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.

(each an "**Applicant**", and collectively, the "**Applicants**")

REPLY BOOK OF AUTHORITIES
(Replying to facta of ESL and SH Re: Litigation Trustee, returnable March 2, 2018)

March 1, 2018

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TAB 1

2010 ONSC 6229
Ontario Superior Court of Justice [Commercial List]

Nelson Financial Group Ltd., Re

2010 CarswellOnt 8655, 2010 ONSC 6229, 195 A.C.W.S. (3d) 319, 71 C.B.R. (5th) 153, 75 B.L.R. (4th) 302

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NELSON FINANCIAL GROUP LTD.

Pepall J.

Judgment: November 16, 2010
Docket: 10-8630-00CL

Counsel: Richard B. Jones, Douglas Turner, Q.C. for Noteholders / Moving Party
J.H. Grout, S. Aggarwal for Monitor
Pamela Foy for Ontario Securities Commission
Frank Lamie for Nelson Financial Group Ltd.
Robert Benjamin Mills, Harold Van Winssen for Respondents, Clifford Styles, Jackie Styles, Play Investments Ltd.
Michael Beardsley, Respondent for himself
Clifford Holland, Respondent for himself
Arnold Bolliger, Respondent for himself
John McVey, Respondent for himself
Joan Frederick, Respondent for herself
Rakesh Sharma, Respondent for himself
Larry Debono, Respondent for himself
Keith McClear, Respondent for himself

Subject: Corporate and Commercial; Insolvency

MOTION by promissory note holders to determine whether certain claims of preferred shareholders constitute equity claims for purposes of *Companies' Creditors Arrangement Act*.

***Pepall J.*:**

1 This motion addresses the legal characterization of claims of holders of preferred shares in the capital stock of the applicant, Nelson Financial Group Ltd. ("Nelson"). The issue before me is to determine whether such claims constitute equity claims for the purposes of sections 6(8) and 22.1 of the *Companies' Creditors Arrangement Act* ("*CCAA*").

Background Facts

2 Nelson was incorporated pursuant to the *Business Corporations Act* of Ontario in September, 1990. Nelson raised money from investors and then used those funds to extend credit to customers in vendor assisted financing programmes. It raised money in two ways. It issued promissory notes bearing a rate of return of 12% per annum and also issued preference shares typically with an annual dividend of 10%.[1] The funds were then lent out at significantly higher rates of interest.

3 The Monitor reported that Nelson placed ads in selected publications. The ads outlined the nature of the various investment options. Term sheets for the promissory notes or the preferred shares were then provided to the investors by Nelson together with an outline of the proposed tax treatment for the investment. No funds have been raised from investors since January 29, 2010.

(a) Noteholders

4 As of the date of the *CCAA* filing on March 23, 2010, Nelson had issued 685 promissory notes in the aggregate principal amount of $36,583,422.89. The notes are held by approximately 321 people.

(b) Preferred Shareholders

5 Nelson was authorized to issue two classes of common shares and 2,800,000 Series A preferred shares and 2,000,000 Series B preferred shares, each with a stated capital of $25.00. The president and sole director of Nelson, Marc Boutet, is the owner of all of the issued and outstanding common shares. By July 31, 2007, Nelson had issued to investors 176,675 Series A preferred shares for an aggregate consideration of $4,416,925. During the subsequent fiscal year ended July 31, 2008, Nelson issued a further 172,545 Series A preferred shares and 27,080 Series B preferred shares. These shares were issued for an aggregate consideration of $4,672,383 net of share issue costs.

6 The preferred shares are non-voting and take priority over the common shares. The company's articles of amendment provide that the preferred shareholders are entitled to receive fixed preferential cumulative cash dividends at the rate of 10% per annum. Nelson had the unilateral right to redeem the shares on payment of the purchase price plus accrued

dividends. At least one investor negotiated a right of redemption. Two redemption requests were outstanding as of the *CCAA* filing date.

7 As of the *CCAA* filing date of March 23, 2010, Nelson had issued and outstanding 585,916.6 Series A and Series B preferred shares with an aggregate stated capital of $14,647,914. The preferred shares are held by approximately 82 people. As of the date of filing of these *CCAA* proceedings, there were approximately $53,632 of declared but unpaid dividends outstanding with respect to the preferred shares and $73,652.51 of accumulated dividends.

8 Investors subscribing for preferred shares entered into subscription agreements described as term sheets. These were executed by the investor and by Nelson. Nelson issued share certificates to the investors and maintained a share register recording the name of each preferred shareholder and the number of shares held by each shareholder.

9 As reported by the Monitor, notwithstanding that Nelson issued two different series of preferred shares, the principal terms of the term sheets signed by the investors were almost identical and generally provided as follows:

• the issuer was Nelson;

• the par value was fixed at $25.00;

• the purpose was to finance Nelson's business operations;

• the dividend was 10% per annum, payable monthly, commencing one month after the investment was made;

• preferred shareholders were eligible for a dividend tax credit;

• Nelson issued annual T-3 slips on account of dividend income to the preferred shareholders;

• the preferred shares were non-voting (except where voting as a class was required), redeemable at the option of Nelson and ranked ahead of common shares; and

• dividends were cumulative and no dividends were to be paid on common shares if preferred share dividends were in arrears.

10 In addition, the Series B term sheet provided that the monthly dividend could be reinvested pursuant to a Dividend Reinvestment Plan ("DRIP").

11 The preferred shareholders were entered on the share register and received share certificates. They were treated as equity in the company's financial statements. Dividends were received by the preferred shareholders and they took the benefit of the advantageous tax treatment.

(c) Insolvency

12 Mr. Boutet knew that Nelson was insolvent since at least its financial year ended July 31, 2007. Nelson did not provide financial statements to any of the preferred shareholders prior to, or subsequent to, the making of the investment.

(d) Ontario Securities Commission

13 On May 12, 2010, the Ontario Securities Commission ("OSC") issued a Notice of Hearing and Statement of Allegations alleging that Nelson and its affiliate, Nelson Investment Group Ltd., and various officers and directors of those corporations committed breaches of the *Ontario Securities Act* in the course of selling preferred shares. The allegations include noncompliance with the prospectus requirements, the sale of shares in reliance upon exemptions that were inapplicable, the sale of shares to persons who were not accredited investors, and fraudulent and negligent misrepresentations made in the course of the sale of shares. The OSC hearing has been scheduled for the end of February, 2011.

(e) Legal Opinion

14 Based on the Monitor's review, the preferred shareholders were documented as equity on Nelson's books and records and financial statements. Pursuant to court order, the Monitor retained Stikeman Elliott LLP as independent counsel to provide an opinion on the characterization of the claims and potential claims of the preferred shareholders. The opinion concluded that the claims were equity claims. The Monitor posted the opinion on its website and also advised the preferred shareholders of the opinion and conclusions by letter. The opinion was not to constitute evidence, issue estoppel or res judicata with respect to any matters of fact or law referred to therein. The opinion, at least in part, informed Nelson's position which was supported by the Monitor, that independent counsel for the preferred shareholders was unwarranted in the circumstances.

(f) Development of Plan

15 The Monitor reported in its Eighth Report that a plan is in the process of being developed and that preferred shareholders would have their existing preference shares cancelled and would then be able to claim a tax loss on their investment or be given a new form of preference shares with rights to be determined.

Motion

16 The holders of promissory notes are represented by Representative Counsel appointed pursuant to my order of June 15, 2010. Representative Counsel wishes to have some clarity as to the characterization of the preferred shareholders' claims. Accordingly, Representative Counsel has brought a motion for an order that all claims and potential claims of the preferred shareholders against Nelson be classified as equity claims within the meaning of the *CCAA*. In addition, Representative Counsel requests that the unsecured creditors, which include the noteholders, be entitled to be paid in full before any claim of a preferred shareholder and that the preferred shareholders form a separate class that is not entitled to vote at any meeting of creditors. Nelson and the Monitor support the position of Representative Counsel. The OSC is unopposed.

17 On the return of the motion, some preferred shareholders were represented by counsel from Templeman Menninga LLP and some were self-represented. It was agreed that the letters and affidavits of preferred shareholders that were filed with the court would constitute their evidence. Oral submissions were made by legal counsel and by approximately eight individuals. They had many complaints. Their allegations against Nelson and Mr. Boutet range from theft, fraud, misrepresentation including promises that their funds would be secured, operation of a Ponzi scheme, breach of trust, dividend payments to some that exceeded the rate set forth in Nelson's articles, conversion of notes into preferred shares at a time when Nelson was insolvent, non-disclosure, absence of a prospectus or offering memorandum disclosure, oppression, violation of section 23(3) of the *OBCA* and of the *Securities Act* such that the issuance of the preferred shares was a nullity, and breach of fiduciary duties.

18 The stories described by the investors are most unfortunate. Many are seniors and pensioners who have invested their savings with Nelson. Some investors had notes that were rolled over and replaced with preference shares. Mr. McVey alleges that he made an original promissory note investment which was then converted arbitrarily and without his knowledge into preference shares. He alleges that the documents effecting the conversion did not contain his authentic signature.

19 Mr. Styles states that he and his company invested approximately $4.5 million in Nelson. He states that Mr. Boutet persuaded him to convert his promissory notes into preference shares by promising a 13.75% dividend rate, assuring him that the obligation of Nelson to repay would be treated the same or better than the promissory notes, and that they would have the same or a priority position to the promissory notes. He then received dividends at the 13.75% rate contrary to the 10% rate found in the company's articles. In addition, at the time of the conversion, Nelson was insolvent.

20 In brief, Mr. Styles submits that:

> (a) the investment transactions were void because there was no prospectus contrary to the provisions of the *Securities Act* and the Styles were not accredited investors; the preferred shares were issued contrary to section 23(3) of the *OBCA* in that Nelson was insolvent at the relevant time and as such, the issuance was a nullity; and the conduct of the company and its principal was oppressive contrary to section 248 of the *OBCA*; and that
>
> (b) the Styles' claim is in respect of an undisputed agreement relating to the conversion of their promissory notes into preferred shares which agreement is enforceable separate and apart from any claim relating to the preferred shares.

The Issue

21 Are any of the claims advanced by the preferred shareholders equity claims within section 2 of the *CCAA* such that they are to be placed in a separate class and are subordinated to the full recovery of all other creditors?

The Law

22 The relevant provisions of the *CCAA* are as follows.

Section 2 of the *CCAA* states:

> In this Act,
>
> "Claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;
>
> "Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others,
>
> > (a) a dividend or similar payment,
> >
> > (b) a return of capital,
> >
> > (c) a redemption or retraction obligation,
> >
> > (d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);"

"Equity Interest" means

(a) in the case of a corporation other than an income trust, a share in the corporation — or a warrant or option or another right to acquire a share in the corporation — other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust — or a warrant or option or another right to acquire a unit in the income trust — other than one that is derived from a convertible debt;

Section 6(8) states:

No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

Section 22.1 states:

Despite subsection 22(1) creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

23 Section 2 of the *Bankruptcy and Insolvency Act* ("*BIA*") which is referenced in section 2 of the *CCAA* provides that a claim provable includes any claim or liability provable in proceedings under the Act by a creditor. Creditor is then defined as a person having a claim provable as a claim under the Act.

24 Section 121(1) of the *BIA* describes claims provable. It states:

All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

25 Historically, the claims and rights of shareholders were not treated as provable claims and ranked after creditors of an insolvent corporation in a liquidation. As noted by Laskin J.A. in *Central Capital Corp., Re*[2], on the insolvency of a company, the claims of creditors have always ranked ahead of the claims of shareholders for the return of their

capital. This principle is premised on the notion that shareholders are understood to be higher risk participants who have chosen to tie their investment to the fortunes of the corporation. In contrast, creditors choose a lower level of exposure, the assumption being that they will rank ahead of shareholders in an insolvency. Put differently, amongst other things, equity investors bear the risk relating to the integrity and character of management.

26 This treatment also has been held to encompass fraudulent misrepresentation claims advanced by a shareholder seeking to recover his investment: *Blue Range Resource Corp., Re* [3] In that case, Romaine J. held that the alleged loss derived from and was inextricably intertwined with the shareholder interest. Similarly, in the United States, the Second Circuit Court of Appeal in *Matter of Stirling Homex Corp.* [4] concluded that shareholders, including those who had allegedly been defrauded, were subordinate to the general creditors when the company was insolvent. The Court stated that "the real party against which [the shareholders] are seeking relief is the body of general creditors of their corporation. Whatever relief may be granted to them in this case will reduce the percentage which the general creditors will ultimately realize upon their claims." *National Bank of Canada v. Merit Energy Ltd.* [5] and *EarthFirst Canada Inc., Re* [6] both treated claims relating to agreements that were collateral to equity claims as equity claims. These cases dealt with separate indemnification agreements and the issuance of flow through shares. The separate agreements and the ensuing claims were treated as part of one integrated transaction in respect of an equity interest. The case law has also recognized the complications and delay that would ensue if *CCAA* proceedings were mired in shareholder claims.

27 The amendments to the *CCAA* came into force on September 18, 2009. It is clear that the amendments incorporated the historical treatment of equity claims. The language of section 2 is clear and broad. Equity claim means a claim in respect of an equity interest and includes, amongst other things, a claim for rescission of a purchase or sale of an equity interest. Pursuant to sections 6(8) and 22.1, equity claims are rendered subordinate to those of creditors.

28 The Nelson filing took place after the amendments and therefore the new provisions apply to this case. Therefore, if the claims of the preferred shareholders are properly characterized as equity claims, the relief requested by Representative Counsel in his notice of motion should be granted.

29 Guidance on the appropriate approach to the issue of characterization was provided by the Ontario Court of Appeal in *Central Capital Corp., Re* [7]. Central Capital was insolvent and sought protection pursuant to the provisions of the *CCAA*. The appellants held preferred shares of Central Capital. The shares each contained a right of retraction, that is, a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. One

shareholder exercised his right of retraction and the other shareholder did not but both filed proofs of claim in the *CCAA* proceedings. In considering whether the two shareholders had provable debt claims, Laskin J.A. considered the substance of the relationship between the company and the shareholders. If the governing instrument contained features of both debt and equity, that is, it was hybrid in character, the court must determine the substance of the relationship between the company and the holder of the certificate. The Court examined the parties' intentions.

30 In *Central Capital*, Laskin J.A. looked to the share purchase agreements, the conditions attaching to the shares, the articles of incorporation and the treatment given to the shares in the company's financial statements to ascertain the parties' intentions and determined that the claims were equity and not debt claims.

31 In this case, there are characteristics that are suggestive of a debt claim and of an equity claim. That said, in my view, the preferred shareholders are, as their description implies, shareholders of Nelson and not creditors. In this regard, I note the following.

(a) Investors were given the option of investing in promissory notes or preference shares and opted to invest in shares. Had they taken promissory notes, they obviously would have been creditors. The preference shares carried many attractions including income tax advantages.

(b) The investors had the right to receive dividends, a well recognized right of a shareholder.

(c) The preference share conditions provided that on a liquidation, dissolution or winding up, the preferred shareholders ranked ahead of common shareholders. As in *Central Capital Corp.*, it is implicit that they therefore would rank behind creditors.

(d) Although I acknowledge that the preferred shareholders did not receive copies of the financial statements, nonetheless, the shares were treated as equity in Nelson's financial statements and in its books and records.

32 The substance of the arrangement between the preferred shareholders and Nelson was a relationship based on equity and not debt. Having said that, as I observed in *I. Waxman & Sons Ltd., Re* [8], there is support in the case law for the proposition that equity may become debt. For instance, in that case, I held that a judgment obtained at the suit of a shareholder constituted debt. An analysis of the nature of the claims is therefore required. If the claims fall within the parameters of section 2 of the *CCAA*, clearly they are to be treated as equity claims and not as debt claims.

33 In this case, in essence the claims of the preferred shareholders are for one or a combination of the following:

(a) declared but unpaid dividends;

(b) unperformed requests for redemption;

(c) compensatory damages for the loss resulting in the purchased preferred shares now being worthless and claimed to have been caused by the negligent or fraudulent misrepresentation of Nelson or of persons for whom Nelson is legally responsible; and

(d) payment of the amounts due upon the rescission or annulment of the purchase or subscription for preferred shares.

34 In my view, all of these claims fall within the ambit of section 2, are governed by sections 6(8) and 22.1 of the *CCAA*, and therefore do not constitute a claim provable for the purposes of the statute. The language of section 2 is clear and unambiguous and equity claims include "a claim that is in respect of an equity interest" and a claim for a dividend or similar payment and a claim for rescission. This encompasses the claims of all of the preferred shareholders including the Styles whose claim largely amounts to a request for rescission or is in respect of an equity interest. The case of *National Bank of Canada v Merit Energy Ltd.* [9] is applicable in regard to the latter. In substance, the Styles' claim is for an equity obligation. At a minimum, it is a claim in respect of an equity interest as described in section 2 of the CCAA. Parliament's intention is clear and the types of claims advanced in this case by the preferred shareholders are captured by the language of the amended statute. While some, and most notably Professor Janis Sarra [10], advocated a statutory amendment that provided for some judicial flexibility in cases involving damages arising from egregious conduct on the part of a debtor corporation and its officers, Parliament opted not to include such a provision. Sections 6(8) and 22.1 allow for little if any flexibility. That said, they do provide for greater certainty in the appropriate treatment to be accorded equity claims.

35 There are two possible exceptions. Mr. McVey claims that his promissory note should never have been converted into preference shares, the conversion was unauthorized and that the signatures on the term sheets are not his own. If Mr. McVey's evidence is accepted, his claim would be qua creditor and not preferred shareholder. Secondly, it is possible that monthly dividends that may have been lent to Nelson by Larry Debono constitute debt claims. The factual record on these two possible exceptions is incomplete. The Monitor is to investigate both scenarios, consider a resolution of same, and report back to the court on notice to any affected parties.

36 Additionally, the claims procedure will have to be amended. The Monitor should consider an appropriate approach and make a recommendation to the court to accommodate the needs of the stakeholders. The relief requested in the notice of motion is therefore granted subject to the two aforesaid possible exceptions.

Motion granted.

Footnotes

1 The Monitor is aware of six preferred shareholders with dividends that ranged from 10.5% to 13.75% per annum.

2 (1996), 38 C.B.R. (3d) 1 (Ont. C.A.).

3 (2000), 15 C.B.R. (4th) 169 (Alta. Q.B.).

4 (1978), 579 F.2d 206 (U.S. 2nd Cir. N.Y.).

5 2001 CarswellAlta 913 (Alta. Q.B.), aff'd 2002 CarswellAlta 23 (Alta. C.A.).

6 2009 CarswellAlta 1069 (Alta. Q.B.).

7 Supra, note 2.

8 2008 CarswellOnt 1245 (Ont. S.C.J. [Commercial List]).

9 Supra, note 5.

10 "From Subordination to Parity: An International Comparison of Equity Securities Law Claims in Insolvency Proceedings" (2007) 16 Int. Insolv. Re., 181.

TAB 2

1996 CarswellOnt 316
Ontario Court of Appeal

Central Capital Corp., Re

1996 CarswellOnt 316, [1996] O.J. No. 359, 132 D.L.R. (4th) 223, 26 B.L.R. (2d) 88, 27 O.R. (3d) 494, 38 C.B.R. (3d) 1, 61 A.C.W.S. (3d) 18, 88 O.A.C. 161

Re CENTRAL CAPITAL CORPORATION; Re Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

Re appeal from disallowance of claims of JAMES W. McCUTCHEON, CENTRAL GUARANTEE TRUST COMPANY, as trustee for Registered Retirement Savings Plan of JAMES W. McCUTCHEON and CONSOLIDATED S.Y.H. CORPORATION by PEAT MARWICK THORNE INC., Administrator of certain assets of CENTRAL CAPITAL CORPORATION

ROYAL BANK OF CANADA, BANCA COMMERCIALE ITALIANA OF CANADA, CREDIT LYONNAIS CANADA, DAI-ICHI KANGYO BANK (CANADA), PRUDENTIAL ASSURANCE COMPANY LIMITED, PRUDENTIAL GLOBAL FUNDING, INC., SANWA BANK CANADA, BANK OF TOKYO CANADA, TORONTO-DOMINION BANK, WESTDEUTSCHE LANDESBANK GIROZENTRALE, BACOB SAVINGS BANK s.c., BANCA NAZIONALE DEL LAVORO OF CANADA, BANCO DI ROMA (LONDON), COMMERZBANK INTERNATIONAL S.A., CREDIT COMMERCIAL DE FRANCE, CREDIT COMMUNAL DE BELGIQUE S.A., CREDIT SUISSE (LUXEMBOURG) S.A., DG BANK LUXEMBOURG S.A., KREDIETBANK NV (BELGIUM), NIPPON TRUST BANK LIMITED, OLFRN INVESTMENT (PANAMA) INC., PAUL REVERE LIFE INSURANCE, RBC FINANCE B.V., SCOR REINSURANCE COMPANY OF CANADA, SOCIÉTÉ GÉNÉRALE, BANK OF TOKYO, LTD., CHIBA BANK LTD., DAI-ICHI KANGYO BANK, LTD. (ATLANTA), HOKURIKU BANK LTD., JOROKU BANK LTD., KYOWA SAITAMA BANK (CHICAGO), LAURENTIAN BANK OF CANADA, LAURENTIAN GROUP CORPORATION AND IMPERIAL LIFE ASSURANCE COMPANY OF CANADA, LONG-TERM CREDIT BANK OF JAPAN, LTD., MARITIME LIFE ASSURANCE COMPANY, MITSUBISHI TRUST AND BANKING CORPORATION, SANWA BANK, LIMITED (LONDON), SHOKO CHUKIN BANK (NEW YORK) and TOHO BANK, LTD. v. CENTRAL CAPITAL CORPORATION

Finlayson, Weiler and Laskin JJ.A.

Heard: August 17, 1995

Judgment: February 7, 1996
Docket: Docs. CA C21479, C21477

Counsel: *Bryan Finlay, Q.C.*, and *John M. Buhlman*, for James W. McCutcheon and Central Guaranty Trust.
James H. Grout and *Anne Sonnen*, for Consolidated S.Y.H. Corporation.
Terence J. O'Sullivan and *Paul G. Macdonald*, for unsecured creditors of Central Capital Corporation.
Neil C. Saxe, for Peat Marwick Thorne Inc.

Subject: Corporate and Commercial; Insolvency

Appeals from judgment reported at (1995), 29 C.B.R. (3d) 33, 22 B.L.R. (2d) 210 (Ont. Gen. Div. [Commercial List]) dismissing appeals from denial of claims by administrator under *Companies' Creditors Arrangement Act* plan of reorganization.

***Finlayson J.A.* (dissenting):**

1 The appellant James W. McCutcheon and Central Guarantee Trust Company as Trustee for the Registered Retirement Savings Plan of James W. McCutcheon (hereinafter sometimes referred to collectively as "McCutcheon") and the appellant Consolidated S.Y.H. Corporation ("SYH") appeal from the order of The Honourable Madam Justice Feldman of the Ontario Court (General Division) dated January 9, 1995 [reported at 29 C.B.R. (3d) 33]. Feldman J. dismissed appeals from decisions dated January 20, 1993 and February 16, 1993 of the respondent Peat Marwick Thorne Inc., in its capacity as Interim Receiver, Manager and Administrator ("Administrator") of certain assets of Central Capital Corporation ("Central Capital"). The Administrator disallowed Proofs of Claim submitted by the appellants with respect to a Plan of Arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("*CCAA*"). Leave to appeal the order of Feldman J. was granted on March 17, 1995 by The Honourable Mr. Justice Houlden.

Overview of the Proceedings

2 These appeals arise out of the insolvency of Central Capital which in and prior to December 1991 defaulted under its obligations to various unsecured lenders, note holders and subordinated debt holders. In early December of 1991, Central Capital advised its creditors that, pending implementation of new financial arrangements, it had decided to discontinue payment of all interest and principal due under outstanding loans, with the exception of indebtedness due under secured notes issued to The Royal Trust Company. In an Agreed Statement of Facts, which was prepared by the parties for the purposes of appeals from the disallowances of the Administrator, it was agreed that at all material times since in or

prior to December 1991, Central Capital was insolvent. It had a total unsecured debt of $1,577,359,000 and, among other things:

(a) it was unable to pay its liabilities as they became due; and

(b) the realizable value of its assets was less than the aggregate of its liabilities.

3 By Notice of Application issued June 12, 1992, thirty-nine of the creditors commenced an application pursuant to the *CCAA* for an order declaring the following: that Central Capital was a debtor company to which the *CCAA* applied; that Peat Marwick Thorne Inc. be appointed Administrator of the property, assets and undertaking of Central Capital; that a stay of proceedings against Central Capital, except with leave of the court, be granted and; that the applicants be authorized and permitted to file a plan of compromise or arrangement under the *CCAA*.

4 By order of Houlden J. made June 15, 1992, Central Capital was declared to be a company to which the *CCAA* applied and all proceedings against Central Capital were stayed. By further order of Houlden J. made July 9, 1992, it was provided, among other things, that:

(a) Peat Marwick Thorne Inc. was appointed Administrator, Interim Receiver and Manager of such of the undertaking, property and assets of Central Capital as necessary for the pur pose of effecting the transaction described in the order pursuant to which specified significant assets of Central Capital would be transferred to a newly incorporated company called Canadian Insurance Group Limited ("CIGL");

(b) the Administrator was authorized to enter into and carry out a Subscription and Escrow Agreement with creditors of Central Capital pursuant to which creditors of Central Capital would be entitled to elect to exchange a portion of the indebtedness owing to them by Central Capital for shares and debentures to be issued by CIGL;

(c) the Administrator was authorized and directed to supervise the calling for claims of creditors of Central Capital who elected to exchange a portion of the indebtedness from Central Capital for shares and debentures to be issued by CIGL as aforesaid; and

(d) Central Capital was authorized and permitted to file with the court a formal plan of compromise or arrangement with Central Capital's secured and unsecured creditors and shareholders in accordance with the *CCAA* and the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*"), which would provide for the restructuring and reorganization of the debt and equity of Central Capital in the manner set out in the said order.

5 According to the Agreed Statement of Facts, the order of Houlden J. was made without prejudice to the rights of the appellants to assert claims as creditors in the CIGL transaction. Pursuant to the terms of the July 9, 1992 order, all claims of creditors of Central Capital who wished to participate in CIGL were required to be submitted to the Administrator by September 8, 1992, or such other date fixed by the court. The Administrator received claims from various persons who wished to participate, including the claims submitted by the appellants herein.

6 The Administrator disallowed the claims of McCutcheon and SYH by Notices of Disallowance dated January 20, 1993 and February 16, 1993 in which various reasons were cited as to why the appellants did not qualify as creditors. The effect of this disallowance was that McCutcheon and SYH could participate only as shareholders in the plan of compromise and arrangement under the *CCAA* to be put forward by Central Capital. In dismissing the appeals from this disallowance, Feldman J. found that the appellants were not creditors because they did not have a claim provable under the *Bankruptcy Act* (Canada), R.S.C. 1985, c. B-3 ("*Bankruptcy Act*").

Issue

7 The Agreed Statements of Facts set out the issue in the appeal in the following language:

> Do the appellants, or any of them, have claims provable against CCC [Central Capital] within the meaning of the *Bankruptcy Act (Canada)*, as amended as of the date of the Restated Subscription and Escrow Agreement? If the appellants, or any of them, have provable claims, then the proof of claim of any appellant that has a claim provable is to be allowed as filed and the appeal from the disallowance allowed, and the appellants, or any of them, whose claim is allowed, are to participate in the Plan of Arrangement of Central Capital as a senior creditor.

8 The determination of this issue was deferred by Houlden J.'s order of October 27th, 1992. He ordered therein that preferred shareholders who had filed claims against Central Capital as creditors were not permitted to vote at the meeting of creditors called to consider the Plan of Arrangement "... but such is without prejudice to the rights of those claimants to prosecute their claims as filed". The last paragraph in the order ended:

> For greater certainty, the validity of any claim filed by a preferred shareholder shall not be affected by the terms of this paragraph.

Overview of the Restructuring of Central Capital

9 The order of Houlden J. of July 9, 1992 directed the restructuring of Central Capital under the *aegis* of the court. The order, and others that would follow, contemplated that the restructuring would take place in two stages. The first stage involved the transfer to the Administrator of certain major assets of Central Capital to a company to be incorporated called Central Insurance Group Limited (CIGL). This company is frequently referred to in the documentation and the reasons of Feldman J. as "Newco". CIGL was then to be owned by those Central Capital creditors who chose to participate in the reorganization by accepting a reduction in their debts due from Central Capital and exchanging this reduced indebtedness for debentures in CIGL. Subscription for debentures by this means additionally entitled the creditors to subscribe for shares in CIGL. Our understanding from counsel is that the assets transferred to CIGL included the assets acquired by Central Capital from the appellant in purchase agreements described later in these reasons.

10 The court approved a Subscription and Escrow Agreement setting out this arrangement. In order to participate, the creditors were required to file with the Administrator of Proof of Claim in the prescribed form along with other documents confirming the creditor's intention to reduce its claim against Central Capital and to subscribe for debentures and shares of CIGL. Claims were to be based on Central Capital's indebtedness to creditors as of June 15, 1992, the date of the court-ordered stay of proceedings. This transaction was completed on October 1, 1992 and resulted in CIGL being owned by the creditors of Central Capital in exchange for a reduction in Central Capital's unsecured debt in the amount of $603,000.000.

11 The second stage of the restructuring involved a Plan of Arrangement under the *CCAA*. That plan as put forward by Central Capital recognized four classes of creditors, only one of which, namely that of "Senior Creditors", could apply to the appellants. The Plan of Arrangement, as amended, provided that Central Capital would issue to Senior Creditors *pro rata* on the basis of their senior claims of secured promissory notes in the aggregate principal amount of $20,000,000 of secured debt, which were to be known as first secured notes. A similar arrangement was made for the issuance of $1,000,000 of second secured promissory notes to subordinated creditors. Senior and subordinated creditors included any creditor whose claim had been allowed under the CIGL claims procedure in the first stage, to the extent of that creditor's reduced claim.

12 The Plan of Arrangement also called for the creation of a new class of shares in Central Capital to be called the Central New Common Shares. Central Capital would issue to the above Senior and Subordinated Creditors ninety percent of the new share capital of Central Capital in extinguishment of the balance of their debt. The Central Capital shareholders of all classes would have their existing shares converted into the remaining ten percent of the Central New Common Shares. All of the existing preferred and common shares would be cancelled upon implementation of the plan.

13 The amended Plan of Arrangement was ultimately voted on and approved by all four classes of creditors of Central Capital. On December 18, 1992, Houlden J. sanctioned this plan of arrangement under the *CCAA*. He authorized and directed Central Capital to apply for Articles of Reorganization pursuant to s. 191 of the *CBCA*, so as to authorize the creation of the Central New Common Shares for implementation of the amended Plan of Arrangement. He also lifted the stays of proceedings affecting Central Capital and its ability to carry on business as of January 1, 1993.

14 The effect of the amended Plan of Arrangement after approval was that all remaining debts and obligations owed by Central Capital to its creditors on or before June 15, 1992 were extinguished and all outstanding and unissued shares of any kind in Central Capital were cancelled and replaced by Central New Common Shares. Central Capital was then free to carry on business. It was no longer insolvent.

Facts as They Relate to the Claim of McCutcheon

15 By a Share Purchase Agreement dated June 15, 1987 between Central Capital and Gormley Investments Limited ("Gormley") and Heathley Investments Limited ("Heathley"), Central Capital agreed to purchase all Class "B" Voting Shares of Canadian General Securities Limited ("CGS") that were owned by Gormley and Heathley. James W. McCutcheon and his brother, who were the sole shareholders of Gormley, represented to Central Capital that CGS owned substantially all of the shares of Canadian Insurance Sales Limited, which in turn owned substantially all of the shares in a number of operating insurance, credit and trust companies. The consideration for the purchase of the CGS shares was $575 per share. The vendors were to be paid $400 per share in cash on closing and were to receive seven Series B Senior Preferred Shares of Central Capital. These shares contained a retraction clause entitling the holder to retract each preferred share on July 1, 1992 for $25. Failing issuance of the shares by Central Capital, the vendors were to receive an additional $175 for each CGS share. The Share Purchase Agreement and later the Articles of Central Capital further provided that the holders of Series B Senior Preferred Shares were entitled to receive dividends as and when declared by the directors of Central Capital out of monies of the corporation properly applicable to the payment of dividends and in the amount of $1.90625 per share per annum (being 7 5/8% per annum on the stated capital of $25 per share) payable in equal quarterly payments. No dividends were in fact declared.

16 The Certificate of Amendment for Central Capital dated July 30, 1987, and the Articles of Amendment setting out the provisions attaching to the Series B Senior Preferred Shares contain all the terms and conditions governing the said shares. I am setting out below a description of those that are relevant to this appeal.

17 Pursuant to Article 4.1 of the Senior Series B Provisions, each holder of Series B Senior Preferred Shares was entitled, subject to and upon compliance with the provisions of Article 4, to require Central Capital to redeem all or any part of the Series B Senior Preferred Shares registered in the name of that holder on July 1, 1992 at a price equal to $25 per share, plus all accrued and unpaid dividends thereon, calculated to but excluding the Retraction Date.

18 Article 4.2 of the Senior Series B Provisions sets out the procedure for retraction of the shares. Article 4.3 of the Senior Series B Provisions provides that if the redemption by Central Capital of all of the Series B Senior Preferred Shares required to be redeemed on the Retraction Date would be contrary to applicable law or the rights, privileges, restrictions and conditions attaching to any shares of Central Capital ranking prior to Series B Senior Preferred Shares, then Central Capital shall redeem only the maximum number of Series B Senior Preferred Shares which it determined was permissible to redeem at that time. Article 4.3 provides the mechanism for a *pro rata* redemption from each holder of the tendered Series B Senior Preferred Shares and redemption of the tendered Series B Senior Preferred Shares by Central Capital at further dates.

19 Article 4.4(a) provides that subject to Section 4.4(b), the election of any holder to require Central Capital to redeem any Series B Senior Preferred Shares shall be irrevocable upon receipt by the transfer agent of the Certificates for the shares to be redeemed and the signification of election of the holder of the Series B Senior Preferred Shares.

20 Article 4.4(b) of the Senior Series B Provisions provides that if the retraction price is not paid by Central Capital, Central Capital shall forthwith notify each holder of the Series B Senior Preferred Shares who has not received payment for his deposited shares of the holder's right to require Central Capital to return all (but not less than all) of the holder's deposited Share Certificates and the holder's rights under Article 4.3 outlined above.

21 Article 4.5 of the Senior Series B Provisions provides that the inability of Central Capital to effect a redemption shall not affect or limit the obligation of Central Capital to pay any dividends accrued or accruing on the Series B Senior Preferred Shares from time to time not redeemed and remaining outstanding.

22 Article 7 of the Series Senior B Provisions provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets of Central Capital among its shareholders for the purposes of winding up its affairs, the holders of the Series B Senior Preferred Shares shall be entitled to receive, from the assets of Central Capital, $25 per Series B Senior Preferred Shares, plus all accrued and unpaid dividends thereon, to be paid prior to payment to junior ranking shareholders. Upon payment of such amounts, the holders of the Series B Senior Preferred Shares shall not be entitled to share in any further distribution of assets of Central Capital.

23 A Notice of Retraction Privilege was sent by Central Capital to the holders of Series B Senior Preferred Shares with a cover letter dated April 23, 1992. The letter stated, among other things, that Central Capital would not redeem any shares because the redemption of such shares would be contrary to applicable law in the context of Central Capital's then current financial situation. McCutcheon and Central Guaranty Trust deposited for redemption 406,800 and 26,000 Series B Senior Preferred Shares, respectively, in accordance with the Senior Series B Provisions and the Notice of Retraction Privilege. The shares were deposited on May 28, 1992, with Montreal Trust Company of Canada, pursuant to the Notice of Retraction Privilege. The shares were properly tendered for redemption in the manner and within the time required by Central Capital's Articles of Amendment.

24 Central Capital did not pay the redemption price on July 1, 1992 and on July 20, 1992 it notified each holder of Series B Senior Preferred Shares of its right to require Central Capital to return all of the holder's deposited Share Certificates as required by Article 4.4(b) of the Senior Series B Provisions. McCutcheon and Central Guaranty Trust did not exercise that right.

25 Pursuant to the terms of Houlden J.'s order of July 9, 1992 directing the restructuring of Central Capital, McCutcheon submitted to the Administrator, as a creditor of Central Capital, Proofs of Claim dated September 3, 1992 and September 4, 1992, respectively. McCutcheon claimed the amount of $10,913,593.69 in respect of his Series B Senior Preferred Shares tendered for redemption. Central Guaranty Trust claimed the amount of $697,526.68 in respect of its tendered 26,000 Series B Senior Preferred Shares. McCutcheon also executed and submitted the Restated Subscription and Escrow Agreement and other documents electing to participate in CIGL. These claims were completed and submitted in the prescribed form and within the time required by Houlden J.'s order.

26 As was previously noted, these claims were disallowed by the Administrator. The substance of the Administrator's reasons for disallowance was that the ability of Central Capital to redeem these preference shares is restricted by the provisions of the *CBCA* and it would be contrary to applicable law to redeem the shares in the context of Central Capital's financial position. The relevant provision of the *CBCA* provides:

> **Redemption of shares.**
>
> *36.* (1) Notwithstanding subsection 34(2) or 35(3), but subject to subsection (2) and to its articles, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.
>
> **Limitation.**

(2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that

(*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or

(*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of

(i) its liabilities, and

(ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

Evidently, the Administrator equated redemption by the corporation with the right of retraction by the preferred shareholder. It agreed with Central Capital's position that once it became insolvent in December of 1991, Central Capital no longer had the ability to redeem the shares tendered for retraction and thus McCutcheon was restricted to exercising what rights it might have as a shareholder.

Facts as They Relate to the Claim of SYH

27 Pursuant to an Agreement of Purchase and Sale made as of June 30, 1989, as amended, Scottish & York Holdings Limited (the predecessor to SYH) sold to Central Capital the shares of Central Canada Insurance Services Limited, Eaton Insurance Company, Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada (collectively the "Insurance Companies"), except for certain preference shares held by the directors of those corporations. In consideration of this transfer, Central Capital issued to Scottish & York Holdings Limited 60,116,000 Series A Junior Preferred Shares and 9,618,560 Series B Junior Preferred Shares.

28 The Articles of Central Capital provided that it would pay on each dividend payment date prior to the fifth anniversary of this issue, as and when declared by the directors out of the assets of the corporation properly applicable to the payment of dividends, a dividend of $.08 for each outstanding Series A Junior Preferred Share. The dividend was payable quarterly by the issuance of .02 Series Junior Preferred Shares for every outstanding Series A Junior Preferred Share. No dividends were in fact declared.

29 The Articles also provided that Central Capital was obligated to retract the Series A Junior Preferred Shares and Series B Junior Preferred Shares, at the option of the holders of those shares, on the fifth anniversary of their issuance. The retraction price was $1.00 per

share plus all accrued and unpaid dividends. Payment of the retraction price of these shares by Central Capital was subject to the provisions of the *CBCA*, which governs the affairs of Central Capital. For the purposes of this appeal, I believe that we can treat the balance of the provisions relating to these preferred shares as being the same as those governing the McCutcheon Series B Senior Preferred Shares.

30 Given that the operative date for proving claims against Central Capital was June 15, 1992, the retraction date governing the preferred shares of SYH was some two years removed. Notwithstanding, on September 8, 1992 SYH executed and delivered to the Administrator a Proof of Claim, a Counterpart of the Restated Subscription and Escrow Agreement, an initial Share Subscription and an Instrument of Claims Reduction Form, all in the prescribed form and within the time required. The claim was that SYH was holding or entitled to hold the following shares of Central Capital:

(a) 60,116,000 Junior Preferred Series A shares;

(b) 9,618,560 Junior Preferred Series B shares;

(c) 4,611,095 Junior Preferred Series B shares accrued to June 15th, 1992 but not yet issued to SYH;

for a total of 74,345,655 shares, each having a retraction value of $1.00. However, because of some adjustments in favour of Central Capital to the purchase price of the shares sold by SYH to Central Capital under the June 30, 1989 Agreement of Purchase and Sale, the net claim as of June 15, 1992 was reduced from $74,345,655 to $72,388,836.

31 By Notice of Disallowance dated January 20, 1993, the Administrator disallowed the claim by SYH to subscribe for debentures and common shares to be issued by CIGL. The reasons for the disallowance are similar to those provided for disallowing the claims of McCutcheon. The Administrator found that SYH's right to require Central Capital to retract the Series A and B Junior Preferred Shares only arose on the expiry of the fifth anniversary of their issuance and that Central Capital was precluded from retracting those shares by virtue of its insolvency and the provisions of the *CBCA*. Hence SYH, like McCutcheon, was limited to exercising what other rights it might have as a shareholder.

Analysis

32 Although the factual groundwork is necessary for putting in perspective the sole issue before the court, the final question confronting us is a narrow one. Did the retraction clauses in the appellants' shares create a debt owed by Central Canada as of June 15, 1992 within the meaning of the *Bankruptcy Act*? I think that they did.

33 It is agreed that the operative section of the *Bankruptcy Act* is s. 121(1). It reads as follows:

> *121.*(1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation in curred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

There was no bankruptcy in this case and thus the relevant date was agreed to be June 15, 1992. The obligations of Central Capital to the appellants were incurred before that date, and so the only question becomes whether the obligations created a debt between the appellants and Central Capital.

34 What then is a debt? All the parties turn to *Black's Law Dictionary*, quoting different editions. The following is from the Sixth Edition (1990), at p. 403:

> **Debt.**
>
> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only the obligation of debtor to pay but right of creditor to receive and enforce payment. ...
>
> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future.

35 The above is consistent with what is defined as a debt by *Jowitt's Dictionary of English Law*, 2nd ed. (1977), at p. 562:

> A debt exists when a certain sum of money is owing from one person (the debtor) to another (the creditor). Hence "debt" is properly opposed to unliquidated damages; to liability, when used in the sense of an inchoate or contingent debt; and to certain obligations not enforceable by ordinary process. "Debt" denotes not only the obligation of the debtor to pay, but also the right of the creditor to receive and enforce payment.

And finally, *The Shorter Oxford Dictionary*, 3rd ed. (1973), at p. 497:

> **Debt**
>
> *1.* That which is owed or due; anything (as money, goods or service) which one person is under obligation to pay or render to another.
>
> *2.* A liability to pay or render something; the being under such liability.

36 I have no difficulty in finding that the claims of the appellants in the case under appeal fall within all of the above definitions. As will be discussed herein, concern was expressed in this case over whether or not the appellants as creditors were entitled to "receive and enforce payment" on the "debt" because of the insolvency of Central Capital on June 15, 1992. I will deal with the specific arguments relating to the effect of insolvency on this particular indebtedness in due course, but for the moment I am content to observe that the above definitions contemplate only that the creditor's right to recover is the reciprocal of the debtor's obligation to pay. For every debtor there must be a creditor. There may be cases where it is difficult to identify the person who in law may receive and enforce payment, but this is not such a one.

37 With great respect to the judge of first instance and to the submissions of counsel for the unsecured creditors, I believe that the fundamental error that has been made in these proceedings arises from the conception that the preferred shares in question can either be debt instruments or equity participation instruments, but they cannot have the attributes of both. Feldman J. had this to say at p. 48 of her judgment:

> Although the right of retraction at the option of the preferred shareholder may be less common than the usual right of the company to redeem at its option, that right is one of the incidents or provisions attaching to the preferred shares, but does not change the nature of those shares from equity to debt. The parties have characterized the transaction as a share transaction. The court would require strong evidence that they did not intend that characterization in order to hold that they rather intended a loan.
>
> In my view, this case turns on whether the right of retraction itself creates a debt on the date the company becomes obligated to redeem even if it cannot actually redeem by payment on that date, or a contingent future debt on the same analysis, not on whether the preferred shares themselves with the right of retraction are actually debt documents.
>
> Because the preferred shares remain in place as shares until the actual redemption, the appellants are not creditors and have no claim provable under the *Bankruptcy Act* (Canada), and the appeals are therefore dismissed.

38 As I read these reasons, the learned judge is in effect stating that these instruments are preferred shares in the corporation because the parties have so described them. In the first place, I do not think that describing the documents as preferred shares is conclusive as to what instrument the parties thought they were creating. In the second place, it is not what the parties call the documents that is determinative of their identity, but rather it is what the facts require the court to call them. The character of the instrument is revealed by the language creating it and the circumstances of its creation. Although these instrument may "remain in place as shares" until they are actually redeemed, they also contain a specific promise to pay at

a specified date. This is the language of debt. I cannot accept the proposition that a corporate share certificate cannot create a corporate debt in addition to the certificate holder's rights as a shareholder.

39 The rules relating to the competing rights of shareholders and creditors of an insolvent corporation have become so regulated by governmental action that one can readily lose sight of the common law basis for making a distinction. To understand the difference in treatment, we must re-examine what a share of a corporation represents. Initially, a share is issued by the corporation to raise share capital. The price of the share is money or the promise of money. Accordingly, an individual share is one of a number of separate but integral parts of the authorized capital of a corporation. Even though it is the shareholders who contribute to the capital of the corporation, the capital remains the property of the corporation. The shareholders, however, as owners of the shares of capital, effectively control the corporation. They have the responsibility of managing its affairs through their control over the board of directors and in popular terminology are considered to be the owners of the corporation. However, the corporation is a separate entity in law, and if in the course of carrying out its business it incurs debts to third parties, those debts are those of the corporation. A corporation is an intangible and its capital therefore represents its substance to third parties having business dealings with the corporation. A preferred share is simply a share of a class of issued shares which contains a preference over other classes of shares, whether preferred or common: see Sutherland, *Fraser and Stewart on Company Law of Canada*, 6th ed. (1993), at pp. 157 and 195 for further discussion.

40 The rights of shareholders are conveniently summarized by R.M. Bryden in his chapter, "The Law of Dividends", contained in Ziegel ed., *Studies in Canadian Company Law* (1967), at p. 270:

> The purchaser of a share in a business corporation acquires three basic rights: he is entitled to vote at shareholders' meetings; he is entitled to share in the profits of the company when these are declared as dividends in respect of the shares of the class of which his share forms a part, and he is entitled, upon the winding-up of the corporation, to participate in the distribution of the assets of the company that remain after creditors are paid. A fourth right which should be noted is the right to transfer ownership in his share, whereby the owner for the time being may realize upon the increase in value of the company's assets, or its favourable prospects, by selling his share at a price reflecting the buyer's estimation of the value of the rights he will acquire. Unless the shareholder chooses to sell his share, he can realize a return upon his investment only through receipt of dividends or by the return of his capital upon an authorized reduction of capital or winding up.

41 Shareholders are variously characterized as entrepreneurs, investors or risktakers and as such they have the opportunities of benefitting from the successes of the corporation and suffering from its failures. While the corporation is an operating entity, the shareholders receive their rewards, if they are any, through the payment of dividends declared from time to time by the board of directors. While the source of these dividends is not restricted to surplus funds, the result of the payment of the dividend must not result in a return of capital to the shareholders. The classic justification for this rule was stated by Sir George Jessel, Master of the Rolls in *Re Exchange Banking Co.; Flitcroft's Case* (1882), 21 Ch. D. 519 (C.A.), at 533-4:

> The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor ... gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders. ...

42 Creditors, on the other hand, do not have an ownership or equity interest in the corporation. They are third parties who have loaned money or otherwise advanced credit to the corporation. They look to the company for payment in accordance with the terms of the contract creating the indebtedness. They are also restricted in their recovery to the amounts stipulated in the terms of indebtedness. They are entitled to payment regardless of the financial circumstances of the debtor corporation and accordingly are not restricted to receiving payment of the debt from surplus. They can be paid out of assets or through the creation of further indebtedness. It is immaterial how the corporation records this indebtedness in its internal books. In some circumstances the indebtedness could properly reflect the acquisition of property from a creditor as a capital asset. This does not, however, convert the creditor into an investor. The vendor of the property remains a creditor and retains priority over shareholders in the event of a bankruptcy or insolvency.

43 In my view, the reasons under appeal do not reflect a sensitivity to the circumstances which gave rise to the issuance of the preference shares. The shares were not issued by Central Capital to the general public in order to raise capital and do not represent an investment by the public in the capital of the corporation. They were issued to specific persons as payment for the acquisition of specified assets. While the corporation was authorized by its Articles of Incorporation to issue preferred shares generally, the shares issued to the appellants were structured to meet the requirements of the appellants as vendors of the controlling interest in the operating companies that Central Capital was acquiring. In my view, these preference shares are the equivalent of vendor shares in that the appellants received them in exchange for the transfer of assets to Central Capital.

44 In the case of McCutcheon, the retraction provision in the preferred shares represented only partial payment of an agreed value for the assets, but in the case of SYH, they represented the full value. In both cases, the agreed value as reflected in the retraction price was guaranteed by Central Capital to be retractable at a fixed price at a predetermined date. By postponing the obligation to pay the purchase price in this way, Central Capital was using the retraction provisions of the preference shares as a vehicle for the financing of its expanding asset base. The appellants, for their part, deferred the realization of the purchase price of their assets to the agreed dates and thereby extended credit to the corporation. In return for extending credit for some or all of the selling price, the appellants agreed to receive dividends calculated in advance but payable as and when declared by the board of directors.

45 Thus, in looking at the substance of the transaction that led to the issuance of the preference shares, it appears to me that the retraction clauses were promises by Central Capital to pay fixed amounts on definite dates to the appellants. They evidenced a debt to the appellants. The fact that the appellants as holders of the preference shares had rights as shareholders in the corporation up to the time when the retraction clauses were exercisable did not affect their right to enforce payment of the retraction price when it became due.

46 The validity of an analysis directed to the substance of the transaction is supported by *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558, a judgment of the Supreme Court of Canada delivered by Iacobucci J. The case involved a number of corporations constituting a support group which entered into an arrangement to provide emergency financial assistance to Canadian Commercial Bank ("CCB"). On the ultimate failure of the bank, the issue arose as to whether the monies advanced to CCB under this support arrangement were in the nature of a loan or in the nature of a capital investment. I find instructive to our situation Iacobucci J.'s observation at pp. 590-1:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and

every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplemen tary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement. [Emphasis in original.]

47 I have no difficulty in finding that the appellants' preferred shares with their retraction clauses are of "a hybrid nature, combining elements of both debt and equity". As to the equity component, the appellants are shareholders prior to exercising their retraction rights in that they have the right to vote in certain circumstances and have a right to receive dividends when and if they are declared by the board of directors. The debt component is more significant however. The shares were not issued to investors, but to vendors of property. The vendors were entitled to receive a fixed sum at a specified time in payment therefor. Pending payment, the vendors were entitled to receive dividends which were the equivalent of interest on the unpaid balance.

48 I can think of no reason why the holders of these preferred shares should not be treated as both shareholders and creditors. It does not concern me that these appellants act as shareholders before their retraction rights are exercisable. Nor do I see any hardship to other creditors of Central Capital arising from the ability of these appellants to claim as creditors in the restructuring of the company given that the appellants are unpaid with respect to substantial assets sold to the corporation and now transferred on the restructuring to GIGL.

49 Much was made in argument of the fact that the retraction amounts could not be paid on the retraction dates. In the case of McCutcheon, the corporation was insolvent and subject to court administration on the due date of July 1, 1992. In the case of SYH, the retraction date did not arrive before the reorganization was complete.

50 The narrow issue of the effect of insolvency on a debt has been dealt with by the British Columbia Court of Appeal in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1. In this case, the appellants were one-time members of three co-operative associations. The rules of the co-operatives permitted a member to withdraw upon written notice to the board of directors to that effect. The member was entitled to elect to have his shares redeemed either in equal instalments over five years or in one payment with interest at the end of five years. In April of 1987, the superintendent of co-operatives, under the authority of the *Cooperative Association Act*, R.S.B.C. 1979, c. 66, suspended the co-operatives' right to redeem their shares until their financial situation was no longer impaired. The three co-operatives subsequently went bankrupt and a two-fold issue came before the bankruptcy

court: (1) whether those members whose notices of withdrawal had been accepted by the board of directors but who had not yet received the value of the shares were entitled to rank as unsecured creditors, and (2) whether those who had delivered notices that had not been accepted were to be treated as unsecured creditors. The court of first instance found that the members were shareholders and answered both questions in the negative. That judge was reversed on appeal with the majority of the court deciding that the answer to both questions was yes. Hutcheon J.A. for the majority stated at p. 13:

> I shall use Mr. Neels [a co-operative member] as my example. According to R. 3.06 he ceased to be a shareholder in May 1983. In May 1984 the Agricultural Co-operative owed him the first of five payments, or $686.40. I know of no principle of law that would support the proposition that Neels could not sue for that amount if the Agricultural Co-operative failed to pay in May 1984. Of course, the superintendent of co-operatives has power under s. 15(2) to suspend payments if, in his opinion, the financial position of the co-operative was impaired. Subject to that power, the position of Neels and the Agricultural Co-operative would be that of ordinary creditor and debtor. In my opinion, the order made by the judge cannot be sustained on the first ground.

