 amendments, initial *CCAA* orders typically authorized the disposal of redundant or non-material assets below a specified monetary value. The template initial orders of some jurisdictions continue to include such provisions except that they require court approval in respect of sales to related parties.[156] Others are more equivocal on the basis that the list of factors indicates that pre-approval is not permitted and that in any event notice would need to be given to affected secured creditors.[157]

2) The Sales Process

The court has considerable latitude in the sale process that it authorizes. The traditional Canadian sales process relied upon the efforts of the court appointed insolvency professional. More recently, auction based sales processes similar to those that were developed in the United States have been used. Regardless of the type of process that is chosen, an overarching principle is that the court must consider the efficacy and integrity of the sales process. This means that a court should not view the maximization of the sale proceeds in the particular case at hand as the sole or primary consideration. Changing the process

153 2009 CanLII 63368 (Ont SCJ).

154 *CCAA*, s 36(4)–(5).

155 In a phoenix transaction, the owners use a new company to purchase the assets free of the claims of the creditors and thereafter carry on the former business.

156 See the Alberta initial *CCAA* order, para 10, online: www.albertacourts.ab.ca/CourtofQueensBench/CommercialPractice/tabid/324/Default.aspx.

157 See the Ontario initial *CCAA* order, para 11, online: www.ontariocourts.ca/scj/practice/practice-directions/toronto/#Notices_and_Guides.

rules midstream in order to permit the acceptance of a higher bid has a detrimental effect on future transactions since a prospective purchaser will be less willing to expend the time and effort to participate if the process can be disrupted after these expenses have been incurred.[158]

The traditional sales process is adapted from that employed by a court appointed receiver. The court typically authorizes the sales process, and the monitor or trustee supervises the tender process and devises a marketing plan. Prospective purchasers are identified and given access to sensitive information upon signing confidentiality agreements. After conducting their due diligence, the prospective purchasers will submit their offers and the court officer will select what is considered to be the best offer. The process therefore does not involve a series of escalating bids, but encourages each prospective purchaser to make its most competitive offer in the first instance. Further negotiations will produce a definitive agreement that will then be submitted to the court for approval.

As an alternative to the traditional approach, a private auction process rather than the more usual process of tendering bids may be proposed. A difficulty with an auction is that a potential buyer will be reluctant to go to the considerable expense of investigating the business affairs only to have the fruit of its efforts scooped by a later bidder that takes advantage of its research. In order to ameliorate this problem, the debtor may enter into a stalking horse agreement that contains a set of provisions that create the incentive for the bidder to act as a stalking horse. These typically take the form of break-up fees and expense reimbursement, minimum overbids, and mandatory bid increments. A break fee remunerates the stalking horse bidder if the business is sold to some other bidder. A minimum overbid defines the amount by which a bid must exceed the stalking horse bid. A mandatory bid increment defines that amount by which a subsequent bid must exceed the prior bid.[159]

In evaluating the reasonableness of a stalking horse bid process, courts must be alert to the fact that the stalking horse bidder has a strong incentive to negotiate the terms of the stalking horse agreement in such a way to stifle competitive bidding so that its stalking horse bid is accepted and used to negotiate the definitive agreement.[160] The court

158 See *Terrace Bay Pulp Inc (Re)*, 2012 ONSC 4247 at para 59.

159 See A Taylor & Y Katirai, "An Analysis of Stalking Horse Processes in Canadian Insolvency Proceedings" (2013) 2 *Journal of the Insolvency Institute of Canada* 95.

