2004 CarswellBC 1262, 2004 BCSC 733, 45 B.L.R. (3d) 78, 29 B.C.L.R. (4th) 178, 1 C.B.R. (5th) 7

2004 CarswellBC 1262, **2004** BCSC 733, 45 B.L.R. (3d) 78, 29 B.C.L.R. (4th) 178, 1 C.B.R. (5th) 7

Doman Industries Ltd., Re

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

IN THE MATTER OF THE COMPANY ACT R.S.B.C. 1996, c. 62

IN THE MATTER OF THE CANADA BUSINESS CORPORATIONS ACT R.S.C. 1985, c. C-44

IN THE MATTER OF THE PARTNERSHIP ACT R.S.B.C. 1996, c. 348

IN THE MATTER OF DOMAN INDUSTRIES LIMITED, ALPINE PROJECTS LIMITED, DIAMOND LUMBER SALES LIMITED, DOMAN FOREST PRODUCTS LIMITED, DOMAN'S FREIGHTWAYS LTD., DOMAN HOLDINGS LIMITED, DOMAN INVESTMENTS LIMITED, DOMAN LOG SUPPLY LTD., DOMAN-WESTERN LUMBER LTD., EACOM TIMBER SALES LTD., WESTERN FOREST PRODUCTS LIMITED, WESTERN PULP INC., WESTERN PULP LIMITED PARTNERSHIP, and QUATSINO NAVIGATION COMPANY LIMITED (PETITIONERS)

British Columbia Supreme Court

Tysoe J.

Heard: May 25, 2004
Judgment: May 25, 2004[FN*]
Docket: Vancouver L023489

Counsel: E.J. Harris, Q.C., P.D. McLean for Petitioner, Western Forest Products Ltd.

I.G. Nathanson, Q.C., S.R. Schachter, Q.C. for Hayes Forest Services Ltd.

M.I. Buttery for Tricap Restructuring Fund

S.R. Ross for Strathcona Contracting Ltd.

K. Zych for Committee of Unsecured Noteholders

C.E. Hirst for Petro-Canada Inc.

Subject: Insolvency; Corporate and Commercial

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

Insolvent company was in process of attempting restructuring under Companies' Creditors Arrangement Act — Insolvent company brought application for approval of termination of contracts it had with H Ltd. and S Ltd. — Application dismissed — Insufficient evidence existed to support conclusion that proposed contract terminations were fair and reasonable in all circumstances — Available evidence simply supported conclusion that insolvent company would have opportunity of being more profitable if contracts were terminated — It was not demonstrated that loss of this opportunity to be more profitable would outweigh prejudice that would be suffered by H Ltd. and S Ltd. if contracts were terminated — Termination of contracts as condition precedent of restructuring plan was not contained in initial draft of plan and there was no evidence as to why it was inserted later — It could not be said that condition precedent was result of adversarial negotiation and that restructuring was unlikely to proceed if it was not satisfied — It is not necessary for insolvent company to demonstrate that termination of contract is essential to making of viable plan or arrangement.

Cases considered by *Tysoe J.*:

Blue Range Resource Corp., Re (1999), 1999 CarswellAlta 597, 245 A.R. 154, 1999 ABQB 1038 (Alta. Q.B.) — not followed

Dylex Ltd., Re (1995), 31 C.B.R. (3d) 106, 1995 CarswellOnt 54 (Ont. Gen. Div. [Commercial List]) — followed

Repap British Columbia Inc., Re (June 11, 1997), Doc. Vancouver A970588 (B.C. S.C.) — considered

Skeena Cellulose Inc., Re (2002), 43 C.B.R. (4th) 178, 2002 BCSC 1280, 2002 CarswellBC 2032, 5 B.C.L.R. (4th) 193 (B.C. S.C.) — considered

Skeena Cellulose Inc., Re (2003), 43 C.B.R. (4th) 187, 184 B.C.A.C. 54, 302 W.A.C. 54, 2003 BCCA 344, 2003 CarswellBC 1399, 13 B.C.L.R. (4th) 236 (B.C. C.A.) — distinguished

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

Statutes considered:

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

Generally — referred to

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

Generally — referred to

Forest Act, R.S.B.C. 1996, c. 157

Generally — referred to

Forestry Revitalization Act, S.B.C. 2003, c. 17

Generally — referred to

Regulations considered:

Forest Act, R.S.B.C. 1996, c. 157

Timber Harvesting Contract and Subcontract Regulation, B.C. Reg. 22/96

Generally

APPLICATION by insolvent company for approval of termination of contracts.