From this case, I extract the proposition that the fact of an insolvency, whether declared or not, does not change the nature of the relationship between debtor and creditor. It continues notwithstanding the inability of the debtor to pay or the creditor to collect.

51 It appears to me, with deference, that the issue of the effect of Central Capital's insolvency on the character of the retraction payments is something of a red herring. The contest in this appeal is between those who are conceded to be unsecured creditors and those whose claim to such status is contested. In both cases, any right to payment was suspended by Central Capital's announcement in December of 1991 that it was insolvent and that it had suspended all payments of principal and interest to unsecured creditors. This course of action was not freely chosen but was required by law. Any payments to creditors after the date of insolvency would be voidable at the instance of creditors on the basis that they were fraudulent preferences. In addition to ss. 95 and 96 of the *Bankruptcy Act* dealing with fraudulent preferences generally, there is provincial legislation in the form of the *Fraudulent Conveyances Act*, R.S.O. 1990, c. F.29, and the *Assignments and Preferences Act*, R.S.O. 1990, c. A.33, that would be applicable. Counsel for the unsecured creditors maintains that the right to redeem shares, including preference shares was postponed by s. 36(2) of the *CBCA, supra*. I am not certain that s. 36(2) applies to the retraction provisions of the appellants' preference shares as opposed to the redemption privileges of Central Capital, but in my opinion the point is irrelevant to this appeal. Once Central Capital acknowledged its insolvency, it could neither redeem its shares nor honour its retraction obligations. The whole purpose for the creditors applying to the court for a stay of Central Capital's obligations, including those of the acknowledged unsecured creditors, was to arrange for a scheme of

payments to all creditors that could not be subject to attack as preferences. There is no suggestion on the evidence before us that the claims of unsecured creditors accepted by the Administrator were claims that had crystallized prior to the insolvency of Central Capital. Nor is it suggested that any creditors were rejected because some or all of their claims were not payable until after the date of the insolvency. The fact of insolvency, by itself, does not provide a rational basis for distinguishing the claims of the appellants from those of other unsecured creditors.

52 Much also was made of the provision in the Articles authorizing the shares in question, which states that if the obligation to redeem "would be contrary to applicable law", then Central Capital "shall redeem only the maximum number of [shares] it is then permitted to redeem". Counsel for the unsecured creditors submits that the reference to "applicable law" is to s. 36 of the *CBCA*. The reference certainly embraces the *CBCA*, but it is not restricted by its terms to that statute. For example, "applicable law" would also capture s. 101 of the *Bankruptcy Act*, which provides for penalties against directors and shareholders where insolvent companies redeem shares or pay dividends.

53 There was no evidence led as to why this provision was placed in the Articles and the share certificates. It appears to be a standard clause in all the preference shares issued by the corporation and not just those that were adapted to the appellants' situations where specific retraction clauses were drafted to satisfy the particular asset acquisitions. For my part, I have difficulty in understanding how a consideration of this provision assists the process of determining the underlying character of the retraction obligations. The statement is so self-evident that it is almost banal. I can only assume that the statement was included in the share provisions of a corporation marketing its securities world-wide so as to inform purchasers that legal restrictions in this jurisdiction apply to the company's right to redeem shares.

54 In summary then regarding the insolvency argument, these various statutes prohibit payments of any kind to shareholders by an insolvent company. As I understand it, counsel does not question that when a dividend has been lawfully declared by a corporation, it is a debt of the corporation and each shareholder is entitled to sue the corporation for his proportion: see *Fraser and Stewart, supra*, at p. 220 for a list of authorities. However, once a company is insolvent it cannot make payments to shareholders or creditors so long as it continues to be insolvent. On the other hand, nowhere in the *CBCA* or else where will we find authority for the proposition that once a corporation is insolvent, it is no longer obliged to pay its debts. The obligation is postponed until the insolvency is corrected or the corporation makes an accommodation with its creditors and obtains a release with or without the assistance of the various statutes dealing with insolvency.

55 The existence of provisions prohibiting payment to shareholders and creditors on insolvency does not in anyway assist the determination of whether the retraction obligations

at issue in this appeal constitute a debt or a return of capital at the time they are payable. Speaking of the obligation to honour the retraction in terms of the corporation redeeming its shares also introduces the wrong emphasis. The corporation is not redeeming the shares at its option as contemplated by most redemptions. It is being forced to redeem them because of a prior contractual obligation for which the preferred shareholder gave good consideration. It is for this reason that I question whether s. 36 of the *CBCA* is the appropriate reference point. This is not the type of payment which concerned Jessel M.R. in *Flitcroft's Case, supra*.

56 At the risk of over simplifying this case, it appears to me that many of the arguments made against the appellants' claims to be creditors of Central Capital are impermissible in the context of the Agreed Statement of Facts. The issue in appeal is frozen in time by the stipulation that the court is to determine if these retraction clauses created a debt within the meaning of the *Bankruptcy Act* on June 15, 1992. The arguments against the appellants' claims also ignore that debts under s. 121(1) of the *Bankruptcy Act* need not be payable at the date of the bankruptcy (or June 15, 1992 in our scenario). They need only come beneath the broad umbrella of "debts and liabilities, present and future, to which [Central Capital] is subject" on June 15, 1992. The fact that the debts could not be paid after June 15, 1992, does not mean that they were not provable claims pursuant to s. 121 of the *Bankruptcy Act*. Moreover, assuming the retraction clauses created a debt payable on a future date, neither the order of Houlden J. nor the restrictions in the Articles creating the shares themselves purported to extinguish that debt.

57 There is nothing in either the Articles of Central Capital or in the law that excuses the obligation to pay the retraction amounts. Rather, discharge of the obligation is simply postponed until the cessation of the disabling event of insolvency. Article 4.3 of the Senior Series B Provisions provides the mechanism for future redemption of tendered shares that are not redeemed because such redemption would be contrary to law. Article 4.5 provides that the inability to effect a redemption does not affect the obligation to pay dividends accrued or accruing on the unredeemed shares.

58 So far as SYH is concerned, the retraction price was not payable until the fifth anniversary of the June 1989 sale of assets. Therefore, no issue of the effect of insolvency arose in 1992. The orders of Houlden J. of June 15 and July 9, 1992 changed the rules of the game. If this appellant is a creditor, it does not have to wait until the retraction date. It can claim as a creditor now. It did and the claim was disallowed. However, if this court holds that the claim should have been allowed, then in accordance with the narrow issue put to us, SYH is entitled to be accepted as a full creditor in the entire reorganization of Central Capital.

59 An additional factor raised by counsel during argument was that Article 7, *supra*, provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets among its shareholders

for the purpose of winding up its affairs, the holders of these preferred shares are entitled to recover "from the assets of Central Capital" the retraction price plus all accrued and unpaid dividends thereon. Such amount is to be paid prior to payment to junior ranking shareholders. The Article further provides that "[u]pon payment of such amounts, the holders of [the preferred shares] shall not be entitled to share in any further distribution of assets of [Central Capital]". Because it is trite law that shareholders are entitled to recover from assets only after all ordinary creditors have been paid in full, counsel for the unsecured creditors submits that the fact that the clause contemplates priorities between shareholders on a winding up or a liquidation of assets is clear evidence that they were shareholders only.

60 I have two responses to this submission. The first is the obvious, that we are not dealing with this contemplated event. We are dealing with a reorganization in which the parties have put a single question to the court: are the appellants creditors? Consideration of issues of priority or the valuation of claims have been taken away by the narrow scope of the agreed question. If the answer to the question posed is yes, then in accordance with the Agreed Statement of Facts, the appellants are entitled to have their claims as creditors allowed under the Subscription and Escrow Agreement and to participate in the Amended Plan of Arrangement as Senior Creditors. If the answer is no, they are to be treated as the Administrator has treated them: they are not creditors at all and are restricted to receiving Central New Common Shares under the Amended Plan of Arrangement.

61 My second response is that counsel for the unsecured creditors misses the significance of the clause. He assumes that there will be a deficiency in all circumstances leading up to a liquidation, dissolution or winding up that will necessitate a *pro rata* distribution, first to creditors and then to shareholders of all classes. However, the clause does not say that those with retraction rights are not creditors. It says that the retraction amounts are to be paid out of assets, not suplus. Once the retraction amounts have been paid in full, the appellants are not entitled to share in any further distribution. This contemplates a surplus after all creditors, including the appellants, have been paid in full. Accordingly, far from classifying the appellants as shareholders, the clause provides that they are not entitled to be treated as shareholders under a winding up or liquidation but only as creditors.

62 Finally, with respect to SYH's claims, it was submitted that these claims were so contingent as to be virtually non-existent. The claims anticipate a retraction date that as of June 15, 1992 was some two years into the future. Upon approval of the Amended Plan of Arrangement of December 18, 1992, the shares of SYH were cancelled and replaced by a new issue of shares, the Central New Common Shares. Counsel relied upon the finding of Feldman J. that there was then no discernable basis upon which the retraction could occur. Once again, with respect, this conclusion misses the point. Following the final order of Houlden J. approving the Amended Plan of Arrangement, all the shares *and* all the debts of Central Capital disappeared. There was thereafter no discernable basis upon which any

event contemplated by any debt or share instruments could occur. We are only concerned with the status of shareholders and creditors as of June 15, 1992.

63 Based on the reasons set out above, I have concluded that the retraction amounts do fall within the definition of debts and liabilities, present or future, to which Central Capital was subject on June 15, 1992. This does not apply to undeclared dividends however, because until a dividend is declared no action on behalf of a shareholder lies to enforce its payment: see *Fairhall v. Butler*, [1928] S.C.R. 369 at 374. If undeclared dividends have been claimed by any of the appellants they should be disallowed. In all other respects the claims should be allowed.

64 Accordingly, I would allow the appeals, set aside the order of Feldman J. and order that the appellants have provable claims that are to be allowed by the Administrator. The record does not disclose what order if any Feldman J. made as to costs. Certainly the appellants are entitled to their costs of this appeal. If the parties are unable to agree with respect to any other disposition of costs, I would suggest that they submit their positions to the court in writing.

***Weiler J.A.*:**

65 I have had the benefit of reading the reasons of Finlayson J.A. and for the reasons which follow I respectfully disagree with his conclusion that the appellants are entitled to prove a claim pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*").

66 Section 12(1) of the *CCAA* requires that persons wishing to participate in a reorganization have claims which would be provable in bankruptcy. Section 121(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, states that "[a]ll debts and liabilities, present or future ... shall be deemed to be claims provable in proceedings under this Act."

67 In order to decide whether the obligation of Central Capital to redeem the preferred shares of the appellants is a claim provable in bankruptcy, it is necessary to characterize the true nature of the transaction. The court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability by the company: *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In this case, the decision is not an easy one. Where, as here the agreements between the parties are reflected in the articles of the corporation, it is necessary to examine them carefully to characterize the true relationship. It is not disputed that if the true nature of the relationship is that of a shareholder-equity relationship after the retraction date and at the time of the reorganization, then the appellants do not have a claim provable in bankruptcy. Consequently, they will not have a claim under the *CCAA*.

68 As I see it, three main questions need to be addressed:

(1) Was Feldman J. correct in characterizing the relationship between Central Capital and the companies owned by James McCutcheon ("McCutcheon"), and between Central Capital and Scottish and York Holdings Limited (the predecessor of S.Y.H., hereinafter referred to as "SYH"), as a shareholder relationship?

(2) Did the nature of the relationship change after the retraction date for redeeming the shares of McCutcheon or, in the case of SYH, at the time of the reorganization?

(3) If the nature of the relationship is not a shareholder-equity relationship, are the appellants entitled to prove a claim under the *CCAA*.?

69 In addition, the appellants raise the question of whether they have a right to prove a claim for dividends, which have accrued but have not yet been declared payable. The price to be paid by Central Capital to McCutcheon on the retraction date, July 1, 1992, was $25 per share plus *all accrued and unpaid dividends thereon*. The dividends are therefore part of the retraction price. Similar provisions apply to SYH.

70 The reasons of Finlayson J.A. contain a comprehensive statement of the background to the litigation and I will therefore only refer to the facts in a summary fashion.

71 James McCutcheon and his brother sold their shares in Central Guarantee Trust Company to Central Capital Corporation ("Central Capital"), a trust company, for $575 a share. They received $400 per share in cash. The balance of $175 owing on each share was paid through the issue of seven preferred shares in Central Capital, with each share having a par value of $25. Following this transaction, McCutcheon purchased his brother's shares. These preferred shares, known as Senior Series B Preferred Shares, were to be listed on the Toronto Stock Exchange. These shares carried with them a retraction privilege. The shareholder had the right to have his shares redeemed by Central Capital on July 1, 1992, for $25 a share, provided that such redemption would not be "contrary to law in the context of the Corporation's current financial position." McCutcheon chose not to sell his shares.

72 Scottish & York Holdings Limited (the predecessor to SYH) sold its shares in certain insurance companies which it owned to Central Capital. Central Capital paid for these shares by the issue of Series A Junior Preferred Shares. These shares were not listed on a stock exchange. SYH had the right to have its shares redeemed by Central Capital on or after September 1994 at a price of $1 per share, subject to the provisions of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "*CBCA*").

73 It should be noted that the right of retraction was not unique to these two classes of shareholders. Even common shareholders had the right to have their shares retracted under certain circumstances.

74 By December 1991, Central Capital was unable to pay its liabilities as they became due and its total liabilities greatly exceeded the value of its assets. As a result, the various banks and subordinated debtholders, collectively referred to as the lenders, had a choice to make. Inasmuch as the definition of a corporation in s. 2 of the *Bankruptcy and Insolvency Act* precludes a creditor from bringing a petition against a trust company, they could either wind up Central Capital under the *Winding-up Act*, R.S.C. 1985, c. W-11, or they could try to restructure Central Capital under the *CCAA*. In a winding up or liquidation, the trustee would sell the company's assets, either piecemeal or as a going concern, to third parties. The proceeds from the sale would then be distributed to those who proved a claim according to set priority rules. In a reorganization, existing fixed amounts owed to Central Capital's creditors would be traded for new claims and ownership interests in the reorganized corporation which would remain a going concern. The lenders chose to reorganize.

75 Two transactions were involved. In the Consolidated Insurance Group Limited transaction, or "CIGL transaction", Central Capital transferred some of its significant assets to a newly incorporated company, CIGL. Thirty-nine creditors of Central Capital then elected to exchange a portion of Central Capital's debt owing to them for equity in this newly incorporated company. In the second transaction, common shares were issued for the remaining assets of Central Capital. The creditors of Central Capital were given 90 per cent of the common shares of the reorganized company. The balance of 10 per cent was allocated to the shareholders of Central Capital. All of the preferred, common and subordinate voting shares in Central Capital were then converted into these "new" common shares. The reorganization was subsequently approved by the creditors and sanctioned by the Court as required by the Act, but this approval was given without prejudice to any claims that McCutcheon and SYH might have.

76 McCutcheon's position was that the right to have his shares retracted accrued before the reorganization, and that his exercise of this right of retraction in May 1992 constituted a present debt or liability entitling him to rank as a creditor in the CIGL transaction and in the reorganized Central Capital. SYH's position was that the right to have its shares retracted in 1994 created a future debt or liability and thus a provable claim. The administrator of Central Capital disallowed both claims. McCutcheon and SYH appealed the administrator's decision to Feldman J. In dismissing their appeals, she held that the appellants were shareholders and that the right of retraction attaching to the shares did not change the nature of the shares from equity into debt.

1. Was Feldman J. correct in characterizing the agreement between Central Capital and the companies owned by McCutcheon, and between Central Capital and SYH, as creating a shareholder relationship between the parties?

77 Feldman J. analyzed the transaction and came to the conclusion that it was an equity transaction.

78 Finlayson J.A. is of the opinion that the nature of this transaction is different and that Feldman J. erred in not showing sensitivity to the fact that she was dealing with the sale of a business by its owners. He is of the opinion that the shares issued by Central Capital are the equivalent to "vendor shares" in that the appellants received them in exchange for the transfer of assets to Central Capital. He does not see the transaction as being either a contribution to capital by McCutcheon and SYH or as a return of capital. Although the transaction has debt and equity features, Finlayson J.A. is of the opinion that the true nature of the transaction is that of a debt owing by Central Capital to McCutcheon and SYH for the shares in their companies.

79 My analysis of the transaction is that when McCutcheon sold his shares in Central Guaranty and took back preferred shares in Central Capital as part payment, he transferred part of his capital investment from a smaller entity to a larger entity. Similarly, SYH transferred its investment in the shares of the insurance companies for shares in the larger entity of Central Capital. Both appellants could look to a larger asset base than before to generate a return on their capital. Until the retraction date, McCutcheon chose to take the risk of continuing his investment in Central Capital, which offered the prospect of a stable, yet relatively high, annual return through the receipt of 7-5/8 per cent dividends. Because the shares traded on the Toronto Stock Exchange, he would have had the option of realizing upon his investment by selling his shares for what they would bring on the open market, but he did not do so. In the case of SYH, although these shares were not required to be publicly listed, the corporation's articles did not restrict their transfer. The corporation's articles indicate that these shares had some preference over other shares with respect to the right to receive dividends and in the distribution of assets after creditors are paid on a liquidation. As preferred shareholders, McCutcheon and SYH did not have a voice in company affairs unless the company failed to pay the dividends it had promised to pay. This is quite typical: see Welling, *Corporate Law in Canada*, 2nd ed. (1991) at p. 604; Ziegel et al, *Cases and Materials on Partnership and Canadian Business Corporations*, 2nd ed. (1989) at p. 1198. Risk taking, profit sharing, transferability of investment, and the right to participate in a share of the assets on a liquidation after the creditors have been paid are the hallmarks of a shareholder: see R.M. Bryden, "The Law of Dividends" contained in Ziegel ed., *Studies in Canadian Company Law* (1967) at p. 270. In my opinion, Feldman J. was correct that the true nature of the relationship between the parties initially was that of an equity transaction.

2. Did the nature of the relationship change after the retraction date for McCutcheon's shares and did the reorganization trigger a right of redemption respecting SYH's shares?

80 Ordinarily, shareholders cannot realize on their investment in a company except by transferring their shares. The retraction privilege attaching to the shares gives the preferred shareholders the option of realizing on their investment other than by transferring their shares to a third party.

81 Feldman J. found that McCutcheon continued to be a shareholder after the retraction date and that he remained a shareholder at the time of the reorganization. She found SYH's claim to be too remote inasmuch as the retraction date not yet arrived at the time of the reorganization.

82 The appellants argue that Feldman J. erred in this conclusion. They submit that although McCutcheon and SYH may have been shareholders initially, this relationship changed. Upon McCutcheon's exercise of his right to have the corporation pay him the retraction price of his shares, he ceased to be a shareholder. When Central Capital failed to pay him, he became a creditor of the corporation. In the case of SYH, it is submitted that when the lenders opted to reorganize the company, they, in effect, triggered the obligation to redeem SYH's shares.

(a) Nature of the transaction's relationship to the capital structure of the corporation

83 Section 25(3) of the *CBCA* states that shares shall not be issued until the consideration for the shares is fully paid either in cash or with property having a fair market value equivalent to the shares issued. Therefore, by issuing preferred shares with a fixed par value, Central Capital paid McCutcheon for his shares of Central Guaranty and paid SYH for the shares of the insurance companies that Central Capital received. Central Capital could not issue preferred shares *except* as full payment for the shares it received. The preferred shares were part of the capital of Central Capital and the preferred shares were always shown as shareholders' equity on Central Capital's books. The capital of the corporation is representative of the assets available to pay creditors. If, on the date for redemption of McCutcheon's shares, or on the date of reorganization in the case of SYH, the shares are redeemed, the amount paid must be deducted from the stated capital of the corporation s. 39 *CBCA*. Consequently, the total assets that Central Capital will have available to pay the lenders and other creditors outside the corporation will be reduced. A reduction of capital by the redemption of redeemable shares is permitted under the *CBCA* but only where the requirements of s. 36 are met.

(b) Section 36 of the CBCA

84 Section 36 of the *CBCA* makes the ability of a corporation to redeem its redeemable shares subject to (1) its articles and (2) a solvency requirement. For ease of reference s. 36 is reproduced below.

> *36.*(1) Notwithstanding subsection 34(2) or 35(3) [both of which deal with a corporation's acquisition of its own shares in other circumstances], but *subject to subsection (2) and to its articles*, a corporation may purchase or redeem any redeemable shares issued by it at prices not exceeding the redemption price thereof stated in the articles or calculated according to a formula stated in the articles.
>
> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of shares to be purchased or redeemed. [Emphasis added.]

85 There is no dispute that Central Capital was unable to redeem McCutcheon's shares on the retraction date. Nor could it redeem SYH's shares on the date of the reorganization. The appellants agree that the effect of s. 36 renders the agreement between themselves and Central Capital unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish a debt or liability which they say has been created. The appellants rely on the decision in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1 (B.C. C.A.) in support of their position that a debt or liability is created notwithstanding the solvency requirements of s. 36 respecting payment. The appellants' submission does not take into consideration the major differences between the decision in *East Chilliwack* and the present situation relating to the timing, effect of the solvency requirements and the provisions in the articles governing the relationship of the parties.

> 1) In *East Chilliwack*, farmers who owned shares in an agricultural co-operative gave notice to the co-op of their intention to have their shares redeemed. After the notices had been given, the superintendent of co-operatives suspended the right of the co-op to redeem its shares. Here, the request to redeem the shares by McCutcheon and the

retraction date occurred after Central Capital had sent out a notice that it would not be able to redeem the shares due to its financial position. SYH had no right to demand that its shares be retracted until the retraction date, which was some two years after the date of Central Capital's insolvency.

As in the instant case, the issue in *East Chilliwack* was whether the farmers were entitled to rank with the creditors of the co-op. Hutcheon J.A., with Toy J.A. concurring, held that they were entitled to be treated as creditors.

At the outset of his reasons, Hutcheon J.A. noted, at p. 11, that the effect of the superintendent's suspension on the farmers' rights was not argued on appeal and that the court had been asked to determine the status of the farmers without regard to the suspension.

Here, the effect of Central Capital's inability to redeem its shares due to insolvency is very much in issue and cannot be ignored. Although the articles provide for the redemption of all of the shares held by McCutcheon and SYH on or after the retraction date, the articles also state that Central Capital will only redeem so many of its shares as would not be "contrary to law." Pursuant to s. 36(1) of the *CBCA*, a corporation may purchase or redeem redeemable shares, but the corporation is prohibited from doing so if the corporation is unable to pay its liabilities as they become due or if the assets of the corporation are less than the total of its liabilities and the amount required for the redemption. Because Central Capital could not comply with the solvency requirements, redemption would be "contrary to law."

2) In *East Chilliwack, supra*, at p. 13, the rules of the co-op provided that upon the giving of a notice of redemption, the farmer giving it ceased to be a shareholder. Central Capital's articles do not state that a request for redemption of the holder's shares terminates his status as a shareholder. McCutcheon continued to have the right to receive dividends pursuant to Article 4.5 while his shares were not redeemed. In effect, so long as Central Capital was unable to redeem the shares but had profits, McCutcheon continued to be entitled to a share of the profits through the declaration of dividends. If the dividends remained unpaid for eight consecutive quarters then, pursuant to Article 8, McCutcheon had the right to receive notice of, and to attend, each meeting of shareholders at which directors were to be elected and was entitled to vote for the election of two directors. The articles relating to the preferred shares held by SYH contain a similar provision. The result of insolvency as envisaged by the articles was that McCutcheon and SYH would continue as shareholders.

3) In *East Chilliwack, supra*, Hutcheon J.A. held, at p. 13, that, subject to the power of the superintendent of co-operatives, the farmer's position would be that of an ordinary creditor.

Here, the terms attaching to McCutcheon's shares do not give him that right. Instead, he is given the right to continue to receive dividends so long as the company cannot pay him. The articles relating to the shares held by SYH contain a similar provision. In addition, Article 4.3(b), respecting the retraction of the shares, indicates that if the directors have acted in good faith in making a determination that the number of shares the corporation is permitted to redeem is zero, then the *corporation* is not liable in the event this determination proves inaccurate. This would hardly be the position *vis à vis* an ordinary creditor.

4) Article 8 and a similar provision in the articles relating to the shares held by SYH provide that upon a sale of all or a substantial part of the company's undertaking, the preferred shareholders have a right to receive notice of and to be present at the meeting called to consider this sale. The farmers in *East Chilliwack* do not appear to have had any similar right.

5) Article 7 provides that in the event of a liquidation, dissolution or winding-up of the Corporation the preferred shareholders have a right to receive $25 per Series B Senior Preferred Share before the corporation pays any money or distributes assets to shareholders in any class subordinate or junior to the Series B Senior Preferred Shares. Similarly, SYH, as the holder of Series A and B Junior Preferred shares has the right, upon the dissolution or winding up of the corporation, to receive a sum equivalent to the redemption amount for each series junior preferred share. This right is subject to the rights of shares ranking in priority to the shares of these series, but is ahead of the rights of the holders of common shares.

Nothing in the articles concerning the retraction date affects the right of McCutcheon and SYH to participate in Central Capital's liquidation. The participation of the farmer in *East Chilliwack* ceased once he had given notice to redeem. Article 4.4 of Central Capital provides that once the shares have been tendered for retraction this election is irrevocable on the part of the holder. In the event that payment of the retraction price was not made, however, the holder had the right to have all deposited share certificates returned. Central Capital offered to return McCutcheon's shares to him, but he refused. Because McCutcheon retained all the rights and privileges of a preferred shareholder after the retraction date, the fact that he refused to take back his share certificates cannot alter the true nature of the relationship. The refusal was merely evidence of a dispute concerning what the relationship was. SYH also retained its full status as a shareholder until the date of the reorganization. This was not the situation in *East Chilliwack*.

86 By way of summary, on the date of the reorganization McCutcheon and SYH had not ceased to be preferred shareholders of Central Capital. The rights attaching to their retractable preferred shares entitled them to continue to share in the profits of the company when these were declared as dividends, to vote at shareholders meetings to elect directors so long as dividends remained unpaid for a specified period of time, and, on a winding up of the company, to participate in the distribution of assets that remained after the creditors were paid according to the ranking of the series of their shares. The company's obligation to redeem its shares was not absolute. Instead, the articles provided for what was realistically a "best efforts" buy-back based on solvency and continuation as a shareholder to the extent a buy-back could not take place. In *East Chilliwack*, because the farmer ceased to be a shareholder, the articles do not appear to make any provision for continued participation or for the postponement of payment depending on the solvency of the co-op.

(c) Evidence of a debtor-creditor relationship is lacking in the articles

87 Looked at another way, after the retraction date and at the time of the reorganization, the common features of a debtor-creditor relationship are not in evidence in Central Capital's articles. The agreements between the parties contain no express provisions that the redemption of the shares is in repayment of a loan. The corporation was not obliged to create any fund or debt instrument to ensure that it could redeem the shares on the retraction date. There is no indemnity in the event that the money is not repaid on the retraction date. There is no provision for the payment of any interest after the retraction date in the event that the money is not repaid on the retraction date. There is no provision that after the retraction date and in the event of insolvency, the appellants would have the right to have the company wound up. (See *Imperial General Properties Ltd. v. R.*, *(*sub nom. *R. v. Imperial General Properties Ltd.)* [1985] 2 S.C.R. 288, for a case where the articles of the company contained this right.) There is no provision that upon a winding up or insolvency the parties are entitled to rank *pari passu* with the creditors as was the case in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank, supra*.

(d) The effect of the reorganization

88 Finlayson J.A. is of the view that it is immaterial that the articles provide, in the event of the liquidation, dissolution or winding-up of the company, that the appellants are only entitled to rank after the creditors but ahead of the junior ranking shareholders. In his view, this provision is irrelevant because we are not dealing with a liquidation but with a reorganization. He finds it significant that, like debtors, the preferred shareholders are not entitled to participate in any surplus once they have been paid. I am of the view that this

provision in the articles is significant. It represents a clear indication that the holders of the retractable shares were not to be dealt with on the same footing as ordinary creditors even after the retraction date. Instead, they were to be dealt with as shareholders, albeit an elevated class. Under the *CBCA* all shares carry equal rights. Words used in the articles to differentiate a class of shares are nothing more than authorized deviations from this statutory position of equality: Welling, *supra*, at p. 683.

89 The appellants submit that a winding-up or liquidation is not the same as a reorganization. This is true. Both, however, are methods of dealing with insolvency. Both are methods for secured creditors to enforce their claims by seizing the assets in which they hold security interests. If the value of the corporation as a going concern exceeds the liquidation value of the assets, it is in the interest of all the debt holders that the corporation be preserved as a going concern. The purpose of both a liquidation and a reorganization is to permit the rehabilitation of the insolvent person unfettered by debt: *Vachon v. Canada (Employment & Immigration Commission)*, [1985] 2 S.C.R. 417. By virtue of s. 20 of the *CCAA*, arrangements under the Act mesh with the reorganization provisions of the *CBCA* so as to affect the company's relations with its shareholders. Shareholders have no right to dissent to a reorganization: s. 191(7), *CBCA*. On a reorganization, among other things, the articles may be amended to alter or remove rights and privileges attaching to a class of shares and to create new classes of shares: s. 173, *CBCA*. These statutory provisions provide a clear indication that, on a reorganization, the interests of all shareholders, including shareholders with a right of redemption, are subordinated to the interests of the creditors. Where the debts exceed the assets of the company, a sound commercial result militates in favour of resolving this problem in a manner that allows creditors to obtain repayment of their debt in the manner which is most advantageous to them.

90 The similarities between a liquidation and a reorganization, together with the express statement in the articles of Central Capital with respect to what is to happen on a winding-up, dictate that the interests of the holders of retractable shares, McCutcheon and SYH, are subordinated to the creditors and they are not entitled to claim under the *CCAA* equally with the creditors. This position is also consistent with the provisions of the *Bankruptcy and Insolvency Act* and the *Winding-up Act*. In the case of an insolvency where the debts to creditors clearly exceed the assets of the company, the policy of federal insolvency legislation appears to be clear that shareholders do not have the right to look to the assets of the corporation until the creditors have been paid.

Dividends

91 Although dividends were payable on the shares of McCutcheon and SYH, no dividends were in fact declared. The appellants contend that the dividends, which have accrued but

which were not declared, are a debt or liability because they were stipulated to be part of the retraction price.

92 Article 7 of Central Capital respecting McCutcheon's shares states that in the event of liquidation, dissolution or winding up of the corporation, the shareholders are entitled to receive not only the $25 per Series B preferred share, but "all accrued and unpaid dividends thereon, whether or not declared ... before any amount is paid by the Corporation or any assets of the Corporation are distributed to the holders of any shares ... ranking as to capital junior to the Series B Senior preferred Shares."

93 It is trite law that a dividend may only be declared if a company is solvent. For corporations governed by the *CBCA*, it appears that the common law tests for solvency have all been subsumed or overruled: *McClurg v. Minister of National Revenue*, *(*sub nom. *R. v. McClurg)* [1991] 2 W.W.R. 244 (S.C.C.) at 259, 260.

94 Section 42 of the *CBCA* provides:

> A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.

95 Section 42 prevents the corporation from declaring or paying a dividend when it does not meet certain solvency requirements. There was no declaration of a dividend in the present case. Any obligation to pay a dividend as part of the retraction price cannot therefore be enforced when the company is insolvent. Dividends which have accrued but which are unpaid are not considered to be a debt because, on reading the articles as a whole, the provision for payment is not one which is made independant of the ability to pay: see Welling, *supra*, at p. 689, citing *Porto Rico Power Co., Re*, [1946] S.C.R. 178 (S.C.C.), where it was held there was no guarantee of payment and hence the accrued but unpaid dividends were not a debt. Instead, accrued but unpaid dividends are considered to be akin to a return of capital. Making these accrued dividends part of the retraction price does not alter this.

96 By way of analogy to the treatment of dividends, it could be said that until the company has declared it will redeem the shares which are tendered to it the obligation to redeem them is not a debt or liability. The promise to pay in the articles of Central Capital is not made independent of any ability to pay.

97 In the event that I am wrong in my conclusion that the true nature of the relationship is one of equity, I shall now consider the position in the event that a debt has been created.

3. If the nature of the relationship is not an equity relationship are the appellants entitled to be claimants under the CCAA.?

98 The parties agree that the effect of s. 36 renders the agreement to redeem their preferred shares unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish Central Capital's obligation to repay them. Their position is that Central Capital's obligation to repay them is a contingent liability and therefore gives them a claim provable in bankruptcy, bringing them under s. 12(1) of the *CCAA*.

The Meaning of Debt

99 Debt is defined in a very broad manner in *Black's Law Dictionary*, 6th ed. (1990) at p. 403. It is the position of the appellants that this definition of "debt" is broad enough to include McCutcheon's right to have Central Capital redeem his shares. In the case of SYH, it is submitted that the right to redemption constitutes a future liability. It is the appellants' position that Feldman J. erred in holding that to have a provable claim, McCutcheon and Central Capital must be able to obtain a judgment against Central Capital for the retraction price and be entitled to seek payment on the judgment. Finlayson J.A. agrees with the appellant's position.

100 Debt is defined in *Black's Law Dictionary, supra*, as:

> A sum of money due by certain and express agreement. A specified sum of money owing to one person from another, including not only obligation of debtor to pay but right of creditor to receive and enforce payment.
>
> A fixed and certain obligation to pay money or some other valuable thing or things, either in the present or in the future. In a still more general sense, that which is due from one person to another, whether money, goods, or services. In a broad sense, any duty to respond to another in money, labour, or service; it may be even a moral or honorary obligation, unenforceable by legal action. Also, sometimes an aggregate of separate debts, or the total sum of the existing claims against person or company. Thus we speak of the "national debt", the "bonded debt" of a corporation, etc.

101 It will be readily apparent that in *Black's* the term "debt" is defined in two distinct ways. In order to constitute a debt as defined in the first paragraph, the obligation must be enforceable. In the second paragraph debt is defined more broadly as any duty or obligation even if unenforceable by legal action. Feldman J. considered the first portion of the definition

in her reasons. If the first portion of the definition applies, no debt is created because the obligation is not enforceable under the *CBCA*. The appellants rely on the second portion of the definition. They also rely on the definition of of the word "liability" in *Black's* which is also defined very broadly.

102 In one sense, support for the position of the appellants is found in s. 40 of the *CBCA*. Section 40 states that a contract with a corporation providing for the purchase of shares of the corporation is specifically enforceable against the corporation except to the extent that the corporation cannot perform the contract without being in breach of ss. 34 or 35. Section 34 contains the solvency requirements concerning the redemption by a company of its own shares other than those carrying a right of redemption. Section 35 deals with shares which have been issued to settle or compromise a debt. In s. 2, "liability" is defined as including "a *debt* of a corporation arising under section 40 ... ."

103 Section 40 does not include any reference to the obligation of a company to repurchase redeemable shares under s. 36. As a result s. 36 is not incorporated by reference into the definition of liability. While it might be suggested that this is a legislative oversight, the omission is also consistent with the position that only the articles of the corporation govern the relationships between the company and the holders of the retractable shares under s. 36. I have already stated my opinion that the articles of Central Capital do not make the obligation to redeem the shares a debt or, for that matter, a liability. Moreover, even if a provision like s. 40 is implied with respect to redeemable preferred shares, it would also be necessary to imply a provision like s. 40(3) which states that in the event of liquidation where the company has not performed its contract to redeem, the other party is entitled to be ranked subordinate to the rights of creditors but in priority to the shareholders. This is a clear expression of legislative intention that on insolvency the claim of those entitled to have their shares redeemed should not be placed on the same footing with the claims of creditors but should rank subordinate to them: see *Nelson v. Rentown Enterprises Inc.*, [1994] 4 W.W.R. 579 (Alta. C.A.), adopting the reasons of Hunt J. at (1992), 96 D.L.R. (4th) 586 (Alta. Q.B.). Policy reasons would again militate in favour of the result being the same on a reorganization.

Claims in Bankruptcy

104 Even if the broader definitions of a debt or liability in *Black's* are adopted, the appellants still do not have a claim provable in bankruptcy.

105 Persuasive authority already exists to the effect that in order to be a provable claim within the meaning of s. 121 of the *Bankruptcy and Insolvency Act* the claim must be one recoverable by legal process: *Farm Credit Corp. v. Holowach (Trustee of)*, [1988] 5 W.W.R. 87 (Alta. C.A.) at 90, leave to appeal to the Supreme Court of Canada dismissed at [1989] 4 W.W.R. lxx (note).

106 In *Holowach*, the seven members of the court were dealing with a situation in which some persons borrowed money from a mortgagee and mortgaged certain lands as security for repayment of the loan. The mortgagors then made an assignment in bankruptcy. The mortgagee filed a proof of claim for the full amount of the deficiency, that is, the amount of the indebtedness less the value of the land which the mortgagee was permitted to purchase. The Alberta *Law of Property Act*, R.S.A. 1980, c. L-8, precluded deficiency claims against individuals in foreclosure actions, although the effect of the legislation was not to extinguish or satisfy the debt. The mortgagee argued that it had a claim provable in bankruptcy under s. 95(1), now s. 121(1), of the *Bankruptcy and Insolvency Act*. The court rejected this argument, holding that a provable claim must be one recoverable by legal process. In coming to its conclusion, the court relied on *Reference re Debt Adjustment Act, 1937 (Alberta)*, [1943] 1 All E.R. 240 (P.C.), and a number of decisions at the trial level which are collected at p. 91 of the decision.

107 Here, the contract to repurchase the shares, while perfectly valid, is without effect to the extent that there is a conflict between the corporation's promise to redeem the shares and its statutory obligation under s. 36 of the *CBCA* not to reduce its capital where it is insolvent. As was the case in the *Holowach* decision, this statutory overlay renders Central Capital's promise to redeem the appellants' preferred shares unenforceable. Although there is a right to receive payment, the effect of the solvency provision of the *CBCA* means that there is no right to enforce payment. Inasmuch as there is no right to enforce payment, the promise is not one which can be proved as a claim.

108 It could be suggested that the decision in *Holowach* can be distinguished from the instant case on the basis that in *Holowach* the claim is made unenforceable forever by statute whereas under the *CCAA* the claim is unenforceable only so long as the corporation does not meet the solvency requirements of s. 36 of the *CBCA*. I do not believe this is a valid distinction for three reasons. First, the relevant date for determining any contingent liability is not the future but the past, namely, September 8, 1992, the date by which proofs of claim had to be submitted. On that date, Central Capital was insolvent. Second, it is only because the lenders were willing to convert their debt obligations into equity in the reorganization that Central Capital is now solvent. Central Capital is not the same company and its liabilities are not the same. The redeemable shares no longer exist. Third, in order to be profitable, the assets of a company must be managed. Any value in the assets after the insolvency of the company is, in this case, due to the new management and not to the preferred shareholders extending credit to the company by having their claim for redemption postponed.

109 Even if Central Capital's obligation to redeem the shares of the appellants created a debt or liability, the appellants do not have a claim provable within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*.

Conclusion

110 I would dismiss the appeal. For the reasons I have given, the retraction amounts do not constitute a debt or liability within the meaning of s. 121 of the *Bankruptcy and Insolvency Act*. Even if I am wrong in my conclusion and a debt or liability is created, it is not a claim within the meaning of the *CCAA*. This is a case of first impression. For these reasons, I would not award any costs of this appeal.

Laskin J.A. (concurring):

111 I have read the reasons of my colleagues Justice Finlayson and Justice Weiler. Like Justice Weiler, I would affirm the decision of the motions judge, Feldman J., and dismiss these appeals. I prefer, however, to state my own reasons for upholding the position of the unsecured creditors of Central Capital Corporation.

The Issue

112 The application was argued before Madam Justice Feldman on an agreed statement of facts. My colleagues have summarized the relevant facts and important provisions of the documents. Each appellant holds preferred shares of Central Capital and each appellant's shares contain a right of retraction — a right to require Central Capital to redeem the shares on a fixed date and for a fixed price. The retraction date for the appellants James McCutcheon and Central Guarantee Trust Company (collectively McCutcheon) was July 1, 1992, and before that date McCutcheon exercised his right of retraction and tendered his shares for redemption. The retraction date for the appellant S.Y.H. Corporation was September 1994 and although it could not render its shares for redemption, it did file a proof of claim with the Administrator of Central Capital. The Administrator disallowed each appellant's claim and Feldman J. dismissed appeals from the Administrator's decisions.

113 The issue on these appeals is whether McCutcheon and S.Y.H. Corporation "have claims provable against Central Capital Corporation within the meaning of the *Bankruptcy Act (Canada)* as amended as of the date of the Restated Subscription and Escrow Agreement." Under the *Bankruptcy Act*, R.S.C. 1985, c. B-3, s. 2, a claim provable "includes any claim or liability provable in proceedings under this Act by a creditor" and a creditor "means a person having a claim, preferred, secured or unsecured, provable as a claim under this Act." Section 121(1) of the *Bankruptcy Act* further defines claims provable as follows:

> *121.* (1) All debts and liabilities, present or future, to which the bankrupt is subject at the date of the bankruptcy or to which he may become subject before his discharge by reason of any obligation incurred before the date of the bankruptcy shall be deemed to be claims provable in proceedings under this Act.

114 The date of the Restated Subscription and Escrow Agreement is May 1992. [1] By then, and indeed since December 1991, Central Capital had been insolvent and therefore was prohibited by s. 36(2) of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, from making any payment to redeem the appellants' shares.

115 On June 15, 1992, Houlden J. provided that Central Capital could be reorganized under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 and he stayed proceedings against it. Houlden J.'s order of July 9, 1992, which approved the restructuring of Central Capital, was made without prejudice to the right of the appellants to assert claims as creditors. Thus the question for this court is whether the appellants' retraction rights created debts of Central Capital in May, 1992. In other words were McCutcheon and S.Y.H. Corporation creditors of Central Capital in May, 1992? If they were creditors, then like the other unsecured creditors of Central Capital, they can elect to take shares in the newly incorporated company, Canadian Insurance Group Limited; if they were not creditors, then they remain shareholders of Central Capital under the restructuring plan.

116 This is a question of characterization. I will address the question first, by considering the "substance" of the relationship between each appellant and the company; and second by considering s. 36(2) of the *Canada Business Corporations Act, supra*. In brief I conclude:

> (1) Although the relationship between each appellant and the company has characteristics of debt and equity, in substance both McCutcheon and S.Y.H. Corporation are shareholders, not creditors of Central Capital. Neither the existence of their retraction rights nor the exercise of those rights converts them into creditors;
>
> (2) Finding that the appellants were creditors of Central Capital would defeat the purpose of s. 36(2) of the statute.

I. The Relationship between the Appellants and Central Capital

117 Preferred shares have been called "compromise securities" and even "financial mongrels": Grover and Ross, *Materials and Corporate Finance* (1975), at p. 49. Invariably the conditions attaching to preferred shares contain attributes of equity and, at least in an economic sense, attributes of debt. Over the years financiers and corporate lawyers have blurred the distinction between equity and debt by endowing preferred shareholders with rights analogous to the rights of creditors. One example is the right of redemption — the right of the corporation to compel preferred shareholders to sell their shares back to the corporation. Another example, and it is the case before us, is the right of retraction — the right of shareholders to compel the corporation to buy back their shares on a specific date for a specific price.

118 I acknowledge, therefore, that redeemable or retractable preferred shares are somewhat different from conventional equity capital. What makes the appeals before us difficult is that although the appellants appear to hold equity, their right of retraction appears to be a basic characteristic of a debtor-creditor relationship. See Grover and Ross, *supra*, at pp. 47-49; Buckley, Gillen and Yalden, *Corporations: Principles and Policies*, 3rd ed. (1995), at pp. 938-940.

119 If the certificate or instrument contains features of both equity and debt — in other words if it is hybrid in character — then the Court must determine the "substance" of the relationship between the holder of the certificate and the company. This is the lesson of Justice Iacobucci's judgment in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S.C.R. 558. In that case the Supreme Court of Canada had to determine whether the financial assistance given by several lending institutions to try to rescue the Canadian Commercial Bank was "in the nature of a loan" or "in the nature of a capital investment." Justice Iacobucci discussed his approach to the problem at pp. 590-591 of his judgment:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the *substance* of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

120 In determining the substance of the relationship, as in any other case of contract interpretation, the court looks to what the parties intended. In *CDIC v. CCB, supra*, Iacobucci J. put this proposition as follows at p. 588:

> As in any case involving contractual interpretation, the characterization issue facing this Court must be decided by determining the intention of the parties to the support agreements. This task, perplexing as it sometimes proves to be, depends primarily on the meaning of the words chosen by the parties to reflect their intention. When the words alone are insufficient to reach a conclusion as to the true nature of the agreement, or when outside support for a particular characterization is required, a consideration of admissible surrounding circumstances may be appropriate.

121 In these appeals what the parties intended is reflected mainly in the share purchase agreements and the conditions attaching to the appellants' shares, but also in the articles of incorporation and in the way Central Capital recorded the appellants' shares in its financial statements. These documents indicate that in substance the appellants are shareholders of Central Capital, not creditors. I rely on the following considerations to support my conclusion:

122 (i) Both appellants agreed to take preferred shares instead of some other instrument — for example, a bond or debenture — that would obviously have made them creditors. The appellant McCutcheon sold shares of one corporation (Canadian General Securities Limited) for cash and for shares of another corporation (Central Capital). Neither the share purchase agreements nor the share conditions support McCutcheon's contention that in taking preferred shares he was extending credit to Central Capital by deferring payment of the purchase price. He made an investment in the capital of Central Capital, no doubt because of the attractive dividend rate, the income tax advantages of preferred shares and "sweeteners" such as conversion privileges. Unlike Finlayson J.A., I place little weight on what he termed "the unique nature of the transaction". McCutcheon transferred assets to acquire his preferred shares rather than acquiring them with cash. But he nonetheless decided to invest in Central Capital and to take the risk and the profits (through dividends) of his investment.

123 Similarly, S.Y.H. Corporation exchanged its equity investment in four insurance companies for an equity investment in Central Capital. It too chose equity not debt. None of the contractual documents indicates that the appellants' retraction rights were intended to trigger an obligation on the part of Central Capital to repay a loan. Moreover, as Weiler J.A. points out, neither the share purchase agreements nor the share conditions provides for interest if Central Capital fails to honour its retraction obligations.

124 (ii) The senior preferred shares and junior preferred shares that the appellants own were part of the authorized capital of Central Capital before the appellants acquired them.

125 (iii) The appellants' shares were recorded in the financial statements of Central Capital as "capital stock," along with the company's issued and outstanding common shares, class "A" shares and warrants. The amount Central Capital might be obligated to pay the appellants if they exercised their retraction rights was not recorded as debt (even contingent debt) in the company's financial statements.

126 (iv) Both appellants had the right to receive dividends on their shares and McCutcheon had the right to vote his shares for the election of directors of Central Capital if dividends remained unpaid for a specified time. These rights — to receive dividends and to vote — are well recognized rights of shareholders. And these rights continue, even after the retraction dates, until the appellants' shares are redeemed.

127 (v) The preferred share conditions provide that on a liquidation, dissolution or winding up, the holders rank with other shareholders and therefore, implicitly, behind creditors. The appellant McCutcheon, who holds senior preferred shares, would rank behind creditors but ahead of the holders of subordinate classes of shares; the appellant S.Y.H. Corporation, which holds junior preferred shares, would rank behind senior preferred shareholders but ahead of common shareholders.

128 These provisions in the preferred share conditions also state that on payment of the amount owing to them the appellants "shall not be entitled to share in any further distribution of assets of the corporation." Finlayson J.A. interprets this to mean that the appellants "are not entitled to be treated as shareholders under a winding up or a liquidation but only as creditors." I disagree. These are typical preferred share provisions, which limit the recovery of the holders but do not treat them as creditors: *Sutherland et al., Fraser & Stewart Company Law of Canada*, 6th ed. (1993), at p. 198. At least on a liquidation, dissolution or winding up, the preferred share conditions evidence that the appellants would be treated not as creditors but as shareholders. In *CDIC v. CCB, supra*, Iacobucci J. placed considerable weight on a provision in the Participation Agreement stating that each participant "shall rank *pari passu* with the rights of the depositors." No such provision exists in this case. Indeed the share conditions I have referred to state the opposite.

129 Of course, Central Capital was reorganized, not liquidated, dissolved or wound up and the preferred share conditions are silent about what occurs on a reorganization. Still these conditions shed light on what the parties intended on the reorganization. Section 12(1) of the *Companies' Creditors Arrangement Act, supra*, defines claim as "any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy Act*." The question the court has been asked to answer

is the same question that would arise on a liquidation. It is illogical to conclude that the appellants could claim only as shareholders on a liquidation and yet can claim as creditors on the reorganization. Whether Central Capital's financial difficulties led to a liquidation or a reorganization, the issue is the same and the analysis and the result should also be the same.

130 The appellants argue, however, that they are shareholders only until they exercise their retraction rights but once they exercise these rights they become creditors. I do not agree with this argument. The share conditions provide that even after exercising their retraction rights, the appellants continue to be entitled to dividends and to vote until their shares are redeemed. In other words, they continue to enjoy the rights of shareholders. Moreover, if when the appellants exercised their retraction rights the company were insolvent and were to be subsequently liquidated (or dissolved or wound up), the appellants would rank as shareholders on the liquidation. And as I have indicated above the result should be no different on the reorganization.

131 It seems to me that these appellants must be either shareholders or creditors. Except for declared dividends, they cannot be both. Once they are characterized as shareholders, their rights of retraction do not create a debtor-creditor relationship. These rights enable them to call for the repayment of their capital on a specific date (and at an agreed upon price) provided the company is solvent. Ordinarily shareholders have to recoup their investment by selling their shares to third parties. If they have retraction rights, however, they can compel the company (if solvent) to repay their investment at a given time for a given price. But the right of retraction provides for the return of capital not for the repayment of a loan. Certainly the *Canada Business Corporations Act* treats a redemption of shares as a return of capital because s. 39 of the statute requires a company on a redemption to deduct from its stated capital account an amount equal to the value of the shares redeemed. The shares redeemed are then either cancelled or returned to the status of authorized but unissued shares.

132 Putting it differently, a preferred shareholder exercising a right of retraction on the terms that exist here must rank behind the company's creditors. Grover and Ross make this point more generally in their *Materials and Corporate Finance, supra*, at pp. 48-49:

> On the other hand, the company cannot issue "secured" preferred shares in the sense that shares cannot have a right to a return of capital which is equal or superior to the rights of creditors. Preferred shareholders are risk-takers who are required to invest capital in the business and who can look only to what is left after creditors are fully provided for. Thus, in the absence of statutory authorization, the claims of shareholders cannot be secured by a lien on the corporate assets. They rank behind creditors but before com mon shareholders (if specified) on a voluntary or involuntary dissolution of the company.

133 Admittedly there is little authority in Canada on the issue confronting this court. Some of the cases that the respondent relies on — for example, *Re Patricia Appliance Shops Ltd.* (1922), [1923] 3 D.L.R. 1160 (Ont. S.C.), *Laronge Realty Ltd. v. Golconda Investments Ltd.* (1986), 63 C.B.R. (N.S.) 76 (B.C. C.A.), and even *Re Meade (Debtor); Ex parte Humber v. Palmer (Trustee)* [1951], 2 All E.R. 168 (P.C.) — are of limited assistance because the shareholders in those cases did not have retraction rights.

134 Perhaps the closest case — and the appellants rely heavily on it — is the judgment of the British Columbia Court of Appeal in *Re East Chilliwack Agricultural Co-op.* (1989), 74 C.B.R. (N.S.) 1. In that case a majority of the court (Craig J.A. dissenting) held that a withdrawing member of a co-operative association who elected to have his shares redeemed in instalments over a five-year period should be treated on the subsequent bankruptcy of the association as an ordinary creditor rather than as a shareholder. I decline to apply *East Chilliwack* for three reasons. First, because the case was decided in 1989, the British Columbia Court of Appeal did not have the benefit of the Supreme Court of Canada's reasons in *CDIC v. CCB, supra*. In *East Chilliwack* Hutcheon J.A., writing for the majority did not focus on what the parties intended when the member contracted with the co-operative. Instead he only considered the relationship between the member and the co-operative after the member had withdrawn. I do not think his approach is consistent with Justice Iacobucci's judgment in *CDIC v. CCB, supra*.