160 See D Dowdall & J Dietrich, "Do Stalking Horses Have a Place in Intra-Canadian Insolvencies" in Janis P Sarra, ed, *Annual Review of Insolvency Law, 2005* (Toronto: Carswell, 2006) 1.

must assess the reasonableness of the time period (too short a period will dissuade bidders) as well as the magnitude and reasonableness of the break-up fee, minimum overbid, and bid increments. Other contractual provisions also need to be assessed, such as those that unduly restrict the identity of qualified bidders. In deciding whether or not to approve the sale process and the break-up fee, Canadian courts may wish to consider the more extensive caselaw from the United States. Break-up fees will be authorized if the court is of the opinion that they will facilitate an auction and result in an enhanced price.[161] However, courts will scrutinize the terms of the agreement and the size of the fee to ensure that it was not designed to benefit a favoured purchaser over other bidders by increasing the cost to other bidders.[162] Break-up fees in bankruptcy are generally limited to 1 to 4 percent of the purchase price.[163]

3) Credit Bids

Credit bidding occurs when a secured creditor uses some or all of its secured obligation to fund its bid for the purchase of the assets. If successful, the purchase price is paid through a corresponding reduction of the secured obligation. There is no statutory limitations on the use of credit bids in Canada. Courts have held that the secured creditor can bid the full amount of the secured obligation and is not limited to the fair market value of the assets.[164] Credit bidding gives a secured creditor an ability to ensure that the assets are not sold for an unacceptably low price. If the other bids are too low, the secured creditor can step in and acquire the assets through a credit bid. A credit bid can only be made in respect of property that is collateral for the secured debt. If there are other, unencumbered assets that are being sold as well, the secured creditor must pay cash for these assets. If there are claims that rank in priority to the secured creditor, these claims must be paid out. The allocation of value between encumbered and unencumbered assets may become controversial — if the encumbered and unencumbered assets are sold together and the unencumbered assets are assigned only

161 *In re Integrated Resources, Inc*, 147 BR 650 (SDNY 1992).

162 *In re O'Brien Environmental Energy, Inc*, 181 F3d 527 (3d Cir 1999).

163 See *In re Tama Beef Packing, Inc*, 321 BR 496 (8th Cir BAP 2005). And see *Brainhunter*, above note 149 in which the court approved a break fee of 2.5 percent.

164 *White Birch Paper Holding Company (Arrangement relatif à)*, 2010 QCCS 4915 at para 34. See *also In re SubMicron Systems Corp*, 432 F3d 448 (3d Cir 2006).

their liquidation value, this may result in the confiscation of value by the secured creditors.[165]

As in the case of a stalking horse bid, there is a concern that the credit bidder may seek to influence the sale process to discourage other prospective purchasers from making bids. A secured creditor will ordinarily be strongly motivated to obtain the best possible price on an asset sale in order to reduce its secured debt. However, a secured creditor who bids on a sale operates under a different incentive — to acquire the assets at the lowest possible price — and this will prejudice junior creditors who might otherwise have a claim to the surplus value in the event that a competitive sales process yielded sufficient funds to fully satisfy the secured debt of the senior creditor. For this reason, the monitor and the court play an important role in ensuring the transparency and integrity of the sale process.

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CHAPTER 14

GOVERNANCE AND SUPERVISION

The debtor does not usually lose control over the management of the business during the period in which restructuring proceedings are ongoing. In this respect, restructuring proceedings are unlike other commercial insolvency proceedings, such as bankruptcy and receivership, in which an insolvency administrator assumes control of the business. However, it would be a grave mistake to think that this means that the debtor will simply carry on business as usual. The initiation of commercial restructuring proceedings radically alters the environment within which the debtor manages and operates the business. The debtor must work closely with insolvency professionals and expert legal advisors and must engage in a series of negotiations with claimants in order to develop an acceptable plan or to implement a sales process.

There are a multitude of decisions that must be made, and there inevitably will be parties who are unhappy about some of these decisions. The governance rules establish the legal framework within which the decision making occurs, and the recourse available to those who wish to contest the decisions that are made. In order to make properly informed decisions, the participants in the process must have accurate and timely information available to them. Therefore, it is also necessary to put mechanisms in place that provide for the free flow of reliable information.

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 SEARS CANADA INC., *et al.*

(Applicants)

Court File No.: CV-17-11846-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced at Toronto

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(Response to Applicants' Motion Returnable July 13, 2017 re: Approval of SISP and Related Relief)

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