***Tysoe J.* (orally):**

1 One of the Petitioners, Western Forest Products Ltd., ("Western") applies, in these proceedings under the *Companies Creditors Arrangement Act* (the "*CCAA*") involving the Doman group of companies, for authorization or approval of the termination of contracts it has with Hayes Forest Services Ltd. ("Hayes") and Strathcona Contracting Ltd. ("Strathcona").

2 The Doman group of companies ("Doman") carry on business in the B.C. forestry industry. Doman encountered financial difficulties and has been in the process of attempting to restructure under the *CCAA* for approximately one and a half years. The liabilities of *Doman* consist of secured term debt in the principal amount of U.S. $160 million, unsecured term notes in the principal amount of U.S. $513 million, unsecured trade debt in excess of $20 million, a secured operating line of credit and other miscellaneous obligations.

3 The restructuring process is nearing completion. A plan of compromise and arrangement (the "Restructuring Plan") has been filed and the meeting of creditors to consider it has been scheduled to be held in approximately two weeks. The deadline for creditors to file proofs of claim is today.

4 In very simple terms, the Restructuring Plan contemplates that the lumber and pulp assets of Doman will be transferred into new corporations and that the unsecured noteholders, trade creditors and other unsecured creditors will have their debt converted into shares in one of the new corporations, which will own the lumber assets and the shares of the other corporation holding the pulp assets. The secured term debt is to be refinanced and the secured operating line of credit will be unaffected. The existing shareholders of Doman are to receive warrants entitling them to purchase a limited number of shares in the new parent corporation.

5 The implementation of the Restructuring Plan is subject to the fulfilment of numerous conditions precedent. One of the conditions is the termination of the contracts with Hayes and Strathcona which are the subject matter of this application.

6 Western holds certain forest tenure, including licenses relating to an area known as the Nootka Region on Vancouver Island and at least one island off the coast of Vancouver Island called Nootka Island. In 1991, the B.C. government decided that logging contractors should have a form of security similar to the tenure enjoyed by license holders and created the concept of replaceable contracts under the *Forest Act*.

7 The attributes of replaceable contracts were discussed at length by the B.C. Court of Appeal in *Skeena Cellulose Inc., Re*, 2003 BCCA 344 (B.C. C.A.) and I will not repeat all of them here. In short, a replaceable contract is a form of evergreen contract which contains statutorily mandated provisions, the most important of which is that the license holder must offer a new or replacement contract to the contractor upon each expiry of the term of the contract as long as the contractor is not in default under the contract. If the parties are not able to

agree on the new rates under the replacement contract, an arbitrator will determine the rates, which are mandated to be competitive within the industry and to permit the contractor to earn a reasonable profit on top of its costs. The contractors with such contracts are known in the industry as Bill 13 contractors. A license holder must have at least 50% of its annual allowable cut harvested by Bill 13 contractors.

8 Western has 7 full-phase Bill 13 logging contracts with 6 contractors for the Nootka Region. Hayes is one of those contractors and it has the full-phase contract for the Plumper Harbour area of the Nootka Region. A full-phase contract includes all aspects of logging ranging from road construction, falling, hauling, sorting and delivery to transportation points. Hayes sold the road construction aspect of its contract, and the replaceable contract for road construction was assigned to Strathcona.

9 When Doman first commenced these *CCAA* proceedings, it was anticipated that the restructuring process would be completed in a relatively short period of time. It was contemplated that all unsecured debt other than the unsecured bondholders would be paid in full and that the unsecured bondholders would take most, but not all, of the equity in Doman in exchange for some of the indebtedness owed to them and would take security for the remainder of their indebtedness. The confirmation or come-back Order of December 6, 2002 authorized a downsizing process for Doman, but it was not instituted in view of the anticipated restructuring.