135 Second, there are important factual differences between *East Chilliwack* and the appeals before us. Justice Weiler has referred to these factual differences in her reasons. The most important of these differences are the following: in *East Chilliwack* the rules of the association provided that a member had to withdraw from the association to trigger the right of redemption, whereas the appellants' share conditions provide that they continue to be shareholders of Central Capital until their shares are redeemed; in *East Chilliwack* the member elected to withdraw and redeem his shares when the association was solvent whereas when the appellant McCutcheon exercised his right of retraction Central Capital was insolvent; and in *East Chilliwack* Hutcheon J.A. expressly stated that he was not considering the effect of the superintendent's power to suspend payments if the financial position of the co-operative was impaired, whereas the effect of the statutory prohibition against Central Capital making payment, found in s. 36(2) of the *Canada Business Corporations Act*, is in issue in these appeals.

136 Third, the decision in *East Chilliwack* is at odds with most of the American case law and I favour the American approach. When a company repurchases shares by instalment and bankruptcy intervenes, the prevailing American position is that the shareholder's claim is deferred to the claims of ordinary creditors. The decision of the Fifth Circuit Court of Appeals in *Robinson v. Wangemann*, 75 F.2d 756 (Tex. 1935) is frequently cited. The facts

of that case are virtually identical to the facts in *East Chilliwack*. A company had agreed to repurchase a stockholder's stock by instalments. Although the company was solvent when the agreement was made it went bankrupt before the repurchase was completed. The stockholder sought to prove as an ordinary creditor for the unpaid purchase price. Foster, Circuit Judge, writing for a unanimous court rejected the stockholder's claim at p. 757:

> A transaction by which a corporation acquires its own stock from a stockholder for a sum of money is not really a sale. The corporation does not acquire anything of value equivalent to the depletion of its assets, if the stock is held in the treasury, as in this case. It is simply a method of distributing a proportion of the assets to the stockholder. The assets of a corporation are the common pledge of its creditors, and stockholders are not entitled to receive any part of them unless creditors are paid in full. When such a transaction is had, regardless of the good faith of the parties, it is essential to its validity that there be sufficient surplus to retire the stock, without prejudice to creditors, at the time payment is made out of assets.

137 At the heart of *Robinson v. Wangemann* is the finding that the selling stockholder is not a creditor in the sense of a person who loans money to a corporation, and therefore is not entitled to parity with the general creditors. The principle in *Robinson v. Wangemann* seeks to protect creditors by refusing to permit selling stockholders, who were risk investors, to withdraw their capital on the same terms as general creditors in the event of insolvency. Section 40(3) of the *Canada Business Corporations Act* — a section to which I shall return when considering s. 36(2) of the same statute — codifies the principle in *Robinson v. Wangemann* for share repurchases, though not for share redemptions. See also Blumberg, *The Law of Corporate Groups* (1989), at pp. 205-210 and see *contra Wolff v. Heidritter Lumber Co.*, 163 A. 140 (N.J. Ch. 1932).

138 Quite apart from the instalment purchase price cases, American courts have often grappled with the question whether preferred stockholders can claim as creditors of the corporation. Although there are cases going both ways, most appear to come to the same conclusion as I do. The American cases are collected in Bjor and Solheim, *Fletcher Cyclopedia of the Law of Private Corporations* (1995), revised vol. 11 and in Bjor and Reinholtz, *Fletcher Cyclopedia of the Law of Private Corporations* (1990), revised vol. 15A. In volume 11 the authors of the text indicate — as did the Supreme Court of Canada in *CDIC v. CCB* — that "[w]hether or not the holder of a particular instrument or certificate is to be regarded as a shareholder or a creditor is a question of interpretation, and depends on the terms of the contract as evidenced by the instrument, the articles of incorporation, and the statutes of the state. The nature of the transaction is to be determined by the real substance and effect of the contract rather than by the name given to the obligations or its form ..." (at p. 566).

139 And in volume 15A the authors state at pp. 290 and 292 that even the arrival of a fixed redemption date does not change a preferred stockholder into a creditor:

> Holders of preferred stock of a corporation, in the absence of express provision to the contrary, are stockholders and not creditors of the corporation, except for dividends declared. They have no lien upon, and are not entitled to, any of the assets of the corporation when it becomes insolvent, until all debts are paid. Furthermore, there is authority that the status of a preferred stockholder is not changed to that of creditor, even though a dividend is guaranteed. Indeed it is beyond the power of a corporation to issue a class of stock, the holders of which are entitled to preference over general creditors.
>
> . . . . .
>
> Even where preferred stock has a fixed redemption date, arrival of that date does not change the status of a preferred stockholder to that of a creditor. (pp. 290, 292)

140 I agree with these statements. I therefore conclude first that the appellants, in substance, were shareholders of Central Capital not creditors; and second that neither the existence nor the exercise of their retraction rights turned them into creditors.

II. Provable Claims and Section 36(2) of the Canada Business Corporations Act

141 In May 1992 Central Capital was insolvent. It was unable to pay its liabilities as they became due and the realizable value of its assets was less than the aggregate of its liabilities. Because it was insolvent it was prohibited by s. 36(2) of the *Canada Business Corporations Act* from redeeming the appellants' shares. Section 36(2) of the statute provides:

> (2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of
>
> (i) its liabilities, and
>
> (ii) the amount that would be required to pay the holders of shares that have a right to be paid, on a redemption or in a liquidation, rateably with or prior to the holders of the shares to be purchased or redeemed.

142 As well, the appellants' share conditions provide that they are not permitted to redeem their shares if to do so would be "contrary to applicable law," in this case s. 36(2) of the statute.

143 To hold that the appellants have provable claims would defeat the purpose of s. 36(2) of the *Canada Business Corporations Act*. At common law a company could not repurchase its own shares on the open market or in the language of *Trevor v. Whitworth* (1887), 12 App. Cas. 409 (H.L.), a company could not "traffick in its own shares." The obvious reason was to prevent companies from using their assets to destroy the claims of their creditors. Modern corporate statutes, such as the *Canada Business Corporations Act*, modified the rule in *Trevor v. Whitworth* to permit repurchases provided the company's creditors would not be prejudiced. Thus the legislation insisted that the company could not repurchase its own shares unless it satisfied stated solvency tests. And so, s. 34(2) of the *Canada Business Corporations Act* provides:

> (2) A corporation shall not make any payment to purchase or otherwise acquire shares issued by it if there are reasonable grounds for believing that
>
> (*a*) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (*b*) the realizable value of the corporation's assets would after the payment be less than the aggregate of its liabilities and stated capital of all classes.

144 In *Nelson v. Rentown Enterprises Inc.* (1992), 96 D.L.R. (4th) 586 (Alta. Q.B.), affirmed (1994), 109 D.L.R. (4th) 608 (Alta. C.A.), Hunt J. of the Alberta Queen's Bench wrote at p. 589:

> The policy behind the s. 34(2) limitation upon a corporation's power to purchase its own shares seems obvious. It is intended to ensure that one or more shareholders in a corporation do not recoup their investments to the detriment of creditors and other shareholders. It has been observed that:
>
>> Corporate power to purchase its own stock has been frequently abused. Done by corporations conducting faltering businesses, it has been employed to create preferences to the detriment of creditors and of the other stockholders.
>
> *(Mountain State Steel Foundries, Inc. v. C.I.R., supra, at p. 741* [284 F.2d 737 (1960)].*)*
>
> Modern business statues permit these share purchases to take place provided that the position of creditors and other shareholders is protected, by virtue of the application of the s. 34(2) tests.

145 Redemptions of preferred shares, unlike repurchases, were always permitted at common law as long as they were not made in contemplation of bankruptcy. But the solvency test in s. 36(2) of the *Canada Business Corporations Act* has the same purpose as the solvency test in s. 34(2): to prevent redemptions if they would allow the company to prejudice the claims of creditors. See Buckley *et al., Corporations: Principles and Policies, supra*, at pp. 968-71. To hold that the appellants' retraction rights gave rise to provable claims in the face of s. 36(2), thereby allowing the appellants to rank equally with the unsecured creditors, would undermine the purpose of the section. If a claim in a bankruptcy or reorganization proceeding is unenforceable under the statute, the claim is not entitled to recognition on a parity with the claims of unsecured creditors: See *Blumberg, supra*, at pp. 205-6; and *Farm Credit Corp. v. Holowach (Trustee of)* (1988), 68 C.B.R. (N.S.) 255 (Alta. C.A.).

146 I draw comfort in this conclusion from s. 40 of the *Canada Business Corporations Act*. Section 40(1) provides that a contract with a corporation for the purchase of its shares is specifically enforceable against the corporation "except to the extent that the corporation cannot perform the contract without thereby being in breach of section 34 ..." Section 40(3) then states:

> (3) Until the corporation has fully performed a contract referred to in subsection (1), the other party retains the status of a claimant entitled to be paid as soon as the corporation is lawfully able to do so or, in a liquidation, to be ranked subordinate to the rights of creditors but in priority to the shareholders.

147 In other words, the section recognizes that if a company contracts to repurchase its shares but is prohibited from doing so because it is insolvent, the vendor of the shares is not a creditor and on a liquidation ranks subordinate to the rights of creditors. The shareholder cannot be repaid at the expense of the company's creditors. Although s. 40 does not expressly apply to s. 36, I think that the rationale for s. 40(3) applies to redemptions as well as to repurchases. Whether a repurchase or a redemption, the shareholder is not a creditor and is subordinate to the rights of creditors. More simply the shareholder does not have a provable claim.

148 The appellants rely on *National Bank für Deutschland v. Blucher*, *(*sub nom. *Blucher v. Canada (Custodian))* [1927] 3 D.L.R. 40 (S.C.C.), but in my view this case does not assist them. In *Blucher* dividends were declared on stock but payment of the dividends was suspended during World War I. The Supreme Court of Canada held at p. 43 that "[t]he right of recovery was in suspense during the war, but the debt nevertheless existed." In that case, however, the dividend was declared before the suspension of payment took place. Moreover, as Justice Finlayson points out in his reasons, courts have always accepted the

proposition that when a dividend is declared it is a debt on which each shareholder can sue the corporation.

149 Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies. Permitting preferred shareholders to be turned into creditors by endowing their shares with retraction rights runs contrary to this policy of creditor protection.

150 I would dismiss these appeals. I would not make any cost order. I am grateful to all counsel for their assistance on this interesting and difficult problem.

Appeals dismissed.

Footnotes

1 There is a discrepancy in the materials before this court on the relevant date for establishing a claim provable against Central Capital: S.Y.H. Corporation used May, 1992, the date of the Restated Subscription and Escrow Agreement whereas McCutcheon and the unsecured creditors of Central Capital Corporation used June 15, 1992, the date of the court-ordered stay of proceedings against Central Capital. I have used the May 1992 date but nothing turns on the use of this date as opposed to the June 15, 1992 date.

TAB 3

2004 CarswellQue 810
Quebec Superior Court

Cable Satisfaction International Inc. v. Richter & Associés inc.

2004 CarswellQue 810, [2004] Q.J. No. 5461, 48
C.B.R. (4th) 205, J.E. 2004-907, REJB 2004-55437

In the Matter of the plan of arrangement and reorganization of: Cable Satisfaction International Inc., Debtor, v. Richter & Associés inc., Interim Receiver - Monitor - Petitioner

Chaput J.

Heard: March 17, 2004
Judgment: March 19, 2004
Docket: C.S. Montréal 500-11-020963-035

Counsel: Me Mortimer Freiheit, Me Guy Martel for Cable Satisfaction Inc.
Me Martin Desrosiers, Me Sandra Abitan, Me David Tardif-Latourelle for Richter & Associés inc.
Me Denis Ferland, Me Vincent Mercier for Catalys Capital Group
Mr. Robert Chadwick for Goodmans LLP
Me Louise Lalonde for Banking Syndicate

Subject: Insolvency; Corporate and Commercial

MOTION by monitor for sanction of debtor company's plan of arrangement and reorganization.

***Chaput J.*:**

1 The Interim Receiver/Monitor (« Monitor ») petitions the Court to sanction a plan of arrangement and reorganization of Cable Satisfaction International Inc. (Csii). The petition is filed pursuant to section 6 of the *Companies' Creditors Arrangement Act* (C.C.A.A.) and section 191 of the *Canada Business Corporations Act* (C.B.C.A.).

Context

2 The Initial Order was made on July 4, 2003 at the request of Csii. That order was subsequently amended.

3 A first plan of arrangement was prepared, but never voted on by the creditors.

4 Following a letter of Commitment between The Catalyst Capital Group (Catalyst), who is a creditor of Csii to the extent of over US$52.9 million, and Cabovisão - Televisão por Cabo S.A., a subsidiary company of Csii in Portugal, Csii was to submit its plan of arrangement to its creditors by January 16, 2004.

5 That plan was filed but not submitted to the creditors.

6 On November 14, 2003, the Board of Csii terminated all of its employees.

7 On November 20, 2003, the Court appointed Petitioner as interim receiver to Csii and as Monitor replacing the Monitor initially appointed.

8 After the appointment of the interim receiver, the Court granted a motion to establish the Claims Process and the Information Circular with the proposed plan was completed and sent out to the creditors.

9 On February 17, 2004, the Court issued an order setting out the conditions for the procedure leading up to the meeting of creditors.

10 The meeting of creditors to vote on the proposed plan was held on March 16, 2004.

11 As is explained in the Information Circular :

> The Plan contemplates a series of steps leading to the overall capital reorganization of Csii including the following transactions to occur on the Effective Date.

12 And :

> Following the implementation of the Plan, the equity of Csii will be held as follows (assuming no exercise of Warrants and without any adjustments as a result of fractional or *de minimis* holdings):
>
> • 70% by the Investor Group and Participating Rightholders, as part of the New Investment;
>
> • 28% by Affected Creditors; and
>
> • 2% by Existing Shareholders.

13 Prior to the meeting of creditors, on March 12, the representative of the Noteholders who are creditors to the extent of US$ 155 million under 12 3/4 % notes due March 1, 2010,

issued by Csii pursuant to a trust indenture, advised the attorneys that he would table on behalf of the Noteholders before the creditors an amendment to the Plan.

14 On the same day, the Monitor announced the proposed amendment by press release. Csii published a press release on March 15, advising that it had not approved the proposed amendment and did not know if the creditors would approve it.

15 The purpose of the amendment was to eliminate the 2% participation of the shareholders and increase the share of the Noteholders to 30%.

16 At the meeting, the creditors voted to accept the amendment and then voted to accept the Amended and Restated Plan (« the Amended Plan »).

17 The Monitor asks the Court to sanction the Amended Plan.

18 On behalf of Csii, its attorneys have filed a Contestation to the Monitor's motion to sanction the Amended Plan.

19 The Contestation raises three reasons why the Amended Plan should not be sanctioned by the Court:

Absence of Consent of Csii

20 Csii alleges that a plan of arrangement proposed under the C.C.A.A., just as a proposal in bankruptcy, must be viewed as a contract. If it is to be altered or modified, the consent of the debtor company must be obtained.

Unfairness of the Amended Plan

21 According to Csii, it would be unfair to the shareholders to sanction the Amended Plan which eliminates their participation in the reorganization of the company, since the proxies, in particular those of 97% of the Noteholders representing 87% in value, contained instructions to vote for the Plan as proposed.

Lack of Procedural Fairness

22 Csii takes the position that, given the proxies to vote in favour of the Plan, the representative of the Noteholders had no authority to propose amendments to the Plan.

Discussion

Sanction Requirements

23 As to the principles governing an application for sanction of a plan pursuant to the C.C.A.A., Delisle, J. of the Quebec Court of Appeal writes in the case of *Michaud c. Steinberg Inc.*: [1]

> OBJECTIF DE LA L.A.C.C.
>
> Dans l'affaire Multidev Immobilia Inc. c. Société Anonyme Just Invest, [1988] R.J.Q. 1928 (C.A.), monsieur le juge Parent a rappelé le but visé de l'adoption de la loi (p. 1930):
>
>> « Il y a lieu de rappeler ici que la loi sur les arrangements avec les créanciers des compagnies a été adoptée au cours de la dépression, pour permettre à des compagnies en difficultés financières, débitrices aux termes d'obligations ou autres titres de créance en circulation, de conclure des ententes avec leurs créanciers, pour régler leurs problèmes en dehors des mécanismes prévus par la Loi sur la faillite et la Loi sur les liquidations. C'est une loi d'"équité » qui favorise des arrangements entre une telle compagnies et tous ses créanciers. »
>
> Le premier but de la L.A.C.C. était donc d'offrir aux compagnies qui rencontraient ses conditions d'application une alternative à certaines autres lois aux effets plus radicaux, l'objectif final étant de permettre à ces compagnies de survivre à des difficultés financières, avec l'accord de ses créanciers.
>
> Au cours des années, ce caractère curatif de la L.A.C.C. a été confirmé par la jurisprudence, de sorte qu'aujourd'hui il y a reconnaissance unanime de la raison d'être de la loi :
>
>> « The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business . . . » Hongkong Bank v. Chef Ready Foods (1991) 4 C.B.R. (3d) 311 (C.A.C.B.) (p. 315)
>>
>> . . . The Act envisions that the rights and remedies of individual creditors, the debtor company and others may be sacrificed, at least temporarily, in an effort to serve the greater good by arriving at some acceptable reorganization which allows the debtor company to continue in operation: . . . » Nova Metal Prods v. Comiskey (Trustee of), [1991] 1 C.B.R. (3d) 101 (C.A.O.) (p. 122)
>>
>> « La loi veut permettre à une compagnie débitrice de soumettre à l'ensemble de ses créanciers un plan de réorganisation . . . » Banque Laurentienne du Canada c. Groupe Bovac Ltée (1991) R.L. 593 (C.A.) (p. 613)

À cause précisément de l'objectif visé, la L.A.C.C. doit recevoir une interprétation libérale. La compagnie qui a recours à cette loi doit être en mesure d'atteindre sa fin.

C'est dans cette optique que le tribunal, saisi d'une requête en homologation d'un arrangement, doit exercer son rôle.

RÔLE DU TRIBUNAL SUR UNE REQUÊTE EN HOMOLOGATION D'ARRANGEMENT

La jurisprudence est bien campée sur le sujet. Les principes suivants s'en dégagent:

> a) le premier devoir du tribunal est de s'assurer que l'arrangement a été accepté par les créanciers conformément aux exigences de l'article 6 L.A.C.C.: il faut une majorité numérique représentant les trois quarts en valeur des créanciers ou d'une catégorie de créanciers, selon le cas, présents et votant soit en personne, soit par fondé de pouvoirs à une assemblée dûment convoquée à cette fin: In re Dorman, Long & Co. In re South Durham Steel and Iron Co., [1934] 1 Ch. 635 (p. 655); Re Northland Properties Ltd., [1989] 73 C.B.R. (N.S.) 175 (p. 182];
>
> b) le tribunal doit ensuite s'assurer du caractère raisonnable de l'arrangement; il faut que celui-ci soit bénéfique aux deux parties en présence; In re Alabama, New Orleans Texas and Pacific Junction Railway Co. [1891] 1 Ch. 213 (C.A.) (p. 243); In re English Scottish and Australian Chartered Bank, [1893] 3 Ch. 385 (C.A.) (p. 408); dans le premier de ces arrêts, Lord Bowen définit ce qu'il faut entendre par un arrangement raisonnable (p. 243):
>
> « A reasonable compromise must be a compromise which can, by reasonable people conversant with the subject, be regarded as beneficial to those on both sides who are making it . . . »
>
> c) le tribunal n'a pas à substituer sa propre appréciation de l'arrangement à celle des créanciers: Re Langley's Ltd., [1938] O.R. 123 (C.A.O.) (p. 142); Carruth v. Imperial Chemical Industries Ltd., [1937] A.C. 707 (p. 770);
>
> d) le tribunal doit cependant s'assurer, et c'est sûrement là la partie la plus importante de son rôle, qu'une minorité de créanciers n'est pas l'objet de coercition de la part de la majorité ou forcée d'accepter des conditions exorbitantes (« unconscionable »):
>
> » . . .

In reviewing the arrangement, the Court is placed under an obligation to see that there is not within the apparent majority some undisclosed or unwarranted coercion of the minority who may not have voted or who may have been opposed . . . » Re Gold Texas Resources Ltd., Brisith Columbia Supreme Court, A883238, (jugement du 14 février 1989; la juge McLachlin)

» . . . The court's role is to ensure that the creditors who are bound unwillingly under the Act are not made victims of the majority and forced to accept terms that are unconscionable . . . » Re Keddy Motors Inns Ltd., [1992] 13 C.B.R. (3d) 245 (C.A.N.E.) (p. 258)

Il y a maintenant lieu de passer aux moyens invoqués par les appellants au soutien de leur appel. »

24 As summarized by Chief Justice McEachern of the B.C. Court of Appeal in *Northland Properties Ltd., Re*: [2]

« The authorities do not permit any doubt about the principles to be applied in a case such as this. They are set out over and over again in many decided cases and may be summarized as follows:

(1) There must be strict compliance with all statutory requirements (it was not suggested in this case that the statutory requirements had not been satisfied);

(2) All material filed and procedures carried out must be examined to determine if anything has been done which is not authorized by the C.C.A.A.;

(3) The plan must be fair and reasonable.

25 The same principles apply to an application in the case of a reorganization under Section 191 C.B.C.A. in *Doman Industries Ltd., Re*., [3] Tysoe, J. writes :

« It was common ground between counsel on this application that the test to be applied by the Court under s. 191 of the *CBCA* is similar to the test applied in deciding whether to sanction a reorganization plan under the *CCAA*; namely:

(1) there must be compliance with all statutory requirements;

(2) the debtor company must be acting in good faith;

(3) the capital restructuring must be fair and reasonable.

26 The statutory requirements under the C.C.A.A. include various matters such as: the status of the company as a « debtor company »; the amount of its indebtedness; compliance with Court orders, especially that dealing with the calling of the creditors meeting; the determination of the classes of creditors; the procedure for calling the meeting of creditors and the voting.

27 As appears from the Contestation filed, an issue is raised as to the legality of the proposal to amend the plan and the voting of the creditors on the Amended Plan.

28 Save for that issue, on the basis of the documents filed and the testimony of the Monitor, it appears that the statutory requirements have been met.

29 Also, it is to be noted that the Amended Plan does contain a provision for the payment of the Crown claims as required by section 18.2 C.C.A.A. In addition, the Monitor has informed the Court that no such claims have become payable since the Court issued the Initial Order.

Contestation

30 The intent of the Contestation is that the Court refuses to sanction the Amended Plan, since it takes away the advantage which the shareholders would receive under the Plan.

31 It was raised during the pleadings that Csii cannot appear before the Court to plead in favour of the shareholders.

32 It is doubtful that Csii has the required legal interest to attend before the Court to argue what should be done in the interest of the shareholders. No doubt, as provided in section 122 C.B.C.A., the directors and officers of a corporation must act in the best interest of the corporation. But, in the present case, it is not the directors or officers who are before the Court, but Csii through its attorneys.

33 However, at the outset of the hearing, no preliminary exception was taken to the filing of the Contestation by Csii and the Contestation was pleaded.

34 The Contestation raises that the consent of Csii should have been obtained to the proposed amendment to the Plan, as a plan under the C.C.A.A. is to be considered a contract.

35 That is not the case. As is provided in section 4 of the C.C.A.A., the arrangement or compromise is a proposal. It is a plan of terms and conditions for the arrangement or compromise to be presented to the creditors for their consideration and eventual acceptance.

36 In the case of *Michaud*, [4] Delisle, J. commented that the binding force of the arrangement or compromise arises from the law itself through the sanction of the Court, and not from the effect of mutually agreed upon the terms as in a contract.

> « S'il est vrai qu'un arrangement est une offre qui, pour être soumise à l'autorité compétente pour homologation, nécessite son acceptation par les créanciers dans les proportions exigées par la L.A.C.C., il n'est pas exact, avec respect, de qualifier la situation juridique qui en résulte de « contrat liant les parties ». La conséquence de l'homologation d'un arrangement est de le rendre exécutoire par le seul effet de la loi, non de rendre obligatoires des stipulations découlant d'un contrat. »

37 The proxy to be completed by the Noteholders for the vote at the creditors' meeting contains the following:

> **Section 2 - To be completed by Noteholder**
>
> **THE NOTEHOLDER ______________________(insert name),** hereby revokes all proxies previously given and nominates, constitutes, and appoints Mr. Robert Chadwick of Goodmans LLP, counsel to the Noteholder committee, of failing him, such person as Mr. Robert Chadwick may designate, or instead ______________________(**insert name, if applicable**), as nominee of the Noteholder, with power of substitution, to attend on behalf of and act for the Noteholder at the Meeting of Affected Creditors to be held in connection with CSII's Plan and at any and all adjournments or postponements thereof, and to vote the Voting Claim of the Noteholder as follows:
>
> **A. (mark one only):**
>
> VOTE FOR approval of the Plan; or
>
> VOTE AGAINST approval of the Plan
>
> and
>
> **B. vote at the nominee's discretion and otherwise act thereat for and on behalf of the Noteholder in respect of any amendments or variations to the above matter and to any other matters that may come before the Meeting of Affected Creditors or any adjournment or postponement thereof.**

38 And the Information Circular did notify the creditors that the proxy holders could be called upon to vote on amendments to the proposed plan at the meeting of creditors.

> The forms of proxy accompanying this Circular are to be used in connection with the Meeting. Such forms of proxy confer discretionary authority upon the individuals named therein with respect to amendments or variations to matters identified in the Notice of Meeting and with respect to other matters which may properly come before the Meeting including amendments or variations to the Plan. Any material amendments to the Plan known prior to the Meeting will, to the extent practicable, be disclosed by press release and by notice to the service list; however, amendments to the Plan may be made at any time prior to the termination of the Meeting. Accordingly, Affected Creditors are urged to attend the Meeting in person.

39 The Monitor has testified 97% of the proxies tabulated were marked: « VOTE FOR approval of the plan ».

40 It is argued on behalf of Csii that the required majority of the proxies did indicate the intention of the creditors to vote for the plan that provided for a 2% distribution to the shareholders, and the Court should sanction the Plan as tabled at the meeting of creditors prior to the amendment.

41 The Court cannot accept that argument.

42 Nothing in the C.C.A.A. precludes creditors from proposing an amendment to the plan to be considered at the meeting of creditors. It clearly provides that a proposed plan may be modified before or at the meeting of creditors.

> 6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
>> (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and
>>
>> (b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy and Insolvency Act* or in the course of being wound up under the *Winding-up and Restructuring Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

> 7. Where an alteration or a modification of any compromise or arrangement is proposed at any time after the court has directed a meeting or meetings to be summoned, the meeting or meetings may be adjourned on such term as to notice and otherwise as the court may direct, and those directions may be given after as well as before adjournment of any meeting or meetings, and the court may in its discretion direct that it is not necessary to adjourn any meeting or to convene any further meeting of any class of creditors or shareholders that in the opinion of the court is not adversely affected by the alteration or modification proposed, and any compromise or arrangement so altered or modified may be sanctioned by the court and have effect under section 6.

43 The notice that the Noteholders would propose the amendment was given to the Monitor and press released by him on March 12. The meeting of creditors was scheduled on March 15.

44 No doubt that is a short notice. But it was possible for any one of the creditors or any other interested party to request from the Monitor or by Court Order an adjournment of the meeting. Also, the adjournment could have been requested at the meeting at the time the amendment was proposed.

45 That is not the case. It appears from the results of the voting that the creditors did consider the proposed amendment and did vote for it.

46 To accept the position of Csii that the Court should sanction the Plan as proposed before the amendment would mean that it sanctions a plan on which the creditors have not voted. The plan submitted for sanction must necessarily be the one voted on by the creditors. The Court cannot force on the creditors a plan which they have not voted to accept.

47 The Monitor did testify that if either the Plan or the Amended Plan is not implemented, the only alternative available is the liquidation of Csii. In that case, the creditors will have a greater loss than under the Plan or the Amended Plan.

48 As regards the interests of the creditors, at this stage there appears to be no other viable option than to carry forward with the arrangement.

49 From the representations made, the Court understands that the shareholders are not investing nor participating in the arrangement or the reorganization.

50 The Amended Plan does take away the 2% participation which had been proposed for the shareholders. However, the creditors who will suffer an important shortfall have decided that since the shareholders bring nothing to the efforts being made to revitalize the company, they should get nothing.

51 In the present case, the reorganization proposed in the Plan is also sought under section 191 C.B.C.A. Sub-section (7) of that section reads as follows:

> (7) A shareholder is not entitled to dissent under section 190 if an amendment to the articles of incorporation is effected under this section.

52 On a reorganization, Martel comments as follows [5]:

> « Lorsqu'une société fédérale est insolvable et qu'elle fait une proposition à ses créanciers en vertu de la *Loi sur la faillite et l'insolvabilité* ou une transaction ou un arrangement avec ceux-ci sous l'autorité de la *Loi sur les arrangements avec les créanciers des compagnies*, elle peut à cette occasion apporter des modifications à ses statuts par voie de réorganisation en vertu de l'article 191 de la *Loi canadienne sur les sociétés par actions*. L'ordonnance rendue par le tribunal en vertu des deux premières de ces lois peut effectuer dans les statuts de la société toute modification prévue à l'article 173, incluant des modifications au capital-actions, sans qu'aucune résolution des actionnaires ne soit requise. De plus, le tribunal qui rend l'ordonnance peut autoriser, en en fixant les modalités, l'émission de titres de créance (obligations, débentures ou billets) convertibles ou non en actions de toute catégorie ou assorties de l'option d'acquérir de telles actions; il peut aussi ajouter d'autres administrateurs ou remplacer ceux qui sont en fonction.
>
> La réorganisation ordonnée par le tribunal s'effectue par le dépôt de clauses de réorganisation (formule 14) auprès du Directeur, et de la délivrance par celui-ci d'un certificat de modification.
>
> Non seulement les actionnaires ne sont-ils pas appelés à voter sur la réorganisation, mais en plus ils ne bénéficient pas du droit de dissidence. Le raisonnement derrière cette entorse à la protection statutaire des actionnaires est que, puisque la société est insolvable, leurs actions ne valent rien et il ne leur appartient pas de faire échec à une proposition ou un arrangement avec les créanciers qui sera à l'avantage de la société et, éventuellement, si la société parvient à survivre et à redémarrer grâce à cette démarche, au leur. »
>
> (*references omitted*)

53 And, in the case of an arrangement proposed under the C.C.A.A., the shareholders of the debtor company cannot expect any advantage from the arrangement. As the company is insolvent, the shareholders have no economic interest to protect. More so when, as in the present case, the shareholders are not contributing to any of the funding required by the Plan. Accordingly, they have no standing to claim a right under the proposed arrangement. As Paperny, J. wrote in *Canadian Airlines Corp., Re*: [6]

> [Paragraph 143] « Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of a liquidation of insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. <u>Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where the creditors' claims are not being paid in full</u>. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have « a true interest to be protected » because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: *Royal Oak Mines Ltd., supra*, par. 4, *Re Cadillac Fairview Inc.* (March 7, 1995), Doc. B28/95 (Ont. Gen Div. [Continental List]) and *T. Eaton Company, supra. »*
>
> (*emphasis added*)
>
> [Paragraph 170] « [. . .] « Where secured creditors have compromised their claims and unsecured creditors are accepting 13 cents on the dollar in a potential pool of unsecured claims totalling possibly in excess of $1 billion, <u>it is not unfair that shareholders receive nothing</u>. »
>
> (*emphasis added)*

54 In the end, the Amended Plan does not appear to be unfair and should be sanctioned.

55 (As regards the other conclusions sought in the Motion, there was no contestation.)

56 FOR THESE REASONS, THE COURT:

57 GRANTS the motion pf Petitioner to sanction the Second Amended and Restated Plan of Arrangement and Reorganization of Cable Satisfaction International Inc. (the « Motion »);

58 DECLARES that the time for service of the Motion is hereby abridged and that Cable Satisfaction International Inc., all creditors and shareholders have been properly notified;

59 DECLARES that capitalized terms used in the Motion and not otherwise defined herein shall have the meaning set out in the Second Amended and Restated Plan of Arrangement and Reorganization, Exhibit M-19 (the « Amended Plan »);

60 SANCTIONS the Amended Plan pursuant to Section 6 of the *Companies*' *Creditors Arrangement Act*;

61 DIRECTS and AUTHORIZES Richter & Associés Inc., acting for and on behalf of Cable Satisfaction International Inc., to complete all of the corporate and financial transactions contemplated under the Amended Plan, including, without limitation, (i) all acts required in section 3.1 of the Amended Plan, and (ii) the incorporation of a new wholly-owned subsidiary under the laws of the Netherlands;

62 DECLARES that the compromises and the reorganization of share capital effected by the Amended Plan (including section 6 thereof) are approved, binding and effective upon all Affected Creditors, shareholders of Cable Satisfaction International Inc. and other Persons affected by the Amended Plan;

63 APPROVES the form of articles of reorganization, Exhibit M-21, providing for the reorganization of Cable Satisfaction International Inc.'s share capital, including the appointment of the New Board as contemplated by Section 9.4 of the Amended Plan;

64 APPROVES the releases and discharges as at the Effective Date of Cable Satisfaction International Inc. and other Persons in accordance with the provisions of Section 9.1 and 9.3 of the Amended Plan;

65 DISCHARGES as at the Effective Date all charges against assets of Cable Satisfaction International Inc. by any Order;

66 DISCHARGES, as at the Effective date, the Monitor and the Interim Receiver from all duties (except, in the case of the Monitor, the adjudication of Claims which then remain unresolved and any other duties specified by the orders rendered herein) and RELEASES the Monitor and the Interim Receiver from any and all claims as at the Effective Date;

67 STAYS any and all steps or proceedings, including, without limitation, administrative orders, declarations or assessments commenced, taken or proceeded with against any of the Persons released pursuant to Section 9.1 and 9.3 of the Amended Plan and to the extent provided therein;

68 DECLARES the Shareholders Agreement terminated as at the Effective Date;

69 DECLARES the Trust Indenture terminated and Cable Satisfaction International Inc. released from its obligations thereunder upon the Effective Date;

70 DECLARES all issued and outstanding options (including any options issued pursuant to the Stock Option Plan), warrants (including warrants issued pursuant to the Existing Warrant Indenture) and rights to acquire shares of Cable Satisfaction International Inc. cancelled as at the Effective Date without payment of any consideration, and DECLARES the Stock Option Plan and Existing Warrant Indenture terminated as at the Effective Date;

71 CONFIRMS that all executory contracts to which Cable Satisfaction International Inc. is a party are in full force and effect notwithstanding the Proceedings, or the Amended Plan and its attendant compromises, and that no Person party to any such executory contract shall be entitled to terminate or repudiate its obligations under such contract by reason of the commencement of the Proceedings or the content of the Amended Plan, or the compromises effected under the Amended Plan (excluding, for greater certainly, the agreement referred to in paragraphs 67, 68 and 69 above and the Lease Agreement);

72 GIVES EFFECT from and after the Effective Date to the waivers, permanent injunction and other provisions contemplated by Section 9.2 of the Amended Plan;

73 DECLARES that all the transactions contemplated in the Amended Plan will be effective as of the Effective Date unless otherwise provided in the Amended Plan and are authorized and approved under the Amended Plan and by this Court, where appropriate, as part of the orders rendered herein, in all respects and for all purposes without any requirement of further action by the Affected Creditors or the shareholders or directors of Cable Satisfaction International Inc.;

74 DECLARES that following the Effective Date, all Charges in respect of the Claims of the Affected Creditors will be released and all instruments or other documents related thereto, if any, will be terminated and cancelled. If any affected Creditors refuses to provide a discharge in respect of registered Charges to Cable Satisfaction International Inc. on terms acceptable to Cable Satisfaction International Inc., Cable Satisfaction International Inc. will seek an Order from the Court (or any court of competent jurisdiction in the jurisdiction where such Charges are registered) for the discharge of the Charges of such Affected Creditor from title to the affected property;

75 DECLARES that on the Effective Date, each Affected Creditor whose Claim is affected by the Amended Plan shall be deemed to have consented and agreed to all of the provisions of the Amended Plan in their entirety. In particular, each Affected Creditor whose Claim is affected by the Amended Plan shall be deemed:

> a) to have executed and delivered to Cable Satisfaction International Inc. all consents, releases, assignments and waivers, statutory or otherwise, required to implement and carry out the Amended Plan in its entirety;
>
> b) to have waived any non-compliance by Cable Satisfaction International Inc. with any provision, express or implied, in any agreement or other arrangement, written or oral, referred to in Section 9.2 of the Amended Plan existing between such Affected Creditor and Cable Satisfaction Inc. that has occurred on or prior to

the Effective Date, and where provided for in the orders rendered herein, after the Effective Date as provided herein; and

c) to have agreed that, if there is any conflict between the provisions, express or implied, of any agreement or other arrangement, written or oral, existing between such Affected Creditor and Cable Satisfaction International Inc. at the Effective Date (other than those entered into by Cable Satisfaction International Inc. on, or with effect from, the Effective Date) and the provisions of the Amended Plan, the provisions of the Amended Plan take precedence and priority and the provisions of such agreement or other arrangement shall be deemed to be amended accordingly;

76 DECLARES, to the extent provided in the Amended Plan that the terms and conditions of the Amended Plan and procedures for the exchange of Common Shares and Rights are fair to those to whom securities will be issued;

77 ORDERS that:

a) the Amended Initial Order remains in full force and effect and that the Stay Termination Date (as defined in paragraph 22 of the Initial Order) is hereby extended until the earlier of the Effective Date and April 30, 2004; and

b) the appointment of Richter & Associés Inc. as Interim Receiver under the Interim Receiver Order remains in full force and effect until the earlier of the Effective Date and April 30, 2004;

78 DECLARES that the orders rendered herein shall supersede and/or complete any previous Order;

79 DECLARES the orders rendered herein executory notwithstanding any appeal or application seeking leave therefrom;

80 WITHOUT COSTS.

Motion allowed.

Footnotes

1 [1993 CarswellQue 229 (Que. C.A.)], 500-09-000668-939, June 16, 1993 (C.C.A.), p. 3 to 7.

2 (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.), p. 3 and 4.

3 (2003), 41 C.B.R. (4th) 42 (B.C. S.C. [In Chambers]), 45.

4 Above, note 1, p. 18.

5 La compagnie au Québec, Éditions Wilson & Lafleur Martel Ltée, 2004, p. 19-87 - 19-88.

6 (2000), 20 C.B.R. (4th) 1 (Alta. Q.B.).

End of Document

TAB 4

2000 ABQB 442
Alberta Court of Queen's Bench

Canadian Airlines Corp., Re

2000 CarswellAlta 662, 2000 ABQB 442, [2000] 10 W.W.R. 269, [2000] A.W.L.D. 654, [2000] A.J. No. 771, 20 C.B.R. (4th) 1, 265 A.R. 201, 84 Alta. L.R. (3d) 9, 98 A.C.W.S. (3d) 334, 9 B.L.R. (3d) 41

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

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

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

Paperny J.

Heard: June 5-19, 2000
Judgment: June 27, 2000 *
Docket: Calgary 0001-05071

Counsel: *A.L. Friend, Q.C.*, *H.M. Kay, Q.C.*, *R.B. Low, Q.C.*, and *L. Goldbach*, for Petitioners.
S.F. Dunphy, *P. O'Kelly*, and *E. Kolers*, for Air Canada and 853350 Alberta Ltd.
D.R. Haigh, Q.C., *D.N. Nishimura*, *A.Z.A. Campbell* and *D. Tay*, for Resurgence Asset Management LLC.
L.R. Duncan, Q.C., and *G. McCue*, for Neil Baker, Michael Salter, Hal Metheral, and Roger Midiaty.
F.R. Foran, Q.C., and *P.T. McCarthy, Q.C.*, for Monitor, PwC.
G.B. Morawetz, *R.J. Chadwick* and *A. McConnell*, for Senior Secured Noteholders and the Bank of Nova Scotia Trust Co.
C.J. Shaw, Q.C., for Unionized Employees.
T. Mallett and *C. Feasby*, for Amex Bank of Canada.
E.W. Halt, for J. Stephens Allan, Claims Officer.
M. Hollins, for Pacific Costal Airlines.
P. Pastewka, for JHHD Aircraft Leasing No. 1 and No. 2.
J. Thom, for Royal Bank of Canada.

J. Medhurst-Tivadar, for Canada Customs and Revenue Agency.
R. Wilkins, Q.C., for Calgary and Edmonton Airport Authority.

Subject: Corporate and Commercial; Insolvency

APPLICATION by airline for approval of plan of arrangement; COUNTER-APPLICATION by investment corporation for declaration that plan constituted merger or transfer of airline's assets to AC Corp., that plan would not affect investment corporation, and directing repurchase of notes pursuant to trust indenture, and that actions of airline and AC Corp. in formulating plan were oppressive and unfairly prejudicial; COUNTER-APPLICATION by minority shareholders.

***Paperny J.*:**

I. Introduction

1 After a decade of searching for a permanent solution to its ongoing, significant financial problems, Canadian Airlines Corporation ("CAC") and Canadian Airlines International Ltd. ("CAIL") seek the court's sanction to a plan of arrangement filed under the *Companies' Creditors Arrangement Act* ("CCAA") and sponsored by its historic rival, Air Canada Corporation ("Air Canada"). To Canadian, this represents its last choice and its only chance for survival. To Air Canada, it is an opportunity to lead the restructuring of the Canadian airline industry, an exercise many suggest is long overdue. To over 16,000 employees of Canadian, it means continued employment. Canadian Airlines will operate as a separate entity and continue to provide domestic and international air service to Canadians. Tickets of the flying public will be honoured and their frequent flyer points maintained. Long term business relationships with trade creditors and suppliers will continue.

2 The proposed restructuring comes at a cost. Secured and unsecured creditors are being asked to accept significant compromises and shareholders of CAC are being asked to accept that their shares have no value. Certain unsecured creditors oppose the plan, alleging it is oppressive and unfair. They assert that Air Canada has appropriated the key assets of Canadian to itself. Minority shareholders of CAC, on the other hand, argue that Air Canada's financial support to Canadian, before and during this restructuring process, has increased the value of Canadian and in turn their shares. These two positions are irreconcilable, but do reflect the perception by some that this plan asks them to sacrifice too much.

3 Canadian has asked this court to sanction its plan under s. 6 of the CCAA. The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all the stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan represent a fair and reasonable compromise that will permit a viable commercial

entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.

II. Background

Canadian Airlines and its Subsidiaries

4 CAC and CAIL are corporations incorporated or continued under the *Business Corporations Act* of Alberta, S.A. 1981, c. B-15 ("ABCA"). 82% of CAC's shares are held by 853350 Alberta Ltd.("853350") and the remaining 18% are held publicly. CAC, directly or indirectly, owns the majority of voting shares in and controls the other Petitioner, CAIL and these shares represent CAC's principal asset. CAIL owns or has an interest in a number of other corporations directly engaged in the airline industry or other businesses related to the airline industry, including Canadian Regional Airlines Limited ("CRAL"). Where the context requires, I will refer to CAC and CAIL jointly as "Canadian" in these reasons.

5 In the past fifteen years, CAIL has grown from a regional carrier operating under the name Pacific Western Airlines ("PWA") to one of Canada's two major airlines. By mid-1986, Canadian Pacific Air Lines Limited ("CP Air"), had acquired the regional carriers Nordair Inc. ("Nordair") and Eastern Provincial Airways ("Eastern"). In February, 1987, PWA completed its purchase of CP Air from Canadian Pacific Limited. PWA then merged the four predecessor carriers (CP Air, Eastern, Nordair, and PWA) to form one airline, "Canadian Airlines International Ltd.", which was launched in April, 1987.

6 By April, 1989, CAIL had acquired substantially all of the common shares of Wardair Inc. and completed the integration of CAIL and Wardair Inc. in 1990.

7 CAIL and its subsidiaries provide international and domestic scheduled and charter air transportation for passengers and cargo. CAIL provides scheduled services to approximately 30 destinations in 11 countries. Its subsidiary, Canadian Regional Airlines (1998) Ltd. ("CRAL 98") provides scheduled services to approximately 35 destinations in Canada and the United States. Through code share agreements and marketing alliances with leading carriers, CAIL and its subsidiaries provide service to approximately 225 destinations worldwide. CAIL is also engaged in charter and cargo services and the provision of services to third parties, including aircraft overhaul and maintenance, passenger and cargo handling, flight simulator and equipment rentals, employee training programs and the sale of Canadian Plus frequent flyer points. As at December 31, 1999, CAIL operated approximately 79 aircraft.

8 CAIL directly and indirectly employs over 16,000 persons, substantially all of whom are located in Canada. The balance of the employees are located in the United States, Europe, Asia, Australia, South America and Mexico. Approximately 88% of the active employees of CAIL are subject to collective bargaining agreements.

Events Leading up to the CCAA Proceedings

9 Canadian's financial difficulties significantly predate these proceedings.

10 In the early 1990s, Canadian experienced significant losses from operations and deteriorating liquidity. It completed a financial restructuring in 1994 (the "1994 Restructuring") which involved employees contributing $200,000,000 in new equity in return for receipt of entitlements to common shares. In addition, Aurora Airline Investments, Inc. ("Aurora"), a subsidiary of AMR Corporation ("AMR"), subscribed for $246,000,000 in preferred shares of CAIL. Other AMR subsidiaries entered into comprehensive services and marketing arrangements with CAIL. The governments of Canada, British Columbia and Alberta provided an aggregate of $120,000,000 in loan guarantees. Senior creditors, junior creditors and shareholders of CAC and CAIL and its subsidiaries converted approximately $712,000,000 of obligations into common shares of CAC or convertible notes issued jointly by CAC and CAIL and/or received warrants entitling the holder to purchase common shares.

11 In the latter half of 1994, Canadian built on the improved balance sheet provided by the 1994 Restructuring, focussing on strict cost controls, capacity management and aircraft utilization. The initial results were encouraging. However, a number of factors including higher than expected fuel costs, rising interest rates, decline of the Canadian dollar, a strike by pilots of Time Air and the temporary grounding of Inter-Canadien's ATR-42 fleet undermined this improved operational performance. In 1995, in response to additional capacity added by emerging charter carriers and Air Canada on key transcontinental routes, CAIL added additional aircraft to its fleet in an effort to regain market share. However, the addition of capacity coincided with the slow-down in the Canadian economy leading to traffic levels that were significantly below expectations. Additionally, key international routes of CAIL failed to produce anticipated results. The cumulative losses of CAIL from 1994 to 1999 totalled $771 million and from January 31, 1995 to August 12, 1999, the day prior to the issuance by the Government of Canada of an Order under Section 47 of the *Canada Transportation Act* (relaxing certain rules under the *Competition Act* to facilitate a restructuring of the airline industry and described further below), the trading price of Canadian's common shares declined from $7.90 to $1.55.

12 Canadian's losses incurred since the 1994 Restructuring severely eroded its liquidity position. In 1996, Canadian faced an environment where the domestic air travel market saw increased capacity and aggressive price competition by two new discount carriers based in western Canada. While Canadian's traffic and load factor increased indicating a positive response to Canadian's post-restructuring business plan, yields declined. Attempts by Canadian to reduce domestic capacity were offset by additional capacity being introduced by the new discount carriers and Air Canada.

13 The continued lack of sufficient funds from operations made it evident by late fall of 1996 that Canadian needed to take action to avoid a cash shortfall in the spring of 1997. In November 1996, Canadian announced an operational restructuring plan (the "1996 Restructuring") aimed at returning Canadian to profitability and subsequently implemented a payment deferral plan which involved a temporary moratorium on payments to certain lenders and aircraft operating lessors to provide a cash bridge until the benefits of the operational restructuring were fully implemented. Canadian was able successfully to obtain the support of its lenders and operating lessors such that the moratorium and payment deferral plan was able to proceed on a consensual basis without the requirement for any court proceedings.

14 The objective of the 1996 Restructuring was to transform Canadian into a sustainable entity by focussing on controllable factors which targeted earnings improvements over four years. Three major initiatives were adopted: network enhancements, wage concessions as supplemented by fuel tax reductions/rebates, and overhead cost reductions.

15 The benefits of the 1996 Restructuring were reflected in Canadian's 1997 financial results when Canadian and its subsidiaries reported a consolidated net income of $5.4 million, the best results in 9 years.

16 In early 1998, building on its 1997 results, Canadian took advantage of a strong market for U.S. public debt financing in the first half of 1998 by issuing U.S. $175,000,000 of senior secured notes in April, 1998 ("Senior Secured Notes") and U.S. $100,000,000 of unsecured notes in August, 1998 ("Unsecured Notes").

17 The benefits of the 1996 Restructuring continued in 1998 but were not sufficient to offset a number of new factors which had a significant negative impact on financial performance, particularly in the fourth quarter. Canadian's eroded capital base gave it limited capacity to withstand negative effects on traffic and revenue. These factors included lower than expected operating revenues resulting from a continued weakness of the Asian economies, vigorous competition in Canadian's key western Canada and the western U.S. transborder markets, significant price discounting in most domestic markets following a labour disruption at Air Canada and CAIL's temporary loss of the ability to code-share with American Airlines on certain transborder flights due to a pilot dispute at American Airlines. Canadian also had increased operating expenses primarily due to the deterioration of the value of the Canadian dollar and additional airport and navigational fees imposed by NAV Canada which were not recoverable by Canadian through fare increases because of competitive pressures. This resulted in Canadian and its subsidiaries reporting a consolidated loss of $137.6 million for 1998.

18 As a result of these continuing weak financial results, Canadian undertook a number of additional strategic initiatives including entering the *oneworldTM* Alliance, the introduction of its new "Proud Wings" corporate image, a restructuring of CAIL's Vancouver hub, the sale and leaseback of certain aircraft, expanded code sharing arrangements and the implementation of a service charge in an effort to recover a portion of the costs relating to NAV Canada fees.

19 Beginning in late 1998 and continuing into 1999, Canadian tried to access equity markets to strengthen its balance sheet. In January, 1999, the Board of Directors of CAC determined that while Canadian needed to obtain additional equity capital, an equity infusion alone would not address the fundamental structural problems in the domestic air transportation market.

20 Canadian believes that its financial performance was and is reflective of structural problems in the Canadian airline industry, most significantly, over capacity in the domestic air transportation market. It is the view of Canadian and Air Canada that Canada's relatively small population and the geographic distribution of that population is unable to support the overlapping networks of two full service national carriers. As described further below, the Government of Canada has recognized this fundamental problem and has been instrumental in attempts to develop a solution.

Initial Discussions with Air Canada

21 Accordingly, in January, 1999, CAC's Board of Directors directed management to explore all strategic alternatives available to Canadian, including discussions regarding a possible merger or other transaction involving Air Canada.

22 Canadian had discussions with Air Canada in early 1999. AMR also participated in those discussions. While several alternative merger transactions were considered in the course of these discussions, Canadian, AMR and Air Canada were unable to reach agreement.

23 Following the termination of merger discussions between Canadian and Air Canada, senior management of Canadian, at the direction of the Board and with the support of AMR, renewed its efforts to secure financial partners with the objective of obtaining either an equity investment and support for an eventual merger with Air Canada or immediate financial support for a merger with Air Canada.

Offer by Onex

24 In early May, the discussions with Air Canada having failed, Canadian focussed its efforts on discussions with Onex Corporation ("Onex") and AMR concerning the basis upon which a merger of Canadian and Air Canada could be accomplished.

25 On August 23, 1999, Canadian entered into an Arrangement Agreement with Onex, AMR and Airline Industry Revitalization Co. Inc. ("AirCo") (a company owned jointly by Onex and AMR and controlled by Onex). The Arrangement Agreement set out the terms of a Plan of Arrangement providing for the purchase by AirCo of all of the outstanding common and non-voting shares of CAC. The Arrangement Agreement was conditional upon, among other things, the successful completion of a simultaneous offer by AirCo for all of the voting and non-voting shares of Air Canada. On August 24, 1999, AirCo announced its offers to purchase the shares of both CAC and Air Canada and to subsequently merge the operations of the two airlines to create one international carrier in Canada.

26 On or about September 20, 1999 the Board of Directors of Air Canada recommended against the AirCo offer. On or about October 19, 1999, Air Canada announced its own proposal to its shareholders to repurchase shares of Air Canada. Air Canada's announcement also indicated Air Canada's intention to make a bid for CAC and to proceed to complete a merger with Canadian subject to a restructuring of Canadian's debt.

27 There were several rounds of offers and counter-offers between AirCo and Air Canada. On November 5, 1999, the Quebec Superior Court ruled that the AirCo offer for Air Canada violated the provisions of the *Air Canada Public Participation Act*. AirCo immediately withdrew its offers. At that time, Air Canada indicated its intention to proceed with its offer for CAC.

28 Following the withdrawal of the AirCo offer to purchase CAC, and notwithstanding Air Canada's stated intention to proceed with its offer, there was a renewed uncertainty about Canadian's future which adversely affected operations. As described further below, Canadian lost significant forward bookings which further reduced the company's remaining liquidity.