10 The restructuring initially contemplated by Doman did not take place, in part because I made a ruling that the covenants in the trust deed for the secured term debt could not be overridden into the future. By the beginning of April 2004, the unsecured bondholders were pressing for their own restructuring plan and had made it clear that there should be some downsizing in Doman's operations, particularly the closure of Doman's pulp mill in Port Alice. On April 6, 2004, I declined Doman's application for an extension of the stay for the sole purpose of pursuing refinancing of its debt and the sale of the Port Alice pulp mill, but I also declined an application of the unsecured bondholders to call a meeting of creditors to consider its plan of arrangement. I extended the stay for the purpose of allowing Doman to file its own restructuring plan while still pursuing refinancing and sale alternatives, but I imposed a fairly concrete deadline by directing that the creditors meeting be held on June 7. In my April 6 Order, I authorized Doman to reinstitute its downsizing process with special emphasis on the closure of the Port Alice pulp mill if a purchaser was not located. I also placed a restriction on any downsizing by providing that any termination of a replaceable contract under the *Forest Act* was not to be effective unless authorized by the court.

11 By letters dated April 27, 2004, Western terminated its contracts with Hayes and Strathcona effective upon court approval of the terminations. An affidavit of Mr. Zimmerman, a Western employee, provided the following rationale for the decision to terminate these replaceable contracts:

> As part of the reorganization and "downsizing" processes of [Western], we have looked at methods to rationalize harvesting operations in the Nootka Region so as to reduce costs and improve profitability of [Western]. [Western] has worked in conjunction with representatives of the Bondholder committee who have asked for recommendations so as to increase profitability. [Western] has determined that within the Nootka Region, operational efficiencies can be achieved and significant cost savings can be achieved if the number of contractors is reduced and if that contractor's allocated volume is re-allocated to the remaining contractors. [Western] has recommended this reduction to the Bondholders Committee and the representatives of the Committee have asked that [Western] institute a rationalization and termination of contract, which is subject to Court approval as provided in this Court's Order of April 6, 2004.

The affidavit goes on to state that the rationalization can best be carried out by the termination of the Plumper Harbour contracts, principally because the contractor costs associated with this location are the highest in the Nootka Region. The volume under the contracts would then be re-allocated to other Bill 13 contractors in the Nootka Region. The average contract rate for logging a cubic metre of timber under the Hayes contract for the period from 1998 to 2001, as determined by arbitration, was approximately $4 higher than the average rate under the other contracts for the Nootka Region.

12 Mr. Zimmerman's affidavit indicated that Western did not intend to harvest at Plumper Harbour for the next three years and set out the savings that Western would be able to achieve by terminating the Hayes and Strathcona contracts. These savings were estimated at $5 million over the next three years and $800,000 for each year thereafter. These included annual savings of approximately $165,000 in road building costs, but the main reason Western wants to terminate its contract with Strathcona is that the full-phase contractor replacing Hayes may have its own road building capabilities. Mr. Zimmerman also exhibited to his affidavit a proposal which Hayes had made to Western in 1999 whereby Hayes offered to exchange its rights under its Bill 13 contract for the exclusive right to do helicopter logging in the Nootka Region with an annual minimum guarantee. In the proposal, Hayes stated that the average cut for many of the Bill 13 contractors had been reduced below an efficient economic operating level and that higher costs were being passed on to Western. The proposal was not accepted by Western because it did not want to give exclusive rights for helicopter logging with a guaranteed entitlement.

13 Representatives of Hayes and Strathcona swore affidavits disputing that the savings would be of the magnitude estimated by Mr. Zimmerman. They also set out the prejudice which their companies would suffer if the contracts were terminated, including the loss of employment and the inability to utilize fixed assets. Mr. Hayes deposed that there is no reasonable or rational economic reason for Western to forego harvesting in Plumper Harbour this year because most of the engineering and road construction costs have already been incurred. Mr. Hayes estimated that if Western harvested the timber on its logging plan for this year in Plumper Harbour, it would receive revenue, net of additional harvesting costs, of approximately $2 million.

14 The affidavit of Mr. Hayes also stated that Hayes recognized that the operations of the Bill 13 contractors in the Nootka Region are inefficient, unwieldy and costly. Despite this acknowledgment, Mr. Hayes expressed a view that the termination of its contract will not have a material impact on cost reduction in the Nootka Region when one takes into account that the Province will be taking back approximately 20% of Western's annual allowable cut in the Nootka Region pursuant to the recently enacted *Forestry Revitalization Act* and will thereby cause a reduction in the volumes harvested by all of the Bill 13 contractors. No affidavit was sworn by a Western representative to dispute this statement.