Offer by 853350

29 On November 11, 1999, 853350 (a corporation financed by Air Canada and owned as to 10% by Air Canada) made a formal offer for all of the common and non-voting shares of CAC. Air Canada indicated that the involvement of 853350 in the take-over bid was necessary in order to protect Air Canada from the potential adverse effects of a restructuring of Canadian's debt and that Air Canada would only complete a merger with Canadian after the completion of a debt restructuring transaction. The offer by 853350 was conditional upon, among other things, a satisfactory resolution of AMR's claims in respect of Canadian and a satisfactory resolution of certain regulatory issues arising from the announcement

made on October 26, 1999 by the Government of Canada regarding its intentions to alter the regime governing the airline industry.

30 As noted above, AMR and its subsidiaries and affiliates had certain agreements with Canadian arising from AMR's investment (through its wholly owned subsidiary, Aurora Airline Investments, Inc.) in CAIL during the 1994 Restructuring. In particular, the Services Agreement by which AMR and its subsidiaries and affiliates provided certain reservations, scheduling and other airline related services to Canadian provided for a termination fee of approximately $500 million (as at December 31, 1999) while the terms governing the preferred shares issued to Aurora provided for exchange rights which were only retractable by Canadian upon payment of a redemption fee in excess of $500 million (as at December 31, 1999). Unless such provisions were amended or waived, it was practically impossible for Canadian to complete a merger with Air Canada since the cost of proceeding without AMR's consent was simply too high.

31 Canadian had continued its efforts to seek out all possible solutions to its structural problems following the withdrawal of the AirCo offer on November 5, 1999. While AMR indicated its willingness to provide a measure of support by allowing a deferral of some of the fees payable to AMR under the Services Agreement, Canadian was unable to find any investor willing to provide the liquidity necessary to keep Canadian operating while alternative solutions were sought.

32 After 853350 made its offer, 853350 and Air Canada entered into discussions with AMR regarding the purchase by 853350 of AMR's shareholding in CAIL as well as other matters regarding code sharing agreements and various services provided to Canadian by AMR and its subsidiaries and affiliates. The parties reached an agreement on November 22, 1999 pursuant to which AMR agreed to reduce its potential damages claim for termination of the Services Agreement by approximately 88%.

33 On December 4, 1999, CAC's Board recommended acceptance of 853350's offer to its shareholders and on December 21, 1999, two days before the offer closed, 853350 received approval for the offer from the Competition Bureau as well as clarification from the Government of Canada on the proposed regulatory framework for the Canadian airline industry.

34 As noted above, Canadian's financial condition deteriorated further after the collapse of the AirCo Arrangement transaction. In particular:

> a) the doubts which were publicly raised as to Canadian's ability to survive made Canadian's efforts to secure additional financing through various sale-leaseback transactions more difficult;

b) sales for future air travel were down by approximately 10% compared to 1998;

c) CAIL's liquidity position, which stood at approximately $84 million (consolidated cash and available credit) as at September 30, 1999, reached a critical point in late December, 1999 when it was about to go negative.

35 In late December, 1999, Air Canada agreed to enter into certain transactions designed to ensure that Canadian would have enough liquidity to continue operating until the scheduled completion of the 853350 take-over bid on January 4, 2000. Air Canada agreed to purchase rights to the Toronto-Tokyo route for $25 million and to a sale-leaseback arrangement involving certain unencumbered aircraft and a flight simulator for total proceeds of approximately $20 million. These transactions gave Canadian sufficient liquidity to continue operations through the holiday period.

36 If Air Canada had not provided the approximate $45 million injection in December 1999, Canadian would likely have had to file for bankruptcy and cease all operations before the end of the holiday travel season.

37 On January 4, 2000, with all conditions of its offer having been satisfied or waived, 853350 purchased approximately 82% of the outstanding shares of CAC. On January 5, 1999, 853350 completed the purchase of the preferred shares of CAIL owned by Aurora. In connection with that acquisition, Canadian agreed to certain amendments to the Services Agreement reducing the amounts payable to AMR in the event of a termination of such agreement and, in addition, the unanimous shareholders agreement which gave AMR the right to require Canadian to purchase the CAIL preferred shares under certain circumstances was terminated. These arrangements had the effect of substantially reducing the obstacles to a restructuring of Canadian's debt and lease obligations and also significantly reduced the claims that AMR would be entitled to advance in such a restructuring.

38 Despite the $45 million provided by Air Canada, Canadian's liquidity position remained poor. With January being a traditionally slow month in the airline industry, further bridge financing was required in order to ensure that Canadian would be able to operate while a debt restructuring transaction was being negotiated with creditors. Air Canada negotiated an arrangement with the Royal Bank of Canada ("Royal Bank") to purchase a participation interest in the operating credit facility made available to Canadian. As a result of this agreement, Royal Bank agreed to extend Canadian's operating credit facility from $70 million to $120 million in January, 2000 and then to $145 million in March, 2000. Canadian agreed to supplement the assignment of accounts receivable security originally securing Royal's $70 million facility with a further Security Agreement securing certain unencumbered assets of Canadian in consideration for this increased credit availability. Without the support

of Air Canada or another financially sound entity, this increase in credit would not have been possible.

39 Air Canada has stated publicly that it ultimately wishes to merge the operations of Canadian and Air Canada, subject to Canadian completing a financial restructuring so as to permit Air Canada to complete the acquisition on a financially sound basis. This pre-condition has been emphasized by Air Canada since the fall of 1999.

40 Prior to the acquisition of majority control of CAC by 853350, Canadian's management, Board of Directors and financial advisors had considered every possible alternative for restoring Canadian to a sound financial footing. Based upon Canadian's extensive efforts over the past year in particular, but also the efforts since 1992 described above, Canadian came to the conclusion that it must complete a debt restructuring to permit the completion of a full merger between Canadian and Air Canada.

41 On February 1, 2000, Canadian announced a moratorium on payments to lessors and lenders. As a result of this moratorium Canadian defaulted on the payments due under its various credit facilities and aircraft leases. Absent the assistance provided by this moratorium, in addition to Air Canada's support, Canadian would not have had sufficient liquidity to continue operating until the completion of a debt restructuring.

42 Following implementation of the moratorium, Canadian with Air Canada embarked on efforts to restructure significant obligations by consent. The further damage to public confidence which a CCAA filing could produce required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection.

43 Before the Petitioners started these CCAA proceedings, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

44 Canadian and Air Canada have also been able to reach agreement with the remaining affected secured creditors, being the holders of the U.S. $175 million Senior Secured Notes, due 2005, (the "Senior Secured Noteholders") and with several major unsecured creditors in addition to AMR, such as Loyalty Management Group Canada Inc.

45 On March 24, 2000, faced with threatened proceedings by secured creditors, Canadian petitioned under the CCAA and obtained a stay of proceedings and related interim relief by Order of the Honourable Chief Justice Moore on that same date. Pursuant to that Order, PricewaterhouseCoopers, Inc. was appointed as the Monitor, and companion proceedings in the United States were authorized to be commenced.

46 Since that time, due to the assistance of Air Canada, Canadian has been able to complete the restructuring of the remaining financial obligations governing all aircraft to be retained

by Canadian for future operations. These arrangements were approved by this Honourable Court in its Orders dated April 14, 2000 and May 10, 2000, as described in further detail below under the heading "The Restructuring Plan".

47 On April 7, 2000, this court granted an Order giving directions with respect to the filing of the plan, the calling and holding of meetings of affected creditors and related matters.

48 On April 25, 2000 in accordance with the said Order, Canadian filed and served the plan (in its original form) and the related notices and materials.

49 The plan was amended, in accordance with its terms, on several occasions, the form of Plan voted upon at the Creditors' Meetings on May 26, 2000 having been filed and served on May 25, 2000 (the "Plan").

The Restructuring Plan

50 The Plan has three principal aims described by Canadian:

(a) provide near term liquidity so that Canadian can sustain operations;

(b) allow for the return of aircraft not required by Canadian; and

(c) permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset values and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

51 The proposed treatment of stakeholders is as follows:

1. Unaffected Secured Creditors- Royal Bank, CAIL's operating lender, is an unaffected creditor with respect to its operating credit facility. Royal Bank holds security over CAIL's accounts receivable and most of CAIL's operating assets not specifically secured by aircraft financiers or the Senior Secured Noteholders. As noted above, arrangements entered into between Air Canada and Royal Bank have provided CAIL with liquidity necessary for it to continue operations since January 2000.

Also unaffected by the Plan are those aircraft lessors, conditional vendors and secured creditors holding security over CAIL's aircraft who have entered into agreements with CAIL and/or Air Canada with respect to the restructuring of CAIL's obligations. A number of such agreements, which were initially contained in the form of letters of intent ("LOIs"), were entered into prior to the commencement of the CCAA proceedings, while a total of 17 LOIs were completed after that date. In its Second and Fourth Reports the Monitor reported to the court on these agreements. The LOIs entered into after the proceedings commenced were reviewed and approved by the court on April 14, 2000 and May 10, 2000.

The basis of the LOIs with aircraft lessors was that the operating lease rates were reduced to fair market lease rates or less, and the obligations of CAIL under the leases were either assumed or guaranteed by Air Canada. Where the aircraft was subject to conditional sale agreements or other secured indebtedness, the value of the secured debt was reduced to the fair market value of the aircraft, and the interest rate payable was reduced to current market rates reflecting Air Canada's credit. CAIL's obligations under those agreements have also been assumed or guaranteed by Air Canada. The claims of these creditors for reduced principal and interest amounts, or reduced lease payments, are Affected Unsecured Claims under the Plan. In a number of cases these claims have been assigned to Air Canada and Air Canada disclosed that it would vote those claims in favour of the Plan.

2. Affected Secured Creditors- The Affected Secured Creditors under the Plan are the Senior Secured Noteholders with a claim in the amount of US$175,000,000. The Senior Secured Noteholders are secured by a diverse package of Canadian's assets, including its inventory of aircraft spare parts, ground equipment, spare engines, flight simulators, leasehold interests at Toronto, Vancouver and Calgary airports, the shares in CRAL 98 and a $53 million note payable by CRAL to CAIL.

The Plan offers the Senior Secured Noteholders payment of 97 cents on the dollar. The deficiency is included in the Affected Unsecured Creditor class and the Senior Secured Noteholders advised the court they would be voting the deficiency in favour of the Plan.

3. Unaffected Unsecured Creditors-In the circular accompanying the November 11, 1999 853350 offer it was stated that:

> The Offeror intends to conduct the Debt Restructuring in such a manner as to seek to ensure that the unionized employees of Canadian, the suppliers of new credit (including trade credit) and the members of the flying public are left unaffected.
>
> The Offeror is of the view that the pursuit of these three principles is essential in order to ensure that the long term value of Canadian is preserved.

Canadian's employees, customers and suppliers of goods and services are unaffected by the CCAA Order and Plan.

Also unaffected are parties to those contracts or agreements with Canadian which are not being terminated by Canadian pursuant to the terms of the March 24, 2000 Order.

4. Affected Unsecured Creditors- CAIL has identified unsecured creditors who do not fall into the above three groups and listed these as Affected Unsecured Creditors under the Plan. They are offered 14 cents on the dollar on their claims. Air Canada would fund this payment.

The Affected Unsecured Creditors fall into the following categories:

a. Claims of holders of or related to the Unsecured Notes (the "Unsecured Noteholders");

b. Claims in respect of certain outstanding or threatened litigation involving Canadian;

c. Claims arising from the termination, breach or repudiation of certain contracts, leases or agreements to which Canadian is a party other than aircraft financing or lease arrangements;

d. Claims in respect of deficiencies arising from the termination or re-negotiation of aircraft financing or lease arrangements;

e. Claims of tax authorities against Canadian; and

f. Claims in respect of the under-secured or unsecured portion of amounts due to the Senior Secured Noteholders.

52 There are over $700 million of proven unsecured claims. Some unsecured creditors have disputed the amounts of their claims for distribution purposes. These are in the process of determination by the court-appointed Claims Officer and subject to further appeal to the court. If the Claims Officer were to allow all of the disputed claims in full and this were confirmed by the court, the aggregate of unsecured claims would be approximately $1.059 million.

53 The Monitor has concluded that if the Plan is not approved and implemented, Canadian will not be able to continue as a going concern and in that event, the only foreseeable alternative would be a liquidation of Canadian's assets by a receiver and/or a trustee in bankruptcy. Under the Plan, Canadian's obligations to parties essential to ongoing operations, including employees, customers, travel agents, fuel, maintenance and equipment suppliers, and airport authorities are in most cases to be treated as unaffected and paid in full.

In the event of a liquidation, those parties would not, in most cases, be paid in full and, except for specific lien rights and statutory priorities, would rank as ordinary unsecured creditors. The Monitor estimates that the additional unsecured claims which would arise if Canadian were to cease operations as a going concern and be forced into liquidation would be in excess of $1.1 billion.

54 In connection with its assessment of the Plan, the Monitor performed a liquidation analysis of CAIL as at March 31, 2000 in order to estimate the amounts that might be recovered by CAIL's creditors and shareholders in the event of disposition of CAIL's assets by a receiver or trustee. The Monitor concluded that a liquidation would result in a shortfall to certain secured creditors, including the Senior Secured Noteholders, a recovery by ordinary unsecured creditors of between one cent and three cents on the dollar, and no recovery by shareholders.

55 There are two vociferous opponents of the Plan, Resurgence Asset Management LLC ("Resurgence") who acts on behalf of its and/or its affiliate client accounts and four shareholders of CAC. Resurgence is incorporated pursuant to the laws of New York, U.S.A. and has its head office in White Plains, New York. It conducts an investment business specializing in high yield distressed debt. Through a series of purchases of the Unsecured Notes commencing in April 1999, Resurgence clients hold $58,200,000 of the face value of or 58.2% of the notes issued. Resurgence purchased 7.9 million units in April 1999. From November 3, 1999 to December 9, 1999 it purchased an additional 20,850,000 units. From January 4, 2000 to February 3, 2000 Resurgence purchased an additional 29,450,000 units.

56 Resurgence seeks declarations that: the actions of Canadian, Air Canada and 853350 constitute an amalgamation, consolidation or merger with or into Air Canada or a conveyance or transfer of all or substantially all of Canadian's assets to Air Canada; that any plan of arrangement involving Canadian will not affect Resurgence and directing the repurchase of their notes pursuant to the provisions of their trust indenture and that the actions of Canadian, Air Canada and 853350 are oppressive and unfairly prejudicial to it pursuant to section 234 of the Business Corporations Act.

57 Four shareholders of CAC also oppose the plan. Neil Baker, a Toronto resident, acquired 132,500 common shares at a cost of $83,475.00 on or about May 5, 2000. Mr. Baker sought to commence proceedings to "remedy an injustice to the minority holders of the common shares". Roger Midiaty, Michael Salter and Hal Metheral are individual shareholders who were added as parties at their request during the proceedings. Mr. Midiaty resides in Calgary, Alberta and holds 827 CAC shares which he has held since 1994. Mr. Metheral is also a Calgary resident and holds approximately 14,900 CAC shares in his RRSP and has held them since approximately 1994 or 1995. Mr. Salter is a resident of Scottsdale, Arizona and is the beneficial owner of 250 shares of CAC and is a joint beneficial owner of

250 shares with his wife. These shareholders will be referred in the Decision throughout as the "Minority Shareholders".

58 The Minority Shareholders oppose the portion of the Plan that relates to the reorganization of CAIL, pursuant to section 185 of the *Alberta Business Corporations Act* ("ABCA"). They characterize the transaction as a cancellation of issued shares unauthorized by section 167 of the ABCA or alternatively is a violation of section 183 of the ABCA. They submit the application for the order of reorganization should be denied as being unlawful, unfair and not supported by the evidence.

III. Analysis

59 Section 6 of the CCAA provides that:

> 6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> > (a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and
> >
> > (b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the Bankruptcy and Insolvency Act or is in the course of being wound up under the Winding-up and Restructuring Act, on the trustee in bankruptcy or liquidator and contributories of the company.

60 Prior to sanctioning a plan under the CCAA, the court must be satisfied in regard to each of the following criteria:

> (1) there must be compliance with all statutory requirements;
>
> (2) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and
>
> (3) the plan must be fair and reasonable.

61 A leading articulation of this three-part test appears in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 182-3, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C.

C.A.) and has been regularly followed, see for example *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 172 and *Re T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 7. Each of these criteria are reviewed in turn below.

1. Statutory Requirements

62 Some of the matters that may be considered by the court on an application for approval of a plan of compromise and arrangement include:

(a) the applicant comes within the definition of "debtor company" in section 2 of the CCAA;

(b) the applicant or affiliated debtor companies have total claims within the meaning of section 12 of the CCAA in excess of $5,000,000;

(c) the notice calling the meeting was sent in accordance with the order of the court;

(d) the creditors were properly classified;

(e) the meetings of creditors were properly constituted;

(f) the voting was properly carried out; and

(g) the plan was approved by the requisite double majority or majorities.

63 I find that the Petitioners have complied with all applicable statutory requirements. Specifically:

(a) CAC and CAIL are insolvent and thus each is a "debtor company" within the meaning of section 2 of the CCAA. This was established in the affidavit evidence of Douglas Carty, Senior Vice President and Chief Financial Officer of Canadian, and so declared in the March 24, 2000 Order in these proceedings and confirmed in the testimony given by Mr. Carty at this hearing.

(b) CAC and CAIL have total claims that would be claims provable in bankruptcy within the meaning of section 12 of the CCAA in excess of $5,000,000.

(c) In accordance with the April 7, 2000 Order of this court, a Notice of Meeting and a disclosure statement (which included copies of the Plan and the March 24th and April 7th Orders of this court) were sent to the Affected Creditors, the directors and officers of the Petitioners, the Monitor and persons who had served a Notice of Appearance, on April 25, 2000.

(d) As confirmed by the May 12, 2000 ruling of this court (leave to appeal denied May 29, 2000), the creditors have been properly classified.

(e) Further, as detailed in the Monitor's Fifth Report to the Court and confirmed by the June 14, 2000 decision of this court in respect of a challenge by Resurgence Asset Management LLC ("Resurgence"), the meetings of creditors were properly constituted, the voting was properly carried out and the Plan was approved by the requisite double majorities in each class. The composition of the majority of the unsecured creditor class is addressed below under the heading "Fair and Reasonable".

2. Matters Unauthorized

64 This criterion has not been widely discussed in the reported cases. As recognized by Blair J. in *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) and Farley J. in *Re Cadillac Fairview Inc.* (February 6, 1995), Doc. B348/94 (Ont. Gen. Div. [Commercial List]), within the CCAA process the court must rely on the reports of the Monitor as well as the parties in ensuring nothing contrary to the CCAA has occurred or is contemplated by the plan.

65 In this proceeding, the dissenting groups have raised two matters which in their view are unauthorized by the CCAA: firstly, the Minority Shareholders of CAC suggested the proposed share capital reorganization of CAIL is illegal under the ABCA and Ontario Securities Commission Policy 9.1, and as such cannot be authorized under the CCAA and secondly, certain unsecured creditors suggested that the form of release contained in the Plan goes beyond the scope of release permitted under the CCAA.

a. Legality of proposed share capital reorganization

66 Subsection 185(2) of the ABCA provides:

(2) If a corporation is subject to an order for reorganization, its articles may be amended by the order to effect any change that might lawfully be made by an amendment under section 167.

67 Sections 6.1(2)(d) and (e) and Schedule "D" of the Plan contemplate that:

a. All CAIL common shares held by CAC will be converted into a single retractable share, which will then be retracted by CAIL for $1.00; and

b. All CAIL preferred shares held by 853350 will be converted into CAIL common shares.

68 The Articles of Reorganization in Schedule "D" to the Plan provide for the following amendments to CAIL's Articles of Incorporation to effect the proposed reorganization:

(a) consolidating all of the issued and outstanding common shares into one common share;

(b) redesignating the existing common shares as "Retractable Shares" and changing the rights, privileges, restrictions and conditions attaching to the Retractable Shares so that the Retractable Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital;

(c) cancelling the Non-Voting Shares in the capital of the corporation, none of which are currently issued and outstanding, so that the corporation is no longer authorized to issue Non-Voting Shares;

(d) changing all of the issued and outstanding Class B Preferred Shares of the corporation into Class A Preferred Shares, on the basis of one (1) Class A Preferred Share for each one (1) Class B Preferred Share presently issued and outstanding;

(e) redesignating the existing Class A Preferred Shares as "Common Shares" and changing the rights, privileges, restrictions and conditions attaching to the Common Shares so that the Common Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital; and

(f) cancelling the Class B Preferred Shares in the capital of the corporation, none of which are issued and outstanding after the change in paragraph (d) above, so that the corporation is no longer authorized to issue Class B Preferred Shares;

Section 167 of the ABCA

69 Reorganizations under section 185 of the ABCA are subject to two preconditions:

a. The corporation must be "subject to an order for re-organization"; and

b. The proposed amendments must otherwise be permitted under section 167 of the ABCA.

70 The parties agreed that an order of this court sanctioning the Plan would satisfy the first condition.

71 The relevant portions of section 167 provide as follows:

> 167(1) Subject to sections 170 and 171, the articles of a corporation may by special resolution be amended to
>
>> (e) change the designation of all or any of its shares, and add, change or remove any rights, privileges, restrictions and conditions, including rights to accrued dividends, in respect of all or any of its shares, whether issued or unissued,
>>
>> (f) change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series into the same or a different number of shares of other classes or series,
>>
>> (g.1) cancel a class or series of shares where there are no issued or outstanding shares of that class or series,

72 Each change in the proposed CAIL Articles of Reorganization corresponds to changes permitted under s. 167(1) of the ABCA, as follows:

Proposed Amendment in Schedule "D"	**Subsection 167(1), ABCA**
(a) — consolidation of Common Shares	167(1)(f)
(b) — change of designation and rights	167(1)(e)
(c) — cancellation	167(1)(g.1)
(d) — change in shares	167(1)(f)
(e) — change of designation and rights	167(1)(e)
(f) — cancellation	167(1)(g.1)

73 The Minority Shareholders suggested that the proposed reorganization effectively cancels their shares in CAC. As the above review of the proposed reorganization demonstrates, that is not the case. Rather, the shares of CAIL are being consolidated, altered and then retracted, as permitted under section 167 of the ABCA. I find the proposed reorganization of CAIL's share capital under the Plan does not violate section 167.

74 In R. Dickerson et al, *Proposals for a New Business Corporation Law for Canada*, Vol.1: Commentary (the "Dickerson Report") regarding the then proposed Canada Business Corporations Act, the identical section to section 185 is described as having been inserted with the object of enabling the "court to effect any necessary amendment of the articles of the corporation in order to achieve the objective of the reorganization without having to comply with the formalities of the Draft Act, particularly shareholder approval of the proposed amendment".

75 The architects of the business corporation act model which the ABCA follows, expressly contemplated reorganizations in which the insolvent corporation would eliminate the interest

of common shareholders. The example given in the Dickerson Report of a reorganization is very similar to that proposed in the Plan:

> For example, the reorganization of an insolvent corporation may require the following steps: first, reduction or even elimination of the interest of the common shareholders; second, relegation of the preferred shareholders to the status of common shareholders; and third, relegation of the secured debenture holders to the status of either unsecured Noteholders or preferred shareholders.

76 The rationale for allowing such a reorganization appears plain; the corporation is insolvent, which means that on liquidation the shareholders would get nothing. In those circumstances, as described further below under the heading "Fair and Reasonable", there is nothing unfair or unreasonable in the court effecting changes in such situations without shareholder approval. Indeed, it would be unfair to the creditors and other stakeholders to permit the shareholders (whose interest has the lowest priority) to have any ability to block a reorganization.

77 The Petitioners were unable to provide any case law addressing the use of section 185 as proposed under the Plan. They relied upon the decisions of *Re Royal Oak Mines Inc.* (1999), 14 C.B.R. (4th) 279 (Ont. S.C.J. [Commercial List]) and *T. Eaton Co.*, *supra* in which Farley J.of the Ontario Superior Court of Justice emphasized that shareholders are at the bottom of the hierarchy of interests in liquidation or liquidation related scenarios.

78 Section 185 provides for amendment to articles by court order. I see no requirement in that section for a meeting or vote of shareholders of CAIL, quite apart from shareholders of CAC. Further, dissent and appraisal rights are expressly removed in subsection (7). To require a meeting and vote of shareholders and to grant dissent and appraisal rights in circumstances of insolvency would frustrate the object of section 185 as described in the Dickerson Report.

79 In the circumstances of this case, where the majority shareholder holds 82% of the shares, the requirement of a special resolution is meaningless. To require a vote suggests the shares have value. They do not. The formalities of the ABCA serve no useful purpose other than to frustrate the reorganization to the detriment of all stakeholders, contrary to the CCAA.

Section 183 of the ABCA

80 The Minority Shareholders argued in the alternative that if the proposed share reorganization of CAIL were not a cancellation of their shares in CAC and therefore allowed under section 167 of the ABCA, it constituted a "sale, lease, or exchange of substantially all the property" of CAC and thus required the approval of CAC shareholders pursuant to section 183 of the ABCA. The Minority Shareholders suggested that the common shares in

CAIL were substantially all of the assets of CAC and that all of those shares were being "exchanged" for $1.00.

81 I disagree with this creative characterization. The proposed transaction is a reorganization as contemplated by section 185 of the ABCA. As recognized in *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.) aff'd (1988), 70 C.B.R. (N.S.) xxxii (S.C.C.), the fact that the same end might be achieved under another section does not exclude the section to be relied on. A statute may well offer several alternatives to achieve a similar end.

Ontario Securities Commission Policy 9.1

82 The Minority Shareholders also submitted the proposed reorganization constitutes a "related party transaction" under Policy 9.1 of the Ontario Securities Commission. Under the Policy, transactions are subject to disclosure, minority approval and formal valuation requirements which have not been followed here. The Minority Shareholders suggested that the Petitioners were therefore in breach of the Policy unless and until such time as the court is advised of the relevant requirements of the Policy and grants its approval as provided by the Policy.

83 These shareholders asserted that in the absence of evidence of the going concern value of CAIL so as to determine whether that value exceeds the rights of the Preferred Shares of CAIL, the Court should not waive compliance with the Policy.

84 To the extent that this reorganization can be considered a "related party transaction", I have found, for the reasons discussed below under the heading "Fair and Reasonable", that the Plan, including the proposed reorganization, is fair and reasonable and accordingly I would waive the requirements of Policy 9.1.

b. Release

85 Resurgence argued that the release of directors and other third parties contained in the Plan does not comply with the provisions of the CCAA.

86 The release is contained in section 6.2(2)(ii) of the Plan and states as follows:

> As of the Effective Date, each of the Affected Creditors will be deemed to forever release, waive and discharge all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities...that are based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Applicants and Subsidiaries, the CCAA Proceedings, or the Plan against:(i) The Applicants and Subsidiaries; (ii) The Directors, Officers and

> employees of the Applicants or Subsidiaries in each case as of the date of filing (and in addition, those who became Officers and/or Directors thereafter but prior to the Effective Date); (iii) The former Directors, Officers and employees of the Applicants or Subsidiaries, or (iv) the respective current and former professionals of the entities in subclauses (1) to (3) of this s.6.2(2) (including, for greater certainty, the Monitor, its counsel and its current Officers and Directors, and current and former Officers, Directors, employees, shareholders and professionals of the released parties) acting in such capacity.

87 Prior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company. In 1997, section 5.1 was added to the CCAA. Section 5.1 states:

> 5.1 (1) A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> (2) A provision for the compromise of claims against directors may not include claims that:
>
> > (a) relate to contractual rights of one or more creditors; or
> >
> > (b) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> (3) The Court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.

88 Resurgence argued that the form of release does not comply with section 5.1 of the CCAA insofar as it applies to individuals beyond directors and to a broad spectrum of claims beyond obligations of the Petitioners for which their directors are "by law liable". Resurgence submitted that the addition of section 5.1 to the CCAA constituted an exception to a long standing principle and urged the court to therefore interpret s. 5.1 cautiously, if not narrowly. Resurgence relied on *Crabtree (Succession de) c. Barrette*, [1993] 1 S.C.R. 1027 (S.C.C.) at 1044 and *Bruce Agra Foods Inc. v. Everfresh Beverages Inc. (Receiver of)* (1996), 45 C.B.R. (3d) 169 (Ont. Gen. Div.) at para. 5 in this regard.

89 With respect to Resurgence's complaint regarding the breadth of the claims covered by the release, the Petitioners asserted that the release is not intended to override section

5.1(2). Canadian suggested this can be expressly incorporated into the form of release by adding the words "*excluding the claims excepted by s. 5.1(2) of the CCAA*" immediately prior to subsection (iii) and clarifying the language in Section 5.1 of the Plan. Canadian also acknowledged, in response to a concern raised by Canada Customs and Revenue Agency, that in accordance with s. 5.1(1) of the CCAA, directors of CAC and CAIL could only be released from liability arising before March 24, 2000, the date these proceedings commenced. Canadian suggested this was also addressed in the proposed amendment. Canadian did not address the propriety of including individuals in addition to directors in the form of release.

90 In my view it is appropriate to amend the proposed release to expressly comply with section 5. 1(2) of the CCAA and to clarify Section 5.1 of the Plan as Canadian suggested in its brief. The additional language suggested by Canadian to achieve this result shall be included in the form of order. Canada Customs and Revenue Agency is apparently satisfied with the Petitioners' acknowledgement that claims against directors can only be released to the date of commencement of proceedings under the CCAA, having appeared at this hearing to strongly support the sanctioning of the Plan, so I will not address this concern further.

91 Resurgence argued that its claims fell within the categories of excepted claims in section 5.1(2) of the CCAA and accordingly, its concern in this regard is removed by this amendment. Unsecured creditors JHHD Aircraft Leasing No. 1 and No. 2 suggested there may be possible wrongdoing in the acts of the directors during the restructuring process which should not be immune from scrutiny and in my view this complaint would also be caught by the exception captured in the amendment.

92 While it is true that section 5.2 of the CCAA does not authorize a release of claims against third parties other than directors, it does not prohibit such releases either. The amended terms of the release will not prevent claims from which the CCAA expressly prohibits release. Aside from the complaints of Resurgence, which by their own submissions are addressed in the amendment I have directed, and the complaints of JHHD Aircraft Leasing No. 1 and No. 2, which would also be addressed in the amendment, the terms of the release have been accepted by the requisite majority of creditors and I am loathe to further disturb the terms of the Plan, with one exception.

93 Amex Bank of Canada submitted that the form of release appeared overly broad and might compromise unaffected claims of affected creditors. For further clarification, Amex Bank of Canada's potential claim for defamation is unaffected by the Plan and I am prepared to order Section 6.2(2)(ii) be amended to reflect this specific exception.

3. Fair and Reasonable

94 In determining whether to sanction a plan of arrangement under the CCAA, the court is guided by two fundamental concepts: "fairness" and "reasonableness". While these

concepts are always at the heart of the court's exercise of its discretion, their meanings are necessarily shaped by the unique circumstances of each case, within the context of the Act and accordingly can be difficult to distill and challenging to apply. Blair J. described these concepts in *Olympia & York Developments Ltd. v. Royal Trust Co.*, *supra*, at page 9:

> "Fairness" and "reasonableness" are, in my opinion, the two keynote concepts underscoring the philosophy and workings of the Companies' Creditors Arrangement Act. Fairness is the quintessential expression of the court's equitable jurisdiction — although the jurisdiction is statutory, the broad discretionary powers given to the judiciary by the legislation which make its exercise an exercise in equity — and "reasonableness" is what lends objectivity to the process.

95 The legislation, while conferring broad discretion on the court, offers little guidance. However, the court is assisted in the exercise of its discretion by the purpose of the CCAA: to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and, in many instances, a much broader constituency of affected persons. Parliament has recognized that reorganization, if commercially feasible, is in most cases preferable, economically and socially, to liquidation: *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), [1989] 2 W.W.R. 566 (Alta. Q.B.) at 574; *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*, [1989] 3 W.W.R. 363 (B.C. C.A.) at 368.

96 The sanction of the court of a creditor-approved plan is not to be considered as a rubber stamp process. Although the majority vote that brings the plan to a sanction hearing plays a significant role in the court's assessment, the court will consider other matters as are appropriate in light of its discretion. In the unique circumstances of this case, it is appropriate to consider a number of additional matters:

a. The composition of the unsecured vote;

b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;

c. Alternatives available to the Plan and bankruptcy;

d. Oppression;

e. Unfairness to Shareholders of CAC; and

f. The public interest.

a. Composition of the unsecured vote

97 As noted above, an important measure of whether a plan is fair and reasonable is the parties' approval and the degree to which it has been given. Creditor support creates an inference that the plan is fair and reasonable because the assenting creditors believe that their interests are treated equitably under the plan. Moreover, it creates an inference that the arrangement is economically feasible and therefore reasonable because the creditors are in a better position then the courts to gauge business risk. As stated by Blair J. at page 11 of *Olympia & York Developments Ltd.*, *supra*:

> As other courts have done, I observe that it is not my function to second guess the business people with respect to the "business" aspect of the Plan or descending into the negotiating arena or substituting my own view of what is a fair and reasonable compromise or arrangement for that of the business judgment of the participants. The parties themselves know best what is in their interests in those areas.

98 However, given the manner of voting under the CCAA, the court must be cognizant of the treatment of minorities within a class: see for example *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.) and *Re Alabama, New Orleans, Texas & Pacific Junction Railway* (1890), 60 L.J. Ch. 221 (Eng. C.A.). The court can address this by ensuring creditors' claims are properly classified. As well, it is sometimes appropriate to tabulate the vote of a particular class so the results can be assessed from a fairness perspective. In this case, the classification was challenged by Resurgence and I dismissed that application. The vote was also tabulated in this case and the results demonstrate that the votes of Air Canada and the Senior Secured Noteholders, who voted their deficiency in the unsecured class, were decisive.

99 The results of the unsecured vote, as reported by the Monitor, are:

> 1. For the resolution to approve the Plan: 73 votes (65% in number) representing $494,762,304 in claims (76% in value);
>
> 2. Against the resolution: 39 votes (35% in number) representing $156,360,363 in claims (24% in value); and
>
> 3. Abstentions: 15 representing $968,036 in value.

100 The voting results as reported by the Monitor were challenged by Resurgence. That application was dismissed.

101 The members of each class that vote in favour of a plan must do so in good faith and the majority within a class must act without coercion in their conduct toward the minority. When asked to assess fairness of an approved plan, the court will not countenance secret

agreements to vote in favour of a plan secured by advantages to the creditor: see for example, *Hochberger v. Rittenberg* (1916), 36 D.L.R. 450 (S.C.C.)

102 In *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) at 192-3 aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), dissenting priority mortgagees argued the plan violated the principle of equality due to an agreement between the debtor company and another priority mortgagee which essentially amounted to a preference in exchange for voting in favour of the plan. Trainor J. found that the agreement was freely disclosed and commercially reasonable and went on to approve the plan, using the three part test. The British Columbia Court of Appeal upheld this result and in commenting on the minority complaint McEachern J.A. stated at page 206:

> In my view, the obvious benefits of settling rights and keeping the enterprise together as a going concern far outweigh the deprivation of the appellants' wholly illusory rights. In this connection, the learned chambers judge said at p.29:
>
>> I turn to the question of the right to hold the property after an order absolute and whether or not this is a denial of something of that significance that it should affect these proceedings. There is in the material before me some evidence of values. There are the principles to which I have referred, as well as to the rights of majorities and the rights of minorities.
>>
>> Certainly, those minority rights are there, but it would seem to me that in view of the overall plan, in view of the speculative nature of holding property in the light of appraisals which have been given as to value, that this right is something which should be subsumed to the benefit of the majority.

103 Resurgence submitted that Air Canada manipulated the indebtedness of CAIL to assure itself of an affirmative vote. I disagree. I previously ruled on the validity of the deficiency when approving the LOIs and found the deficiency to be valid. I found there was consideration for the assignment of the deficiency claims of the various aircraft financiers to Air Canada, namely the provision of an Air Canada guarantee which would otherwise not have been available until plan sanction. The Monitor reviewed the calculations of the deficiencies and determined they were calculated in a reasonable manner. As such, the court approved those transactions. If the deficiency had instead remained with the aircraft financiers, it is reasonable to assume those claims would have been voted in favour of the plan. Further, it would have been entirely appropriate under the circumstances for the aircraft financiers to have retained the deficiency and agreed to vote in favour of the Plan, with the same result to Resurgence. That the financiers did not choose this method was explained by the testimony of Mr. Carty and Robert Peterson, Chief Financial Officer for Air Canada; quite simply it amounted to a desire on behalf of these creditors to shift the "deal

risk" associated with the Plan to Air Canada. The agreement reached with the Senior Secured Noteholders was also disclosed and the challenge by Resurgence regarding their vote in the unsecured class was dismissed There is nothing inappropriate in the voting of the deficiency claims of Air Canada or the Senior Secured Noteholders in the unsecured class. There is no evidence of secret vote buying such as discussed in *Re Northland Properties Ltd.*

104 If the Plan is approved, Air Canada stands to profit in its operation. I do not accept that the deficiency claims were devised to dominate the vote of the unsecured creditor class, however, Air Canada, as funder of the Plan is more motivated than Resurgence to support it. This divergence of views on its own does not amount to bad faith on the part of Air Canada. Resurgence submitted that only the Unsecured Noteholders received 14 cents on the dollar. That is not accurate, as demonstrated by the list of affected unsecured creditors included earlier in these Reasons. The Senior Secured Noteholders did receive other consideration under the Plan, but to suggest they were differently motivated suggests that those creditors did not ascribe any value to their unsecured claims. There is no evidence to support this submission.

105 The good faith of Resurgence in its vote must also be considered. Resurgence acquired a substantial amount of its claim after the failure of the Onex bid, when it was aware that Canadian's financial condition was rapidly deteriorating. Thereafter, Resurgence continued to purchase a substantial amount of this highly distressed debt. While Mr. Symington maintained that he bought because he thought the bonds were a good investment, he also acknowledged that one basis for purchasing was the hope of obtaining a blocking position sufficient to veto a plan in the proposed debt restructuring. This was an obvious ploy for leverage with the Plan proponents

106 The authorities which address minority creditors' complaints speak of "substantial injustice" (*Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.), "confiscation" of rights (*Re Campeau Corp.* (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.); *Re SkyDome Corp.* (March 21, 1999), Doc. 98-CL-3179 (Ont. Gen. Div. [Commercial List])) and majorities "feasting upon" the rights of the minority (*Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.). Although it cannot be disputed that the group of Unsecured Noteholders represented by Resurgence are being asked to accept a significant reduction of their claims, as are all of the affected unsecured creditors, I do not see a "substantial injustice", nor view their rights as having been "confiscated" or "feasted upon" by being required to succumb to the wishes of the majority in their class. No bad faith has been demonstrated in this case. Rather, the treatment of Resurgence, along with all other affected unsecured creditors, represents a reasonable balancing of interests. While the court is directed to consider whether there is an injustice being worked within a class, it must also determine whether there is an injustice with respect the stakeholders as a whole. Even if a plan might at first blush appear to have that effect, when viewed in relation to all other parties, it may nonetheless be considered

appropriate and be approved: *Algoma Steel Corp. v. Royal Bank* (1992), 11 C.B.R. (3d) 1 (Ont. Gen. Div.) and *Re Northland Properties Ltd.*, *supra* at 9.

107 Further, to the extent that greater or discrete motivation to support a Plan may be seen as a conflict, the Court should take this same approach and look at the creditors as a whole and to the objecting creditors specifically and determine if their rights are compromised in an attempt to balance interests and have the pain of compromise borne equally.

108 Resurgence represents 58.2% of the Unsecured Noteholders or $96 million in claims. The total claim of the Unsecured Noteholders ranges from $146 million to $161 million. The affected unsecured class, excluding aircraft financing, tax claims, the noteholders and claims under $50,000, ranges from $116.3 million to $449.7 million depending on the resolutions of certain claims by the Claims Officer. Resurgence represents between 15.7% - 35% of that portion of the class.

109 The total affected unsecured claims, excluding tax claims, but including aircraft financing and noteholder claims including the unsecured portion of the Senior Secured Notes, ranges from $673 million to $1,007 million. Resurgence represents between 9.5% - 14.3% of the total affected unsecured creditor pool. These percentages indicate that at its very highest in a class excluding Air Canada's assigned claims and Senior Secured's deficiency, Resurgence would only represent a maximum of 35% of the class. In the larger class of affected unsecured it is significantly less. Viewed in relation to the class as a whole, there is no injustice being worked against Resurgence.

110 The thrust of the Resurgence submissions suggests a mistaken belief that they will get more than 14 cents on liquidation. This is not borne out by the evidence and is not reasonable in the context of the overall Plan.

b. Receipts on liquidation or bankruptcy

111 As noted above, the Monitor prepared and circulated a report on the Plan which contained a summary of a liquidation analysis outlining the Monitor's projected realizations upon a liquidation of CAIL ("Liquidation Analysis").

112 The Liquidation Analysis was based on: (1) the draft unaudited financial statements of Canadian at March 31, 2000; (2) the distress values reported in independent appraisals of aircraft and aircraft related assets obtained by CAIL in January, 2000; (3) a review of CAIL's aircraft leasing and financing documents; and (4) discussions with CAIL Management.

113 Prior to and during the application for sanction, the Monitor responded to various requests for information by parties involved. In particular, the Monitor provided a copy of the Liquidation Analysis to those who requested it. Certain of the parties involved requested

the opportunity to question the Monitor further, particularly in respect to the Liquidation Analysis and this court directed a process for the posing of those questions.

114 While there were numerous questions to which the Monitor was asked to respond, there were several areas in which Resurgence and the Minority Shareholders took particular issue: pension plan surplus, CRAL, international routes and tax pools. The dissenting groups asserted that these assets represented overlooked value to the company on a liquidation basis or on a going concern basis.

Pension Plan Surplus

115 The Monitor did not attribute any value to pension plan surplus when it prepared the Liquidation Analysis, for the following reasons:

> 1) The summaries of the solvency surplus/deficit positions indicated a cumulative net deficit position for the seven registered plans, after consideration of contingent liabilities;
>
> 2) The possibility, based on the previous splitting out of the seven plans from a single plan in 1988, that the plans could be held to be consolidated for financial purposes, which would remove any potential solvency surplus since the total estimated contingent liabilities exceeded the total estimated solvency surplus;
>
> 3) The actual calculations were prepared by CAIL's actuaries and actuaries representing the unions could conclude liabilities were greater; and
>
> 4) CAIL did not have a legal opinion confirming that surpluses belonged to CAIL.

116 The Monitor concluded that the entitlement question would most probably have to be settled by negotiation and/or litigation by the parties. For those reasons, the Monitor took a conservative view and did not attribute an asset value to pension plans in the Liquidation Analysis. The Monitor also did not include in the Liquidation Analysis any amount in respect of the claim that could be made by members of the plan where there is an apparent deficit after deducting contingent liabilities.

117 The issues in connection with possible pension surplus are: (1) the true amount of any of the available surplus; and (2) the entitlement of Canadian to any such amount.

118 It is acknowledged that surplus prior to termination can be accessed through employer contribution holidays, which Canadian has taken to the full extent permitted. However, there is no basis that has been established for any surplus being available to be withdrawn from an ongoing pension plan. On a pension plan termination, the amount available as a solvency surplus would first have to be further reduced by various amounts to determine

whether there was in fact any true surplus available for distribution. Such reductions include contingent benefits payable in accordance with the provisions of each respective pension plan, any extraordinary plan wind up cost, the amounts of any contribution holidays taken which have not been reflected, and any litigation costs.

119 Counsel for all of Canadian's unionized employees confirmed on the record that the respective union representatives can be expected to dispute all of these calculations as well as to dispute entitlement.

120 There is a suggestion that there might be a total of $40 million of surplus remaining from all pension plans after such reductions are taken into account. Apart from the issue of entitlement, this assumes that the plans can be treated separately, that a surplus could in fact be realized on liquidation and that the Towers Perrin calculations are not challenged. With total pension plan assets of over $2 billion, a surplus of $40 million could quickly disappear with relatively minor changes in the market value of the securities held or calculation of liabilities. In the circumstances, given all the variables, I find that the existence of any surplus is doubtful at best and I am satisfied that the Monitor's Liquidation Analysis ascribing it zero value is reasonable in this circumstances.

CRAL

121 The Monitor's liquidation analysis as at March 31, 2000 of CRAL determined that in a distress situation, after payments were made to its creditors, there would be a deficiency of approximately $30 million to pay Canadian Regional's unsecured creditors, which include a claim of approximately $56.5 million due to Canadian. In arriving at this conclusion, the Monitor reviewed internally prepared unaudited financial statements of CRAL as of March 31, 2000, the Houlihan Lokey Howard and Zukin, distress valuation dated January 21, 2000 and the Simat Helliesen and Eichner valuation of selected CAIL assets dated January 31, 2000 for certain aircraft related materials and engines, rotables and spares. The Avitas Inc., and Avmark Inc. reports were used for the distress values on CRAL's aircraft and the CRAL aircraft lease documentation. The Monitor also performed its own analysis of CRAL's liquidation value, which involved analysis of the reports provided and details of its analysis were outlined in the Liquidation Analysis.

122 For the purpose of the Liquidation Analysis, the Monitor did not consider other airlines as comparable for evaluation purposes, as the Monitor's valuation was performed on a distressed sale basis. The Monitor further assumed that without CAIL's national and international network to feed traffic into and a source of standby financing, and considering the inevitable negative publicity which a failure of CAIL would produce, CRAL would immediately stop operations as well.

123 Mr. Peterson testified that CRAL was worth $260 million to Air Canada, based on Air Canada being a special buyer who could integrate CRAL, on a going concern basis, into its network. The Liquidation Analysis assumed the windup of each of CRAL and CAIL, a completely different scenario.

124 There is no evidence that there was a potential purchaser for CRAL who would be prepared to acquire CRAL or the operations of CRAL 98 for any significant sum or at all. CRAL has value to CAIL, and in turn, could provide value to Air Canada, but this value is attributable to its ability to feed traffic to and take traffic from the national and international service operated by CAIL. In my view, the Monitor was aware of these features and properly considered these factors in assessing the value of CRAL on a liquidation of CAIL.

125 If CAIL were to cease operations, the evidence is clear that CRAL would be obliged to do so as well immediately. The travelling public, shippers, trade suppliers, and others would make no distinction between CAIL and CRAL and there would be no going concern for Air Canada to acquire.

International Routes

126 The Monitor ascribed no value to Canadian's international routes in the Liquidation Analysis. In discussions with CAIL management and experts available in its aviation group, the Monitor was advised that international routes are unassignable licenses and not property rights. They do not appear as assets in CAIL's financials. Mr. Carty and Mr. Peterson explained that routes and slots are *not* treated as assets by airlines, but rather as rights in the control of the Government of Canada. In the event of bankruptcy/receivership of CAIL, CAIL's trustee/receiver could not sell them and accordingly they are of no value to CAIL.

127 Evidence was led that on June 23, 1999 Air Canada made an offer to purchase CAIL's international routes for $400 million cash plus $125 million for aircraft spares and inventory, along with the assumption of certain debt and lease obligations for the aircraft required for the international routes. CAIL evaluated the Air Canada offer and concluded that the proposed purchase price was insufficient to permit it to continue carrying on business in the absence of its international routes. Mr. Carty testified that something in the range of $2 billion would be required.

128 CAIL was in desperate need of cash in mid December, 1999. CAIL agreed to sell its Toronto — Tokyo route for $25 million. The evidence, however, indicated that the price for the Toronto — Tokyo route was not derived from a valuation, but rather was what CAIL asked for, based on its then-current cash flow requirements. Air Canada and CAIL obtained Government approval for the transfer on December 21, 2000.

129 Resurgence complained that despite this evidence of offers for purchase and actual sales of international routes and other evidence of sales of slots, the Monitor did not include Canadian's international routes in the Liquidation Analysis and only attributed a total of $66 million for all intangibles of Canadian. There is some evidence that slots at some foreign airports may be bought or sold in some fashion. However, there is insufficient evidence to attribute any value to other slots which CAIL has at foreign airports. It would appear given the regulation of the airline industry, in particular, the *Aeronautics Act* and the *Canada Transportation Act*, that international routes for a Canadian air carrier only have full value to the extent of federal government support for the transfer or sale, and its preparedness to allow the then-current license holder to sell rather than act unilaterally to change the designation. The federal government was prepared to allow CAIL to sell its Toronto — Tokyo route to Air Canada in light of CAIL's severe financial difficulty and the certainty of cessation of operations during the Christmas holiday season in the absence of such a sale.

130 Further, statements made by CAIL in mid-1999 as to the value of its international routes and operations in response to an offer by Air Canada, reflected the amount CAIL needed to sustain liquidity without its international routes and was not a representation of market value of what could realistically be obtained from an arms length purchaser. The Monitor concluded on its investigation that CAIL's Narida and Heathrow slots had a realizable value of $66 million, which it included in the Liquidation Analysis. I find that this conclusion is supportable and that the Monitor properly concluded that there were no other rights which ought to have been assigned value.

Tax Pools

131 There are four tax pools identified by Resurgence and the Minority Shareholders that are material: capital losses at the CAC level, undepreciated capital cost pools, operating losses incurred by Canadian and potential for losses to be reinstated upon repayment of fuel tax rebates by CAIL.

Capital Loss Pools

132 The capital loss pools at CAC will not be available to Air Canada since CAC is to be left out of the corporate reorganization and will be severed from CAIL. Those capital losses can essentially only be used to absorb a portion of the debt forgiveness liability associated with the restructuring. CAC, who has virtually all of its senior debt compromised in the plan, receives compensation for this small advantage, which cost them nothing.

Undepreciated capital cost ("UCC")

133 There is no benefit to Air Canada in the pools of UCC unless it were established that the UCC pools are in excess of the fair market value of the relevant assets, since Air Canada could create the same pools by simply buying the assets on a liquidation at fair market value. Mr. Peterson understood this pool of UCC to be approximately $700 million. There is no evidence that the UCC pool, however, could be considered to be a source of benefit. There is no evidence that this amount is any greater than fair market value.

Operating Losses

134 The third tax pool complained of is the operating losses. The debt forgiven as a result of the Plan will erase any operating losses from prior years to the extent of such forgiven debt.

Fuel tax rebates

135 The fourth tax pool relates to the fuel tax rebates system taken advantage of by CAIL in past years. The evidence is that on a consolidated basis the total potential amount of this pool is $297 million. According to Mr. Carty's testimony, CAIL has not been taxable in his ten years as Chief Financial Officer. The losses which it has generated for tax purposes have been sold on a 10 - 1 basis to the government in order to receive rebates of excise tax paid for fuel. The losses can be restored retroactively if the rebates are repaid, but the losses can only be carried forward for a maximum of seven years. The evidence of Mr. Peterson indicates that Air Canada has no plan to use those alleged losses and in order for them to be useful to Air Canada, Air Canada would have to complete a legal merger with CAIL, which is not provided for in the plan and is not contemplated by Air Canada until some uncertain future date. In my view, the Monitor's conclusion that there was no value to any tax pools in the Liquidation Analysis is sound.

136 Those opposed to the Plan have raised the spectre that there may be value unaccounted for in this liquidation analysis or otherwise. Given the findings above, this is merely speculation and is unsupported by any concrete evidence.

c. Alternatives to the Plan

137 When presented with a plan, affected stakeholders must weigh their options in the light of commercial reality. Those options are typically liquidation measured against the plan proposed. If not put forward, a hope for a different or more favourable plan is not an option and no basis upon which to assess fairness. On a purposive approach to the CCAA, what is fair and reasonable must be assessed against the effect of the Plan on the creditors and their various claims, in the context of their response to the plan. Stakeholders are expected to decide their fate based on realistic, commercially viable alternatives (generally seen as the prime motivating factor in any business decision) and not on speculative desires or hope

for the future. As Farley J. stated in *T. Eaton Co.* (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J. [Commercial List]) at paragraph 6:

> One has to be cognizant of the function of a balancing of their prejudices. Positions must be realistically assessed and weighed, all in the light of what an alternative to a successful plan would be. Wishes are not a firm foundation on which to build a plan; nor are ransom demands.

138 The evidence is overwhelming that all other options have been exhausted and have resulted in failure. The concern of those opposed suggests that there is a better plan that Air Canada can put forward. I note that significant enhancements were made to the plan during the process. In any case, this is the Plan that has been voted on. The evidence makes it clear that there is not another plan forthcoming. As noted by Farley J. in *T. Eaton Co.*, *supra*, "no one presented an alternative plan for the interested parties to vote on" (para. 8).

d. Oppression

Oppression and the CCAA

139 Resurgence and the Minority Shareholders originally claimed that the Plan proponents, CAC and CAIL and the Plan supporters 853350 and Air Canada had oppressed, unfairly disregarded or unfairly prejudiced their interests, under Section 234 of the ABCA. The Minority Shareholders (for reasons that will appear obvious) have abandoned that position.

140 Section 234 gives the court wide discretion to remedy corporate conduct that is unfair. As remedial legislation, it attempts to balance the interests of shareholders, creditors and management to ensure adequate investor protection and maximum management flexibility. The Act requires the court to judge the conduct of the company and the majority in the context of equity and fairness: *First Edmonton Place Ltd. v. 315888 Alberta Ltd.* (1988), 40 B.L.R. 28 (Alta. Q.B.). Equity and fairness are measured against or considered in the context of the rights, interests or reasonable expectations of the complainants: *Diligenti v. RWMD Operations Kelowna Ltd.* (1976), 1 B.C.L.R. 36 (B.C. S.C.).

141 The starting point in any determination of oppression requires an understanding as to what the rights, interests, and reasonable expectations are and what the damaging or detrimental effect is on them. MacDonald J. stated in *First Edmonton Place*, *supra* at 57:

> In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected in general commercial practice should all be material. More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations:

> The protection of the underlying expectation of a creditor in the arrangement with the corporation, the extent to which the acts complained of were unforeseeable where the creditor could not reasonably have protected itself from such acts and the detriment to the interests of the creditor.

142 While expectations vary considerably with the size, structure, and value of the corporation, all expectations must be reasonably and objectively assessed: *Pente Investment Management Ltd. v. Schneider Corp.* (1998), 42 O.R. (3d) 177 (Ont. C.A.).

143 Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: *Royal Oak Mines Ltd.*, *supra*, para. 4., *Re Cadillac Fairview Inc.* (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), and *T. Eaton Company*, *supra*.

144 To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.

145 It is through the lens of insolvency legislation that the rights and interests of both shareholders and creditors must be considered. The reduction or elimination of rights of both groups is a function of the insolvency and not of oppressive conduct in the operation of the CCAA. The antithesis of oppression is fairness, the guiding test for judicial sanction. If a plan unfairly disregards or is unfairly prejudicial it will not be approved. However, the court retains the power to compromise or prejudice rights to effect a broader purpose, the restructuring of an insolvent company, provided that the plan does so in a fair manner.

Oppression allegations by Resurgence

146 Resurgence alleges that it has been oppressed or had its rights disregarded because the Petitioners and Air Canada disregarded the specific provisions of their trust indenture, that Air Canada and 853350 dealt with other creditors outside of the CCAA, refusing to negotiate with Resurgence and that they are generally being treated inequitably under the Plan.

147 The trust indenture under which the Unsecured Notes were issued required that upon a "change of control", 101% of the principal owing thereunder, plus interest would be immediately due and payable. Resurgence alleges that Air Canada, through 853350, caused CAC and CAIL to purposely fail to honour this term. Canadian acknowledges that the trust indenture was breached. On February 1, 2000, Canadian announced a moratorium on payments to lessors and lenders, including the Unsecured Noteholders. As a result of this moratorium, Canadian defaulted on the payments due under its various credit facilities and aircraft leases.

148 The moratorium was not directed solely at the Unsecured Noteholders. It had the same impact on other creditors, secured and unsecured. Canadian, as a result of the moratorium, breached other contractual relationships with various creditors. The breach of contract is not sufficient to found a claim for oppression in this case. Given Canadian's insolvency, which Resurgence recognized, it cannot be said that there was a reasonable expectation that it would be paid in full under the terms of the trust indenture, particularly when Canadian had ceased making payments to other creditors as well.

149 It is asserted that because the Plan proponents engaged in a restructuring of Canadian's debt before the filing under the CCAA, that its use of the Act for only a small group of creditors, which includes Resurgence is somehow oppressive.

150 At the outset, it cannot be overlooked that the CCAA does not require that a compromise be proposed to *all* creditors of an insolvent company. The CCAA is a flexible, remedial statute which recognizes the unique circumstances that lead to and away from insolvency.

151 Next, Air Canada made it clear beginning in the fall of 1999 that Canadian would have to complete a financial restructuring so as to permit Air Canada to acquire CAIL on a financially sound basis and as a wholly owned subsidiary. Following the implementation of the moratorium, absent which Canadian could not have continued to operate, Canadian and Air Canada commenced efforts to restructure significant obligations by consent. They perceived that further damage to public confidence that a CCAA filing could produce, required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection. Before the Petitioners started the CCAA proceedings on March 24, 2000, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

152 The purpose of the CCAA is to create an environment for negotiations and compromise. Often it is the stay of proceedings that creates the necessary stability for that process to unfold. Negotiations with certain key creditors in advance of the CCAA filing, rather than being oppressive or conspiratorial, are to be encouraged as a matter of principle if their impact is to provide a firm foundation for a restructuring. Certainly in this case, they were of critical importance, staving off liquidation, preserving cash flow and allowing the Plan to proceed. Rather than being detrimental or prejudicial to the interests of the other stakeholders, including Resurgence, it was beneficial to Canadian and all of its stakeholders.

153 Resurgence complained that certain transfers of assets to Air Canada and its actions in consolidating the operations of the two entities prior to the initiation of the CCAA proceedings were unfairly prejudicial to it.

154 The evidence demonstrates that the sales of the Toronto — Tokyo route, the Dash 8s and the simulators were at the suggestion of Canadian, who was in desperate need of operating cash. Air Canada paid what Canadian asked, based on its cash flow requirements. The evidence established that absent the injection of cash at that critical juncture, Canadian would have ceased operations. It is for that reason that the Government of Canada willingly provided the approval for the transfer on December 21, 2000.

155 Similarly, the renegotiation of CAIL's aircraft leases to reflect market rates supported by Air Canada covenant or guarantee has been previously dealt with by this court and found to have been in the best interest of Canadian, not to its detriment. The evidence establishes that the financial support and corporate integration that has been provided by Air Canada was not only in Canadian's best interest, but its only option for survival. The suggestion that the renegotiations of these leases, various sales and the operational realignment represents an assumption of a benefit by Air Canada to the detriment of Canadian is not supported by the evidence.

156 I find the transactions predating the CCAA proceedings, were in fact Canadian's life blood in ensuring some degree of liquidity and stability within which to conduct an orderly restructuring of its debt. There was no detriment to Canadian or to its creditors, including its unsecured creditors. That Air Canada and Canadian were so successful in negotiating agreements with their major creditors, including aircraft financiers, without resorting to a stay under the CCAA underscores the serious distress Canadian was in and its lenders recognition of the viability of the proposed Plan.

157 Resurgence complained that other significant groups held negotiations with Canadian. The evidence indicates that a meeting was held with Mr. Symington, Managing Director of Resurgence, in Toronto in March 2000. It was made clear to Resurgence that the pool of unsecured creditors would be somewhere between $500 and $700 million and that Resurgence

would be included within that class. To the extent that the versions of this meeting differ, I prefer and accept the evidence of Mr. Carty. Resurgence wished to play a significant role in the debt restructuring and indicated it was prepared to utilize the litigation process to achieve a satisfactory result for itself. It is therefore understandable that no further negotiations took place. Nevertheless, the original offer to affected unsecured creditors has been enhanced since the filing of the plan on April 25, 2000. The enhancements to unsecured claims involved the removal of the cap on the unsecured pool and an increase from 12 to 14 cents on the dollar.

158 The findings of the Commissioner of Competition establishes beyond doubt that absent the financial support provided by Air Canada, Canadian would have failed in December 1999. I am unable to find on the evidence that Resurgence has been oppressed. The complaint that Air Canada has plundered Canadian and robbed it of its assets is not supported but contradicted by the evidence. As described above, the alternative is liquidation and in that event the Unsecured Noteholders would receive between one and three cents on the dollar. The Monitor's conclusions in this regard are supportable and I accept them.

e. Unfairness to Shareholders

159 The Minority Shareholders essentially complained that they were being unfairly stripped of their only asset in CAC — the shares of CAIL. They suggested they were being squeezed out by the new CAC majority shareholder 853350, without any compensation or any vote. When the reorganization is completed as contemplated by the Plan, their shares will remain in CAC but CAC will be a bare shell.

160 They further submitted that Air Canada's cash infusion, the covenants and guarantees it has offered to aircraft financiers, and the operational changes (including integration of schedules, "quick win" strategies, and code sharing) have all added significant value to CAIL to the benefit of its stakeholders, including the Minority Shareholders. They argued that they should be entitled to continue to participate into the future and that such an expectation is legitimate and consistent with the statements and actions of Air Canada in regard to integration. By acting to realign the airlines before a corporate reorganization, the Minority Shareholders asserted that Air Canada has created the expectation that it is prepared to consolidate the airlines with the participation of a minority. The Minority Shareholders take no position with respect to the debt restructuring under the CCAA, but ask the court to sever the corporate reorganization provisions contained in the Plan.

161 Finally, they asserted that CAIL has increased in value due to Air Canada's financial contributions and operational changes and that accordingly, before authorizing the transfer of the CAIL shares to 853350, the current holders of the CAIL Preferred Shares, the court must have evidence before it to justify a transfer of 100% of the equity of CAIL to the Preferred Shares.

162 That CAC will have its shareholding in CAIL extinguished and emerge a bare shell is acknowledged. However, the evidence makes it abundantly clear that those shares, CAC's "only asset", have no value. That the Minority Shareholders are content to have the debt restructuring proceed suggests by implication that they do not dispute the insolvency of both Petitioners, CAC and CAIL.

163 The Minority Shareholders base their expectation to remain as shareholders on the actions of Air Canada in acquiring only 82% of the CAC shares before integrating certain of the airlines' operations. Mr. Baker (who purchased *after* the Plan was filed with the Court and almost six months after the take over bid by Air Canada) suggested that the contents of the bid circular misrepresented Air Canada's future intentions to its shareholders. The two dollar price offered and paid per share in the bid must be viewed somewhat skeptically and in the context in which the bid arose. It does not support the speculative view that some shareholders hold, that somehow, despite insolvency, their shares have some value on a going concern basis. In any event, any claim for misrepresentation that Minority Shareholders might have arising from the take over bid circular against Air Canada or 853350, if any, is unaffected by the Plan and may be pursued after the stay is lifted.

164 In considering Resurgence's claim of oppression I have already found that the financial support of Air Canada during this restructuring period has benefited Canadian and its stakeholders. Air Canada's financial support and the integration of the two airlines has been critical to keeping Canadian afloat. The evidence makes it abundantly clear that without this support Canadian would have ceased operations. However it has not transformed CAIL or CAC into solvent companies.

165 The Minority Shareholders raise concerns about assets that are ascribed limited or no value in the Monitor's report as does Resurgence (although to support an opposite proposition). Considerable argument was directed to the future operational savings and profitability forecasted for Air Canada, its subsidiaries and CAIL and its subsidiaries. Mr. Peterson estimated it to be in the order of $650 to $800 million on an annual basis, commencing in 2001. The Minority Shareholders point to the tax pools of a restructured company that they submit will be of great value once CAIL becomes profitable as anticipated. They point to a pension surplus that at the very least has value by virtue of the contribution holidays that it affords. They also look to the value of the compromised claims of the restructuring itself which they submit are in the order of $449 million. They submit these cumulative benefits add value, currently or at least realizable in the future. In sharp contrast to the Resurgence position that these acts constitute oppressive behaviour, the Minority Shareholders view them as enhancing the value of their shares. They go so far as to suggest that there may well be a current going concern value of the CAC shares that has been

conveniently ignored or unquantified and that the Petitioners must put evidence before the court as to what that value is.

166 These arguments overlook several important facts, the most significant being that CAC and CAIL are insolvent and will remain insolvent until the debt restructuring is fully implemented. These companies are not just technically or temporarily insolvent, they are massively insolvent. Air Canada will have invested upward of $3 billion to complete the restructuring, while the Minority Shareholders have contributed nothing. Further, it was a fundamental condition of Air Canada's support of this Plan that it become the sole owner of CAIL. It has been suggested by some that Air Canada's share purchase at two dollars per share in December 1999 was unfairly prejudicial to CAC and CAIL's creditors. Objectively, any expectation by Minority Shareholders that they should be able to participate in a restructured CAIL is not reasonable.

167 The Minority Shareholders asserted the plan is unfair because the effect of the reorganization is to extinguish the common shares of CAIL held by CAC and to convert the voting and non-voting Preferred Shares of CAIL into common shares of CAIL. They submit there is no expert valuation or other evidence to justify the transfer of CAIL's equity to the Preferred Shares. There is no equity in the CAIL shares to transfer. The year end financials show CAIL's shareholder equity at a deficit of $790 million. The Preferred Shares have a liquidation preference of $347 million. There is no evidence to suggest that Air Canada's interim support has rendered either of these companies solvent, it has simply permitted operations to continue. In fact, the unaudited consolidated financial statements of CAC for the quarter ended March 31, 2000 show total shareholders equity went from a deficit of $790 million to a deficit of $1.214 million, an erosion of $424 million.

168 The Minority Shareholders' submission attempts to compare and contrast the rights and expectations of the CAIL preferred shares as against the CAC common shares. This is not a meaningful exercise; the Petitioners are not submitting that the Preferred Shares have value and the evidence demonstrates unequivocally that they do not. The Preferred Shares are merely being utilized as a corporate vehicle to allow CAIL to become a wholly owned subsidiary of Air Canada. For example, the same result could have been achieved by issuing new shares rather than changing the designation of 853350's Preferred Shares in CAIL.

169 The Minority Shareholders have asked the court to sever the reorganization from the debt restructuring, to permit them to participate in whatever future benefit might be derived from the restructured CAIL. However, a fundamental condition of this Plan and the expressed intention of Air Canada on numerous occasions is that CAIL become a wholly owned subsidiary. To suggest the court ought to sever this reorganization from the debt restructuring fails to account for the fact that it is not two plans but an integral part of a single plan. To accede to this request would create an injustice to creditors whose claims are

being seriously compromised, and doom the entire Plan to failure. Quite simply, the Plan's funder will not support a severed plan.

170 Finally, the future profits to be derived by Air Canada are not a relevant consideration. While the object of any plan under the CCAA is to create a viable emerging entity, the germane issue is what a prospective purchaser is prepared to pay in the circumstances. Here, we have the one and only offer on the table, Canadian's last and only chance. The evidence demonstrates this offer is preferable to those who have a remaining interest to a liquidation. Where secured creditors have compromised their claims and unsecured creditors are accepting 14 cents on the dollar in a potential pool of unsecured claims totalling possibly in excess of $1 billion, it is not unfair that shareholders receive nothing.

e. The Public Interest

171 In this case, the court cannot limit its assessment of fairness to how the Plan affects the direct participants. The business of the Petitioners as a national and international airline employing over 16,000 people must be taken into account.

172 In his often cited article, *Reorganizations Under the Companies' Creditors Arrangement Act* (1947), 25 Can.Bar R.ev. 587 at 593 Stanley Edwards stated:

> Another reason which is usually operative in favour of reorganization is the interest of the public in the continuation of the enterprise, particularly if the company supplies commodities or services that are necessary or desirable to large numbers of consumers, or if it employs large numbers of workers who would be thrown out of employment by its liquidation. This public interest may be reflected in the decisions of the creditors and shareholders of the company and is undoubtedly a factor which a court would wish to consider in deciding whether to sanction an arrangement under the C.C.A.A.

173 In *Re Repap British Columbia Inc.* (1998), 1 C.B.R. (4th) 49 (B.C. S.C.) the court noted that the fairness of the plan must be measured against the overall economic and business environment and against the interests of the citizens of British Columbia who are affected as "shareholders" of the company, and creditors, of suppliers, employees and competitors of the company. The court approved the plan even though it was unable to conclude that it was necessarily fair and reasonable. In *Re Quintette Coal Ltd.*, *supra*, Thackray J. acknowledged the significance of the coal mine to the British Columbia economy, its importance to the people who lived and worked in the region and to the employees of the company and their families. Other cases in which the court considered the public interest in determining whether to sanction a plan under the CCAA include *Re Canadian Red Cross Society / Société Canadienne de la Croix-Rouge* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) and *Algoma Steel Corp. v. Royal Bank* (April 16, 1992), Doc. Toronto B62/91-A (Ont. Gen. Div.)

174 The economic and social impacts of a plan are important and legitimate considerations. Even in insolvency, companies are more than just assets and liabilities. The fate of a company is inextricably tied to those who depend on it in various ways. It is difficult to imagine a case where the economic and social impacts of a liquidation could be more catastrophic. It would undoubtedly be felt by Canadian air travellers across the country. The effect would not be a mere ripple, but more akin to a tidal wave from coast to coast that would result in chaos to the Canadian transportation system.

175 More than sixteen thousand unionized employees of CAIL and CRAL appeared through counsel. The unions and their membership strongly support the Plan. The unions represented included the Airline Pilots Association International, the International Association of Machinists and Aerospace Workers, Transportation District 104, Canadian Union of Public Employees, and the Canadian Auto Workers Union. They represent pilots, ground workers and cabin personnel. The unions submit that it is essential that the employee protections arising from the current restructuring of Canadian not be jeopardized by a bankruptcy, receivership or other liquidation. Liquidation would be devastating to the employees and also to the local and national economies. The unions emphasize that the Plan safeguards the employment and job dignity protection negotiated by the unions for their members. Further, the court was reminded that the unions and their members have played a key role over the last fifteen years or more in working with Canadian and responsible governments to ensure that Canadian survived and jobs were maintained.

176 The Calgary and Edmonton Airport authorities, which are not for profit corporations, also supported the Plan. CAIL's obligations to the airport authorities are not being compromised under the Plan. However, in a liquidation scenario, the airport authorities submitted that a liquidation would have severe financial consequences to them and have potential for severe disruption in the operation of the airports.

177 The representations of the Government of Canada are also compelling. Approximately one year ago, CAIL approached the Transport Department to inquire as to what solution could be found to salvage their ailing company. The Government saw fit to issue an order in council, pursuant to section 47 of the *Transportation Act*, which allowed an opportunity for CAIL to approach other entities to see if a permanent solution could be found. A standing committee in the House of Commons reviewed a framework for the restructuring of the airline industry, recommendations were made and undertakings were given by Air Canada. The Government was driven by a mandate to protect consumers and promote competition. It submitted that the Plan is a major component of the industry restructuring. Bill C-26, which addresses the restructuring of the industry, has passed through the House of Commons and is presently before the Senate. The Competition Bureau has accepted that Air Canada has

the only offer on the table and has worked very closely with the parties to ensure that the interests of consumers, employees, small carriers, and smaller communities will be protected.

178 In summary, in assessing whether a plan is fair and reasonable, courts have emphasized that perfection is not required: see for example *Re Wandlyn Inns Ltd.* (1992), 15 C.B.R. (3d) 316 (N.B. Q.B.), *Quintette Coal*, *supra* and *Repap*, *supra*. Rather, various rights and remedies must be sacrificed to varying degrees to result in a reasonable, viable compromise for all concerned. The court is required to view the "big picture" of the plan and assess its impact as a whole. I return to *Algoma Steel v. Royal Bank*, *supra* at 9 in which Farley J. endorsed this approach:

> What might appear on the surface to be unfair to one party when viewed in relation to all other parties may be considered to be quite appropriate.

179 Fairness and reasonableness are not abstract notions, but must be measured against the available commercial alternatives. The triggering of the statute, namely insolvency, recognizes a fundamental flaw within the company. In these imperfect circumstances there can never be a perfect plan, but rather only one that is supportable. As stated in *Re Sammi Atlas Inc.* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) at 173:

> A plan under the CCAA is a compromise; it cannot be expected to be perfect. It should be approved if it is fair, reasonable and equitable. Equitable treatment is not necessarily equal treatment. Equal treatment may be contrary to equitable treatment.

180 I find that in all the circumstances, the Plan is fair and reasonable.

IV. Conclusion

181 The Plan has obtained the support of many affected creditors, including virtually all aircraft financiers, holders of executory contracts, AMR, Loyalty Group and the Senior Secured Noteholders.

182 Use of these proceedings has avoided triggering more than $1.2 billion of incremental claims. These include claims of passengers with pre-paid tickets, employees, landlords and other parties with ongoing executory contracts, trade creditors and suppliers.

183 This Plan represents a solid chance for the continued existence of Canadian. It preserves CAIL as a business entity. It maintains over 16,000 jobs. Suppliers and trade creditors are kept whole. It protects consumers and preserves the integrity of our national transportation system while we move towards a new regulatory framework. The extensive efforts by Canadian and Air Canada, the compromises made by stakeholders both within

and without the proceedings and the commitment of the Government of Canada inspire confidence in a positive result.

184 I agree with the opposing parties that the Plan is not perfect, but it is neither illegal nor oppressive. Beyond its fair and reasonable balancing of interests, the Plan is a result of bona fide efforts by all concerned and indeed is the only alternative to bankruptcy as ten years of struggle and creative attempts at restructuring by Canadian clearly demonstrate. This Plan is one step toward a new era of airline profitability that hopefully will protect consumers by promoting affordable and accessible air travel to all Canadians.

185 The Plan deserves the sanction of this court and it is hereby granted. The application pursuant to section 185 of the ABCA is granted. The application for declarations sought by Resurgence are dismissed. The application of the Minority Shareholders is dismissed.

Application granted; counter-applications dismissed.

Footnotes

* Leave to appeal refused 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, [2000] 10 W.W.R. 314, 2000 ABCA 238, 20 C.B.R. (4th) 46 (Alta. C.A. [In Chambers]).

TAB 5

2009 ONCA 276
Ontario Court of Appeal

Shaw Estate (Trustee of) v. Nicol Island Development Inc.

2009 CarswellOnt 1748, 2009 ONCA 276, [2009] O.J. No. 1333, 177 A.C.W.S. (3d) 296, 248 O.A.C. 35, 51 C.B.R. (5th) 12

Ernst & Young (Thunder Bay) Inc., Trustee of the Estate of Herbert Graham Shaw (Respondent) and Nicol Island Development Incorporated and Andre Nicol (Appellants)

Northern Lights Credit Union Limited (Respondent) and Nicol Island Development Incorporated and Andre Nicol (Appellants)

Doherty, E.A. Cronk, R.G. Juriansz JJ.A.

Heard: November 6, 2008
Judgment: April 3, 2009
Docket: CA C48494

Proceedings: reversing in part *Ernest & Young (Thunder Bay) Inc. v. Nicol Island Development Inc.* (2007), 2007 CarswellOnt 8282, 38 C.B.R. (5th) 92 (Ont. S.C.J.)

Counsel: Allan D. McKitrick for Appellants
Tracey Nieckarz for Respondent, Northern Lights Credit Union Limited

Subject: Civil Practice and Procedure; Insolvency

APPEAL by defendants from judgment reported at *Ernest & Young (Thunder Bay) Inc. v. Nicol Island Development Inc.* (2007), 2007 CarswellOnt 8282, 38 C.B.R. (5th) 92 (Ont. S.C.J.), granting credit union's motion for order striking paragraphs of statement of defence relating to plaintiff's status as creditor.

***E.A. Cronk J.A.*:**

I. Introduction

1 This appeal involves a fraudulent preference and conveyance action commenced by the alleged creditor of a bankrupt with leave of the court under s. 38(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the "Act"). The court is required to consider whether the defendants named in the action have standing to challenge the s. 38(1)

court order and the action commenced pursuant to that order, as well as the standing of the plaintiff to obtain relief under s. 38(1) and to maintain the action authorized thereunder.

II. Relevant Statutory Provisions

2 The following provisions of the Act are central to the issues on appeal:

2. In this Act,

. . . . .

"creditor" means a person having a claim, unsecured, preferred by virtue of priority under section 136 or secured, provable as a claim under this Act;

. . . . .

38. (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

(2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.

. . . . .

121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

3 The parties also rely on the following remedial provisions of the Act:

37. Where the bankrupt or any of the creditors or any other person is aggrieved by any act or decision of the trustee, he may apply to the court and the court may confirm, reverse or modify the act or decision complained of and make such order in the premises as it thinks fit.

. . . . .

187.(5) Every court may review, rescind or vary any order made by it under its bankruptcy jurisdiction.

. . . . .

(9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

I will refer in these reasons to certain other provisions of the Act in the context of the issues to which they relate.

III. Facts

4 This dispute has a lengthy procedural history. Given the submissions made by the appellants on appeal, a somewhat detailed chronology is necessary.

(1) Events Prior to Section 38 Motion

5 In the early 1990s, Herbert Graham Shaw ("Shaw") operated two companies: Shaw Transportation Services (Thunder Bay) Limited ("Shaw Transportation") and Shaw Baking Company Limited ("Shaw Baking"). In 1993, when Shaw Transportation experienced financial difficulties, Shaw decided to access funds in two of his self-directed registered retirement savings plans ("RRSPs") to pay some of Shaw Transportation's debts.

6 However, Shaw did not wish to diminish his retirement fund by collapsing his RRSPs, thereby triggering adverse income tax consequences. He therefore persuaded his friend, the appellant Andre Nicol ("Nicol"), to arrange for the appellant, Nicol Island Development Incorporated ("Nicol Island"), to borrow funds from the RRSPs, to be secured by mortgages granted by Nicol Island on lands owned by it in favour of the trustee of the RRSPs.

7 On June 17, 1993, Nicol Island borrowed $37,000 from the RRSPs, the repayment of which was secured by a mortgage in a like amount from Nicol Island to the trustee of the RRSPs and Nicol's personal guarantee. On July 10, 1998, Nicol Island borrowed an additional $55,000 from the RRSPs. The repayment of this loan was again secured by a mortgage granted by Nicol Island in favour of the trustee of the RRSPs, in the same amount as the loan. It appears that the proceeds of both loans were funnelled, directly or indirectly, to Shaw Transportation. No payments were ever made on the Mortgages by any party. [1]

8 On June 20, 2003, the respondent, Northern Lights Credit Union Limited (the "Credit Union"), commenced an action against Shaw and his wife, Carol Shaw, on their personal guarantee of Shaw Bakery's indebtedness to the Credit Union (the "Guarantee Action").

9 Five days later, on June 25, 2003, Shaw arranged for the discharge of the Mortgages, although the full amount of principal and interest owing thereunder remained outstanding (the "Discharges").

10 On August 18, 2003, when the Shaws did not defend the Guarantee Action, the Credit Union obtained default judgment against them in the amount of $109,748.58, plus postjudgment interest and costs.

11 On October 15, 2003, Shaw filed an assignment in bankruptcy under the Act. The respondent, Ernst & Young (Thunder Bay) Inc., was appointed trustee of the bankrupt estate (the "Trustee"). On October 17, 2003, the Trustee filed a notice of stay of proceedings against Shaw in the Superior Court of Justice, the effect of which was to preclude any efforts by the Credit Union to enforce its default judgment against Shaw, without leave of the court. Consequently, at the end of October, the Credit Union filed a proof of claim in Shaw's bankruptcy, in the amount of $108,863.28. The proof of claim was accepted by the Trustee.

12 In his sworn statement of creditors and liabilities filed in the bankruptcy, Shaw listed the Credit Union as an unsecured creditor who was owed $108,200. In his sworn statement of affairs (assets) in the bankruptcy, Shaw did not disclose the Mortgages or the Discharges. Indeed, he indicated that his RRSPs had no value.

13 Neither Shaw (prior to his bankruptcy) nor his Trustee (after the bankruptcy) moved to set aside the Credit Union's default judgment against Shaw. However, after the default judgment against her was set aside in May 2004, Mrs. Shaw delivered a statement of defence and counterclaim in the Guarantee Action. In her pleading, she challenged the validity of the guarantee granted to the Credit Union and claimed damages of approximately $5 million on her own behalf and that of her husband for wrongs allegedly committed by the Credit Union in realizing on its security against Shaw Bakery and the Shaws.

14 Shaw received an automatic discharge from bankruptcy on July 16, 2004. It appears that his discharge was unopposed.

15 When the Trustee subsequently learned of the Mortgages and the Discharges, it concluded that the Discharges constituted a wrongful settlement, fraudulent conveyance and/or preference without which the Mortgages would have formed part of the assets available in Shaw's bankrupt estate to satisfy creditors. Accordingly, on December 6, 2004, the Trustee moved in the bankruptcy proceeding for various relief against the appellants, including orders: setting aside the Discharges and reinstating the Mortgages; directing the appellants to pay the principal amounts owing under the Mortgages ($92,000) to the Trustee; and directing a trial of the issues raised on the motion (the "Trustee's Motion").

16 The appellants countered with a cross-motion in which they sought an order dismissing the Trustee's Motion in its entirety on the ground that it was frivolous and without merit or, in the alternative, dismissing it in respect of the 1993 mortgage on the basis that the 10-year limitation period applicable to actions on a mortgage had expired, among other relief. In their motion materials, the appellants alleged that the RRSP loans to Nicol Island were designed to assist Shaw in his financial difficulties, that the appellants derived no benefit therefrom, that the RRSP funds were provided to Shaw Transportation or its creditors at Shaw's direction, and that the parties never intended that the appellants should be liable under the Mortgages.

17 The motions were heard together by Platana R.S.J. of the Superior Court of Justice. On June 9, 2005, he dismissed the appellants' motion, rejected or declined to rule on much of the relief claimed in the Trustee's Motion, and ruled that there should be a trial on a number of the issues raised. He therefore directed the parties to reattend before him to settle the issues for trial.

18 For various reasons, the directed reattendance before Platana R.S.J. did not take place for almost 18 months. In the intervening period, by letters dated March 14, 2005 to Mrs. Shaw and January 9, 2006 to both Mr. and Mrs. Shaw, counsel for the Credit Union communicated directly with the Shaws regarding the possible settlement of the Guarantee Action. In his January 9 letter, counsel indicated that his client had agreed "to accept your offer that the actions be dismissed on a without costs basis provided that you are responsible for the costs in taking out these Orders". On January 30, 2006, when payment of the required costs was not forthcoming, the Credit Union's counsel informed the Shaws that the Credit Union would not take any further steps concerning the dismissal of the Guarantee Action.

(2) Section 38 Motion

19 On January 18, 2006, the Credit Union wrote to the Trustee and requested it to move forward with the litigation against the appellants. The Trustee refused to do so as Shaw's estate lacked sufficient funds to finance the litigation. Instead, the Trustee informed the Credit Union that if it obtained an order under s. 38(1) of the Act permitting it to take the proceeding against the appellants in its own name, the Trustee would assign and transfer its interest in the proceeding to the Credit Union in accordance with s. 38(2) of the Act.

20 In October 2006, the Credit Union moved for an order under s. 38(1) of the Act. In its motion materials, it identified itself as a creditor in Shaw's bankruptcy and indicated that it wished "to continue the proceedings commenced by the Trustee by arranging an appointment to settle the issues and obtain an order directing trial of those issues ...". The Credit Union served its motion materials on the Trustee, but did not serve the appellants or Shaw.

21 At the time of the s. 38 motion, the Trustee had not assigned its interest in the proceeding to the Credit Union. A formal assignment was delivered in June 2007.

22 By order dated October 16, 2006, Pierce J. of the Superior Court of Justice (the "Motion Judge") authorized the Credit Union to continue proceedings against the appellants in its own name, provided a procedure for so doing, and directed that the costs of the s. 38 motion were to be in the discretion of the court hearing the proceedings (the "s. 38 Order"). Notice of the s. 38 Order was provided thereafter to the creditors identified in the bankruptcy and to the appellants.

(3) The Platana Order

23 The Credit Union and the appellants eventually appeared before Platana R.S.J. to settle the terms of his June 9, 2005 order and to resolve the issues to be tried. Although the Trustee did not participate, its former counsel — T. Michael Strickland — appeared for the Credit Union. By order dated December 19, 2006, Platana R.S.J. directed in part that: (i) on consent, the matter was to proceed as a regular trial under the simplified procedure set out in the *Rules of Civil Procedure*; and (ii) the issues to be tried were "as specified in [the] Draft Statement of Issues filed and initialled by counsel" (the "Platana Order").

24 The parties' Draft Statement of Issues contained no explicit reference to the Credit Union's status as a creditor of the bankrupt or its entitlement to seek the s. 38 Order. The issues identified for trial were confined to the following:

> (1) Were either or both of the Discharges "a settlement, a fraudulent conveyance and/or a fraudulent preference"?
>
> (2) If so, should either or both of the Discharges be set aside and the Mortgage(s) reinstated?
>
> (3) In respect of the 1993 mortgage, did the granting of the relevant Discharge extend the applicable limitation period?
>
> (4) Were the appellants liable to pay the principal amounts, together with interest, owed under the Mortgages?
>
> (5) If the appellants were liable to pay interest, what rate of interest applied in the circumstances?

The appellants did not appeal the Platana Order.

25 The parties dispute certain of the events at the December 2006 court attendance. In particular, in an affidavit filed on the motions that gave rise to this appeal, Strickland swore that, during this attendance, the appellants' counsel raised the issue of the Credit Union's status as a "proper creditor" of Shaw and, therefore, its entitlement to the s. 38 Order. However, he also said that the appellants' counsel did not "elaborate on why [the appellants] suspected that [the Credit Union] was not a proper creditor", nor was it suggested that the appellants suspected that the Credit Union had released Shaw from any claims. On the contrary, Strickland deposed that when he agreed to provide the appellants with a copy of the Credit Union's proof of claim in bankruptcy, Platana R.S.J. asked the appellants' counsel whether that information "would be sufficient". In response, counsel for the appellants allegedly "made no further objections and abandoned their argument" regarding the Credit Union's status as a proper plaintiff.

26 The appellants maintain that they did not abandon the creditor status issue during their appearance before Platana R.S.J. They rely on affidavit evidence from Nicol that the appellants did not learn of the "settlement" of the Guarantee Action until February 2007. But the appellants do not deny that the question of the Credit Union's creditor status was raised before Platana R.S.J. Nor have they adduced any evidence that contradicts Strickland's version of what was said before Platana R.S.J. on this issue.

(4) The Competing Motions

27 At the end of January 2007, in reliance on the s. 38 Order, the Credit Union instituted a fresh action against the appellants, claiming essentially the same relief as had been sought on the Trustee's Motion (the "s. 38 Action").

28 The appellants responded to the s. 38 Action in two ways. First, in their statement of defence, they put in issue: (i) the Credit Union's status as a creditor of Shaw and its standing to seek the s. 38 Order; (ii) the alleged settlement of the Credit Union's claims against the Shaws; (iii) the validity of the Guarantee Action; and (iv) the Credit Union's failure to disclose the alleged settlement to Platana R.S.J. and on the s. 38 motion.

29 Next, the appellants moved for orders dismissing the Trustee's Motion and the s. 38 Action and setting aside the s. 38 Order, among other relief. The stated grounds for the motion included claims that the Credit Union had no standing or capacity to initiate the s. 38 Action or to seek the s. 38 Order, that the s. 38 Order was obtained on the Credit Union's false representation that it was a creditor of Shaw and without full and fair disclosure of all material facts, and that the s. 38 Action was based on a request for the payment of a settled account.

30 While the appellants' motion was brought under several rules of the *Rules of Civil Procedure*, it was framed principally as a motion to dismiss the s. 38 Action under subrules 21.01(3)(b) and (d) and as a motion for summary judgment under Rule 76 (the simplified procedure) or, in the alternative, under Rule 20. Importantly, although the appellants sought to set aside the s. 38 Order under rule 59.06(2), they did not invoke the authority of the court under s. 187(5) of the Act to rescind or vary an order made in the bankruptcy or under s. 37 of the Act for relief against the Trustee concerning its assignment in favour of the Credit Union.

31 For its part, the Credit Union brought its own cross-motion for an order under rules 25.11 and 38.10 striking those paragraphs of the appellants' pleading that dealt with the Credit Union's creditor status, the alleged settlement with the Shaws, and alleged defects in the s. 38 motion, primarily on the basis that they raised issues unrelated to the issues ordered for trial.

32 These competing motions proceeded before the Motion Judge. By order dated December 13, 2007, she dismissed the appellants' motion and granted the relief sought by the Credit Union. In the Motion Judge's view: (i) the impugned paragraphs of the appellants' pleading raised a new issue that was outside the scope of the issues to be tried under the Platana Order; (ii) no binding settlement was entered into by the Credit Union with Shaw — rather, the settlement discussions relied on by the appellants "could only have been with Carol Shaw"; (iii) the Credit Union was a creditor of Shaw at the time of his assignment in bankruptcy and, therefore, was eligible to seek an order under s. 38(1) of the Act; and (iv) the appellants' challenge to the Credit Union's creditor status constituted an impermissible collateral attack on the s. 38 Order.

33 The appellants appeal from the Motion Judge's ruling.

IV. Issues

34 The appellants raise four issues:

> (1) Did the Motion Judge err by holding that the appellants did not have standing to challenge the creditor status of the Credit Union?
>
> (2) Did the Motion Judge err by holding that the Credit Union was a creditor of Shaw with standing to seek the s. 38 Order?
>
> (3) Did the Motion Judge err by failing to set aside the s. 38 Order on the basis of the alleged unfair treatment of the appellants and abuse of process?
>
> (4) Did the Motion Judge err by striking the impugned paragraphs of the appellants' pleading?

V. Analysis

(1) Applicable Interpretive Principles

35 It is well-established that an overly narrow, legalistic approach to the interpretation of the Act is to be avoided: *A. Marquette & fils Inc. v. Mercure*, [1977] 1 S.C.R. 547 (S.C.C.), at p. 556. Lloyd W. Houlden, Geoffrey B. Morawetz and Janis P. Sarra in *The 2009 Annotated Bankruptcy and Insolvency Act* (Toronto: Thomson Carswell: 2008) note at p. 2:

> The general approach to the *Act* by the courts has been that it is a commercial statute, the administration of which is largely in the hands of business people and technical objections should, therefore, not be given effect to beyond what is necessary for the proper interpretation of the *Act*...Litigation and court proceedings are to be avoided, thus maximizing the return to creditors. [Citations omitted.]

36 The general purpose of the Act is described by these authors at p. 3 of the above-cited text in part as follows:

> The *Act* was passed to provide for the orderly and fair distribution of the property of a bankrupt among his or her creditors on a *pari passu* basis.
>
> . . . . .
>
> The *Act* permits the setting aside of preferences, settlements, and other fraudulent transactions so that all ordinary creditors may share equally in the administration of the bankrupt's assets. [Citations omitted.]

37 The central issues in this case concern s. 38(1) of the Act. In *Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.* (1994), 27 C.B.R. (3d) 1 (Alta. C.A.), at paras. 14-15, leave to appeal to S.C.C. refused, [1994] S.C.C.A. No. 346 (S.C.C.), the Alberta Court of Appeal expressed the purpose of s. 38 in this fashion:

> In my view, its primary purpose is to ensure that the bankrupt's assets are preserved for the benefit of the creditors. It provides the mechanism for creditors to proceed with an action when the trustee refuses or fails to act; thereby ensuring that assets of the bankrupt (which may otherwise go unrecovered) are available to creditors willing to finance the litigation.
>
> The secondary purpose, relating to notice, is to make sure the section operates fairly. While it is fair that those parties willing to accept the risks and costs of litigation receive a preference in terms of recovering their losses, the right to that preference must be shared with all creditors.

See also, *Jaston & Co. v. McCarthy* (1998), 8 C.B.R. (4th) 25 (B.C. C.A.), at paras. 48-50; *Penfold v. Provenzano* (1996), 30 O.R. (3d) 230 (Ont. Gen. Div.), at para. 18.

38 The appellants rely on the following statement in *Toyota* at para. 6 to urge, in effect, a strict constructionist approach to s. 38: "[as] the right of a creditor to bring an action under s. 38 is purely statutory, a creditor must bring itself strictly within the provisions of the section in order to exercise the powers provided by it" (citations omitted.)

39 This passage from *Toyota* cannot be taken out of context. *Toyota* holds at para. 23, that a "purposive" approach to the interpretation of s. 38 is required to meet the objectives of preserving the bankrupt's assets, while still providing fairness to creditors. On this basis, the court in *Toyota* concluded that mere procedural irregularities associated with a s. 38 motion could not operate to defeat the purpose of the provision but, rather, could be cured under s. 187(9) of the Act.

40 The purposive approach to the construction of s. 38 adopted in *Toyota* accords with the modern process of statutory interpretation favoured by the Supreme Court of Canada, as first described in E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) at p. 87:

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

See also *Bell ExpressVu Ltd. Partnership v. Rex*, [2002] 2 S.C.R. 559 (S.C.C.), at para. 26; *Rizzo & Rizzo Shoes Ltd., Re*, [1998] 1 S.C.R. 27 (S.C.C.), at para. 21.

41 Our consideration of the issues on appeal must proceed in recognition of these settled interpretive principles. I turn now to the threshold issue whether the appellants had standing to challenge the s. 38 Order and the proceeding authorized by it.

(2) The Appellants' Standing

42 The appellants argue that the Motion Judge erred by holding that their challenge to the Credit Union's creditor status constituted "a collateral attack on the [s. 38 Order] which the defendants had no standing to make", such that it was not open to the appellants to challenge the s. 38 Order and the s. 38 Action. In the particular circumstances of this case, I agree.

43 A s. 38 motion is a proceeding between a trustee in bankruptcy and a creditor of the bankrupt. There is no requirement under the Act that either the bankrupt or the proposed defendant receive notice of a s. 38 motion: *Krupp MaK Maschinenbau GmbH v. Black* (1996), 154 N.S.R. (2d) 321 (N.S. C.A.), at paras. 19 and 25-27, leave to appeal to S.C.C. refused,

[1997] S.C.C.A. No. 144 (S.C.C.); *Coroban Plastics Ltd., Re* (1994), 34 C.B.R. (3d) 50 (B.C. C.A.), at para. 8 [hereinafter *Formula Atlantic*]; *Salloum, Re* (1990), 1 C.B.R. (3d) 204 (B.C. C.A.), at para. 27; *Bank of British Columbia v. McCracken* (1986), 61 C.B.R. (N.S.) 287 (B.C. C.A.), at paras. 8-9; *Swerdlow, Re* (1985), 57 C.B.R. (N.S.) 180 (Ont. S.C.), at para. 17.

44 Similarly, as a general rule, neither the bankrupt nor the proposed defendant has standing to be heard on a s. 38 motion. This rule recognizes that so long as the s. 38 order in question merely authorizes the proceeding to be brought, the rights of the intended defendant will not be affected and no prejudice will be suffered: see *Formula Atlantic*, at para. 8; *Krupp*, at para. 25.

45 However, the courts have recognized certain limited exceptions to this general standing rule. In *McCracken*, the British Columbia Court of Appeal held at paras. 9-10 that where an order under a predecessor version of s. 38(1) of the Act purported to impose on the intended defendant obligations in the conduct of the authorized litigation, directed the defendant to take specific steps in that litigation, or subjected the defendant to costs, the defendant had standing to move to vary the order in question. Further, in *Formula Atlantic*, the same appellate court indicated at para. 13 that the general standing restriction will be displaced where necessary "to prevent [the court's] process being used so as to perpetrate a fraud". There is also authority for the proposition that a defendant named in a s. 38(1) proceeding has standing under s. 187(5) of the Act to challenge the order authorizing the proceeding on the basis of alleged procedural irregularities: see *Jaston & Co.*

46 Thus, if a proposed or named defendant seeks to challenge the validity of a s. 38 order, the appropriate practice is to bring an application for review under s. 187(5) of the Act. To proceed otherwise — for example, by bringing a motion under the *Rules of Civil Procedure* as the appellants did here — will generally constitute an improper collateral attack on the s. 38 order: see *Caisse populaire Vanier Ltée v. Bales* (1991), 2 O.R. (3d) 456 (Ont. Gen. Div.), at p. 460.

47 In this case, relying on *Krupp* and *Formula Atlantic*, the Motion Judge held that the appellants' challenge to the Credit Union's creditor status was an impermissible collateral attack on the s. 38 Order. The Motion Judge's reasons do not suggest that this holding was based on the appellants' failure to bring a variation motion under s. 187(5) of the Act. Rather, the Motion Judge appears to have concluded that it was not open to the appellants to challenge the finding — implicit in the s. 38 Order — that the Credit Union was a creditor of Shaw. For three reasons, I disagree.

48 First, the appellants' objection to the s. 38 Order rested on allegations of abuse of process, non-disclosure, procedural irregularities, fraud and misrepresentation to the court. These serious claims triggered the exceptions to the restriction on standing that generally

applies to challenges of s. 38 orders. They required the scrutiny of the court to ensure that the administration of justice and the integrity of the bankruptcy process had not been undermined.

49 Second, there were two aspects to the appellants' motion before the Motion Judge. In addition to their request that the s. 38 Order be set aside, the appellants also sought summary judgment and dismissal of the s. 38 Action. There was no restriction on the appellants' standing to seek the latter relief. The Motion Judge was obliged to address both components of the appellants' motion.

50 Finally, the costs provision of the s. 38 Order exposed the appellants to potential liability for the costs of the s. 38 motion. The Credit Union accepts that the appellants had standing to seek to set aside this costs provision and, further, that it should be set aside. I agree with this concession.

51 I recognize that the appellants did not invoke the remedial jurisdiction of the court under ss. 37 or 187(5) of the Act in their notice of motion filed with the Motion Judge. It is unclear on this record whether they relied on these statutory provisions in their submissions before the Motion Judge — neither provision is mentioned in her reasons.

52 However, the potential application of these provisions was fully argued before this court without objection by the Credit Union. Indeed, on appeal, the Credit Union relied on s. 187(9) of the Act, although that provision was not cited by it in its cross-motion before the Motion Judge. In these circumstances, I do not regard the appellants' failure to explicitly 'plead' ss. 37 and 187(5) of the Act as fatal to their standing to attack the s. 38 Order and the s. 38 Action.

(3) The Credit Union's Standing

53 There are three prerequisites to the invocation of s. 38(1): (i) the applicant for a s. 38 order must be a creditor of the bankrupt; (ii) the applicant must request the trustee in bankruptcy to take the proceeding that the applicant believes would be for the benefit of the estate of the bankrupt; and (iii) the trustee must refuse or neglect to take the requested proceeding. Where these prerequisites are satisfied, the court, in the exercise of its discretion, may grant leave to the applicant to take the proposed proceeding in its own name and at its own expense and risk, subject to notice of the contemplated proceeding being given to the bankrupt's other creditors.

54 Only the first prerequisite is at issue in this case. The appellants argue that the Credit Union was not a creditor of Shaw at the time of his bankruptcy and when the s. 38 Order was obtained, since the Credit Union had settled its claims against Mr. and Mrs. Shaw. As

a result, the appellants submit, the Credit Union had no standing to seek the s. 38 Order or to commence the s. 38 Action.

55 The Motion Judge disagreed. She reasoned as follows:

> [28] Firstly, Herbert Shaw did not obtain an order setting aside [the Credit Union's] default judgment against him. There was, therefore, no *lis* between the parties to settle. The default judgment against Herbert Shaw was subsumed in his bankruptcy. Mr. Shaw had no case to settle and no status to settle it, unlike his wife, Carol Shaw. Despite the correspondence directed to both Herbert and Carol Shaw, I conclude that the settlement discussions could only have been with Carol Shaw.
>
> . . . . .
>
> [30] Secondly, s. 38 [of the Act] allows the Bankruptcy Court to authorize a creditor to stand in the shoes of the trustee when the trustee refuses to act.
>
> . . . . .
>
> [34] I conclude that [the Credit Union], having been a creditor of Herbert Shaw upon his assignment in bankruptcy, was a creditor eligible to make a s. 38 application pursuant to the [Act], as it has done. Even if a settlement subsequent to the bankruptcy were possible in law, it would be irrelevant to a s. 38 application.

56 In my view, the Motion Judge did not err in holding that the Credit Union was a creditor of Shaw on the date of his bankruptcy. It follows that she correctly concluded that the Credit Union was eligible to seek relief under s. 38(1) of the Act.

57 The word "creditor" is broadly defined under s. 2 of the Act as a person having a secured, unsecured or preferred claim "provable as a claim" under the Act. Pursuant to s. 121(1) of the Act, a debt or liability "to which the bankrupt is subject *on the day on which the bankrupt becomes bankrupt*" is deemed to be a claim "provable in proceedings under this Act" (emphasis added). Thus, the date of bankruptcy is the relevant time at which to assess creditor status under the Act.

58 In this case, when Shaw made his assignment in bankruptcy, the Credit Union had an outstanding default judgment against him. In its capacity as a judgment-creditor, the Credit Union filed an unchallenged proof of claim in bankruptcy. Shaw himself acknowledged the Credit Union's status as one of his unpaid creditors in his sworn statement of creditors and liabilities, filed in the bankruptcy. On these facts, as the debt owed by Shaw to the Credit Union was a debt to which Shaw was subject on the day on which he became bankrupt, the debt was deemed to be a claim provable in the bankruptcy proceeding by virtue of s. 121(1) of the Act. Accordingly, as of that date, the Credit Union fit squarely within the definition of "creditor" under s. 2 of the Act.

59 The appellants challenge both the sufficiency and the accuracy of the evidence of the Credit Union's creditor status adduced on the s. 38 motion. They contend that the Credit Union lost its creditor status prior to the date of and for the purpose of the s. 38 motion by entering into a final and binding settlement of its claims against Shaw. The fact of that settlement, the appellants say, constituted an "acknowledge[ment]", "recognition", and "confirm[ation]" by the Credit Union that it had no claim against Shaw both at the time of bankruptcy and at the time of the s. 38 motion. I disagree.

60 For the purpose of a s. 38 motion, the court need only be satisfied on a balance of probabilities that the applicant is a creditor of the bankrupt: see *DeGroote v. Canadian Imperial Bank of Commerce* (1996), 45 C.B.R. (3d) 132 (Ont. Bktcy.), at para. 7, aff'd (1998), 37 O.R. (3d) 651 (Ont. C.A.), leave to appeal to S.C.C. refused, [1998] S.C.C.A. No. 149 (S.C.C.).

61 In this case, the Credit Union's s. 38 motion was supported by an affidavit sworn by its Vice-President of Lending, B. Brian MacDonald. In his affidavit, MacDonald set out the date of Shaw's bankruptcy, the Credit Union's request of the Trustee to proceed with the claim against the appellants, the Trustee's refusal to do so, and the Trustee's expressed willingness to assign its interest in the proceeding to the Credit Union. He also swore that the Credit Union was a creditor of Shaw's bankrupt estate. Although the Credit Union's proof of claim in bankruptcy did not form part of MacDonald's affidavit, Shaw's sworn statement of creditors and liabilities, in which he acknowledged the Credit Union as one of his unpaid creditors at the date of bankruptcy, was attached as an exhibit to the affidavit.

62 Thus, the MacDonald affidavit afforded some evidence that the Credit Union had a claim provable in Shaw's bankruptcy, such that it was a creditor of Shaw. Although not extensive, that evidence was sufficient to establish the Credit Union's standing to bring a s. 38 motion. The MacDonald affidavit also provided evidence that the other statutory prerequisites for relief under s. 38(1) had been satisfied.

63 The appellants' real complaint is that the Credit Union misrepresented its status as a creditor of Shaw on the s. 38 motion since the Credit Union had earlier settled its claims against Shaw. In my opinion, on this record, this assertion is unsustainable.

64 On Shaw's assignment in bankruptcy, all his property vested in the Trustee by operation of s. 71 of the Act. [2] Further, under ss. 30(1)(d), (h) and (i) of the Act, the Trustee became empowered to bring, institute or defend proceedings relating to Shaw's property, to compromise and settle any debts owing to Shaw, and to compromise any claim made by or against Shaw's estate. [3] I therefore agree with the Motion Judge's apt observation that, at the time of the alleged settlement, "Shaw had no case to settle and no status to settle it." Only

the Trustee could conclude a settlement with a creditor of Shaw that was binding on Shaw's bankrupt estate, as distinct from his wife. This did not occur.

65 More importantly, Shaw was discharged from bankruptcy on July 16, 2004 — many months before the date of the March 2005 and January 2006 settlement correspondence. By virtue of s. 178(2) of the Act, [4] the effect of that discharge was to release Shaw from his debt to the Credit Union. Consequently, at the time of the settlement correspondence, there was no debt owing from Shaw to the Credit Union that was susceptible to compromise. Only the Credit Union's claim against Mrs. Shaw continued. It follows that the Credit Union did not forfeit its creditor status by entering into a binding post-bankruptcy settlement with Shaw.

66 In light of this conclusion, it is unnecessary to consider the Credit Union's additional argument that since the Shaws failed to pay the costs of dismissing the Guarantee Action, no binding settlement was ever finalized with them. The issue whether the Credit Union relinquished its claims against Mrs. Shaw, who is not a party to this appeal, remains to be determined in other proceedings — for example, in the outstanding Guarantee Action against Mrs. Shaw. For the purpose of this appeal, the critical point is that no final and binding settlement was entered into with Shaw himself.

67 It is in this context that the appellants' submission that the Motion Judge erred by holding that the evidence of the alleged settlement was "irrelevant to a s. 38 application" must be considered. To the extent that this comment signified the Motion Judge's conclusion that the settlement correspondence did not affect the Credit Union's creditor status in Shaw's bankruptcy, I agree.

68 However, if this statement was intended to indicate that evidence of post-bankruptcy events can never be relevant to the determination of creditor status for the purpose of a s. 38 order, I respectfully disagree. I would not rule out the possibility that post-bankruptcy events may inform a s. 38 creditor status review in a proper case. For example, evidence confirming that a creditor's claim was paid in full after the initial date of bankruptcy and before the date of a s. 38 motion would clearly be relevant on a motion to rescind or vary a s. 38 order subsequently granted to the creditor. But that is not this case.