15 Mr. Zimmerman, Mr. Hayes and the deponent on behalf of Strathcona were cross-examined on their affidavits. In his cross-examination, Mr. Zimmerman stated that Western did intend to liquidate the developed timber at Plumper Harbour of approximately 130,000 cubic metres over the next two years before putting the area in abeyance for a three year period. Western has not introduced any evidence with respect to the anticipated costs if this developed timber is harvested or is harvested by other Bill 13 contractors rather than Hayes.

16 In addition to the *Skeena Cellulose Inc.* decision which dealt with the termination of replaceable contracts in *CCAA* proceedings, counsel referred me to several other cases involving the termination of contracts, leases or licenses in *CCAA* proceedings.

17 In *Dylex Ltd., Re*, [1995] O.J. No. 595 (Ont. Gen. Div. [Commercial List]), Farley J. authorized the in-

solvent company to repudiate the leases of three of its stores as part of a program to close 200 of its stores across Canada. The three stores had been a financial drain on Dylex. Although the closures were going to have a detrimental effect on the shopping centres in which the stores were located, Farley J. held that in weighing the balancing of interests in a *CCAA* context, the court's discretion should be exercised in favour of Dylex over the landlord, which was in sound financial condition. Farley J. declined to import into the *CCAA* the requirement applicable to proposals under the *Bankruptcy and Insolvency Act* that the insolvent company has to show that it would not be able to make a viable proposal unless it terminated the leases in question.

18 In *Blue Range Resource Corp., Re*, 1999 ABQB 1038 (Alta. Q.B.), the insolvent company had been authorized by the court under the initial stay order to terminate such of its contracts as it deemed appropriate to permit it to proceed with an orderly restructuring of its business. Blue Range terminated some of its natural gas supply contracts and three of the parties to such contracts sought to challenge the termination of their contracts. One of the issues they raised was that the stay order should be varied to provide that Blue Range would only be permitted to terminate the contracts if it was incapable of performing them or if the termination was essential to the success of their restructuring. Lo Vecchio J. dismissed the application to vary the stay order in this fashion. He made the following comments at paras. 36 through 38, which have been quoted in subsequent cases:

> The purpose of the CCAA proceedings generally and the stay in particular is to permit a company time to reorganize its affairs. This reorganization may take many forms and they need not be listed in this decision. A common denominator in all of them is frequently the variation of existing contractual relationships. Blue Range might, as any person might, breach a contract to which they are a party. They must however bear the consequences. This is essentially what has happened here.
>
> A unilateral termination, as in any case of breach, may or may not give rise to a legitimate claim in damages. Although the Order contemplates and to a certain extent permits unilateral termination, nothing in Section 16.e or in any other part of the Order would suggest that Blue Range is to be relieved of this consequence; indeed Blue Range's liability for damages seems to have been assumed by Duke and Engage in their set-off argument. The application amounts to a request for an order of specific performance or an injunction which ought not to be available indirectly. In my view, an order authorizing the termination of contracts is appropriate in a restructuring, particularly given that it does not affect the creditors' rights to claim for damages.
>
> The Applicants are needless to say not happy about having to look to a frail and struggling company for a potentially significant damages claim. They will be relegated to the ranks of unsecured judgment creditors and may not, indeed likely will not, have their judgments satisfied in full. While I sympathize with the Applicants' positions, they ought not to, in the name of equity, the guide in CCAA proceedings, be able to elevate their claim for damages above the claims of all the other unsecured creditors through this route.

19 Lo Vecchio J. held that the court has the necessary jurisdiction to permit termination of contracts and that the termination of the contracts in question was necessary to the company's survival program.

20 In *T. Eaton Co., Re*, [1999] O.J. No. 4216 (Ont. S.C.J. [Commercial List]), Farley J. refused to order specific performance of an exclusive license to provide credit card services that had been repudiated by the insolvent company as part of a sale of its assets which was the foundation of its restructuring plan. He held that the licensee could be adequately compensated in damages and should not have a higher claim than any other unsecured creditor. In the course of his reasons, he quoted the above portions of the *Blue Range Resource Corp.* de-

cision, and said the following at para. 7:

> It is clear that under CCAA proceedings debtor companies are permitted to unilaterally terminate in the sense of repudiate leases, and contracts without regard to the terms of those leases and contracts including any restrictions conferred therein that might ordinarily (i.e. outside CCAA proceedings) prevent the debtor company from so repudiating the agreement. To generally restrict debtor companies would constitute an insurmountable obstacle for most debtor companies attempting to effect compromises and reorganizations under the CCAA. Such a restriction would be contrary to the purposive approach to CCAA proceedings followed by the courts to this date.