69 I add this final observation. The claim sought to be pursued under the authority of the s. 38 Order was not the Credit Union's claim against Shaw. As I have said, that claim was extinguished by operation of law on Shaw's discharge from bankruptcy. [5] The claim that formed the subject-matter of the proposed s. 38 proceeding was that of the Trustee regarding the Mortgages and the Discharges. The information relevant to that claim, which was unaffected by any alleged settlement between the Credit Union and Shaw, was included in the affidavit materials filed by the Credit Union on the s. 38 motion.

(4) Alleged Unfair Treatment and Abuse of Process

70 In support of their claim of unfair treatment and abuse of process, the appellants argue that: (i) it was an abuse of process and contrary to public policy for the Credit Union to settle its claims against Shaw and to thereafter seek to pursue such claims against his estate through an action authorized under s. 38(1) of the Act; (ii) the Credit Union failed to make full disclosure of all material facts and misrepresented its creditor status before Platana R.S.J. and on the s. 38 motion, with the result that the court was misled regarding the Credit Union's standing to bring the s. 38 motion; and (iii) the s. 38 Order merely authorized the continuation of the proceeding commenced by the Trustee, rather than the initiation of a fresh action by the Credit Union. I would not give effect to these submissions.

71 As I have already indicated, no settlement of the Credit Union's claims against Shaw effective against his bankrupt estate had been concluded at the time of the s. 38 motion. The Credit Union's proof of claim in bankruptcy had been accepted by the Trustee and evidence of its status as a creditor of Shaw on the day on which Shaw became bankrupt was adduced on the s. 38 motion. Further, the Credit Union's status as a "creditor" of Shaw within the meaning of that term as defined under the Act had not been displaced by any post-bankruptcy event. As a result, the Credit Union did not mislead the court by failing to mention the settlement correspondence during the December 2006 attendance before Platana R.S.J. [6] or on the s. 38 motion — there was no settlement with Shaw — or by representing on the s. 38 motion that it was one of Shaw's creditors.

72 A creditor obtaining a s. 38 order advances not his or her own cause of action but, rather, the trustee's cause of action: *Zammit, Re* (1998), 3 C.B.R. (4th) 193 (Ont. Bktcy.), at para. 4. The proceeding authorized by a s. 38 order is brought on the basis that the trustee in bankruptcy has the right to bring the action, and the creditor with a s. 38 order is taking the action as if the creditor were the trustee. As the Motion Judge indicated, once a s. 38 order is made, the creditor to whom it is granted stands in the shoes of the trustee: see for example, *Swerdlow* , at para. 17. This accords with the intended purpose of s. 38(1) of the Act, namely, to ensure that the bankrupt's assets are preserved for the benefit of all creditors.

73 Accordingly, on the s. 38 motion, the Credit Union was not pursuing its own claim in bankruptcy against Shaw based on its default judgment against him in the Guarantee Action. Rather, it was seeking leave of the court to proceed with the Trustee's claim against the appellants in relation to the Mortgages and the Discharges.

74 I do not accept that the issues of the validity of the alleged settlement and the Credit Union's status as a creditor were 'in play' when the Credit Union commenced the s. 38 motion, such that disclosure of the settlement correspondence by the Credit Union was necessary.

75 Contrary to the appellants' submission, the agreed issues for trial under the Platana Order did not encompass a challenge to the Credit Union's creditor status. Although the appellants claim that they did not learn of the alleged settlement until late February 2007, some two months after the date of the Platana Order, it was Strickland's uncontradicted evidence that the issue whether the Credit Union was a proper creditor of Shaw was known to and raised by the appellants when the issues for trial were settled *on consent*. It may therefore be expected that if the appellants intended to pursue this issue, some express mention of it would have been included in the agreed issues for trial. This did not occur.

76 I also note that the Credit Union provided the appellants with a copy of its proof of claim in bankruptcy and Shaw's statement of creditors and liabilities in early January 2007. With this information in hand, the appellants were positioned to move to vary the Platana Order when, on their evidence, they learned in February 2007 of the alleged settlement. They failed to do so.

77 Finally, the assertion that the s. 38 Order authorized only the continuation of the proceeding initiated by the Trustee, rather than the commencement of a new action by the Credit Union, does not assist the appellants. Proceedings commenced under the authority of s. 38(1) of the Act are undertaken at the expense and risk of the moving party and, hence, are conducted in the name of the creditor who obtains the s. 38 order. Furthermore, s. 38(1) contemplates the continuance of existing proceedings as well as the commencement of a new proceeding. See Houlden, Morawetz and Sarra, at pp. 107 and 109.

78 In this case, the s. 38 Action involves precisely the same issues as authorized for trial under the Platana Order. There is no evidence of any prejudice to the appellants occasioned by the fact that the authorized s. 38(1) proceeding was initiated by way of a statement of claim delivered by the Credit Union in its own name. Further, there is no evidence that the Trustee took any steps in respect of the matters authorized for trial under the Platana Order. On the contrary, the Trustee, in effect, consented to the s. 38 Order by inviting the Credit Union to apply for it and by thereafter formally assigning its interest in the proceeding to the Credit Union. [7] That said, as the s. 38 Action is essentially duplicative of the Trustee's Motion, I agree with the appellants that the Trustee's Motion should be stayed. I did not understand the Credit Union to assert otherwise.

(5) Order Striking Parts of the Appellants' Pleading

79 During oral argument before this court, counsel for the appellants acknowledged that if the s. 38 Order is not set aside on the basis of the appellants' creditor status argument, the Motion Judge's discretionary decision to strike the impugned paragraphs of the appellants' pleading must stand. I agree.

VI. Disposition

80 For these reasons, I would allow the appeal in part, by setting aside paragraph nine of the s. 38 Order — the costs provision — and staying the Trustee's Motion. In all other respects, I would dismiss the appeal. As the respondent has been successful on the main issues before this court, it is entitled to its costs of the appeal on a partial indemnity basis, fixed in the total amount of $5,000, inclusive of disbursements and GST. There is no basis on which to interfere with the Motion Judge's costs award in the amount of $4,000 in favour of the respondent.

***Doherty J.A.*:**

I agree.

***R.G. Juriansz J.A.*:**

I agree.

Appeal allowed in part.

Footnotes

1 I refer in these reasons to the 1993 and 1998 mortgages, collectively, as the "Mortgages".

2 Section 71 of the Act provides: "On a bankruptcy order being made or an assignment being filed with an official receiver, a bankrupt ceases to have any capacity to dispose of or otherwise deal with their property, which shall, subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee named in the bankruptcy order or assignment ..."

3 In material part, s. 30(1) of the Act reads as follows: "The trustee may, with the permission of the inspectors, do all or any of the following things: ... (d) bring, institute or defend any action or other legal proceeding relating to the property of the bankrupt; ... (h) compromise and settle any debts owing to the bankrupt; (i) compromise any claim made by or against the estate..."

4 Section 178(2) of the Act states: "Subject to subsection (1) [which does not apply in this case], an order of discharge releases the bankrupt from all claims provable in bankruptcy."

5 Shaw's discharge from bankruptcy prior to the s. 38 motion did not bring the bankruptcy to an end. The discharge of the bankrupt is not a bar to a subsequent s. 38 motion: see *Gladstone v. Bronson Granite & Marble Ltd.* (1998), 4 C.B.R. (4th) 265 (Ont. Bktcy.).

6 By the time of the December 2006 court attendance, only the March 2005 'settlement' letter had been delivered — to Mrs. Shaw alone.

7 Although the appellants complained in their factum of the late delivery of the Trustee's assignment, this issue was wisely not pursued during oral argument. The late delivery of the assignment was a procedural irregularity on the s. 38 motion, capable of being cured under s. 187(9) of the Act: see *Jaston & Co.* ; *Penfold* .

End of Document

TAB 6

1994 CarswellBC 1186
British Columbia Court of Appeal

Coroban Plastics Ltd., Re

1994 CarswellBC 1186, [1994] B.C.J. No. 3253, [1995] B.C.W.L.D. 2254, 10 B.C.L.R. (3d) 52, 34 C.B.R. (3d) 50, 52 B.C.A.C. 214, 86 W.A.C. 214

FORMULA ATLANTIC FINANCIAL CORP. v. ATTORNEY GENERAL OF CANADA

ATTORNEY GENERAL OF CANADA v. COROBAN PLASTICS LTD., Bankrupt, and FORMULA ATLANTIC FINANCIAL CORP.

Taylor J.A. [in Chambers]

Heard: October 4, 1994
Judgment: November 18, 1994
Docket: Docs. Vancouver CA019333, CA019334

Counsel: *Robert A. Millar*, for appellants.
Donald F. Gurney, for respondent.

Subject: Corporate and Commercial; Insolvency; Estates and Trusts

Application for leave to appeal judgment reported at (1994), 28 C.B.R. (3d) 260, and for stay of proceedings.

***Taylor J.A.*:**

1 These are applications for leave to appeal and for a stay of proceedings brought both in the bankruptcy of Coroban Plastics Ltd., in which an order has been made permitting the federal Crown to commence proceedings to set aside certain transfers of assets alleged to be fraudulent conveyances, and also in the action commenced by the Crown pursuant to that order against the bankrupt company and the applicant, Formula Atlantic Financial Corp., the alleged transferee of the assets concerned.

2 The applicant seeks leave in both proceedings to appeal a decision of Mr. Justice Cohen [(1994), 28 C.B.R. (3d) 260] holding that it has no status in either proceeding to challenge the order of the Master under s. 38 of the *Bankruptcy and Insolvency Act* authorizing the Attorney General, on behalf of Revenue Canada, to bring the fraudulent conveyance action.

The applicant also seeks an order in the fraudulent conveyance action staying that proceeding pending the outcome of the proposed appeal. The ground on which it sought to have the s. 38 order set aside by Mr. Justice Cohen was that the material on which the order was obtained did not establish a prima facie case on the fraudulent conveyance claim. Mr. Justice Cohen did not embark on a consideration of the sufficiency of the material, but decided only that the applicant lacked status to bring the application to set aside the s. 38 order.

3 Mr. Millar, for the applicant, accepts that his client had no right to be given notice of the application for the s. 38 order. But he says it does not follow that the applicant therefore had no status to challenge the order once made.

4 Section 38 of the *Bankruptcy and Insolvency Act* (which was s. 20 of the former *Bankruptcy Act*) provides:

> 38. (1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.
>
> (2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.
>
> (3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.
>
> (4) Where, before an order is made under subsection (1), the trustee, with the permission of the inspectors, signifies to the court his readiness to institute the proceeding for the benefit of the creditors, the order shall fix the time within which he shall do so, and in that case the benefit derived from the proceeding, if instituted within the time so fixed, belongs to the estate.

There are two decisions of this court dealing with that provision in the present context: *Bank of British Columbia v. McCracken* (1986), 4 B.C.L.R. (2d) 35, and *Re Salloum* (1990), 51 B.C.L.R. (2d) 336.

5 In the *Bank of B.C.* case the court was concerned with an order under the then s. 20 authorizing the principals of a bankrupt company, as creditors of the company, to bring an action against the bank which was petitioner in the bankruptcy proceeding. The bank

had not been served with the application for the s. 20 order. It applied to have the order set aside but failed in the trial court and succeeded in this court only to the extent that the order provided that costs of the application which led to the s. 20 order being made would be in the discretion of the court hearing the action authorized by it. Giving judgment for the Court, Mr. Justice Hutcheon said (at pp. 36-37 [4 B.C.L.R. (2d)]):

> Section 20 of the Bankruptcy Act, in my view, clearly shows that the issue on the application is between the creditor making the application and the trustee ...
>
> I agree that there is nothing in s. 20 that requires notice of the application for that order to be served upon the intended defendant, or in the case of a continuing action, upon the defendant named in the action. The authorities supporting that view include the case of *Re Swerdlow* (1985), 57 C.B.R. (N.S.) 180. Mr. Justice Trainor of the Ontario Supreme Court, at p. 184, said:
>
>> In the present circumstances, where the trustee has not been discharged, but where he has decided against prosecuting the action, I can find no requirement or necessity to serve the proposed defendants with notice. Section 20 contemplates two parties, the moving creditor and the trustee.
>>
>> Rule 13 mandates service on parties affected by the motion. The proposed defendants are not parties. The creditor or creditors, upon an order being granted, stand in the shoes of the trustee. In the facts of this case, I can see no cogent reason to require the creditors to give notice to the defendants, any more than I could find reason to require the trustee to serve notice if he brought the action. The trustee must be served because, by the bankruptcy, any property of the bankrupt is vested in him as is the cause of action against the bankrupt.
>
> As I have said, where the order is made under s. 20 and when the issue is whether the trustee or creditor will take proceedings, then I agree that the intended defendant need not be served.

Mr. Justice Hutcheon went on to say that the intended defendant would have standing if the order dealt with other matters than the commencement of proceedings against it. He said [p. 38]:

> Suppose the order under s. 20 purported to impose on the intended defendant certain obligations in the conduct of the litigation, or to direct the defendant to take certain steps in that litigation. The appropriate court to hear that complaint, in my view, would be the court that made the order, that is to say, the Bankruptcy Court.

In the present case, however, there is no suggestion that the order does anything more than authorize commencement of action.

6 In *Re Salloum* a bank had been granted an order under the then s. 20, after the bankrupt had been discharged. The order permitted it to bring proceedings to impeach as fraudulent conveyances certain dispositions made by the bankrupt. The bankrupt sought to appeal the order to this court, his counsel asserting that the bankrupt was entitled to notice of the application for the order by reason of the fact that he had been discharged from bankruptcy. Counsel contended that the order had been granted without the bank having established that it had a prima facie case that the transfers were fraudulent, and also that the order was inequitable in the circumstances. Mr. Justice Wallace, giving judgment of this court dismissing the appeal, said (at pp. 339-40):

> The order granted by the chambers judge on the application is in the standard form. It authorized the Royal Bank to commence and prosecute proceedings in its own name and at its own expense and risk for the purpose of setting aside the dispositions of the lots and the boat. In other words, it authorized the Royal Bank to do that which the trustee could and presumably would have done, had he had sufficient funds.
>
> The order did not contain any provisions that affected the status of the discharged bankrupt in any way that he would not have been affected had the trustee had the funds to pursue the intended action and decided to initiate the same. The intended defendant Mr. Salloum will, of course, be served with the proceedings in the intended action and have full opportunity to raise such defences as he considers appropriate.

And later (at p. 340):

> The trustee's obligation to realize and distribute the estate of the bankrupt which is vested, or which may become vested, in him continues until the trustee is discharged, regardless of the prior discharge of the bankrupt. It is this obligation that the bank seeks to pursue with respect to the specific properties described in the application. The trustee, because it does not have the required funds, agrees that the bank may do so. There is no logical or legal reason why a discharged, or an undischarged bankrupt, or any other intended defendant should have notice of such a s. 20 application.

Mr. Justice Wallace held that since the bankrupt, discharged or undischarged, is not a necessary party to the s. 20 proceeding, he could have no standing to appeal the order made.

7 Counsel for the applicant in the present proceedings does not seek to have those decisions reconsidered. He says instead that they do not decide the question he seeks to raise.

8 I do not understand how such an argument could succeed. These decisions, taken together, seem to me to establish clearly that on a s. 38 application, such as that which resulted in the present order, neither the bankrupt nor any other proposed defendant in the intended action has a right either to notice or to be heard on the application, and that neither the bankrupt nor any other proposed defendant will have standing to appeal any order made on such an application, provided that it goes no further than to authorize action to be brought — this being for the reason that their rights will not be affected by a s. 38 order so long as it goes no further than that. The effect of the order is to transfer from trustee to creditor whatever right of action may exist — much, no doubt, as a chose in action may be contractually transferred from one party to another, without adversely affecting the debtor. The order in this case imposes no liability on the appellant which did not previously exist, and leaves it free to assert in the action every defence it ever had.

9 The applicant may, of course, move as defendant in the action for summary dismissal of the claim if the plaintiff is unable to make out a prima facie case.

10 After hearing the application I invited the assistance of counsel with respect to two decisions, *R. v. Wilson*, [1983] 2 S.C.R. 594, and *Caisse populaire Vanier Ltée v. Bales* (1991), 2 O.R. (3d) 456 (Gen. Div.), which were not referred to in argument. I am obliged to them for their written responses to this request. *R. v. Wilson* sets out the principle that, absent fraud or new evidence, it is not possible to attack an order in proceedings other than those whose specific purpose is the reversal, variation or nullification of that order. In *Caisse populaire Vanier Ltée v. Bales* it was held that challenging the validity of a s. 38 order in the proceeding commenced pursuant to the order would amount to such a collateral attack, and is therefore impermissible.

11 While in that case the defendant company's application to dismiss an action commenced pursuant to a s. 38 order brought in the action itself was held to be an improper attack on the validity of the s. 38 order, the matter was then heard as an application for review under s. 187(5) of the then *Bankruptcy Act*. The present applicant's counsel says in his written argument that if the validity of the order cannot be challenged collaterally, the matter should be dealt with as in the *Bales* case. The former s. 187(5) (still s. 187(5) in the present Act) was not pleaded but counsel suggests this is merely a procedural defect. The subsection permits a court to "review, rescind or vary any order made by it under its bankruptcy jurisdiction". I am, however, of the view that such a provision cannot invoke any wider test for standing than would otherwise apply. In the *Bales* case the issue of standing does not appear to have been raised, and the decisions of this court mentioned above are not cited.

12 On the basis of those previous decisions of this court it seems to me clear that the present applicant has no status to challenge the order under s. 38 in the bankruptcy action,

and nothing said by counsel suggests to me that the validity of the order could properly be subject to collateral challenge — that is to say, in the action commenced pursuant to the order.

13 I would note that the proposition that a prima facie case must be established on a s. 38 application was not supported by any authority referred to before me. Assuming for the present purpose that an applicant for such an order has that burden, I would not assume, as counsel contends, that the purpose of the requirement must necessarily be to protect the intended defendant. It seems to me that the requirement could be intended to serve other purposes, including that of showing that the action which the creditor seeks to bring is capable of succeeding, so that other creditors may make an informed decision whether or not to join in it. I would note, finally, that counsel for the applicant says that if the intended defendant has no status to seek to have such an order set aside then an order obtained by fraud could not be impeached. But, of course, the court will always act to prevent its process being used so as to perpetrate a fraud. There can, in my view, be no basis for the assertion that it follows from this that a court will grant status to impeach an order on grounds other than fraud.

14 I am of the view that the applicant has not shown that it has any reasonable prospect of persuading a panel of this court that the order appealed from is in error. If there is merit in the suggestion that the Crown has no prima facie case, that is something which can be promptly dealt with in the action itself, under the ordinary rules governing summary disposition of unmeritorious proceedings. It seems to me that the proposed appeal could only delay resolution of the litigation on its merits.

15 The applications are therefore dismissed.

Application dismissed.

TAB 7

1998 ABQB 912
Alberta Court of Queen's Bench

Nesi Energy Marketing Canada Inc., Re

1998 CarswellAlta 1012, 1998 ABQB 912, [1998] A.J. No. 1203, [1999] 7 W.W.R. 217, 233 A.R. 347, 68 Alta. L.R. (3d) 150, 83 A.C.W.S. (3d) 904, 8 C.B.R. (4th) 76

In the Matter of the Bankruptcy of Nesi Energy Marketing Canada Inc.

In the Matter of Section 38 of the *Bankruptcy and Insolvency Act*

In the Matter of the Application of Refco Alberta Inc.

Moore C.J.Q.B.

Judgment: November 13, 1998
Docket: Calgary Bktcy. BK01-055996

Counsel: *L.A. Westersund* and *T.F. Mayson*, for Refco Alberta Inc.
J.L. Ircandia and *J. Kruger*, for the Nipsco Group.
E.W. Halt, for Jeffrey Yundt, Randall St. Aubyn and William Guinan.
B.M. Tsukishima, for Curtis Chandler and Bruce Chandler.

Subject: Insolvency; Civil Practice and Procedure; Estates and Trusts

MOTION by creditor for leave to bring action in lieu of trustee; APPLICATION by proposed defendants to make submissions and cross-examine on affidavit.

***Moore C.J.Q.B.*:**

I. Introduction

1 The motion is an application by Refco Alberta Inc. ("Refco"), a creditor of the bankrupt Nesi Energy Marketing Canada Ltd. ("Nesi") for authorization to step in the shoes of the trustee in pursuing claims of Nesi against Nipsco Energy Services Inc., Nipsco Industries Inc., Nipsco Capital Markets Inc., Nipsco Energy Services Canada Inc. (collectively, the "Nipsco Group"), Curtis Chandler, Bruce Chandler, Jeffrey Yundt, Randall St. Aubyn and William Guinan (collectively, the "Nesi Directors"), pursuant to section 38 of the *Bankruptcy and Insolvency Act* ("BIA").

II. Facts

2 Nesi is a Calgary gas marketing firm. Nipsco Energy Services Canada Ltd. owns the majority of Nesi's shares.

3 In the fall of 1996, Nesi began to suffer daily losses as a result of purchasing gas on the spot market to deliver against its long term commitments. Ultimately, Nesi was petitioned into bankruptcy effective December 12, 1996.

4 Lynn Edge, President and Director of Nesi at the material times deposes, *inter alia*, that the following occurred in the period leading up to Nesi's bankruptcy:

a. Shareholders loans of $1.55 million made by Curtis Chandler and North American Gas to Nesi were repaid 9 days before the proposed defendant Randall St. Aubyn deposed that Nesi was insolvent in an affidavit in support of a CCAA application. Other creditors were going unpaid and the repayment was contrary to the unanimous shareholders agreement ("USA") to which some of the proposed defendants were party;

b. Nesi's Directors and some of the Nipsco Group subsequently tried to make recovery of this money impossible by Nesi by executing mutual releases and purporting to retroactively amend the USA;

c. The Nipsco Group had contracted to take steps to ensure that Nesi had a $15 million line of credit available for its use but failed to do so; and

d. Nesi's Directors issued a press release on November 1, 1996 which falsely stated that Nesi had a $15 million line of credit in place guaranteed by Nipso Capital. The proposed defendants never corrected the statement.

5 Numerous claims for misrepresentation have been filed against the Nipsco Group by creditors of Nesi, including Refco, relating to the Nipsco Group's conduct in the period leading up to Nesi's financial demise. These actions are ongoing and are subject to case management. Claims were also filed against Nesi prior to its bankruptcy for misrepresentation but have been stayed pursuant to the BIA.

6 With the hope of getting some recovery from Nesi, one of Nesi's creditors, Refco, has asked the trustee of Nesi's estate to commence an action against the Nipsco Group and the Nesi Directors seeking recovery of damages suffered by Nesi in relation to the conduct of the Nipsco Group and the Nipsco Directors in the final quarter of 1996.

7 The trustee has declined to pursue such a proceeding and as a result Refco must apply to the court for leave to step into the shoes of the trustee in pursuing the alleged claims of

Nesi against the Nipsco Group and the Nesi Directors. Refco's counsel confirmed that the trustee had been served with all the material filed in respect of this motion and takes no issue with it. Refco also provided counsel for a number of the proposed defendants with a draft of the material filed.

III. Issues

8 There is an issue preliminary to the determination of whether Refco is entitled to an order under section 38 of the BIA. The proposed defendants argue they have standing to make submissions on whether an order should issue authorizing the trustee to assign these causes of action to Refco and other interested creditors. They also want to cross examine on the affidavit submitted in support of the application. Refco states that the proposed defendants do not have standing to make submissions or cross-examine on the affidavit.

IV. Analysis

1. Standing of proposed defendants at section 38 application and entitlement to cross-examine

a. The legislation

9 It is interesting to note s.38 of the BIA which states in part as follows:

> 38(1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.

b. Refco's position

10 Refco pointed out that section 38 of the BIA does *not* require that the proposed defendants to the contemplated proceeding be given notice of the leave application.

11 Significantly, there is a large body of case law that supports the proposition that a section 38 application is one between the trustee and the creditor applying for the order, so that only the trustee need be served with notice of the application. Refco referred to 14 decisions supporting this proposition, including decisions from the British Columbia Court of Appeal (*Bank of British Columbia v. McCracken* (1986), 4 B.C.L.R. (2d) 35 (B.C. C.A.); *Salloum, Re* (1990), 51 B.C.L.R. (2d) 336 (B.C. C.A.); *Coroban Plastics Ltd., Re* (1994), 34 C.B.R. (3d) 50 (B.C. C.A.).), the Quebec Court of Appeal (*Imprimerie canadienne Gazette c. Turcotte* (November 27, 1991), Doc. Montréal 500-09-000625-913) [reported at 50 Q.A.C. 152 (Que. C.A.)], the Saskatchewan Court of Appeal (*Roles v. Smith Roles Ltd. (Trustee of)*

(April 21, 1992), Cameron J.A., Sherstobitoff J.A., Vancise J.A. (Sask. C.A.)), the Ontario Court of Appeal (*Dominion Trustco Corp., Re* (1997), 45 C.B.R. (3d) 25 (Ont. Bktcy.)) and the Alberta Court of Appeal (*Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.* (1993), 10 Alta. L.R. (3d) 127 (Alta. Q.B.); aff'd (1994), 21 Alta. L.R. (3d) 336 (Alta. C.A.).).

12 Counsel to Refco also advised that there have been no decisions in the last 20 years which hold that a proposed defendant to a contemplated proceeding has standing at the section 38 application when all that is being sought is the court's authorization to commence an action, without seeking to impose any obligations on the proposed defendants in the contemplated proceeding. Refco asserts that it only seeks an order authorizing it to commence a proceeding for a pre-existing cause of action and accordingly there is no standing for proposed defendants as their rights are not affected. Simply, the effect of a section 38 order is to transfer from trustee to Refco whatever cause of action may exist. The order sought, Refco argues, imposes no liability on the proposed defendants which did not previously exist and leaves them free to assert in the action any defence they ever had.

b. The Nipsco Group's position

13 Counsel to the Nipsco Group argued that his clients should have standing at the section 38 application as they have been named as defendants in 10 other actions brought by Refco and other creditors of Nesi arising out of the same circumstances as the contemplated proceeding, namely, the failure of Nesi. Counsel say that the contemplated proceeding may be duplicative of the existing actions, that Refco may be motivated to file the contemplated proceeding as a "stalking horse" to gain advantage in the other actions and that in any case the contemplated proceeding is without merit. Accordingly, counsel stated, the Nipsco Group should have standing to oppose the granting of the section 38 order and should be entitled to cross-examine on the affidavit to test its complaints about the contemplated proceeding.

14 Refco argued that the contemplated proceeding is not duplicative of claims already advanced against the Nipsco Group - outside of section 38 proceedings, only the trustee in bankruptcy can sue for breaches of contractual or fiduciary duties owed to the bankrupt. The trustee is also the only party who can seek to set aside fraudulent preferences or conveyances made by the bankrupt: *Schlumpf v. Corey* (1994), 19 Alta. L.R. (3d) 385 (Alta. Master). The converse is also true; the trustee has no capacity to advance misrepresentation claims on behalf of individual creditors: *Principal Group Ltd. (Trustee of) v. Principal Savings & Trust Co.* (1990), 80 C.B.R. (N.S.) 313 (Alta. Q.B.); aff'd (December 20, 1990), Bracco J.A., Harradence J.A., Hetherington J.A. (Alta. C.A.); leave to appeal to S.C.C. denied (1991), 6 C.B.R. (3d) 169 (note) (S.C.C.). In any event, Refco stated that the proposed defendants' remedy for complaints regarding the contemplated proceeding is to attack the Statement of Claim on any grounds they feel are appropriate: *Coroban Plastics Ltd., Re*, supra.

c. The Nesi Directors' position

15 Counsel to Curtis Chandler and Bruce Chandler conceded that section 38 and the related case law provide that proposed defendants are not entitled to notice of the section 38 application. However, it was pointed out that this Court in *Toyota Canada Inc. v. Imperial Richmond Holdings Ltd.*, supra held that defendants to a proceeding authorized by a section 38 order have standing to challenge the order once granted and since the proposed defendants in this case in fact have notice of the section 38 application, they should be heard on whether the order should be granted.

16 She stated that this would avoid a multiplicity of proceedings and result in a savings of judicial resources. Counsel also pointed out that in addition to the statutory requirements, Refco must also establish a *prima facie* case for the contemplated proceeding and that proposed defendants should be permitted to cross examine in order to test whether a *prima facie* case has been made out.

17 Counsel to the proposed defendants Jeffrey Yundt, Randall St. Aubyn and William Guinan stated that his clients are clearly interested in the application and the court should allow the application and its supporting evidence to be tested by permitting submissions from proposed defendants and cross-examination on the affidavit.

18 I conclude that the proposed defendants do not have standing at this application under section 38 of the BIA. The only parties with standing are the trustee and Refco. With the possible exception of the costs provision (which leaves costs of this application to the court in the contemplated proceeding), the rights of the proposed defendants are *not* affected by the order sought; Refco is simply asking for leave to commence a proceeding for a pre-existing cause of action which the trustee has determined not to pursue. The fact that Refco provided drafts of the material to counsel for the proposed creditors does not create standing in the proposed defendants. As a courtesy, Refco was giving these parties the opportunity to make their argument that they should be heard on the application.

19 It follows from my conclusion on standing that the proposed defendants are not entitled to cross-examine on the affidavit in support of the application. This would amount to permitting the proposed defendants to test the case in advance. In my view, this is not the purpose of section 38. The opportunity to attempt to stop a case on its merits before it starts is not afforded in other circumstances. For example, the proposed defendants would have no opportunity to prevent the trustee from commencing the contemplated proceeding had the trustee elected to do so. The proposed defendants' remedy is to apply in the proceeding for a prompt resolution of their complaints regarding the merit of that proceeding.

2. Entitlement to a section 38 order

20 Section 38 contains 2 pre-conditions to the granting of an order:

a. That the creditor request the trustee to take proceedings; and

b. That the trustee decline or neglect to do so.

21 These conditions have been met (paragraph 2, Affidavit of Lynn Edge) and are not disputed by the trustee.

22 There is some authority which suggests that the applicant for a section 38 order must also establish a "*prima facie*" case. Justice Hart held in *Peddie v. Peddie* (1996), 38 Alta. L.R. (3d) 434 (Alta. Q.B.) that the requirement in this regard was simply that some evidence needs to be presented which is sufficient to persuade the court that the claim is not "obviously spurious" (page 437). At pages 437-438, Justice Hart quoted from *Jolub Construction Ltd., Re* (1993), 21 C.B.R. (3d) 313 (Ont. Bktcy.):

> It is apparent... that the judge to whom the application is made 'is not a mere rubber stamp'. There would otherwise be no need for the Court's approval. Some form of screening of such actions on the part of creditors is clearly contemplated ... It was in this vein, I think, that Mr. Justice Spencer said, in relation to the 'prima facie' test: 'All that means is that the court will not grant leave where the claim is obviously spurious' Re Farwest Cedar Fencing, supra, at p. 127 [C.B.R.].

23 I am satisfied that the affidavit of Lynn Edge contains sufficient evidence to persuade me that the contemplated proceeding is not "obviously spurious".

24 While the Nipsco Group has raised issues as to the motivation for the initiation of the proceeding and the likelihood of ultimate success for some of the contemplated claims, such issues do not form a proper basis to preclude Refco from asserting its claims at this stage. Nipsco's assertions that the contemplated proceeding is duplicative, a mere "stalking horse" and without merit can be dealt with expeditiously in the contemplated proceeding. Section 38 of the BIA does not intend that the application for leave be the forum to try such issues. As Taylor J.A. of the British Columbia Court of Appeal stated at page 56 of *Coroban Plastics Ltd., Re*, supra:

> I am of the view that the applicant has not shown that it has any reasonable prospect of persuading a panel of this court that the order appealed from is in error. If there is merit in the suggestion that the Crown has no prima facie case, that is something which can be promptly dealt with in the action itself, under the ordinary rules governing summary disposition of unmeritorious proceedings. It seems to me that the proposed appeal could only delay resolution of the litigation on its merits.

25 Refco's application is allowed but there shall be no order as to costs.

Motion granted; application dismissed.

End of Document

TAB 8

2012 ONSC 5107
Ontario Superior Court of Justice

Hollinger Inc., Re

2012 CarswellOnt 11499, 2012 ONSC 5107, [2012] O.J. No. 4346, 220 A.C.W.S. (3d) 261, 96 C.B.R. (5th) 1

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

And In the Matter of a Proposed Plan of Compromise or Arrangement with Respect to Hollinger Inc., 4322525 Canada Inc., and Sugra Limited (Applicants)

C. Campbell J.

Heard: July 24, 2012
Judgment: September 12, 2012 *
Docket: 07-CL-7120

Proceedings: additional reasons at *Hollinger Inc., Re* (2012), 2012 CarswellOnt 16526, 2012 ONSC 7040 (Ont. S.C.J. [Commercial List])

Counsel: Michael E. Barrack, Megan Keenberg, Robert I. Thornton for Applicant
Earl A. Cherniak Q.C., Kenneth Kraft, Peter Howard, Maria Konyukhova, Jason Squire, Lisa Munro for Conrad M. Black, Conrad Black Capital Corporation
J.L. McDougall Q.C., Norman J. Emblem, Matthew Fleming for KPMG LLP
Ronald Foerster, Christiaan Jordaan for Torys LLP
Peter Griffin, Matthew Lerner, Monique Jilesen for Monitor, Ernst & Young Inc.
Paul D. Guy, Scott McGrath for Daniel Colson
Sandra A. Forbes, Sarah Weingarten for Outside Directors
Irwin G. Nathanson, Q.C., Geoffery B. Gomery, Q.C. for Respondents, Radler
Harry R. Burkman for Argus Corporation Limited
G. Benchetrit for Indenture Trustees
David Moore for Catalyst Partners Inc.

Subject: Insolvency; Civil Practice and Procedure; Corporate and Commercial; Evidence

MOTION by company's litigation trustee for approval of settlement entered into between company and its former auditor and counsel.

***C. Campbell J.*:**

1 Two motions are before the court in respect of this CCAA proceeding.

2 The first motion seeks approval of a settlement entered into between the Applicants, hereinafter collectively, referred to as Hollinger and its former auditors and lawyers.

3 The second motion, which among other things, is dependent on the Court having jurisdiction to grant the relief sought in the first motion seeks to compel Hollinger to file a CCAA Plan and put that plan to a vote of Hollinger's creditors. The second motion has yet to be scheduled for argument.

4 The first motion raises serious issues regarding the conduct of litigation within the context of a CCAA regime and the court's ability, assuming jurisdiction, to manage the litigation having regard to the interests of creditors, the parties to the litigation and to the principles of proportionality which are now a much more significant and the important part of the Rules of Civil Procedure.

Background

5 The issues that form the foundation of the claims involved in the litigation now sought to be partially settled go back at least a decade and involve a company and subsidiaries and affiliates now familiar to many Canadians, collectively for this purpose, referred to as Hollinger Inc. which was up until 2007 the parent company of Hollinger International Inc. headquartered in Chicago, Illinois and with various other subsidiaries in Canada and the United States.

6 The plaintiff in various actions, against various defendants principally its former Chairman and Chief Executive Officer Conrad Black and several former close associates. In these reasons I have used the surname Black as a collective reference to the various corporations owned or controlled by Mr. Black and his family. The reference to Black associates in this context is to the Non-Settling Defendants. Those appearing to oppose are David Radler and Daniel Colson but not all formally appeared to oppose the Hollinger settlement with Torys LLP and KPMG LLP.

7 In 2004 a significant creditor of Hollinger, Catalyst Partners Inc., initiated an Application alleging oppression in respect of its rights as a creditor as a result of various alleged acts of misconduct by, among others, Black and his associates in respect to the operation of Hollinger. An Inspector was appointed under the *Ontario Business Corporations Act*.

8 In August 2007 Hollinger applied for, and was granted, protection from creditors under the CCAA by order of this court and Ernst & Young Inc. was appointed Monitor in these proceedings.

9 The stated purpose of this CCAA proceeding is to enable Hollinger to pursue claims in litigation to maximize estate assets with a view to eventual windup and distribution to creditors. Pursuant to the provisions of the Initial Order, the process requires court approval. This includes the settlements being the subject of this motion.

10 By Order dated May 21, 2008 and amended July 3, 2008 this Court approved what has been referred to as the Multi-Party Settlement Order. Among other matters the Order appointed a chief restructuring officer of Hollinger, (CRO), a Litigation Trustee and a litigation advisory committee consisting of a representative of Hollinger, the Litigation Trustee and the representative of Hollinger's largest note holders collectively referred to as the Indenture Trustee and a process for dealing with claims represented in the motion before the court and other claims.

11 Five groups of claims which collectively comprise the Litigation Assets of Hollinger's include claims against:

(a) Hollinger's former counsel Torys LLP

(b) Hollinger's former auditor, KPMG LLP

(c) six of Hollinger's former independent (Outside) Directors

(d) Hollinger's former inside directors and officers including Conrad Black and various associates as well as companies owned and controlled by them

(e) members of Hollinger's former banking syndicate.

12 The position of the Applicants is that the value of the Litigation Assets lies in their monetization either in the form of settlement proceeds or damage awards for the purpose of a liquidating CCAA proceeding.

13 The Multi-Party Settlement Agreement which remains in force has created a court-approved mechanism for enhancing and monetizing the Litigation Assets by appointing the Litigation Trustee to administer them with a few to maximizing the net return to the Hollinger stakeholders which includes the company's various subsidiaries and its creditors and shareholders.

14 The Indenture Trustee of Notes issued by Hollinger in 2003 and 2004 represents the largest creditors as they hold legal title to the notes issued by Hollinger pursuant to a financing of which Davidson Kempner Capital Management LLC (D. K.) is the beneficial owner of the majority of the notes. Both the Indenture Trustees and D.K. support the settlements in respect of which court approval is sought.

15 It is to be noted that Conrad Black has filed a one paragraph proof of claim in the CCAA proceeding claiming damages for breach of contract and other relief and he asserts a claim to be the largest creditor of Hollinger. No further steps have been taken since 2008 to advance such claim.

16 This motion concerns approval of settlements reached between Hollinger and Torys, KPMG, and the Outside Directors of Hollinger Inc. (collectively the Settling Defendants.)

17 Starting in 2005 Hollinger advised each of the potential defendants of the intention to commence legal proceedings against them, and entered into tolling agreements with, or commenced claims against, each of them.

18 All of the defendants and potential defendants were advised of the possibility of Hollinger seeking third-party releases in favor of the Settling Defendants in exchange for financial contributions and/or cooperation agreements.

19 Torys, KPMG, and the Outside Directors entered into a mediation process with Hollinger before George Adams Q. C. a former Justice of the Ontario Superior Court of Justice.

20 As a result of the various mediations, Settlement Agreements have been concluded with all of the Settling Defendants. Some of the agreements have been approved; others are now before the court for approval.

21 In each instance the Settlement Agreements provide for a monetary contribution by the respective Settling Defendants to Hollinger, the amounts of which will form part of the public record if all settlements are approved.

22 In an earlier motion, various of the Black defendants took issue with the nondisclosure on the public record of the proposed settlement amounts prior to any approval. All parties who may be directly interested in the amounts of the various settlements were provided access to the details on signing a confidentiality agreement. Further objection even on this basis was not preceded with and all Non-Settling Defendants have had access to settlement details.

Objection to Settlements

23 There are three basic grounds for the opposition put forward by the Non-Settling Defendants against the settlements.

> 1. that the Court lacks jurisdiction to approve the proposed settlements without a detailed analysis of the nature of the claims, their possible success and whether the settlement amounts are reasonable given the claims remaining against the Non-Settling Defendants.
>
> 2. that the third party releases and Bar Orders that form an integral part of the settlements, if approved, would deprive the remaining defendants of substantial rights they would have for documentary production and oral discovery that the remaining defendants would have as entitled rights if the Settling Parties were to remain as defendants or be third parties in any action.
>
> 3. that the settlements, if approved, may deprive Conrad Black of rights he claims as a significant and perhaps the largest creditor of Hollinger by virtue of his claim for damages.

24 In addition, the Non-Settling Defendants urge that in the event the settlements are approved that any order contain a protocol for production and examination of documents and the examination of witnesses that would provide the Non-Settling Defendants with the same opportunity for production discovery and pre-trial and trial examination as if Torys and KPMG were to continue as defendants.

25 It is to be noted that objections of the Non-Settling Defendants are only in respect of the settlements in respect of Torys and KPMG. No objection is taken with the terms of settlements reached with the Outside Directors and with CIBC and Mr. Fullerton, a former director of Hollinger.

26 When this matter first came before the court on April 19, 2012 I expressed concern about the context of the proposed settlements.

27 Each of the Settlement Agreements contain third-party releases in favor of the Settling Parties and are conditional upon the issuance of satisfactory Bar Orders giving effect to the third-party releases which in each case release the Settling Parties from claims advanced against them for contribution by any party in respect of Hollinger's settled claims.

28 Hollinger has confirmed that the scope of the Third Party Releases and Bar Orders is limited to claims by Non- Settling Defendants for contribution and indemnity against Settling Parties in connection with claims brought by Hollinger in respect of damages claimed

by Hollinger. Only the Hollinger initiated claims with the respective Settling Parties will be affected.

29 The court has been advised that in one form or another various of the Non-Settling Defendants have asserted they intend to assert claims for contribution and indemnity against Torys and the KPMG in respect of Hollinger's claims against those Non-Settling Defendants in which they allege Torys and KPMG may be jointly liable.

30 The court has been further advised that none of the Non-Settling Defendants and no other person has asserted an independent cause of action against any of the Settling Defendants and that any claims now advanced would be statute barred.

31 The Court was apprised of a number of proceedings in which claims are made against Black and various associates and in which claims for contribution and indemnity have been made or asserted by Black and others against Torys and KPMG. These proceedings include an action commenced in Illinois by Hollinger International Inc. (now CNLC) and a claim by the Securities and Exchange Commission (SEC) of the United States. There has been some production of some documentation in those proceedings.

32 The Litigation Trustee has confirmed that the Third Party Releases contained in the settlements in respect of Torys and KPMG now before the court and the proposed Bar Orders giving effect to thereto will not prevent the Non-Settling Defendants from asserting or pursuing claims for contribution and indemnity against Torys and KPMG in any of the proceedings in the United States.

33 In order to lessen the objection of the Non-Settling Defendants to the Third Party releases contained in the Settlement Agreements, Hollinger agreed to limit their recovery from a Non-Settling Defendant to his/her or its several liability only, provided that such Non-Settling Defendant's liability is demonstrably shared with a Settling Party against whom the Non- Settling Defendant successfully proves a claim for contribution and indemnity.

34 The position of Hollinger adopts the Report to the Court of the Litigation Trustee, the Honorable John Ground Q. C. in the following extract:

> It is Hollinger's intention to make the settlements by Torys and KPMG an economically neutral event for the Non-Settling Defendants...
>
> Hollinger is prepared to waive its right to joint and several liability in respect of the liability between either Torys, KPMG or other Settling Defendant on the one hand and a Non-Settling Defendant on the other. Hollinger proposes that settlement approval orders provide that if any Non-Settling Defendant would otherwise be able to establish a right of contribution and indemnity from Torys, KPMG or other Settling Defendant,

> then the damage owing to Hollinger jointly and separately by any such Non-Defendant will be reduced by the degree in which Torys and/or KPMG or other Settling Defendants are found to be at fault or negligent.
>
> Therefore, while each Non-Settling Defendant will not have a claim for contribution and indemnity against KPMG, Torys or other Settling Defendant for the amount which any of them might be found to be at fault or negligent, there will be no economic detriment because any such amount will not be sought from the Non-Settling Defendant if that defendant could have otherwise asserted such a claim.
>
> Nothing in the settlement approval orders will prevent any Non-Settling Defendant from requiring the Court to determine the degree in which any of KPMG, Torys or other Settling Defendant is at fault or negligent with respect to any damages suffered by Hollinger. To the extent the Court finds KPMG, Torys or other Settling Defendant responsible for a proportionate share of those damages and the Non-Settling Defendant had a right of contribution and indemnity against either of them, then Hollinger will have no claim against any person in respect of the proportionate share. In such circumstances the settlements will be the total report recovery available to Hollinger in respect of the Settling Defendants are portion and share of any damages suffered by Hollinger.

35 Hollinger asserts that the Non-Settling Defendants' procedural rights will not be prejudiced since Settling Defendants will not be exempt from giving evidence or serving as witnesses and if need be procedural orders may be issued by the court at any appropriate time.

36 The position of the Non-Settling Defendants is that notwithstanding the limitation of liability against them, the Third Party Releases not only impede their procedural entitlements but affect substantive rights they enjoy as litigation defendants.

37 In order to deal with the claims against the Non-Settling Defendants in context, the Court asked for and received a Fresh as a Amended Statement of Claim against the Non-Settling Defendants. This pleading provides the context for the approvals sought. No Statements of Defence have been delivered. That said, there have been a number of actions and regulatory proceedings both in Canada and the United States as well as in this court that have raised issued regarding the management of Hollinger in the period covered in the Amended Statement of Claim.

Issue 1

Does the Court have Jurisdiction under the CCAA to grant the approval sought?

38 The position of Hollinger is that the claims it advances are litigation assets and therefore material assets of the estate which requires court approval for any compromise not unlike standard asset disposition in any other CCAA context. The position of Hollinger is supported by all of the Settling Defendants.

39 The position of Black and associates on the issue of the court's jurisdiction is that within the CCAA regime and the Order sought here an Order should only be made if it can demonstrably facilitate corporate restructuring with a view to "enabling the Corporation to continue its business or to serving a similar broad public purpose such as the preservation of employee benefits".

40 Paragraph 11 of the Black Factum asserts:

> These proposed settlements fail to benefit all of Hollinger Inc.'s creditors generally. They are not part of a plan of compromise or arrangement and they do not pave the way for such a plan. The proceeds of these settlements are to be applied in whole or in part to the ligitation against Mr. Black and other Non-Settling Defendants. Indeed, Hollinger Inc. has not made clear whether any part of the settlement proceeds will be distributed or whether they will be completely devoted to pursing its claims against Mr. Black and the other Non-Settling Defendants. It may be inferred that the entirety of the settlement will be applied to a so-called "litigation reserve" and that nothing will be distributed to its creditors, of whom Mr. Black may be at the largest. Any assertion that he is not assumes that his claims are invalid and that his positions in the various proceedings arising from the affairs of Hollinger Inc. litigation are unmeritorious.

41 The position of Hollinger is that the settlement funds will be used in part to fund the litigation and that the supervision by the Court with the assistance of the Litigation Trustee, the CRO, and the Monitor will enable the court to be satisfied that the litigation will be conducted for the benefit of all creditors and will enable a distribution to entitled creditors. This position is supported by creditors other than Black.

42 Recent jurisprudence has confirmed the application of judicial discretion and flexibility of the CCAA to achieve a variety of corporate purposes including but not limited to the restructuring of the company. These have been reaffirmed in the decision of the Supreme Court of Canada in *Ted Leroy Trucking Ltd., Re*[1] and include, in appropriate cases, the ability to effect a sale of assets and winding up or liquidation of a debtor company and its assets. Also see *Anvil Range Mining Corp., Re*[2]

43 What has been a feature of restructuring since the financial crisis of 2008 has been a variety of processes under the CCAA.

44 The conclusion that I reach is that the court does have jurisdiction consistent with the principles of the CCAA to maximize the assets available to creditors as long as the process is not being used to further a collateral objective that, in the end, is not inconsistent with the ultimate goal of these CCAA see *Houlden, Morawetz Sara*.[3]

45 What is unusual in this instance is that the assets are the product of litigation. The court does need to be satisfied on an ongoing basis that the progress of the litigation is both timely and cost-effective in terms of its progress and will result in benefit to creditors.

46 I am satisfied at this time that consideration of the settlements is an appropriate exercise of jurisdiction with the assistance of the aforementioned court officers. In particular, as noted, the litigation has the support of the major creditor group which advanced more than $200 million to Hollinger and has not been repaid.

47 I am cognizant of the position of Black who wishes to pursue a claim for damages against Hollinger and who claims, as a result, to be the largest creditor of Hollinger. Black is, in my view, at best a claimant creditor since his claim appears to be entirely in damages. He has not advanced that claim which presumably, would in any event, form a counterclaim in the action in which he is the defendant. In addition, it is asserted by Black that he has a direct claim against Torys for damages. Again, since, presumably, the facts, document production and discovery in any such action arise out of the Hollinger Litigation to the extent not covered in a counterclaim against Hollinger, it can be dealt with by a management judge.

48 As in any CCAA proceeding, any affected party may apply to the Court for directions in respect of the ongoing process that the court will continue to supervise.

49 In the submission on behalf of Radler it was assumed that the litigation would not be managed and supervised on the Commercial List. Given the importance of the litigation in the CCAA process it would be appropriate that the litigation be managed by a judge of the Commercial List assisted and where appropriate, a Master assigned to the Commercial List.

50 The Court has the obligation to ensure the integrity of the process which in the first instance is to protect the interests of creditors. A second important consideration is to ensure that the process is consistent with commercial efficacy and integrity and fairness. See *Royal Bank v. Soundair Corp.*,[4]

51 In *Nortel Networks Corp., Re*[5] Morawetz J. reviewed the duties of the Court in a proposed sale of assets in a CC AA context as follows:

> 1) it should consider whether sufficient effort has been made to obtain the best price and that the death or 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 on fairness in the working out of the process.

I am of the view that these same principles should guide a CCAA court which supervises litigation as a major asset of the corporation with the modifications suggested by Hollinger to the process.

52 I am satisfied that the process of maximizing assets for creditors can best be accomplished by the court which has jurisdiction over Hollinger under the CCAA. Management of the litigation will require regular reporting to the court by the Monitor and will enable any party affected by the process to seek direction.

Issue 2

Should the Court approve the requested settlement orders in respect of the Settling Defendants?

A Third Party Releases — Perringer Agreement

53 Counsel for Hollinger submitted that the approval process before the Court is no different then other "Perringer Agreements" which have been approved by the courts in this province and elsewhere.

54 *Pierringer* agreements (so-called after *Pierringer v. Hoger* [6]) permit some parties to withdraw from litigation, leaving the remaining defendants responsible only for the loss that they may be found to have actually caused, with no joint liability. As the remaining, Non-Settling Defendants are responsible only for their proportionate share of any loss, a *Pierringer*agreement can properly be characterized as a "proportionate share settlement agreement".

55 The Applicants in this case seek what they urge are very limited Third party Releases and Bar Orders of the kind commonly ordered in connection with the *Pierringer* agreements in standard, multi-party litigation.

56 The only third parties whose claims are being released and barred are the Non-Settling Defendants. No other parties are affected by them. There have been no independent claims launched by any person arising out of the dealings with Hollinger Inc. Hollinger submits that the facts in issue have been the subject of much publication and any limitation periods have

expired. In addition, it is urged the only claims that are being released and barred are those that form part of the "Settled Claims" between the Settling Parties and the Applicants. Non-Hollinger claims are not being released or barred. Specifically, the Bar Orders sought would not prevent Black or others from pursuing claims for contribution and indemnity against Torys or KPMG in respect of the Illinois Action or the SEC Action or any other litigation outside Ontario. Those claims are classed as non-Hollinger claims.

57 Section 11 of the *Courts of Justice Act* grants the Superior Court of Justice a wide jurisdiction, including "all the jurisdiction, power and authority historically exercised by the courts of common law and equity in England and Ontario". The jurisprudence states that this jurisdiction is not to be displaced absent clear and unequivocal statutory language.

58 Hollinger asserts there is added safety for Non-Settling Defendants. Non-Settling Defendants who are found to be at fault will not be exposed to a greater apportionment of liability for the plaintiff's loss based on their joint liability with Settling Defendants, than would otherwise occur based on their own direct fault.

59 Additional benefits are said to include reduced financial and opportunity costs related to complicated, protracted litigation, and conservation of court resources. This limitation of time and cost exposure is an essential term of the Settling Defendants' agreements.

60 *Pierringer*-type settlement agreements have not been restricted to personal injury cases or cases of negligence. A fulsome description of the Nature and implications of Perringer Agreement is set out in an article by Peter B. Mapp, "Keeping the *Perringer* Promise Fair Settlements and Fair Trials" [7] . The article was written in the context of the jury system in the United States but is instructive in the context here in that it notes the importance of foreseeing trial issue difficulties before any agreement is approved.

61 I accept the submission on behalf of Black and the other Non-Settling Defendants that the effect of these Orders sought may to some extent complicate the Non-Settling Defendants' position to deal with the issue of fault of the Settling Defendants.

62 Where I differ with counsel for the Non-Settling Defendants is the attempt to raise a potential problem to the level of a substantive right which would have the effect in this case of rendering inoperative a settlement which has been negotiated at arm's length which has an essential term that the Settling Defendants no longer remain as parties to the action.

63 Each case does have its own distinct features and the settlements here set out to minimize the effect on the Non-Settling Defendants. Given the background and history of events which give rise to the claims in the Statement of Claim including the documentary production made by various of the Settling and Non-Settling Defendants in investigation by a court appointed

Inspector, regulatory, disciplinary and criminal proceedings as well as the CCAA all serve to limit the detriment to the Non-Settling Defendants.

64 Canadian courts have acknowledged that *Perringer* types of agreements have been increasingly utilized in Canada in a variety of litigation settings, including class actions as one example. See *Ontario New Home Warranty Program v. Chevron Chemical Co.* [8] per Winkler J.

65 As in the CCAA context, settlements in class actions must be approved by the courts. See *Osmun v. Cadbury Adams Canada Inc.* [9]

> TThe authority to make an order giving effect to a *Pierringer* agreement arises from s. 12 of the *Class Proceedings Act* (CPA), which provides that: "[T]he court, on the motion of a party or class member, may make any order it considers appropriate respecting the conduct of a class proceeding to ensure its fair and expeditious determination and, for the purpose, may impose such terms on the parties as it considers appropriate." As well, s. 13 provides that "[T]he court, on its own initiative or on the motion of a party or class member, may stay any proceeding related to the class proceeding before it, on such terms as it considers appropriate". It is well-settled that the bar order cannot interfere with the substantive rights of the Non-Settling Defendants: *Amoco Canada Petroleum Co. v. Propak Systems Ltd.* [10]

66 In this case, the Third Party Releases are rationally related to the resolution of the debtors' claims which will benefit creditors generally, and are not overly broad, the effect of which is that the Settling Defendants have agreed to pay amounts to Hollinger in respect of their proportionate share of the plaintiff's claims. No party in any way affected including the Non-Settling Defendants has opposed those settlements on the basis of the amounts involved. Black asserts that the Perringer Agreements in issue may only bar claims for contribution and indemnity and cannot operate to bar independent claims that Black may have based on an independent duty owed by Torys to Black. To date no actions involving claims of independent duty to Black have been brought to the court's attention.

67 By their very nature, *Pierringer* Agreements have the potential to prejudice the procedural rights of Non-Settling Defendants. As I explained in *Lau v. Bayview Landmark Inc.*:

> As long as the Settling Defendants were in the action, the Non-Settling Defendants could rely on the focus the former would attract at trial in distinguishing their conduct from that of the Settling Defendants.
>
> With the Settling Defendants absent from the trial in a meaningful way, the Non-Settling Defendants would be deprived of the benefits that would come from full discovery

and evidence of those parties, which would be supportive of all Defendants vis-à-vis the Plaintiffs and of that evidence that would provide a clear distinction between the Defendants. It would be a different case from the one in which all the Defendants were full participating. [11]

68 The release of Torys by Hollinger is in the following language:

(i) Full and Final Release of Torys by the Hollinger Releasors: Upon payment in full of the Settlement Amount, Hollinger, its past, present and future subsidiaries and divisions (including, without limit the foregoing, 432525 Canada Inc., Sugra Limited, DomGroup Ltd. and 10 Toronto Street Ltd., but not including the Sun Times Media Group, Inc. and its subsidiaries (collectively referred to as "STMG"), all partnerships in which Hollinger or a wholly-owned subsidiary of Hollinger is the general partner and any corporation owned by such partnership, for themselves, their employees, servants, agents, heirs, administrators, successors, assigns and on behalf of any party or parties who claim a right or interest through them (collectively, the "Hollinger Releasors") do hereby fully, finally and forever, release, remise, acquit and forever discharge, without qualification or limitation, Torys and it past, present and future partners, employees, directors, officers, affiliates, agents, advisors, insurers and reinsurers, and their predecessors, successors and assigns (collectively the "Torys Releasees"), separately and jointly, of and from any and all rights, interests, obligations, debts, dues, sums of money, accounts, reckonings, damages, claims, actions, allegations, causes of action, counterclaims or demands whatsoever, whether known or unknown, in law or in equity, of whatever kind or character, suspected, fixed or contingent (collectively "Claims") that have been, that could be, or that could have been asserted by the Hollinger Releasors from the beginning of time through the date hereof (including without limitation any claim for contribution, indemnification, reimbursement or any other forms of claims over related to the subject matter of the Settled Claims that could be asserted on or after the date hereof by the Hollinger Releasors based on events occurring prior to and through the date hereof) against the Torys Releasees concerning (i) Torys' representation of the Hollinger Releasors or (ii) any allegations of injury to the Hollinger Releasors caused by Torys including, without limiting the generality of the foregoing all claims raised or which could have been raised in the Intended Action (collectively the "Settled Claims").

(ii) Unknown Claims: Without limiting the generality of paragraph 2 above, the Hollinger Releasors declare that the intent of the full and final release set out therein is to conclude all issues arising from the Settled Claims and it is understood and agreed that the release is intended to cover, and does cover, not only all known injuries, losses and damages, but all injuries, losses and damages not now known or anticipated but which may later develop or be discovered, including all the effects and consequences thereof.

In addition, Torys agrees that it has not filed, and will not file, any claims against the estates of any of the Hollinger Releasors.

(iii) Full and Final Releases of Torys by Third Parties: It is the intent of the Parties that this Agreement and the terms of the Release Order will eliminate any basis for (i) any other party against whom any of the Hollinger Releasors has brought or in the future brings any Claims relating in any way to the subject matter of the Settled Claims; and (ii) any past or present shareholder, officer, director, creditor or subsidiary (other than STMG) of the Hollinger Releasors (together the "Third Party Releasors"), from being able to claim contribution, indemnification, reimbursement or other forms of claims over from the Torys Releasees for such party's liability to the Hollinger Releasors or from bringing claims against the Torys Releasees relating in any way to the subject matter of the Settled Claims (the "Third Party Releases").

69 I do not see from the above that any claim of Black with respect to a duty of Torys to him apart from duties to Hollinger are covered by the release language.

Bar Orders — Perringer Agreements

70 I agree that the general intention of a bar order is to preclude claims arising from the subject matter of the action in order to achieve finality for a partial settlement. Without the security provided by a bar order, partial settlement of litigation may be impossible. As has been said:

Any single defendant who refuses to settle, for whatever reason, forces all other defendants to trial. Anyone foolish enough to settle without barring contribution is courting disaster. They are allowing the total damages from which their ultimate share will be derived to be determined in a trial where they are not even represented.

71 A properly crafted bar order therefore promotes an overriding public interest in resolving disputes and conserving judicial resources. The significance of these goals was recognized by the Ontario Court of Appeal in *M. (J.) v. Bradley*[12] as a powerful reason to support the implementation of *Pierringer* agreements:

This laudatory objective [of promoting settlement] has long been recognized by Canadian courts as fundamental to the proper administration of civil justice: see for example, *Sparling v. Southam Inc.* ... (Ont. H.C.), at 230, referred to with approval by the Supreme Court of Canada in *Loewen, Ondaatje, McCutcheon & Co. c. Sparling*, ... (S.C.C.) at para. 48; and *Ontario New Home Warranty Program v. Chevron Chemical Co.* ... (Ont. S.C.J.), at 147. Furthermore, the promotion of settlement is especially salutary in complex, costly, multi-party litigation. As observed in *Amoco* at p. 677:

> In these days of spiraling litigation costs, increasingly complex cases and scarce judicial resources, settlement is critical to the administration of justice.

72 The basic position of the Non-Settling Defendants is that the settlements if approved would deprive them of procedural rights in respect of the ongoing litigation to production and discovery that would otherwise be available assuming Torys and KPMG remained as defendants.

73 It should be noted that only the litigation involving the Non-Settling Defendants in Ontario would be subject to the Orders sought. Litigation in the United States in which Torys and KPMG are defendants is unaffected. Undoubtedly, there will be production and discovery in those actions that overlaps in the actions to be covered by these settlements.

74 The position of the Non-Settling Defendants was simply put by counsel on behalf of Radler. The complaint is that the procedural rights to full production and discovery from Torys and KPMG are in effect substantial when the effect of the settlements is to prevent the advancement of a full defense to the claims of Hollinger that the Non-Settling Defendants would have had with Torys and KPMG continuing as defendants or third parties.

75 The Non-Settling Defendants object to the Bar Order on the basis that only when they can assert liability attribution to the other defendants can they advance their own defence.

76 It was with this position before the court that a request was made that the parties with the assistance of the Monitor consult to determine whether a protocol for production and discovery with respect to Torys and KPMG could be agreed to.

77 It would appear that the position of the Non-Settling Defendants, at least at present, is that they do not see any issues with production or discovery from Outside Directors or other Non-Settling Defendants apart from Torys, KPMG and Hollinger.

78 As originally put before the court the Settling Defendants conceded and agreed that any approval the court might grant would recognize the rights of Non-Settling Defendants to seek production and discovery pursuant to Rules 30.10 and 31.10 of the *Rules of Civil Procedure*. Both Torys and KPMG have confirmed that they have taken steps to preserve documents that may be relevant and they recognize that witnesses may be required to give evidence pursuant to Rule 53.04.

79 There is no question that settlement with some defendants as opposed to all defendants does interfere with what might otherwise be the procedural rights of remaining defendants and that more may be required by way of management than the simple application of rules 30, 31 and 53. I do recognize the potential detriment to defendants from *Perringer* Agreements.

Any detriment should be balanced against the benefit to Settling Defendants and to plaintiffs as well as the administration of justice as a whole on a case by case basis.

80 Counsel for Radler sought to distinguish another decision which involved settlement in respect of some defendants in a class action in *Gariepy v. Shell Oil Co.*.[13]

81 It is urged that the decision in that case of Nordheimer J. and his reasoning on the discovery point, that the claims against the Settling Defendants were not shown to be relevant to an assessment of the claims against the Non-Settling Defendants, was a particular feature of the particular case before him. In a case such as the case at bar, counsel submits, where the question is one of the apportionment of responsibility for a single pool of losses between the Settling and Non-Settling Defendants, the one cannot be determined without the other. They are two sides of the same coin. In such circumstances, Mr. Nathanson for Radler asserts the fault of the Non-Settling Defendants has to be considered at trial; reliance is placed on *M. (J.) v. Bradley*[14], where Cronk JA stated:

> [68] ... Kerr argued before this court that the trial judge in this action would be faced with a most difficult, if not impossible, task if required to determine the Non-Settling Defendants' several share of liability without being in a position to make the same determination concerning the responsibility, if any, of the Settling Defendants for the appellants' losses. Correspondingly, he asserted that the determination of his share of liability without regard to the Settling Defendants' contributory responsibility would be manifestly unfair.
>
> [69] I agree with both of these submissions. ...
>
> [70] ... [F]airness requires that Kerr's several share of fault or neglect not be determined in a vacuum, without consideration of the several liability of all other proven tortfeasors. Were it otherwise, Kerr could be exposed at trial to the potential risk of being required to pay damages to the appellants for part of the Settling Defendants' several shares of liability, claims to which, as Kerr properly points out, have been compromised and released by the appellants under the Agreements.

82 The issue in *Bradley* was whether the court had jurisdiction under the *Negligence Act* to apportion fault against a former party who had settled. The court held that it had, and that a Settling Defendant under a *Pierringer* settlement need not continue as a party in the litigation. In *Bradley*, it is put forward by Black, that since the Settling Defendants in that case had consented to being examined for discovery there was no potential procedural unfairness to the Non-Settling Defendants.

83 In the case at bar I accept that assessing the fault or neglect of Torys, KPMG and the Outside Directors will be fundamental to the court's assessment of the claim against the Radler respondents and the other Non-Settling Defendants. By reason of this interrelationship of the claims, even at this stage it is clear that Torys, KPMG and the Outside Directors are in possession of relevant evidence pertaining to their own responsibility for the losses suffered that can only be obtained by the Non-Settling Defendants through discovery which will primarily involve Hollinger.

84 The question then is does the court simply say party discovery rights trump so that Settling Parties are subject to all of the obligations and costs they would have as if they were to remain defendants OR does the court say the process can be controlled through effective management particularly on the Commercial List. To say the former is to reject approval of an essential term of the settlements.

85 In *Ontario New Home Warranty*, Winkler J. [15] as he then was, said the following at paragraph 77:

> These terms, generally described, are that the non-settling defendants may, on motion obtain:
>
> > 1. documentary discovery and an affidavit of documents in accordance with the Rules of Civil Procedure from each of the settling defendants;
> >
> > 2. oral discovery of a representative of each of the settling defendants, the transcript of which may be read in at trial;
> >
> > 3. leave to serve a request to admit on each settling defendant in respect of factual matters;
> >
> > 4. an undertaking to produce a representative to testify at trial, with such witness to be subject to cross-examination by counsel for the non-settling defendants.
>
> "78. In addition, the fact of the settlement, but not the terms thereof, shall be disclosed to the trial judge at the commencement of trial.
>
> 79. Furthermore, pursuant to its case management powers under the Act, this court shall have ongoing supervisory role in this action. In the event that any settling defendant fails to comply with an order of this court made pursuant to the above terms, the court may, in addressing any such failure, lift the stay of proceedings in respect of that defendant.

86 Part of the opposition by Black and others to the elimination of the Settling Defendants from the action is the prospect that Affidavit of Documents would not have to be produced.

That is why the Non-Settling Defendants urge that even if the settlements are approved that at least Torys & KPMC be required to produce an Affidavit of Documents as if they remained as defendants.

87 I do accept that Affidavits of Documents remain appropriate requirements in many civil cases. What is not apparent in most cases until after the fact is just how costly the production process can be including the full cost of preparation of an Affidavit of Documents in traditional form.

88 A recent study published by the Rand Institute in the United States [16] reveals that more than 70 cents of every dollar spent on producing documents goes to review largely issues of relevance and privilege.

89 This study has brought even more focus on the importance of proportionality as can operative concept in civil litigation. The Non-Settling Defendants should have access to the documents they require for their defence, not necessarily every conceivably relevant document.

90 This does not necessarily mean that they should be entitled as a right to production of all the documents that Torys & KPMG might be required to otherwise produce. Proportionately must have same rational meaning in civil litigation.

91 In England a new Practice Direction Part 31 of the Rules will assist both parties and non-parties with disclosure obligations [17] while adhering to the principle of proportionality.

92 The focus of the above references is on the need for a different approach to discovery in many civil cases. Throughout the common law world there is a recognition of the need for an approach that goes beyond Rules of Civil Procedure even though rules remain a default position. If co-operation between parties cannot resolve discovery disputes the trend is toward assistive judicial management. It is with this background that I reach a conclusion that production and discovery issues in this case given the degree of expected co-operation from Torys & KPMC are not sufficient to reject the settlements reached.

93 The 23rd report of the Monitor received August 17, 2012 reported on the consultation process the court directed to determine whether an agreement for a protocol for production and discovery could be reached between the parties. Despite the efforts of counsel for the Monitor, for which the Court is grateful, no agreement was reached.

94 Hollinger, Torys, KPMG and the other Settling Defendants were largely agreed. Attached as Appendix "A" is the KPMG proposed protocol. The Torys protocol is similar.

The response by Black is as set out in Appendix "B" attached. The Black position gives no meaningful recognition to proportionality.

95 The management of the discovery process in civil litigation, particularly complex civil litigation has been of increasing concern to all who are involved in the administration of justice.

96 If one were to go back 40 years, the parties to litigation and their counsel were largely responsible for managing production and discovery. In that bygone age there were often only 5 to 10 documents for production and less than a half a day for oral discovery.

97 Parenthetically, most judges and many counsel report that at trial today there are rarely more than 5 to 10 documents that are truly determinative. However, in the last decade the world of documentary discovery has changed significantly.

98 Typically there are thousands if not hundreds of thousands and sometimes millions of documents that have become part of the discovery process.

99 This has given rise to the need for the court to participate in the process. In Ontario, it commenced with case management which has achieved significant success in Ottawa and Windsor but less so in Toronto.

100 In 2003 the Task Force on Discovery in Ontario made various recommendations which took until 2010 Rule amendments to come into force. These are found in Rule 1.04.1 mandating proportionately and in Rule 29.1 requiring a Discovery Plan. Rules 30 and 31 with amendments form the basis for regulating documentary and oral discovery for non-parties.

101 In the United States the Joint Task Force of the Institute for the Advancement of the American Legal System and the American College of Trial Lawyers in 2009 recommended pilot projects to among other things place limits on discovery. Several pilot projects have been implemented including in the Southern District of New York. Pilot Project Rules place limits on discoverable documents. [18]

102 Also the Sedona Conference of the United States teamed with members of the Ontario Discovery Task Force and other lawyers and judges from across Canada to create the Sedona Canada Principles. The Sedona Canada Principles which include early consultation employing proportionately are now incorporated by reference in the Rule 29.1 amendments in 2010. In addition, Sedona Canada has published a commentary to add further guidance to the Principles. [19]

103 In Ontario the process has gone further with the creation of the E. Discovery Implementation Committee sponsored by the Advocates Society and the Ontario Bar Association to provide precedents and guidelines to deal with discovery issues. [20]

104 The purpose of the above review has led me to conclude that the discovery process in the litigation that will be left as a result of the settlements in this case can be managed by judges of the Commercial List with the tools that are available to supplement the flexibility now provided for in the Rules.

105 Two rules in particular are intended to be applied with the flexibility necessary to balance the interests of parties who might otherwise be inclined to resort to what used to be known as a "war of attrition". Rule 29 and in particular rule 29.1.01 require the parties to agree on a discovery plan that is consistent with the Sedona Canada Principles. If the parties do not agree the Court may intervene.

106 Rule 1.04 (1), 1.1, and (2) while seemingly adding little by way of substance now operate as a strong signal for a change in culture. Parties cannot expect that the discovery process can with the passage of time and crippling cost destroy the prospect of determination of legal issues on the merits. In recent years this has too often been the case.

107 TThe Supreme Court of Canada has confirmed the application of the principle of proportionately in civil litigation in commenting on Quebec Civil Procedure Rule 4.2 (similar in wording to Ontario Rule 1.04) Madame Justice Deschamps speaking for the court in *Marcotte c. Longueuil (Ville)*, 2009 SCC 43 (S.C.C.) at para. 76 said:

> What is clear from these different sources is that the purpose of art. 4.2 C.C.P. is to reinforce the authority of the judge as case manager. The judge is asked to abandon the role of passive arbiter. At first glance, this case management function does not mean that it would be open to a judge to prevent a party from exercising a right. However, the judge must uphold the principle of proportionality when considering the conditions for exercising a right.

108 As noted above I am mindful that settlements assuming approval will interfere to some extent with what otherwise would have been the procedural entitlements of Black and other Non-Settling Defendants.

109 I have concluded that this interference is not sufficient either to reject the settlement as a whole or to impose as a term that the parties conduct themselves as if Torys and KPMG remain as defendants. I do not accept the argument on behalf of Black and his associates that approval of settlement should be rejected on the basis of failure of Hollinger to immediately bring the settlement before the Court for approval. Not only are the facts in the case relied

on, *Aecon Buildings v. Brampton (City)* [21] readily distinguishable, there is no prejudice to the Non-Settling Defendants here. Indeed the pace of this litigation has in no small part awaited the final disposition of appeals from criminal convictions of Black and others in the United States on related matters. I am satisfied that disclosure of the settlements and the approval process has been reasonable.

110 Consistent with the management that is envisaged with the application of the principle of proportionality and is available with the assistance of the procedures and judges of the Commercial List each of the production and discovery issues that form the objections of the Non-Settling Defendants can be addressed.

111 I am satisfied that the court through management can balance the interests of the defendants with the entitlement of those parties who wish by settlement to be extricated from the process. I doubt that balance could be achieved if Hollinger had not agreed to limit its claims against the Non-Settling Defendants to each of their several liabilities.

112 It would have been preferable to have the Settling Defendants and Non-Settling Defendants agree on a protocol, however, I am satisfied one can be fashioned following delivery of the Non-Settling Defendants' pleadings.

Conclusion

113 On the material before me I am satisfied that the proposed settlements between Hollinger one side and each of Torys and KPMG be approved. The procedural entitlements of the Non-Settling Defendants can be achieved with active management on the Commercial List.

114 To the proposed settlement orders for Torys and KPMG I would add the following:

> 1) that at a minimum each of Torys and KPMG agree to be bound by their respective proposed protocols which should form the appendices to the orders.
>
> 2) that a term in each order provided that each of Torys and KPMG recognize and accept they will have ongoing obligations in the litigation as Non-Parties subject to management by the court.

115 I note that no party objected to the form of Orders approving settlements with the other Settling Parties.

116 The court may be spoken to if the parties cannot agree on the form of order and the issue of costs if that is necessary.

Motion granted.

Appendix A — Non-Party Protocol

This document production protocol is intended to describe the process for obtaining production of documents from KPMG LLP ("KPMG") and Torys LLP ("Torys") (collectively "the Non-Parties") in the context of the proceeding commenced by Hollinger Inc. et al. against Conrad M. Black, F. David Radler et al. (collectively the "Parties to the Action") in Ontario Superior Court of Justice, Court File No. 06-CL-6261 ("the Action").

The protocol assumes that the settlements between Torys and Hollinger Inc. et al. and KPMG and Hollinger Inc. et al. will be approved by the Court, including the bar orders sought.

The Non-Parties have confirmed that to the best of their knowledge documents related to Hollinger Inc. in their power, possession and control as of October 2004, and in the case of the Non-Party Torys those documents that were not transferred in response to directions from Hollinger Inc., have been preserved and will continue to be preserved until the Action has been finally resolved.

Following the close of pleadings in the Action, the Parties to the Action will exchange documentary production in the ordinary course as required by the *Rules of Civil Procedure*. In the case of the plaintiffs, such documentary production shall include all relevant, non-privileged documents in the possession, control or power of the Chief Restructuring Officer or the Litigation Trustee appointed pursuant to the Order of the Court dated May 21, 2008 (the "Multi-Party Settlement Order"). For greater certainty, the documents in the control of the Chief Restructuring Officer or the Litigation Trustee include all documents that are currently in the possession of the plaintiffs' former counsel who acted for the plaintiffs or any of them in connection with the Litigation Assets as defined in the Multi-Party Settlement Order.

In the event the plaintiffs or any of them did not retain a copy of any of their aforementioned relevant documents ("Documents"), the plaintiffs shall write to Ernst & Young Inc. ("E&Y"), in its capacity as court-appointed Inspector, to determine and ask whether it has a copy of the sought after Documents. If so, the plaintiffs shall thereafter seek an order, in the Inspectorship proceedings to obtain copies of the Documents in the possession of the Inspector.

After the close of pleadings and the production of documents by the Parties to the Action, and in accordance with the timetable set out in the Discovery Plan (as set out in paragraph 6 below):

1. The Parties to the Action will identify the categories of relevant documents that they require from the Non-Parties with sufficient particularity regarding time period, document type and the transaction or issue(s) to which the requested documents are relevant all with the objective of making production proportionate and reasonable in the circumstances (for example, "all documents reflecting work done or advice given, as the case may be, by [the Non-Party] in relation to [name of transaction]");

2. To the extent that any list responsive to a request from the Parties to the Action exists, the Non-Parties shall produce such list (subject to editing for relevance and privilege) to assist the Parties to the Action to identify the available documents which may be relevant.

3. Relevance of the documents requested will be defined by the pleadings;

4. Subject to the principles of proportionality and reasonableness set out in paragraph 1, requested non-privileged documents relevant to any matter in issue in the action, shall be made available for inspection and, if requested, copies shall be produced, all in accordance with paragraphs 5 through [8] hereof.

5. The Non-Party KPMG has advised E&Y in its capacity as Monitor that the documents KPMG has in its possession that may be related to the issues in the Action are not organized in an electronic document management database but are contained in paper files. The Non-Party Torys has advised E&Y in its capacity as Monitor that many of the documents it has in its possession that may be related to the issues in the Action are not organized in an electronic document management database but are instead contained in paper files, some of which are available on CD-ROM. Accordingly, the Non-Parties will separately make the categories of documents requested by the parties available for inspection, subject to any applicable solicitor-client privilege, at a mutually acceptable location at mutually accepted times. To the extent that documents are available electronically they shall be made available for inspection in that format, upon request;

6. KPMG and Torys shall be consulted about the proposed schedule for production and discovery with respect to productions pursuant to this protocol before the finalization of the Discovery Plan pursuant to Rule 29.1.03(1) of the Rules of Civil Procedure. KPMG and Torys shall thereafter make documents available for inspection in accordance with the established schedule. Any dispute with respect to the schedule as it affects the Non-Parties may be referred to the Court pursuant to paragraph 11 hereof;

7. The Parties to the Action will be permitted to access the aforementioned categories of documents for an agreed duration during which any such Party may request copies of them.

8. The Non-Parties will arrange for copies of the requested documents to be made and thereafter provided to, not only the Party to the Action requesting copies of the documents, but also

every other Party to the Action. In the case of documents that are now in electronic form, production of such documents will be by electronic copies;

9. Any Party to the Action that requests copies of documents pursuant to paragraph 6 agrees to pay all reasonable expenses relating to the copying or scanning of the requested documents incurred by the Non-Parties (including the costs incurred as a result of a Non-Party retaining a third party vendor for such copying or scanning) for both the Party requesting the documents and all other Parties to the Action who are entitled to receive a duplicate copy, subject to the rights of the Parties to the Action to recover the same from the other Parties to the Action as costs in the Action. Nothing in this paragraph is intended to prevent the Parties to the Action from allocating the costs referred to among themselves in any way they agree is appropriate;

10. All other costs of the Non-Parties relating to the preparation for inspection and the production of documents shall be in the discretion of the Court pursuant to rule 30.10 of the Rules of Civil Procedure and s. 131 of the *Courts of Justice Act* and any Non- Party or Party to the Action may refer the issue of the responsibility for payment of such costs to the Court pursuant to paragraph 11 hereof;

11. The Parties to the Action and the Non-Parties may enlist the assistance of the Court, in case managing or resolving any issues that may arise during implementation of the abovementioned document production protocol, including issues of the relevance of the documents requested, the proportionality and reasonableness of the request in the circumstances, the application and/or waiver of privilege and the responsibility for costs incurred by the Non- Parties referred to in paragraph 10 hereof. The plaintiffs acknowledge that they have waived privilege over documents arising from Torys' representation of the Plaintiffs, which documents are in the possession of the Non-Parties. For greater certainty, the waiver of privilege does not extend to materials exchanged in the mediations that took place between Hollinger Inc. and the Non-Parties, respectively, which mediation materials remain privileged and confidential;

12. The deemed undertaking, as described in Rule 30.1 of the Rules of Civil Procedure shall apply to all documents made available for inspection by the Non-Parties;

> 13. Nothing in this document protocol waives or prejudices the rights that the Parties to the Action and the Non-Parties might have pursuant to rules 30.10, 31.10 and 53.07 of the Rules of Civil Procedure and section 131 of the *Courts of Justice Act*.

Lisa C. Munro

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August 9, 2012

FILE NUMBER 51366-00006

VIA EMAIL

Monique Jilesen Matthew Lerner *LENCZNER SLAGHT ROYCE SMITH GRIFFIN LLP* 130 Adelaide Street West Suite 2600 Toronto, Ontario M5H 3P5

Dear Counsel:

Re: Conrad M. Black et al. ats Hollinger Inc. et al.

We set out here the Black parties' position on production and discovery issues in the current litigation, including the contribution and indemnity claims and the motions to approve the Torys LLP, KPMG LLP, and Hollinger Inc. settlements.

Our primary position on the settlement approval motions remains that they should not be approved on the terms put forward but, even if approved, Torys LLP and KPMG LLP should remain parties to the litigation so that Black's ability to defend the claims against him by Hollinger Inc. are not prejudiced by a bar order. This position is set out in detail in Black's factum and oral argument in response to the settlement approval motions.

However, if the court rules that Torys LLP and KPMG LLP are no longer to be parties to the litigation and a bar order is to issue, there are certain minimal requirements to reduce the prejudice to Black, while imposing reasonable requirements on Torys LLP and KPMG LLP. In essence, if a bar order issues dismissing Black's extant contribution and indemnity claims against Torys LLP and KPMG LLP, Black needs certainty now that he will have no lesser rights (nor is he asking for greater rights) than those to which he would be entitled if Torys LLP and KPMG LLP remained parties. He cannot agree that he, Torys LLP, KPMG

LLP, and Hollinger Inc. may simply reserve their rights on these critical issues, since to do so will be certain to create uncertainty, increased costs, and delay.

Unfortunately, the parties have been unable to reach agreement on a protocol that will ensure that Black's rights will be protected, while also addressing the concerns of Torys LLP and KPMG LLP.

Our proposal is as follows:

• Issues relating to production and discovery in the main action will be pursuant to the Rules of Civil Procedure and determined by the case management judge, when one is appointed. These issues need not be further addressed at this time;

• Torys LLP and KPMG LLP each to provide a sworn affidavit of documents, including a detailed schedule B, listing all documents which are relevant to the issues raised in the pleadings;

• The settling parties to agree upon a reasonable cap for the costs to be incurred by Torys LLP and KPMG LLP associated with producing documents which are relevant to the issues raised in the pleadings and producing witnesses (both for examination for discovery and at trial) and funds to make those payments will be set aside, in trust, out of the settlement funds. The final arbiter of whether the costs incurred paid out of the fund were reasonable will be the CCCA case management judge; and

• Torys LLP and KPMG LLP to agree to cooperate in making available current members of their respective firms as witnesses, both for examination for discovery and at trial. Recognizing that Torys LLP and KPMG LLP cannot control former members of their firms, they must agree to cooperate in the efforts of counsel for the parties to the litigation to obtain the evidence of former members of their firms as witnesses at discovery and/or trial.

We think that this proposal addresses not only Black's concerns, but also the desire of Torys LLP and KPMG LLP to put an end to costs they must incur in respect of the action. It leaves the allocation of those costs between the parties to the litigation to be determined at the end of the litigation in the ordinary course.

This proposal and position is not without prejudice. It will be referred to, if necessary, when the matter comes on again before Justice Campbell. We ask that this letter be included in any report you prepare to Justice Campbell.

Yours truly,

Lisa C. Munro

LCM/emc/ra

cc: Service List

Footnotes

* Additional reasons at *Hollinger Inc., Re* (2012), 2012 CarswellOnt 16526, 2012 ONSC 7040 (Ont. S.C.J. [Commercial List]).

1 [2010] 3 S.C.R. 379 (S.C.C.) at para 56

2 (2002), 34 C.B.R. (4th) 157 (Ont. C.A.).

3 Annotated *Bankruptcy Act* 2012 (Carswell) and reference to *AbitibiBowater inc., Re* (2009), 64 C.B.R. (5th) 189 (C.S. Que.), at 1152.

4 (1991), 4 O.R. (3d) 1 (Ont. C.A.) at para 43.

5 (2009), 56 C.B.R. (5th) 224 (Ont. S.C.J. [Commercial List]) at paragraph 35

6 124 N.W.2d 106, 21 Wis. 2d 182 (U.S. Wis. S.C. 1963).

7 (1994) 20 Wm. Mitchell L. Review 1.

8 CanLII 15098, (1999), 46 O.R. (3d) 130, [1999] O.J. No. 2245 (Ont. S.C.J.) at paras 40, 41, 75, 76.

9 2010 ONSC 2643 (Ont. S.C.J.) aff'd 2010 ONCA 841 (Ont. C.A.).

10 2001 ABCA 110 (Alta. C.A.) (CANLII)

11 *Lau v. Bayview Landmark Inc.*, [2006] O.J. No. 600 (Ont. S.C.J.)

12 (2004), 71 O.R. (3d) 171 (Ont. C.A.) at para 66-67.

13 (2002), 26 C.P.C. (5th) 358 (Ont. S.C.J.)

14 (2004), 71 O.R. (3d) 171 (Ont. C.A.).

15 See footnote # 7 (supra).

16 The Rand Institute for Civil Justice "Where the Money Goes — Understanding Litigant Expenditures for Producing Electronic Discovery", April 2012.

17 Part 31 Disclosure & Inspection of Documents — U.K. Rules of Civil Procedure.

18 "U.S. District Court Southern District of New York — In Re Pilot Project Regarding Case Management Techniques for Complex Civil Cases — Oct.31,2011" and "Institute for the Advancement of the American Legal System: Nov. 1, 2009, A Roadmap for Reform: Pilot Project Rules".

19 See Ontario Bar Association website under Discovery or the website of the Sedona Conference "W6-7 — Sedona Canada".

20 20 See website www.lexum.com/ediscovery.

21 2010 ONCA 898 (Ont. C.A.) at para 13.

End of Document

TAB 9

2010 ONSC 7244
Ontario Superior Court of Justice

D'Angelo Estate, Re

2010 CarswellOnt 9868, 2010 ONSC 7244, 199 A.C.W.S. (3d) 1382, 328 D.L.R. (4th) 359, 64 E.T.R. (3d) 304, 7 C.P.C. (7th) 174

The Estate of Faust D'Angelo, deceased

J.W. Quinn J.

Heard: November 17, 2010
Judgment: December 29, 2010
Docket: St. Catharines 8069/10

Counsel: Peter A. Mahoney for Moving Parties, Emidio D'Angelo, Denise D'Angelo

Subject: Estates and Trusts; Civil Practice and Procedure

MOTION by applicants for Certificate of Appointment of Estate Trustees with a Will and for appointment of monitor.

***J.W. Quinn J.*:**

I Introduction

1 This is a motion without notice made in writing pursuant to rule 37.12.1(1) of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 and brought under rule 74.15(1)(i).

2 The moving parties are the applicants for a Certificate of Appointment of Estate Trustees with a Will. However, they also ask that a monitor be appointed by the court.

3 Is a monitor a person or position recognized by Ontario courts? If so, should an appointment be made in the circumstances of this case?

4 After reviewing the material filed, I sent word to Mr. Mahoney, counsel for the moving parties, regarding additional issues to be addressed. Comprehensive written submissions followed.

II Background

1. The facts

5 Faust D'Angelo ("the deceased") died on August 10, 2009. At the time of his death, he resided in the City of St. Catharines, Ontario.

6 In his Last Will and Testament ("Will"), the deceased appointed a son, Emidio D'Angelo ("Emidio"), and Emidio's daughter, Denise D'Angelo ("Denise"), as his executors and trustees ("co-executors").[1] The co-executors reside in the City of North Tonawanda, in the State of New York, one of the United States of America.

7 Pursuant to the Will, the deceased's estate is to be divided amongst Emidio and his three surviving siblings in equal shares. The estate has a total value of $1,520,962, consisting of real estate in Ontario, along with bank and investment accounts.

8 The co-executors are obliged to obtain a Foreign Executors' Bond ("bond"). To that end they made application to The Dominion of Canada General Insurance Company ("insurer"). However, the insurer advised that it was not prepared to issue a bond unless a resident administrator was added to the estate in addition to the co-executors. The insurer advanced two reasons for its position:

1. The value of the assets of the co-executors is considerably less than the value of the deceased's estate; and,

2. Based upon past experience with other foreign executors, the insurer is concerned that, should the foreign executors, upon administering the estate, not take steps to have the bond cancelled, the insurer would be required to compel the foreign executors to do so.

9 The insurer has now modified its request and advised Mr. Mahoney that it will issue a bond to the co-executors if a member of Mr. Mahoney's law firm is appointed by the court as a monitor for the purpose of monitoring the administration of the estate by the co-executors and providing consent to any disposition of estate assets or distribution of estate funds by the co-executors.

10 Thomas Wall, a lawyer with Mr. Mahoney's firm, has agreed to act as court-appointed monitor.

2. The order sought

11 The order sought by the moving parties was filed in draft form and contains these provisions (I have omitted the Schedules):

1. THIS COURT ORDERS that upon Emidio D'Angelo and Denise D'Angelo filing with the Court a Foreign Executors Bond in the amount of $1,520,962.56 in the form attached as Schedule "A" to this Order, a Certificate of Appointment of Estate Trustees With a Will in the Estate of Faust D'Angelo shall issue to Emidio D'Angelo and Denise D'Angelo in the form attached as Schedule "B" to this Order.

2. THIS COURT ORDERS that Thomas Wall is hereby appointed as a Monitor, an officer of the Court, to monitor the administration of the Estate of Faust D'Angelo by the Estate Trustees With a Will, with the powers and obligations set out herein.

3. THIS COURT ORDERS that the Estate Trustees With a Will shall advise the Monitor of all material steps taken by the Estate Trustees in the administration of the Estate of Faust D'Angelo.

4. THIS COURT ORDERS that the Monitor,

(a) monitor the administration of the Estate of Faust D'Angelo by the Estate Trustees With a Will;

(b) consent to any disposition of estate assets, disbursement of estate funds or distribution of estate funds by the Estate Trustees With a Will which the Monitor believes is appropriate.

5. THIS COURT ORDERS that the Estate Trustees With a Will shall not dispose of any estate assets or disburse any estate funds or distribute any estate funds without the written consent of the Monitor.

6. THIS COURT ORDERS that the Monitor shall not take possession of the property and shall take no part whatsoever in the administration or supervision of the administration of the estate and shall not, by fulfilling his obligations hereunder, be deemed to have taken or maintained possession or control of the property of the estate or any part thereof.

7. THIS COURT ORDERS that the Monitor shall incur no liability or obligation as a result of his appointment or the carrying out of the provisions of this Order save and except for any gross negligence or wilful misconduct on his part.

8. THIS COURT ORDERS that, within two years of the date of issuance of the Certificate of Appointment of Estate Trustees With a Will, the Estate Trustees With a Will shall file estate accounts with the Court and take out an appointment for passing of such accounts.

III Discussion

1. Jurisdiction

(a) rule 74.15(1)

12 Rule 74.15(1) of the *Rules of Civil Procedure* authorizes the making of orders for assistance in respect of estates:

> 74.15 (1) In addition to a motion under section 9 of the *Estates Act*,[2] any person who appears to have a financial interest in an estate may move,
>
> > (a) *Order to Accept or Refuse Appointment* - for an order (Form 74.36) requiring any person to accept or refuse an appointment as an estate trustee with a will;
> >
> > (b) *Order to Accept or Refuse Appointment* - for an order (Form 74.37) requiring any person to accept or refuse an appointment as an estate trustee without a will;
> >
> > (c) *Order to Consent or Object to Proposed Appointment* - for an order (Form 74.38) requiring any person to consent or object to a proposed appointment of an estate trustee with or without a will;
> >
> > (d) *Order to File Statement of Assets of the Estate* - for an order (Form 74.39) requiring an estate trustee to file with the court a statement of the nature and value, at the date of death, of each of the assets of the estate to be administered by the estate trustee;
> >
> > (e) *Order for Further Particulars* - after receiving the statement described in clause (d), for an order for further particulars by supplementary affidavit or otherwise as the court directs;
> >
> > (f) *Order to Beneficiary Witness* - for an order (Form 74.40) requiring a beneficiary or the spouse of a beneficiary who witnessed the will or codicil, or who signed the will or codicil for the testator, to satisfy the court that the beneficiary or spouse did not exercise improper or undue influence on the testator;
> >
> > (g) *Order to Former Spouse* - for an order (Form 74.41) requiring a former spouse of the deceased to take part in a determination under subsection 17 (2) of the *Succession Law Reform Act* of the validity of the appointment of the former spouse as estate trustee, a devise or bequest of a beneficial interest to the former spouse or the conferring of a general or special power of appointment on him or her;

(h) *Order to Pass Accounts* - for an order (Form 74.42) requiring an estate trustee to pass accounts; and

(i) *Order for Other Matters* - for an order providing for any other matter that the court directs.

13 The moving parties rely upon the general, catch-all provisions of rule 74.15(1)(i).

(b) do the co-executors have standing under rule 74.15(1)(i)?

14 To have standing under rule 74.15(1) of the *Rules of Civil Procedure*, a moving party must be a "person who appears to have a financial interest in" the estate.

15 Emidio is a residuary beneficiary under the Will and, as such, has a financial interest in the estate thereby making him an eligible moving party under rule 74.15(1)(i).

16 Denise, on the other hand, is not a beneficiary. Her only financial interest in the estate consists of her entitlement to claim compensation as a named executor. Is this sufficient to give her standing under rule 74.15(1)(i)? Yes. In my opinion, the financial interest contemplated by rule 74.15(1)(i) may be direct, indirect or contingent. An entitlement to claim executor's compensation is a contingent financial interest in the estate.

(c) right to grant of probate v. conditions attached to grant

17 "There is a considerable difference between the right to the grant of probate and the conditions upon which a grant may be made. The latter are definitely within the jurisdiction and discretion of the Court": see *Knox Estate, Re*, [1963] B.C.J. No. 157, 40 D.L.R. (2d) 397 (B.C. S.C.) at para. 8 and the authorities therein cited.

18 I agree with the finding in *Re Knox*. While there is a very limited discretion given to the court when it comes to granting probate, the discretion to attach conditions to the grant is wide. The court may construct such conditions as are necessary to achieve the wishes of the testator, to properly administer the estate and to otherwise do justice in the circumstances of the case. Jurisdictionally, appointing a monitor is such a condition.

2. Court-appointed monitors

(a) recognized in Ontario?

19 Mr. Mahoney provided me with several Ontario cases where the court has appointed a monitor (I had never heard of the practice).

20 In *Ontario Society for the Prevention of Cruelty to Animals v. Toronto Humane Society*, 2010 ONSC 608 (Ont. S.C.J.) (CanLII), the court, at para. 2, appointed "a monitor of the business and financial affairs of [The Toronto Humane Society ("the THS")] and to provide the court with information about how the THS is administering its charitable trust," in an application where it was alleged that the THS had breached the trust created for its charitable purpose and a wide range of relief was sought under the *Charities Accounting Act*, R.S.O. 1990, c. C.10. At para. 94, the court relied upon "the inherent jurisdiction of this court to supervise charities and section 10(1) [3] of the [*Charities Accounting Act*] to appoint [a Chartered Accountant with Deloitte & Touche LLP] to act as monitor of the business and financial affairs of the THS and to inquire into and to report on the charity's financial health ..."

21 Courts have also appointed monitors under the oppression remedies in the *Ontario Business Corporation Act*, R.S.O. 1990, c. B.16, despite that statute referring neither to monitors nor the power to appoint them: [4] see, for example, *Holden v. Infolink Technologies Ltd.* [2004 CarswellOnt 4240 (Ont. S.C.J. [Commercial List])], 2004 CanLII 34078; [5] and *Waxman v. Waxman* [2005 CarswellOnt 698 (Ont. S.C.J. [Commercial List])], 2005 CanLII 4450.

22 Further recognition of monitors can be seen in *Bank of Montreal v. Locilento Investments Inc.* [2003 CarswellOnt 5317 (Ont. S.C.J.)], 2003 CanLII 27033. Although it is not clear from the decision, this appears to be a motion for the appointment of a receiver where, at paras. 2 and 4, the court, concerned that to do so would trigger the precipitous revocation of a Liquor Control Board of Ontario licence for the business in question, instead appointed a monitor of the business "with full day-to-day control of the operations." [6]

(b) definition

23 Interestingly, none of the cases that I have mentioned defines "monitor."

24 The term "monitor" is not included in *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West Group, 1999).

25 In Dukelow and Nuse, *The Dictionary of Canadian Law* (Scarborough: Carswell, 1991), "monitor" is defined (but only within the context of receiverships) as "a person appointed by a security holder to review and report on the cash flow, accounts payable and assets of a debtor's business ..."

26 In *The New Shorter Oxford English Dictionary*, the meaning of the verb "monitor" is "observe, supervise, keep under review ..." and the noun is "a person who monitors something ... a person who ... gives advice or warning as to conduct."

27 It would seem that there is no magic to the use of the term "monitor" and that there is no need to engraft on it anything beyond its everyday meaning.

28 I state the obvious when I say that a monitor must have the necessary skills to perform his or her duties as required in the circumstances of each case and the order of appointment should be as specific as possible in delineating those duties.

3. "Officer of the court"

29 Paragraph 2 of the order sought on this motion refers to the monitor as being an "officer of the court."

(a) definition

30 "Officer of the court" is defined in *Black's Law Dictionary* as:

> ... a person who is charged with upholding the law and administering the judicial system. Typically officer of the court refers to a judge, clerk, bailiff, sheriff, or the like, but the term also applies to a lawyer, who is obliged to obey court rules and who owes a duty of candour to the court. Also termed a court officer.

31 I do not agree that "court officer" and "officer of the court" necessarily are synonymous. I would regard a "court officer" as a "court employee." [7] Thus, "officer of the court" has a broader scope. [8]

32 There does not appear to be any statutory definition for "officer of the court."

(b) is a monitor an officer of the court?

33 A court-appointed receiver is an officer of the court: see *Bennett on Receiverships*, Second Edition, (Toronto: Carswell, 1990) at 180; [9] and a trustee in bankruptcy is an officer of the court: see Houlden & Morawetz, *Bankruptcy and Insolvency Law of Canada* (Toronto: Carswell, 2001) at 1-61. [10] Consequently, I see no reason why a court-appointed monitor would not be an officer of the court. Indeed, the very nature of the appointment renders a monitor an officer of the court.

34 Of course, in the circumstances of this case, the quick answer may be that Mr. Wall, the proposed monitor, is a barrister and solicitor and, therefore, he is an officer of the court pursuant to s. 29 of the *Law Society Act*, R.S.O. 1990, c. L.8. [11]

(c) primary responsibilities of an officer of the court

35 Mr. Mahoney submits, and I agree, that one may describe the duties and responsibilities of an officer of the court by analogy to those historically identified with receivers. Consequently, I consider the primary responsibilities of an appointed officer of the court to be threefold: (1) to act fairly, honestly, impartially and as a fiduciary, on behalf of all persons having a financial interest in the subject-matter of the appointment; (2) to comply with the powers granted in the order of appointment; and, (3) to be accountable both to the court that made the appointment and to those persons in (1).

(d) duties of the monitor

36 The duties of the monitor in this case, therefore, are: (1) to monitor the actions of the co-executors; (2) to ensure that dispositions made by the co-executors are consistent with the proper administration of the estate; (3) to comply with the terms of the order of appointment: and, (4) to otherwise be faithful to the responsibilities of an officer of the court.

4. Threshold of liability

37 Initially, I was concerned that paragraph 7 of the order sought sets out a very lenient threshold of liability ("gross negligence or wilful misconduct"), that is to say, it takes a high level of wrongdoing by the monitor before liability will attach to his conduct). Mr. Mahoney submits that the wording of the threshold is taken from the Superior Court of Justice Commercial List Model CCAA [12] Initial Order (Long Form), paragraph 29, pursuant to which a monitor under the CCAA "shall incur no liability or obligation as a result of its appointment or the carrying out of the provisions of this order, save and except for any gross negligence or wilful misconduct on its part."

38 A Commercial List Users' Subcommittee [13] drafted the Model CCAA Initial Order.

39 In *Collins & Aikman Automotive Canada Inc., Re*, [2007] O.J. No. 4186, 37 C.B.R. (5th) 282 (Ont. S.C.J.), Spence J. had occasion to deal with an objection to the liability threshold under paragraph 29 of the Model CCAA Initial Order. At paragraphs 128-130, Spence J. writes:

> [128] The specific wording in paragraph 29 of the Initial Order is consistent with the standard limitation of liability protections granted to monitors under the standard-form

> model CCAA Initial Order, which was authorized and approved by the Commercial List Users' Committee on September 12, 2006.
>
> [129] That is, of course, not determinative but it suggests that the clause has received serious favourable consideration from members of the bar in a context unrelated to particular party interests.
>
> [130] The monitor submitted in its factum a list of twelve recent CCAA proceedings in which orders have been granted with similar provisions to the limitation of liability in this case. This would seem to suggest that in those cases the clause limiting liability was not disputed or, if it was, the Court found the clause to be acceptable.

40 Although Spence J. was addressing the liability threshold in a different factual situation than the one before this court, his comments are apt regarding the seriousness with which one should treat the liability clause in the Model CCAA Initial Order. In my view, it is sensible to incorporate the same threshold in the order sought at bar. [14] I see no reason to do otherwise.

5. *Cost of monitor*

41 The order sought on the motion is silent as to who will be responsible for the cost of the monitor. Mr. Mahoney submits that this matter may be approached in one of two ways: (1) the cost of the monitor should be regarded as a necessary estate expense to allow the co-executors to carry out their duties; or (2) the cost should be paid out of (that is, deducted from) the co-executors' compensation on the basis that the monitors, effectively, are assisting the executors in their duties.

42 In my view, I need not rule on the matter or otherwise address the issue of the cost of the monitor. It is irrelevant for my purposes and may be left to the judge on the ultimate passing of accounts.

6. *Do the beneficiaries have a say in the appointment of a monitor?*

43 I do not regard the appointment of a monitor as an issue requiring approval or input from the beneficiaries. The motion for the appointment is brought by the co-executors as part of what they perceive to be their duties and it (the motion) will be judged along with the rest of their duties on the final passing of accounts when the matter of compensation is addressed.

7. *Why not renounce and appoint the proposed monitor as estate trustee?*

44 If the co-executors were to renounce, Mr. Wall, the proposed monitor, could be appointed to administer the property of the deceased. This would eliminate the need for a monitor. However, wherever possible, the court must give effect to the wishes of the testator

(who selected the co-executors) and, for that reason alone (without even addressing the implications of s. 29 of the *Estates Act*, R.S.O. 1990, c. E.21), the renunciation approach is not desirable.

8. What if the beneficiaries were to waive the bond requirement?

45 If a bond were not required, there would be no need for a monitor.

46 Section 6 of the *Estates Act* deals with the discretionary requirement of security for non-resident executors:

> 6. Letters probate shall not be granted to a person not resident in Ontario or elsewhere in the Commonwealth unless the person has given the like security as is required from an administrator in case of intestacy [15] or in the opinion of the judge such security should under special circumstances be dispensed with or be reduced in amount.

47 There are no "special circumstances" [16] here that would warrant dispensing with, or reducing, the security; and, even if the beneficiaries were to consent to waiving the requirement of a foreign executors' bond, it would be problematic convincing the court that the consent was fully informed as to all attendant risks.

9. The form of the Certificate

48 Rule 74.04 of the *Rules of Civil Procedure* provides for an application for a Certificate of Appointment of Estate Trustee ("Certificate").

49 The Certificate itself is set out in Form 74.13:

> (Title)
>
> **CERTIFICATE OF APPOINTMENT OF ESTATE TRUSTEE WITH A WILL**
>
> This CERTIFICATE OF APPOINTMENT OF ESTATE TRUSTEE WITH A WILL is hereby issued under the seal of the court to the applicant named above. A copy of the deceased's last will (and codicil(s), if any) is attached.
>
> DATE __________ ____________
> Registrar

50 The Certificate requested by the moving parties (attached as Schedule "B" to the order sought) is described as a "Certificate of Appointment of Estate Trustees with a Will and Court-Appointed Monitor." May one tamper with rules-prescribed forms? Yes.

51 Rule 1.06(1) states:

> 1.06(1) The forms prescribed by these rules shall be used where applicable and with such variations as the circumstances require.

52 The forms prescribed by the rules are not sacrosanct. They may be modified "as the circumstances require." Thus, I see no difficulty with the form of the Certificate being varied to permit reference to a court-appointed monitor.

IV Conclusion

53 The motion is allowed and the relief sought is granted. The order appointing a monitor shall issue in the form filed.

54 I am grateful to Mr. Mahoney for his helpful written submissions.

Motion granted.

Footnotes

1 I am aware that, as of January 1, 1995, under the *Rules of Civil Procedure*, the term "executor" is passé and has been replaced by "estate trustee."

2 Section 9 permits motions to compel "any person to produce ... any paper or writing being or purporting to be testamentary ..."

3 Section 10(1) provides, in part, that"[w]here any two or more persons ... seek the direction of the court for the administration of a trust for a charitable purpose, they may apply to the Superior Court of Justice and the court ... may make such order as it considers just for the carrying out of the trust under the law."

4 Section 248(3) speaks only of the power of the court to "make any interim or final order it thinks fit."

5 Where the court appointed a "monitor/inspector."

6 Query whether this goes beyond the duties of a true monitor.

7 For example, it seems that this is the gist of s. 73(1) of the *Courts of Justice Act*, R.S.O. 1990, c. C.43.

8 However, perhaps I doth quibble.

9 See also: *Confectionately Yours Inc., Re*, [2002] O.J. No. 3569, 36 C.B.R. (4th) 200 (Ont. C.A.) at para. 24.

10 See also: *Reed, Re* (1980), 34 C.B.R. (N.S.) 83 (Ont. C.A.), at 86.

11 Section 29 states: "Every person who is licensed to practise law in Ontario as a barrister and solicitor is an officer of every court of record in Ontario."

12 "CCAA" is the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

13 The Subcommittee "is comprised of members of the judiciary who sit on the Commercial List from time to time, of practitioners who are familiar with the operation of the Commercial List and who are nominated by relevant Bar organizations and of a representative of Courts Administration from the Commercial List Office": see paragraph 53 of 2002 Practice Direction Concerning the Commercial List of the Superior Court of Justice relating to conduct of matters after April 1, 2002.