Farley J. also spoke about being cognizant of the function of a balancing of prejudices within the general approach to the *CCAA*.

21 The issue of the court's jurisdiction to authorize the termination of replaceable contracts under the *B.C. Forest Act* was first addressed in the predecessor to the *CCAA* proceedings of Skeena Cellulose, *Repap British Columbia Inc., Re* (June 11, 1997), Doc. Vancouver A970588 (B.C. S.C.). Thackray J. held that the court had the jurisdiction under the *CCAA* to authorize the insolvent company to terminate replaceable contracts. None of the replaceable contracts in question were actually terminated until the subsequent Skeena Cellulose proceedings.

22 In the Skeena Cellulose proceedings, the come-back order authorized the company to terminate replaceable contracts in order to facilitate the downsizing and consolidation of its business and operations. As part of Skeena Cellulose's plan of compromise and arrangement, a third party agreed to purchase the shares in the company for $8 million, which was to be used for distribution to the creditors having claims in excess of $400 million. It was a condition precedent to the purchase that two of Skeena Cellulose's five replaceable contracts be terminated, and letters of termination were sent. The two contractors applied to the court for a declaration that the terminations were invalid.

23 Brenner C.J.S.C. dismissed the application. In his decision (cited at 2002 BCSC 1280 (B.C. S.C.) [*Skeena Cellulose Inc., Re*]), he said the following at para. 25:

> SCI has no authority to decline to replace the applicants' replaceable contracts under the terms of those contracts, or in accordance with the provisions of the Regulation that deal with when and how a replaceable contract can be terminated. The only authority for SCI to terminate, or indeed, jurisdiction for this court to approve such terminations, must be found in the terms of the Come-back Order, and in the provisions of the CCAA. To be effective, the terminations must:
>
> (a) comply with the procedures and conditions stipulated in the Come-back Order; and,
>
> (b) conform to the broader principles of economic necessity and fairness which underlie the court's discretionary jurisdiction under the CCAA.

Brenner C.J.S.C. expressed the view that the statutory privileges given to the Bill 13 contractors are not sufficient to justify the creation or recognition of a preference in favour of the contractors over other creditors.

24 The appeal from Brenner C.J.S.C.'s decision was dismissed. In its decision, the B.C. Court of Appeal held that the court had an equitable jurisdiction to supplement the *CCAA* by approving a plan of arrangement

which contemplates the termination of contracts by the debtor corporation. Newbury J.A. held that in approving such a plan involving the termination of replaceable contracts, the court was not overriding provincial legislation because nothing in the legislation purported to invalidate a termination of a replaceable contract but that, in any event, the doctrine of paramountcy would result in preference being given to the *CCAA* over the *B.C. Forest Act* in the case of a conflict.

25 The Court of Appeal found no error in the exercise of discretion by Brenner C.J.S.C. Newbury J.A. said the following about the concept of fairness at para. 60:

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

The Court of Appeal concluded that there was a business case for the terminations. Newbury J.A. stated that the situation in *Dylex Ltd.* was no different in principle because, like the leases in *Dylex Ltd.*, the replaceable contracts were too costly for Skeena Cellulose to continue operating under them.

26 Although the Court of Appeal's decision in *Skeena Cellulose Inc.* settles that the court has the necessary jurisdiction to deal with the termination of contracts, none of the above decisions includes any detailed discussion with respect to the basis upon which the court becomes involved in decisions to terminate contracts. Newbury J.A. discussed the jurisdiction in terms of the court approving a plan of arrangement which involves the termination of contracts, but the court will often authorize the termination of contracts prior to the formulation of a plan of arrangement.

27 If a debtor company repudiated a contract prior to commencing *CCAA* proceedings, the court would not have any direct involvement in the termination of the contract unless, possibly, the other party to the contract sought specific performance of the contract (which, as Brenner C.J.S.C. pointed out in *Skeena Cellulose Inc.*, is particularly inappropriate in an insolvency). The other party to the contract would have a claim for damages in respect of the repudiation and would be treated like any other unsecured creditor for the purposes of the plan of arrangement.

28 Once an insolvent company seeks the assistance of the court by commencing *CCAA* proceedings, the company comes under the supervision of the court. The supervision also involves a consideration of the interests of the broad constituency served by the *CCAA* mentioned in *Skeena Cellulose Inc.* by Newbury J.A. These in-

terests, when coupled with the exercise by the court of its equitable jurisdiction, bring into play the requirements for fairness and reasonableness in weighing the interests of affected parties.

29 Generally speaking, the indebtedness compromised in *CCAA* proceedings is the debt which is in existence at the time of the *CCAA* filing, and the debtor company is expected to honour all of its obligations which become owing after the *CCAA* filing. It is common for the initial stay order or the come-back order to provide that the debtor company is to continue carrying on its business and to honour its ongoing obligations unless the court authorizes exceptions.

30 In many reorganizations under the *CCAA*, it is necessary for the insolvent company to restructure its business affairs as well as its financial affairs. Even if the financial affairs are restructured, the company may not be able to survive because portions of the business will continue to incur ongoing losses. In such cases, it is appropriate for the court to authorize the company to restructure its business operations, either during the currency of the *CCAA* proceedings or as part of a plan of arrangement. The process is commonly referred to as a downsizing if it involves certain aspects of the business coming to an end. The liabilities which are incurred as a result of the restructuring of the business operations, for such things as termination of leases and other contracts, are included in the obligations compromised by the plan of arrangement even though the debtor company will have been honouring its ongoing commitments under the leases and other contracts after the commencement of the *CCAA* proceedings. The inclusion of these liabilities in the plan of arrangement is an exception to the general practice of debtor companies paying the full extent of post-filing liabilities and compromising only the pre-filing liabilities.

31 It is within this context that the court is called upon to authorize the termination of contracts which the debtor company could have repudiated without any authorization prior to the commencement of *CCAA* proceedings. The liabilities to be compromised have, in general terms, been crystallized by the filing of the *CCAA* petition, and the affairs of the debtor company are under the supervision of the court, which is required to exercise its equitable jurisdiction fairly and reasonably.

32 I do not approach the matter in the same fashion as Lo Vecchio J. did in *Blue Range Resource Corp.* I do not see the resistance of a party to the termination of a contract with the debtor company to be an attempt to elevate their claim for damages above the claims of all the other unsecured creditors. Apart from any monies which may have been outstanding under the contract at the time of the *CCAA* filing, the party to the contract was not an unsecured creditor who was going to be subjected to a compromise under a plan of arrangement. The party only becomes a creditor in respect of its damage claim if the contract is terminated. Although Lo Vecchio J. could be interpreted as suggesting in the quoted paragraphs 36 to 38 that a debtor company may terminate contractual relations as long as the resulting damage claim is included in its plan of arrangement, I do note that he subsequently commented that the termination of the contracts in that case was necessary to the company's survival program.

33 I prefer the approach of Farley J. in *Dylex Ltd.*, which involves the court weighing the competing interests and prejudices in deciding what is fair and reasonable. I would anticipate that in the majority of cases a debtor company will be able to persuade the court to exercise its discretion in favour of the termination of contracts and other steps required to downsize or rationalize its business affairs. A debtor company must be insolvent to qualify under the *CCAA* and the insolvency may have been caused by over-expansion or continual losses by a part of the business. If the company is to have a reasonable prospect of surviving into the indefinite future, it will be appropriate to downsize its operations or bring an end to the losing aspects of the business. The in-

terests of the broad constituency of stakeholders in taking reasonable steps to ensure the ongoing viability of the business will often outweigh the prejudice caused to parties having their contracts or other arrangements with the debtor company terminated and their consequential damage claim being included in the plan of arrangement. There is no single test for the debtor company to satisfy apart from demonstrating that the termination is fair and reasonable in all of the circumstances. As held in *Dylex Ltd.*, it is not necessary for the debtor company to demonstrate that the termination of the contract is essential to the making of a viable plan of arrangement.

34 An example of this type of situation has already occurred in these proceedings. Doman's pulp mill at Port Alice has been losing money for a significant period of time and causing a financial drain on Doman's resources. At the suggestion of the bondholders, it was decided that the mill should be closed and should not be part of the restructured company. Although the closure of the mill would have had a devastating effect on the employees of the pulp mill and the Village of Port Alice as a whole, I authorized the closure because it would not have been reasonable to require the restructured company to operate a division of its business which was anticipated to continue to lose money. Fortunately, Doman was able to find another party who was willing to take over the pulp mill prior to its closure.

35 On the other hand, there will be circumstances where it will not be appropriate to authorize the debtor company to terminate contracts. For example, suppose that a debtor company became insolvent because its business had been operating at a loss but market conditions had changed and, with a financial restructuring of its existing debt, it was expected to be profitable in the future. Suppose further that the debtor company was party to a contract which did not cause the company to operate the relevant aspect of its business at a loss but the contract was not as favourable as the market would permit the company to obtain if it could divest itself of the existing contract. If the company could terminate the contract and enter into a new one with different rates, it could become substantially more profitable into the future. In these circumstances, it may well be inappropriate for the court to authorize the termination of the contract. The risk of the failure of the debtor company after its restructuring would be relatively low and, depending on the terms of the plan of arrangement, the future benefit of the contract termination may accrue to the shareholders of the company or to the creditors of the company who took risks in exchange for high rates of return.

36 On the present application, all that the evidence establishes is that Doman will likely be able to reduce its costs to some extent at some point in the future if it can terminate the two contracts in question. Mr. Zimmerman's affidavit states that the reason Western made the recommendation to terminate the two contracts was to improve or increase its profitability. There is no evidence on this application with respect to the following points:

(a) whether the logging at Plumper Harbour under the existing contracts has produced a loss in the past or is expected to produce a loss in the future;

(b) whether other logging operations of Doman produce a greater loss;

(c) whether other aspects of Doman's business produce a loss and, if so, what consideration has been given to rationalizing that loss in comparison to the termination of the contracts in question;

(d) whether it is expected that the restructured company will operate at a profit;

(e) what parts of the constituency of stakeholders will benefit from the termination of the contracts in ques-

tion;

(f) whether the developed timber at Plumper Harbour can be harvested in the next two years by other contractors at a cost less than the cost under the contracts in question; and

(g) what is the fallacy, if any, in the assertion of Mr. Hayes that the termination of the contracts will have no material impact on cost reduction after taking into account the 20% government take-back.

37 Some reliance was placed by counsel on the fact that the termination of these contracts is a condition precedent of the Restructuring Plan. In my view, this condition precedent is materially different than the condition precedent in *Skeena Cellulose Inc.* In that case, it was an independent purchaser of the shares in *Skeena Cellulose Inc.* that negotiated the condition on the basis that it was not prepared to purchase the shares unless two of the five replaceable contracts were terminated. The condition resulted from an arm's length negotiation which required the purchaser to put up funds to purchase the shares. In the present case, the bondholder committee produced the initial draft of the Restructuring Plan, which was finalized after a limited negotiation that served to advance the interests of the existing directors and shareholders of Doman. The condition precedent in question was not contained in the initial draft of the Restructuring Plan put forward by the bondholders and there is no evidence as to why the condition was inserted in the Restructuring Plan. I am unable to conclude that the condition precedent was the result of a truly adversarial negotiation and that, unlike the situation in *Skeena Cellulose Inc.*, the restructuring is unlikely to proceed if the condition is not satisfied.

38 In my opinion, therefore, there is insufficient evidence for me to conclude that the proposed contract terminations are fair and reasonable in all of the circumstances. All that the evidence available to me supports is a conclusion that the restructured company will have an opportunity of being more profitable if the contracts are terminated. It has not been demonstrated that the loss of this opportunity will outweigh the prejudice which will be suffered by Hayes and Strathcona if the contracts are terminated. In weighing the competing interests on the evidence before me, it is my conclusion that I should exercise my discretion against approving the contract terminations. I dismiss the application with costs.

Application dismissed.

FN* Leave to appeal refused *Doman Industries Ltd., Re* (2004), 2004 BCCA 382, 2004 CarswellBC 1545 (B.C. C.A. [In Chambers]).

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