14 Perhaps, as Mr. Mahoney submits, this threshold makes sense when one considers that the monitor will not be performing the duties of the co-executors but merely monitoring the co-executors in the performance of those duties. I further observe that although Mr. Wall, the proposed monitor, is a barrister and solicitor who normally would be liable for acts of simple negligence, as a monitor, he is subject to the more lenient threshold.

15 Section 37(1) of the *Estates Act* requires the security to be double the sworn value of the estate. Historically, for reasons unknown to me, this, in practice, is reduced under s. 37(2) to the sworn value of the estate without the need for a court order.

16 Such as, for example, where the foreign estate trustee finds it impossible to come up with an insurer or other surety who will provide the bond.

End of Document

TAB 10

CITATION: U.S. Steel Canada Inc. (Re), 2015 ONSC 5103
COURT FILE NO.: CV-14-10695-00CL
DATE: 20150813

SUPERIOR COURT OF JUSTICE - ONTARIO

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

AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR ARRANGEMENT WITH RESPECT TO U.S. STEEL CANADA INC.

BEFORE: Mr. Justice H. Wilton-Siegel

COUNSEL: *M. Barrack, J. Willis* and *M. Shapiro*, for United States Steel Corporation

R. Paul Steep and *S. Kour*, for the Applicant

A. Mark, R. Chadwick and *T. Jackson,* for the Province of Ontario

G. Capern, L. Harmer and *D. Cooney,* for the United Steel Workers Union and USW Local 8782

S. White, for the United Steel Workers Union, Local 1005

C. Kopach, for Robert and Sharon Milbourne

A. Hatnay and *B. Walancik,* for the Non-unionized active employees and retirees

R. Staley and *K. Zych* for the Monitor

HEARD: May 5, 2015

ENDORSEMENT

[1] This was a motion to schedule the timing of the hearing of a motion brought by United States Steel Corporation ("USS") to determine the amount and status of its claims in these proceedings. In particular, the motion sought directions on the extent and nature of production and discovery in respect of certain objections brought by the Province of Ontario (the "Province"), the United Steel Workers, USW Local 8782 and USW Local 1005 (collectively, the "USW"), and Robert and Sharon Milbourne (collectively, the "Milbournes"). The objections raise fundamental issues regarding the determination of claims for which the objecting parties seek an order of "equitable subordination" in proceedings brought under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA").

[2] The Province, the USW and the Milbournes seek a reduction or a subordination of the USS Claims (as defined below) to the claims of the other creditors of USSC for all purposes of the CCAA proceedings. In particular, they seek such subordination for purposes of determination of

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the amount that USS may bid in any credit bid and for purposes of voting to approve any restructuring plan that may be proposed.

[3] At the conclusion of the hearing, the Court advised that, for written reasons to follow, the claims of the Province would be determined pursuant to the Claims Process Order within these CCAA proceedings and established a schedule for the next steps in that determination process. The Court also concluded that the claims of the USW, and of the Milbournes, other than their debt re-characterization claims, were not to be determined pursuant to the Claims Process Order and, after discussion with counsel, scheduled submissions by the parties regarding the appropriate forum for the determination of these claims. This Endorsement sets out the reasons for the Court's decision that the claims of the USW and the Milbournes, other than their debt re-characterization claims, are to be determined outside of the Claims Process Order, as well as the Court's decision regarding the forum for determination of such claims.

Background

[4] On September 16, 2014, U.S. Steel Canada Inc. ("USSC" or the "Applicant") was granted protection under the CCAA pursuant to an initial order of Morawetz R.S.J. (as amended and restated from time to time, the "Initial Order").

[5] USSC's objective in the CCAA process is to restructure its business by implementing either (i) a consensual CCAA restructuring plan, or (ii) one or more sales of its assets and business as a going concern pursuant to a sale and restructuring/recapitalization process that it has commenced and which was approved by the Court pursuant to an order dated April 2, 2015 (the "SARP").

[6] On November 13, 2014, the Court granted a claims process order (the "Claims Process Order") setting out, among other things, the procedure for the filing of proofs of claim, the Monitor's role in the review of claims, and the procedure for the resolution of claims.

[7] The Claims Process Order set out a specific procedure (the "USS Claims Determination Process") for the review and determination of the claims of USS, U.S. Steel Holdings, Inc., U.S. Steel Canada Limited Partnership, and any affiliates of USS, other than USSC or a subsidiary of USSC (the "USS Claims").

[8] The USS Claims Determination Process contemplated that the Monitor would prepare a report detailing its review of the USS Claims and then promptly seek a hearing to schedule a motion to determine such USS Claims. The Claims Process Order provided that the USS Claims would not be determined to be Proven Claims (as defined in the Claims Process Order) without Court approval.

[9] In accordance with the USS Claims Determination Process, USS and its subsidiaries filed 14 proofs of claim with the Monitor, some of which have since been amended. In aggregate, the proofs of claim set out a non-contingent secured claim in the amount of U.S. $122,471,525, non-contingent unsecured claims in the aggregate amounts of U.S. $127,855,104 and $1,847,169,934, and a contingent secured claim in the amount of $78,761,395.

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[10] In connection with the USS Claims Determination Process, the Monitor filed a Seventh Report dated March 9, 2015 (the "Seventh Report") and a Supplemental Seventh Report dated April 29, 2015 (the "Supplementary Report"), describing its review of the USS Claims. The Monitor recommended that USS bring a motion for Court approval of its claims, and that, subject to the Court's determination of any objections to the USS Claims, USS be found to have Proven Claims in the full amounts claimed for the non-contingent claims. The Monitor also recommended leaving the contingent claims to be determined at a later date, as and when appropriate in the proceedings.

[11] On March 13, 2015, in accordance with the Monitor's recommendation, USS served a Notice of Motion for Court approval of the USS Claims.

[12] On March 18, 2015, a hearing to schedule the motion was held. The Court issued an endorsement setting a deadline of April 14, 2015 for the delivery of objections, and requiring the parties to return on April 24, 2015 to address a scheduling and litigation protocol.

[13] On April 14, 2015, four objections to the USS motion (the "Objections") were delivered by the following parties (collectively, the "Objecting Parties"): (i) the Province, (ii) the USW, (iii) representative counsel on behalf of the non-USW active salaried employees and retirees of USSC ("Representative Counsel"), and (iv) the Milbournes, each in their individual capacities as beneficiaries of a retirement benefits contract originally entered into by Stelco Inc. ("Stelco").

[14] On April 24, 2015, counsel to USSC, the Monitor, three of the Objecting Parties (the Province, the USW, and Representative Counsel), and USS appeared in chambers but were unable to settle a process and timetable for the determination of the USS Claims. A further case conference was held on April 30, 2014 to address the process and timetable, at which time it was agreed that the Objection of the Representative Counsel would be deferred and that a hearing would be scheduled for May 5, 2015 to address the process and timetable for the hearing of the Objections of the Province, the USW and the Milbournes.

[15] At the hearing on May 5, 2015, the parties addressed the substantive issue of whether the claims of the Province, the USW and the Milbournes were to be determined pursuant of the Claims Process Order, together with more procedural and timing issues that would follow after such a determination. This Endorsement does not address any of the latter issues for the reason that no material determinations were made other than to set a schedule for a subsequent case management conference to review the status of documentary production and the scheduling of discoveries, and any unresolved issues in respect thereof, regarding the process for determination of the Province's Objection and the similar claims of the USW and the Milbournes.

[16] This Endorsement is divided into three parts. In the first part, the Court summarizes the claims asserted in the Objections of each of the Province, the USW and the Milbournes. In the second part, the Court sets out its reasons for its previously announced decision that the claims of the Province set out in its Objection, and the similar claims of the USW and the Milbournes, would be determined pursuant to the Claims Process Order in the CCAA proceedings but that the remaining claims of the USW and of the Milbournes, set out in their respective Objections, would not. In the third part, the Court sets out its conclusions regarding the proper forum for the determination of these remaining claims of the USW and the Milbournes.

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The Objections of the Province, the USW and the Milbournes

[17] The following summarizes briefly the claims set out in the Objections of the Province, the USW and the Milbournes, and adds certain observations concerning these claims that are relevant for the issues addressed in this Endorsement.

The Objection of the Province

[18] The Province says its Objection relates to financial issues, which it describes as relating to the proper characterization of the debt and the validity of the security. While it has provided the list of factual issues for which it seeks production and/or discovery, the Province has not provided any greater clarification regarding the specific legal issues that it intends to raise in respect of the USS Claim.

[19] It is my understanding, however, that, essentially, the Province intends to make two allegations: (1) that given the terms of the USS loans to USSC, and the circumstances in which the loans were made, such loans should substantively be characterized, in whole or in part, as equity; and (2) that given the circumstances in which the loans were made, the security for the loans should be invalidated pursuant to federal and/or provincial legislation pertaining to fraudulent preferences or fraudulent assignments.

[20] Although USS disputes the allegations of the Province in its Objection, USS is prepared to have these issues determined by the Court under the process contemplated by the Claims Process Order. The claim that the USS loans are, in substance, debt and should be so treated for the purposes of these CCAA proceedings is referred to herein as a "debt re-characterization claim".

The Objection of the USW

[21] The Union broadly categorizes its objections as follows:

(a) an objection to the granting of security interests on the assets of USSC;

(b) an objection to the characterization of much of the USS Claim as debt when it is properly characterized as equity; and

(c) an objection grounded in USS's conduct in relation to its Canadian plants, unionized pensioners, pension plan members and beneficiaries, which gives rise to claims of oppression and breaches of fiduciary duty.

By way of overview, the USW submits that USS, as the shareholder of USSC, directed the operations of USSC in a manner that has caused it to significantly underperform, thereby incurring substantial losses rather than achieving profitability and requiring it to incur significant debt. In addition, the USW says that such actions undermined the ability of USSC to meet its on-going funding obligations to the USW pension plans of USSC. The USW argues that, as a result, USS has diluted the potential recoveries of the USW members and the USW pension plan beneficiaries in this CCAA proceeding. In Schedule "A" to this Endorsement, I have set out an

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excerpt from the USW Objection which summarizes the claims asserted by the USW in somewhat greater detail.

[22] The USW acknowledges that the first two claims overlap significantly, if not completely, with the claims raised by the Province in its Objection. Accordingly, in this section, I will deal only with the claims of oppression and breaches of fiduciary duty. The following four aspects of these claims are relevant.

[23] First, the USW's claims for oppression and breach of fiduciary duty do not involve a determination that, in substance, the USS loans to USSC are properly chacterized as equity, that is, they are not debt re-characterization claims. Instead, for the purposes of these claims, the USW implicitly accepts that such loans are valid debt claims but argues, instead, that, as a result of USS' actions, the USW should be entitled to equitable relief that would have the substantive result of treating some or all of the loans as if they were equity.

[24] Second, as a related matter, the USW claims are not related to the actions of USS in extending the challenged loans to USSC, and in particular do not involve claims based on the terms of the loans or the circumstances in which they were made. Instead, the oppression claim is based on actions of USS that occurred subsequent to the extension of most of the USS loans to USSC and that pertain principally to the effective integration of the manufacturing operations of USSC within the USS group of companies. Similarly, the breach of fiduciary duty claim pertains to the administration of the USW pension plans after USS acquired USSC. This claim has no connection whatsoever to the USS loans to USSC.

[25] The USW claims proceed on the basis that actions of USS resulted in a loss to the USW Beneficiaries (as defined in the USW Objection) that is represented by the diminished recoveries that they will realize in these CCAA proceedings. In essence, the USW argues that USSC would not have needed to commence these CCAA proceedings but for the decisions taken by USS regarding the operations of USSC. As such, the USW claims are fundamentally claims against USS in its capacity as a shareholder of USSC and as an alleged administrator of the USW pension plans, rather than in its capacity as a creditor of USSC.

[26] Third, while the actions upon which the USW bases its action are clear, the nature of the USW claim and the remedy which it seeks can be approached in two different ways.

[27] In its broadest form, the USW relies upon the actions as a basis for application of the doctrine of equitable subordination for which the relief sought would be a subordination of some or all of the USS Claims to the claims of all other creditors of USSC for all purposes of these CCAA proceedings. In this form, the USW claim asserts that the actions of USS caused loss to all of the other creditors of USSC or resulted in an unfair benefit to USS at the expense of all such other creditors. To anticipate a conclusion reached below, this claim cannot proceed within the process contemplated by the Claims Process Order for the reason that the Court lacks the authority under the CCAA to apply the doctrine of equitable subordination.

[28] In its alternative form, the USW Objection asserts claims on behalf of the USW members and its retirees against USS of oppressive behavior for the purposes of section 241 of the *Canada Business Corporations Act*, R.S.O. 1985, c. C-44 and of breach of trust. The USW asserts that

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the actions of USS giving rise to such claims caused loss that is specific to such USW members and retirees. Two aspects of the USW claims, as expressed in this manner, are significant for present purposes.

[29] First, these claims are asserted against USS and are grounded in actions of USS, as the controlling stakeholder of USSC, pertaining to the manner in which USSC was operated as a subsidiary of USS from and after 2007. They are not asserted against USSC and, to the extent USSC were to be joined as a party to any proceeding in which the claims were determined, such joinder would be only for procedural purposes.

[30] Second if the USW is successful in its oppression claim or its breach of fiduciary duty claim, any remedy ordered subordinating some or all of the USS Claims would be specific to the USW members and retirees. Because the USW claim is based on an allegation of oppressive behaviour that is specific to the USW members, the relief granted by a court would be directed to, and limited to, rectification of the oppressive conduct suffered by such members. It would not extend to other stakeholders of USSC. Any other stakeholder who also considered that the actions of USS constituted oppressive conduct in respect of such stakeholder would have to institute a separate action based on its specific circumstances. In this regard, the Province, which is the other major stakeholder of USSC, while it supports the USW Objection, has not commenced a similar action and, does not suggest that it would be entitled to benefit from any equitable relief granted to the USW in respect of the USW's oppression claim.

[31] Similarly, the USW claim that is based on allegations that USS breached fiduciary duties owed to USW members and pensioners in respect of the USW pension plans is necessarily limited to claims in respect of alleged breaches of duties alleged to be owing to such individuals personally. Any remedy granted would therefore be specific to these individuals, and the loss that they suffered, rather than in favour of all stakeholders.

<u>The Objection of the Milbournes</u>

[32] The Milbournes also submit that the USS Claims should be dismissed in their entirety or subordinated to the claims of the other unsecured creditors of USSC.

[33] Their Objection is also based on the actions of USS as the controlling shareholder of USSC, which are summarized as follows:

> All of the USS Claims arise either as a result of USS's accounting and legal treatment of its investment in the acquisition of Stelco or as a result of its accounting treatment of the normal costs of, and operating results from, USS' fully integrated operation and management of the acquired assets [being the assets of USSC] as part of its North American Flat Rolled Group and are either the result of transactions between itself and non-arm's length entities over which it had dominance and exercised total control at all material times, or are expenses incurred in the normal course of operating its flat rolled steel mills.

[34] Insofar as the Milbournes challenge the treatment of USS' investment in the acquisition of Stelco Inc., the Milbournes appear to raise claims similar to those asserted by the Province, that is a debt re-characterization claim. However, the principal assertion in the Milbournes'

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Objection is that, in its management of the former assets of Stelco as part of its North American Flat Rolled Group of steel plants, USS took actions to idle the blast furnaces and steelmaking units of USSC which resulted in significant operating losses to USSC while USS continued to supply the former customer base of Stelco from its steel plants in the United States. This claim is based on factual assertions similar to, although not identical to, the facts asserted by the USW in respect of the oppression claim and claim for breach of trust asserted on behalf of its members. It is not related in any manner to the actions of USS in extending the challenged loans to USSC or the terms therof. As with the USW oppression claim, the relief sought is an order for subordination of some or all of the USS Claims. Given the relationship of the Milbournes to the situation as pension recipients, the Milbournes' Objection is essentially a claim for breach of a fiduciary duty owed by USS to them personally, although in the discussion below I have also considered the possible expression of the Milbournes' Objection as a claim for application of the doctrine of equitable subordination.

Analysis and Conclusions Regarding the Process for Determination of the Claims of the USW and the Milbournes other than their Debt Re-Characterization Claims

[35] To address the issue in this section of the Endorsement, I will first set out the applicable statutory provisions and the authority of the Court to adjudicate claims in CCAA proceedings. I will then address the issue of whether the claims of the USW and the Milbournes, other than their debt re-characterization claims, are properly determined within the summary process provided for in the Claims Process Order.

The Applicable Statutory Provisions

[36] The following provisions of the CCAA are relevant for the issues on this motion:

2. In this Act,

"Claim" means any indebtedness, liability or obligation of any kind that would be a claim provable within the meaning of section 2 of the *Bankruptcy and Insolvency Act*;

"Equity Claim" means a claim that is in respect of an equity interest, including a claim for, among others,

(a) a dividend or similar payment,

(b) a return of capital,

(c) a redemption or retraction obligation,

(d) a monetary loss resulting from the ownership, purchase or sale of an equity interest or from the rescission, or, in Quebec, the annulment, of a purchase or sale of an equity interest, or

(e) contribution or indemnity in respect of a claim referred to in any of paragraphs (a) to (d);

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"Equity Interest" means

(a) in the case of a corporation other than an income trust, a share in the corporation -- or a warrant or option or another right to acquire a share in the corporation -- other than one that is derived from a convertible debt, and

(b) in the case of an income trust, a unit in the income trust -- or a warrant or option or another right to acquire a unit in the income trust -- other than one that is derived from a convertible debt;

6. (8) No compromise or arrangement that provides for the payment of an equity claim is to be sanctioned by the court unless it provides that all claims that are not equity claims are to be paid in full before the equity claim is to be paid.

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.

20. (1) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor is to be determined as follows:

(*a*) the amount of an unsecured claim is the amount

(i) in the case of a company in the course of being wound up under the *Winding-up and Restructuring Act*, proof of which has been made in accordance with that Act,

(ii) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act*, proof of which has been made in accordance with that Act, or

(iii) in the case of any other company, proof of which might be made under the *Bankruptcy and Insolvency Act*, but if the amount so provable is not admitted by the company, *the amount is to be determined by the court on summary application by the company or by the creditor*; and

(*b*) the amount of a secured claim is the amount, proof of which might be made under the *Bankruptcy and Insolvency Act* if the claim were unsecured, but the amount if not admitted by the company is, in the case of a company subject to pending proceedings under the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act*, to be established by proof in the same manner as an unsecured claim under the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act*, as the case may be, and, in the case of any other company, *the amount is to be determined by the court on summary application by the company or the creditor*. [emphasis added]

22.1 Despite subsection 22(1) creditors having equity claims are to be in the same class of creditors in relation to those claims unless the court orders otherwise and may not, as members of that class, vote at any meeting unless the court orders otherwise.

36.1 (1) Sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act* apply, with any modifications that the circumstances require, in respect of a compromise or arrangement unless the compromise or arrangement provides otherwise.

(2) For the purposes of subsection (1), a reference in sections 38 and 95 to 101 of the *Bankruptcy and Insolvency Act*

(*a*) to *"date of the bankruptcy"* is to be read as a reference to *"day on which proceedings commence under this Act"*;

(*b*) to *"trustee"* is to be read as a reference to *"monitor"*; and

(*c*) to *"bankrupt"*, *"insolvent person"* or *"debtor"* is to be read as a reference to *"debtor company"*.

[37] Section 2 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3 (the "BIA"), which is referenced in section 2 of the CCAA, provides that a "claim provable in bankruptcy" includes any claim or liability provable in proceedings under the BIA by a creditor. "Creditor" is defined in s. 2 of the BIA as a person having a claim provable as a claim under the Act. Section 121(1) of the BIA describes claims provable as follows:

All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

The Authority of the Court to Adjudicate Claims for Debt Re-Characterization and for Equitable Subordination

[38] An important issue on this motion is the authority of the Court to order that part or all of the USS Claims be re-characterized as equity for purposes of these CCAA proceedings or subordinated to the claims of all other unsecured creditors. The two determinations are not synonymous.

[39] The re-characterization of a debt claim as equity proceeds on the basis that a creditor's claim is, in substance, an "Equity Claim" for purposes of the CCAA, based on the terms of the

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debt claim and the circumstances in which the debt claim arose, notwithstanding the creditor's characterization of its claim as debt.

[40] Equitable subordination proceeds on the basis that it is equitable to subordinate in whole or in part an otherwise valid debt claim based on some form of inequitable conduct on the part of a creditor that has resulted in loss to the other creditors of a debtor corporation generally or that has conferred an unfair advantage on the creditor. In this regard, I note that, in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, [1992] 3 S. C. R. 558 at p. 609, Iacobucci J. referred to the following three-part test for the application of the principle of equitable subordination in the United States: (1) the claimant must have engaged in some type of inequitable conduct; (2) the misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant; and (3) equitable subordination of the claim must not be inconsistent with the provisions of the bankruptcy statute.

[41] For the following reasons, I conclude that the Court has the authority to re-characterize a debt claim as equity in accordance with the test for equity implied by the definition of an "Equity Claim" or to invalidate security in favour of a creditor if the granting of such security constituted a fraudulent preference or a transaction at an undervalue. However, I am not persuaded that the Court has the authority under the CCAA to subordinate a valid debt claim to the claims of other creditors of the debtor corporation based on the actions of the creditor pursuant to the principle of equitable subordination.

[42] The CCAA establishes a structure for the adjudication of claims of creditors. It contemplates two categories of claims – "Claims" and "Equity Claims". Under the CCAA, a creditor's valid "Claim" is recognized for all purposes as such unless the Court determines that it shall be treated as an "Equity Claim" for purposes of proceedings under the statute. The definition of "Equity Claim" provides that an "Equity Claim" is "a claim that is in respect of an equity interest". "Equity Interest" is, in turn, defined in very specific terms to mean, in the case of a corporation, a share of the corporation.

[43] The CCAA also provides that, in certain circumstances, creditors can challenge prior transactions of the debtor corporation with a view to invalidating such transactions. Section 36.1 provides, among other things, that the provisions of the BIA pertaining to fraudulent preference transactions and transactions at an undervalue apply to proceedings under the CCAA on the basis provided for therein. Such provision has not been the subject of any litigation of which the Court is aware. However, on its face, such provision appears to be available to creditors to invalidate security granted by a debtor corporation in favour of a creditor if a fraudulent preference under section 95, as amended by section 36.1, can be demonstrated or possibly if a transfer at undervalue under section 96, as so amended, can be established.

[44] Given this framework, the Court has authority to determine whether a valid debt claim is, in substance, an equity claim, that is, to find that a debt claim should be re-characterized as equity. This is inherent in the definition of "Equity Claim" which, by the language of that definition, contains the test to be applied by a court - whether the claim represents, in substance, a share of the debtor corporation. As mentioned, the Court also has the authority to, in effect, subordinate a secured claim of a creditor if the Court determines that the security granted by the debtor constituted a fraudulent preference or a transaction at an undervalue pursuant to the

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provisions of section 36.1 of the CCAA. Such a determination proceeds, however, on the basis of a determination that the actions and intentions of the debtor corporation constituted a fraudulent preference, or that the nature of the transaction itself together with the intentions of the debtor corporation, constituted a transaction at an undervalue. Neither a re-characterization of a debt claim nor an invalidation of security pursuant to section 36.1 of the CCAA would engage the principle of equitable subordination inasmuch as neither determination would address the question of whether the actions of the creditor call for a remedy in favour of the other creditors of the debtor corporation in the form of an equitable subordination of the creditor's claim.

[45] In this CCAA proceeding, however, the principal actions upon which the USW and the Milbournes base their claim of subordination do not fall within the circumstances that would trigger a remedy in the form of a re-characterization of debt as equity or in the form of an invalidation of security under section 36.1. The Court must therefore address the issue of whether a court also has the authority to determine that a valid "Claim" that is not an "Equity Claim", and that was not the subject of a transaction that falls within the circumstances addressed by section 36.1 of the CCAA, should be subordinated to the claims of the other unsecured creditors of a debtor corporation in reliance on equitable principles based on actions of the creditor.

[46] I am not aware of any Canadian case law in which the doctrine of equitable subordination has expressly applied. In *Canada Deposit Insurance Corp. v. Canadian Commercial Bank*, Iacobucci J., speaking for the Supreme Court, declined to express a view on whether the doctrine exists in Canada. In this proceeding, neither the USW nor the Milbournes submits that the doctrine exists in Canada. However, they argue that the Supreme Court has not excluded the possibility of application of the doctrine. They argue that, in addition to the authority to grant an order re-characterizing debt as equity, the Court also has the authority to grant an order of equitable subordination in the exercise of its statutory jurisdiction under section 11 of the CCAA.

[47] If it exists, the authority for the Court's jurisdiction to impose equitable subordination must be found in the authority granted to a court under section 11 of the CCAA. As set out above, section 11 provides that "the court ... 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" (italics added).

[48] Given the definition of "Equity Claim" and the scope of section 36.1 of the CCAA, I am not persuaded that a court has authority under section 11 of the CCAA to subordinate a valid debt claim to the claims of other creditors, based on the actions of the creditor pursuant to the principle of equitable subordination as that doctrine is understood in the United States.

[49] There is no case law supporting such an authority. Moreover, given the silence of the Supreme Court on this issue when presented with the opportunity to affirm its existence in Canadian law, one might infer that the Supreme Court has, in effect, rejected the principle of equitable subordiantion. As mentioned, the Supreme Court refused to endorse the principle outside of the CCAA in *Canada Deposit Insurance Corp. v. Canadian Commercial Bank.* More recently, the Supreme Court also refused to endorse the principle within the operation of the CCAA: see, in particular, Deschamps J. in *Sun Indalex Finance, LLC v. United Steel Workers*,

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[2013] 1 S.C.R. 271 at para. 77. Insofar as the issue remains open, however, I am of the opinion that the CCAA indicates as intention on the part of Parliament to exclude equitable subordination claims based on the conduct of a creditor for the following reason.

[50] Parliament could have provided the authority to order that a "Claim" should be treated as a subordinated claim, or as an "Equity Claim", based on conduct of the creditor. It chose not to do so. There is no language in the definition of "Equity Claim" that gives a court the authority to consider conduct of the creditor, including without limitation conduct in its capacity as a shareholder or as an alleged administrator of a pension plan, as a basis for subordinating a valid debt claim to the claims of other creditors, secured or otherwise. Similarly, Parliament could have drafted section 36.1 of the CCAA more broadly to extend beyond the specidic circumstances in sections 95 and 96 of the BIA. It has chosen instead not to make any such provision in respect of the authority of a court under the CCAA.

[51] In these circumstances, the absence of any provision that would permit the application off the doctrine of equitable subordination must be taken as indicative of an intention to exclude the operation of the doctrine under the CCAA. As a matter of statutory interpretation, therefore, I consider that the language of the definition of an "Equity Claim" and of the provisions of section 36.1 operates as a "restriction set out in the Act" for the purposes of section 11 of the CCAA which has the effect of limiting the authority of the Court in any determination regarding an "Equity Claim" or in any proceeding brought under section 36.1.

[52] I note that the conclusion expressed herein is consistent with the views expressed by Pepall J. (as she then was) in *Nelson Financial Group Ltd., Re.*, 2010 ONSC 6229 (S. Ct.) at para. 34 in respect of actions of a debtor corporation in relation to the issuance of an equity interest:

> In substance, the Styles' claim is for an equity obligation. At a minimum, it is a claim in respect of an equity interest as described in section 2 of the CCAA. Parliament's intention is clear and the types of claims advanced in this case by the preferred shareholders are captured by the language of the amended statute. While some, and most notably Professor Janis Sarra, advocated a statutory amendment that provided for some judicial flexibility in cases involving damages arising from egregious conduct on the part of a debtor corporation and its officers, Parliament opted not to include such a provision. Sections 6(8) and 22.1 allow for little if any flexibility. That said, they do provide for greater certainty in the appropriate treatment to be accorded equity claims.

I acknowledge that that the issue raised in *Nelson* was whether the actions of the debtor corporation could create a debt obligation. However, I do not see any difference in principle, for present purposes, between the circumstances in *Nelson* and the circumstances of the present case, in which it is suggested that the actions of the creditor could give rise to an "Equity Claim", that is, could support the conclusion that a broader test would apply beyond that contemplated by the definition of an "Equity Claim".

[53] In addition, I note that the Court must also have regard to the caution articulated by Deschamps J. in *Sun Indalex* at para. 82 that "courts should not use equity to do what they wish

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Parliament had done through legislation." As addressed above, Parliament could have expressly introduced the law of equitable subordination into the CCAA at the time of the most recent amendments but chose not to do so. The Court must respect that policy decision.

Analysis and Conclusions Regarding the Process for Adjudication of the Equitable Subordination Claims of the USW and the Milbournes

[54] In furtherance of the determination of the secured and unsecured claims of USSC, including the USS Claims, the Court issued the Claims Process Order. It is agreed that the claims contemplated by the Objections of the Province and the USW, to the extent they constitute debt re-characterization claims and claims for the invalidation of security based on allegations of a fraudulent preference, a transaction at an undervalue, or similar concepts under provincial legislation, will be addressed pursuant to such process. The principal issue on this motion is whether the remaining claims described in the Objections of the USW and the Milbournes (herein, the "Subordination Claims") are properly addressed pursuant to the process set out in the Claims Process Order.

[55] As mentioned, the Court advised the parties at the conclusion of the hearing on the motion that it had concluded that the Subordination Claims were not appropriately dealt with pursuant to the Claims Process Order. I reach this conclusion for the following reasons.

[56] For the reasons set out above, I have concluded that the CCAA grants a court the following authority regarding the determination of the Objections of the Province, the USW and the Milbournes in these CCAA proceedings. First, the Court has the authority to address the debt re-characterization claims of the Province, the USW and the Milbournes that some or all of the USS Claims are "Equity Claims" according to the test implied by the definition of an "Equity Claim". Second, the Court has the authority to determine whether any security for the USS Claims should be invalidated pursuant to the provisions of section 36.1 of the CCAA. I would note that I am not addressing in this Endorsement whether such authority also extends to similar proceedings in respect of provincial insolvency legislation. Third, however, the Court does not otherwise have the authority to order that some or all of the USS Claims, if otherwise valid, shall be subordinated to the claims of the other creditors of USSC for the purposes of the CCAA proceedings based on application of the doctrine of equitable subordination to the actions of USS.

[57] As discussed above, the Subordination Claims of the USW and the Milbournes can be approached in two ways. Insofar as the Subordination Claims are based on application of the doctrine of equitable subordination, it necessarily follows from the conclusions set out above that the Court does not have the authority to determine the Subordination Claims pursuant to the Claims Process Order or otherwise.

[58] There remains a question, however, of the proper means of addressing the Subordination Claims of the USW and the Milbournes insofar as they are approached as claims of oppression and breach of fiduciary duty. Approached in this manner, the Subordination Claims are clearly third-party claims between USS and each of the USW and the Milbournes. The issue in the remainder of this section is therefore whether such third-party claims fall to be determined within the process contemplated by the Claims Process Order. I find that such claims

are not properly determined within such process by virtue of both the express language of the Claims Process Order as well as the provisions of the CCAA.

[59] The CCAA is a facilitative statute aimed at allowing financially distressed businesses to devise a plan of compromise or arrangement with their creditors with a view to becoming a viable business again. Section 19(1) of the CCAA provides, in effect, that a plan of compromise or arrangement may only deal with claims that relate to debts or liabilities to which a debtor company is subject at the time of commencement of proceedings under the CCAA or may become subject, prior to sanctioning of a plan of arrangement, by reason of an obligation incurred before the date of commencement of such proceedings.

[60] Section 20(1) provides the manner in which the amount of claims of secured and unsecured creditors are to be determined for the purposes of the CCAA. In particular, in the present circumstances, paragraphs 20(1)(a)(iii) and 20(1)(b) provide that "the amount is to be determined by the court on summary application by the company or the creditor", in respect of unsecured and secured claims, respectively.

[61] Neither the Claims Process Order nor the CCAA contemplate that inter-creditor claims will be addressed, or will be relevant, to a plan of arrangement or compromise under the CCAA.

[62] The Claims Process Order addresses the determination of "Claims" as defined therein. The relevant provisions of the definition of a "Claim" are as follows:

(i) *any right or claim of any Person that may be asserted or made in whole or in part against the Applicant*, whether or not asserted or made, in connection with any indebtedness, liability or obligation of any kind whatsoever, and any interest accrued thereon or costs payable in respect thereof, including by reason of the commission of a tort (intentional or unintentional), by reason of any breach of contract or other agreement (oral or written), by reason of any breach of duty (including any legal, statutory, equitable or fiduciary duty) or by reason of any right of ownership of or title to property or assets or right to a trust or deemed trust (statutory, express, implied, resulting, constructive or otherwise), and whether or not any indebtedness, liability or obligation is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, unsecured, present or future, known or unknown, by guarantee, surety or otherwise, and whether or not any right or claim is executory or anticipatory in nature, including any right or ability of any Person to advance a claim for contribution or indemnity or otherwise with respect to any matter, action, cause or chose in action, whether existing at present or commenced in the future, *which indebtedness, liability or obligation, and any interest accrued thereon or costs payable in respect thereof (A) is based in whole or in part on facts existing prior to the Filing Date, (B) relates to a time period prior to the Filing Date, or (C) is a right or claim of any kind that would be a claim provable in bankruptcy within the meaning of the BIA* *had the Applicant become bankrupt on the Filing Date and includes an Equity Claim and a Secured Claim;* ... [emphasis added]

[63] As indicated in the italicized language, the definition of a "Claim" is restricted to a claim that may be asserted against USSC. Accordingly, on the plain reading of the Claims Process Order, the claims asserted by the USW and the Milbournes do not give rise to a "Claim" for purposes of the Claims Process Order. This restriction of the Claims Process Order to determination of claims asserted against USSC is also consistent with the language, and the policy, of the CCAA.

[64] In this regard, the Claims Process Order is consistent with, and reflects, the approach contemplated by section 20(1) of the CCAA insofar as it provides for a summary application to resolve the determination of any "Claim" under the CCAA. As set out above, a "Claim" for such purposes under the CCAA is a claim against the debtor company, in this case USSC. It does not extend to inter-creditor claims of the nature asserted by the USW and the Milbournes.

[65] The CCAA is directed towards the creation, approval and implementation of a plan of arrangement or compromise proposed between a debtor company and its secured and unsecured creditors, or any claim thereof. Section 19 sets out the only claims that may be dealt with by a compromise or arrangement. Section 19 uses the defined term "claim" throughout, evidencing an intention that only claims against a debtor company are to be the subject of a plan of arrangement or compromise under the CCAA. Similarly, as mentioned, section 20 addresses the determination of claims for the purposes of the CCAA. Again, the operative concept is a "claim" as defined under the CCAA. In addition, pursuant to section 22, the debtor company may establish classes of creditors for purposes of voting upon a plan of arrangement. Pursuant to section 22(2), the factors that determine a commonality of interest for inclusion of creditors in the same class are related to the "claims" of such creditors, as defined in section 2 of the CCAA. In short, the CCAA does not contemplate incorporation of inter-creditor claims into any plan of arrangement or compromise or into the voting process in respect of any proposed plan.

[66] There is, in fact, a strict separation between claims between a creditor and a debtor corporation, on the one hand, and between or among creditors, on the other hand. The former are determined pursuant to the summary application procedure, or otherwise, pursuant to section 20 of the CCAA. The Court's determination of such claims governs for all purposes of the CCAA proceeding proper. The latter are determined outside the process contemplated by section 20 of the CCAA unless specifically incorporated into the restructuring plan as approved by the parties or otherwise ordered. The Court's determination of such claims would govern only the respective rights and obligations of the particular creditors with respect to actual distributions by the debtor corporation.

The Forum for the Remaining Objections

[67] Given the foregoing determination, the Court must also address the forum for determination of the Subordination Claims of the USW and the Milbournes. For clarity, for the reason set out above, in considering this issue, I approach the Subordination Claims of the USW and the Milbournes as claims of oppressive behavior and of breach of fiduciary duty asserted by these parties against USS for which the remedy sought is an order subordinating some or all of the USS Claims to the claims of these parties.

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[68] USS makes a number of arguments against determination of the Subordination Claims against it within the CCAA process. First, it argues that use of the CCAA proceedings to adjudicate inter-creditor claims not involving the debtor company is an impermissible use of the CCAA proceedings with the result that a court would lack jurisdiction to determine such an action. Second, USS argues that the Subordination Claims can only justify a monetary award if successful, which can just as easily be paid by USS directly out of its own assets as it could be paid by USSC pursuant to a plan of arrangement, even if subordination of the position of USS were ordered. Third, USS argues that it would be prejudiced in four respects from a procedural and/or substantive perspective if the Subordination Claims were determined under the CCAA process. Lastly, USS argues that the adjudication of the Subordination Claims within the CCAA process would complicate the adjudication of those claims by, for example, potentially involving unnecessary parties such as USSC and the Monitor. Conversely, it says that any efficiencies associated with determination under the CCAA process could equally be achieved outside that process by having a judge familiar with the CCAA proceedings hear the actions.

[69] The USW and the Milbournes make a number of different arguments which will be addressed in the anlaysis below. The Province supports the USW, principally on the basis that, if the USW were successful in either of its Subordination Claims, it would be entitled to relief that would include relief in respect of distributions under any plan of arrangement. On this basis, the Province argues that the Subordination Claims are sufficiently related to the CCAA proceedings that a timely and orderly resolution of these claims is necessary for a successful plan of arrangement.

[70] I propose to address the USW claims and the Milbourne claims in turn. Before doing so, however, I will address the threshold issue of whether the Court has the authority to order that these claims be determined within this CCAA process. In addition, I will also set out certain observations that inform the conclusions below.

The Jurisdictional Issue

[71] As mentioned, USS argues that the Court lacks jurisdiction to hear the USW 's oppression and breach of fiduciary duty claims under the CCAA proceedings. It says that the use of the CCAA proceedings to determine inter-creditor claims not involving the debtor company is not permissible under the CCAA as such use does not further the purpose of the CCAA. In support of its position, USS relies on dicta of Blair J.A. in *Stelco Inc., Re*, (2005), 78 O.R. (3d) 241 (C.A.) [*Stelco*] at para. 32, which also cited with approval the statement of Paperny J. in *Pacific Coastal Airlines Ltd. v. Air-Canada*, [2001] B.C.J. No. 2580 (B.C.S.C.) at para. 24.

[72] I acknowledge that the purpose of the CCAA is to facilitiate a compromise or arrangement between an insolvent debtor corporation and its creditors to allow the business to continue as a going concern. Accordingly, in most situations, it would be expected that the resolution of inter-creditor disputes would not further such process and may, in fact, delay and possibly hinder such process. In such circumstances, there is no reasonable basis for a determination of such claims within the CCAA process.

[73] The issue for the Court, however, is whether the broad jurisdiction of a court granted under section 11 of the CCAA permits a court to exercise its discretion to determine inter-

creditor claims within a CCAA process if it determines that, in its judgment, such action would further the purposes of the CCAA. USS argues, in effect, for an inflexible rule that excludes such a possibility. I am not persuaded, however, that this is correct as a matter of the statutory interpretation of section 11 of the CCAA. I am also not persuaded that the case law relied upon by USS precludes such an approach.

[74] On its face, section 11 of the CCAA confers broad authority on a court. As mentioned above, it provides that, subject to the restrictions set out in the CCAA, a court may make "any order that it considers appropriate in the circumstances". It is not suggested that there is any express restriction in the CCAA that prevents a court from ordering that inter-creditor claims, such as the Subordination Claims, shall be heard under the CCAA proceeding outside the process contemplated by the Claims Process Order.

[75] Case law establishes that the authority of a court under section 11 is to be interpreted broadly subject, in any particular case, to satisfaction of the baseline requirements of "appropriateness, good faith and due diligence": see *Century Services Inc. v. Canada (Attorney General)*, 2010 SCC 60 at para. 70. In the present case, USS raises the consideration of appropriateness.

[76] In *Century Services*, the Supreme Court defined the test for appropriateness as "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". The application of this test argues against a hard and fast rule of the nature implied by USS and in favour of a more flexible rule that addresses, in any particular case, whether determination of inter-creditor issues will, in such case, further the remedial purpose of the CCAA.

[77] Two further observations in *Century Services* support this conclusion.

[78] First, at para. 60, the Supreme Court stressed that, in exercising a court's authority under the CCAA, the broader public interest may support determination of particular actions in a CCAA proceeding that would not otherwise be addressed within the CCAA process:

> 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 ... 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 ... 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 ... [citations omitted]

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[79] In addition, the Supreme Court noted with approval in para. 61 that, in exercising authority under the CCAA, and in particular under section 11 of the CCAA, courts must necessarily be flexible and innovative in order to further efforts to achieve the remedial purposes of the CCAA.

[80] All of these considerations argue in favour of a broad authority under section 11 that does not preclude the determination of inter-creditor claims within CCAA proceedings in appropriate circumstances. I do not suggest that such circumstances are presented in most circumstances before the courts. I do, however, think that the discretion or authority of a court under section 11 of the CCAA extends to the determination of inter-creditor matters within a CCAA proceeding if, on balance, such action would appear to further the remedial purpose of the CCAA.

[81] I turn then to the two authorities upon which USS relies. I do not read either of these cases as addressing the issue before the Court on this motion.

[82] In *Re Stelco Inc.*, the Court of Appeal addressed adjudication of an inter-creditor dispute in the context of the issue of classification of creditors for purposes of a vote on a plan of arrangement. At para. 30, Blair J.A. refers to the principle of that case in stating that "the classification of creditors is determined by their legal rights in relation to the debtor company, as opposed to their rights as creditors in relation to each other." This case therefore does not address whether the inter-creditor issue was appropriately dealt with inside or outside of the CCAA process. In fact, in the end, the plan of arrangement made provision for a determination of that issue within the CCAA proceedings after implementation of the plan.

[83] The circumstances in *Pacific Coastal Airlines* were also very different from the present circumstances. In that case, the tort claim against Air Canada was not connected in any way to the restructuring of Canadian Airlines. The issue was whether the plaintiff retained a claim after implementation of the plan of arrangement of Canadian Airlines. The plan of arrangement released the plaintiffs' claim against Canadian Airlines but not against its parent, Air Canada. Accordingly, the statement of Paperny J. at para. 24 of *Pacific Coastal Airlines* that "it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company" addresses a totally different situation from the present circumstances.

[84] Based on the foregoing, I conclude that the Court has authority under section 11 of the CCAA to order that the Subordination Claims be determined by a process within the CCAA proceedings, other than the process contemplated by the Claims Process Order, if the Court is of the opinion that, on balance, such action is likely to further the remedial prupose of the CCAA.

Preliminary Observations

[85] The following four general observations establish the framework within which the Court has reached the conclusions in this section of this Endorsement.

[86] First, USS argues that it would be prejudiced in its ability to assert certain defences to the claims of the USW if the Subordination Claims were adjudicated under the CCAA proceedings. I do not believe this to be correct.

[87] To the extent that the determination of the Subordination Claims were to proceed under the CCAA, it would proceed outside of the procedure provided for under the Claims Process Order. Accordingly, the Subordination Claims would have to be asserted in a separate process determined by the Court. I see no reason why such a process could not substantially reflect the normal litigation process contemplated by the *Rules of Civil Procedure*, including an exchange of pleadings, the right to pre-trial motions under, among other provisions Rules 20 and 21 of the *Rules of Civil Procedure*, and appropriate documentary production and discovery.

[88] Second, in their submissions, each of USS and the USW mischaracterizes important aspects of the Subordination Claims that are significant for present purposes.

[89] USS argues that the USW would only be entitled to a monetary award if it were successful on either or both of its claims. However, as pleaded, the USW seeks an order of subordination if it were successful based on the broad remedial statutory authority of a court in respect of the oppression claim and the equitable authority of a court in respect of its breach of fiduciary claim. It is not appropriate for the Court to take a position on this motion on the relative likelihood of such relief in the event the USW were successful on either or both of these claims. The Court must instead proceed on the basis that there is a possibility that such relief might be ordered.

[90] In such event, however, as mentioned, given that such relief would be ordered in the context of an inter-creditor claim, the relief would be limited to an order affecting the priority entitlement to any proceeds of distribution pursuant to the plan of arrangement as between the USW and USS. To be clear, given that any such claim would not be a "Claim" to be determined pursuant to the Claims Process Order, there is no basis on which any relief could extend more generally for the benefit of creditors or other stakeholders who are not a proper party to the action between the USW and USS. Accordingly, the USW's claim for "equitable subordination" of some or all of the USS Claims in the context of its claims for oppression and breach of fiduciary duty is effectively limited to a claim for subordination of the proceeds receivable by USS from USSC pursuant to any plan of arrangement to the extent of any claim of the USW against USSC. The Milbournes' claim for "equitable subordination" in the context of their claims for breach of fiduciary duty is also effectively limited in the same manner.

[91] More generally, the USW suggests that, if successful, the equitable remedies in its favour could directly affect, among other things, the sale of the assets of USSC and any approval of a plan of arrangement in which USSC proposes to make any payment or give any credit to USS. As mentioned, it also suggests that the equitable remedies could disallow or subordinate some or all of the USS Claims, or set off some or all of the USS Claims against not only the USW claim but also the claims of the other creditors of USSC. I understand this submission to contemplate the operation of such remedies within the plan of arrangement rather than outside it.

[92] This concept of the remedies available to the USW is also inconsistent with the earlier determination in this Endorsement that the USW claims are not "Claims" against USSC to be dealt with in the Claims Process Order. Determination of the USW Claims under the CCAA process cannot obscure the difference in nature, and consequence, of inter-creditor claims and claims against USSC. In particular, determination of the inter-creditor claims under the CCAA proceedings does not have the result that any such claims, as so determined, will be applicable in

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respect of any plan of arrangement and compromise in the proceedings without express inclusion of such claims in the plan of arrangement by the debtor company and approval of all the stakeholders. Nor would any such determination affect or alter the amount of a creditor's claim that the creditor could bid in any sales process conducted in the CCAA proceedings.

[93] Third, similarly, inclusion of the determination of the USW's claims within the CCAA process does not imply, as the USW appears to assume, that such determination must be completed before the SARP process is completed or any plan of reorganization is approved. Clearly, resolution of such claims as quickly as possible is highly desirable as addressed further below. However, as inter-creditor claims, the timing of the determination of such claims is not tied to the timing of the various actions of USSC in formulating and proposing a plan of arrangement.

[94] Fourth, given the inherent jurisdiction of a court to control its own processes and the fact that the inter-creditor issues raised by the USW and the Milbournes are not to be determined within the process contemplated by the Claims Process Order, the Court also retains the authority to require, at a later date, that the claims of either or both of the USW and the Milbournes be continued in proceedings outside of the CCAA. Such a determination would be appropriate if, at such time, the Court is of the opinion that continuation of a process for determination of such claims within the CCAA proceeding no longer furthers the remedial purpose of the CCAA.

The Forum for Determination of the USW Subordination Claims

[95] I turn then to the issue of whether the USW oppression and breach of fiduciary claims against USS, as set out in the USW Objection, should be determined within these CCAA proceedings or in a separate action in the Superior Court outside of these proceedings. The comparable question regarding the Milbournes' Subordination Claims will be addressed in the next section.

[96] As set out above, there is little case law on the considerations which should inform the Court's decision. As a practical matter, the easiest answer would be to exclude the USW claims from the CCAA proceedings on the basis proposed by USS – that is, as inter-creditor claims they are not contemplated by the provisions of section 20 of the CCAA. Moreover, there is always the concern that, for strategic purposes, either or both of the USW or USS will seek to tie resolution of these claims to the completion of the SARP or the approval and implementation of a plan of arrangement notwithstanding the Court's determination, for the reasons above, that these are separate and unconnected issues.

[97] Nevertheless, I think there are good reasons in the particular circumstances of this case to order that determination of the USW Subordination Claims should proceed within the CCAA process. In reaching this conclusion, the guiding principle is whether, on balance, such an approach to the determination of the USW Subordination Claims would render a successful plan of arrangement more or less likely. In this regard, the following considerations are relevant.

[98] First, the circumstances giving rise to the USW Subordination Claims are unique in the context of a CCAA restructuring. USS is the predominant creditor of USSC. It has also controlled USSC since 2007. It is important to recognize that the USW position that USS must

bear the financial consequences for the circumstances in which USSC finds itself is honestly and forcefully asserted. Whether there is any legal merit in the specific claims that the USW asserts is not being determined at this time. Under certain scenarios, however, as a practical matter, a resolution of the legal viability of these claims as soon as possible could be an important factor in realising a successful plan of arrangement, insofar as USW support for any such plan is necessary.

[99] Second, as a related matter, it is possible that inclusion of the process for determination of the USW claims within the CCAA process will allow for a more expeditious process based on the dynamic of the related CCAA process. In any event, without in any way intending to cast aspersions on the motives of any of the parties that would be involved in the determination of the USW Subordination Claims, I think it is probable that the process of determining such claims outside the CCAA process would, as the Province suggests, involve protracted and more expensive litigation if any connection to the dynamic of the CCAA process is removed.

[100] Third, as a related matter, inclusion of the determination of the USW Subordination Claims within the CCAA process will permit consideration by a court on an expeditious basis of a certain number of threshold issues pertaining to the USW claims that have been raised by USS and USSC. In addition, the USW says it continues to be prepared to work co-operatively with USS and USSC to ensure that the USW Objection is resolved quickly and efficiently. To the extent it is possible within the CCAA proceedings to significantly advance identification of the factual basis upon which the USW Subordination Claims are asserted, and consideration of the legal merit of such claims, it is possible that the prospects for a negotiated arrangement among the parties would be furthered.

[101] Lastly, as mentioned, I am not persuaded that USS would be prejudiced, or that the USW would gain a tactical advantage, by inclusion of the USW Subordination Claims within the CCAA process, given the procedural approach to determination of those claims described above. In particular, I do not consider that USS would be prejudiced in respect of any of the four specific matters raised by it for the following reasons.

[102] First, inclusion of the claims within the CCAA process does not remove the need for the USW to assert claims based on recognized principles of law – in this case, oppressive behaviour under the *Canada Business Corporations Act* and breach of fiduciary duty under traditional principles of the law of equity as supplemented by applicable statutory provisions. The CCAA does not create or establish any new rights, or remove or affect, any existing defences of either of the parties. Accordingly, determination of the USW claims within the CCAA proceedings would still require the USW to establish that it had standing as a "complainant" under section 238 of the CBCA. Second, there is nothing in the procedures governing the conduct of CCAA proceedings that precludes a costs award in respect of inter-creditor claims in appropriate circumstances in the discretion of the court. Third, I am not persuaded that appeal rights from a determination of inter-creditor claims in a proceeding conducted within the CCAA proceedings should be subject to any different standard from that which would apply in respect of an appeal from a determination in a separate action. In particular, there is nothing in the CCAA that otherwise alters or narrows rights of appeal in the circumstances contemplated in this Endorsement. It is also important to note that the factors referred to by Blair J.A. in *Stelco* at para. 15 that result in leave being granted only sparingly in CCAA matters – the "real-time" dynamic and the

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discretionary character underlying many orders under the CCAA – would not be present in any meaningful way in respect of any determination under the CCAA proceedings of the USW Subordination Claims. Lastly, USS submits that the USW is positioning itself to seek a holdback or escrow arrangement within the CCAA proceedings without having to satisfy the requirements for pre-judgement relief. This concern is entirely speculative and premature. In any event, any such request would require an order of the Court in the exercise of its discretion. I do not think that the considerations that would govern the exercise of that discretion in CCAA proceedings would differ from the applicable considerations in respect of a request for such relief in a separate proceeding commenced in the Superior Court.

The Forum for Determination of the Milbournes' Subordination Claim

[103] The Milbournes also seek to have the Subordination Claim raised in the Milbourne Objection determined within the CCAA proceeding.

[104] The argument for doing so is not a strong one. It is far less clear that determination of the claim will further the remedial purpose of the CCAA proceeding of USSC. In particular, the Milbournes have no continuing relationship with USSC. Other things being equal, the Court would be inclined to require the Milbournes to commence a separate action in the Superior Court.

[105] However, the Subordination Claim of the Milbournes overlaps substantially with the Subordination Claims of the USW. In these circumstances, considerations of efficiency and the avoidance of a multiplicity of actions, with the possibility of conflicting judgments by different courts, argue for determination of all of these claims within the CCAA proceedings so long as the corresponding USW claim is also being determined within the CCAA proceeding. In my view, these latter considerations should be determinative in the present circumstances.

Conclusion

[106] The issues addressed in this Endorsement have been superceded by subsequent events. In particular, since the hearing of this motion, the parties have concentrated on the process for a determination of the debt re-characterization claims of the Province and the USW. Based on the foregoing, however, to the extent that at some stage in these CCAA proceedings, the USW and the Milbournes wish to have their Subordination Claims determined, I conclude that such claims can be determined within the CCAA proceedings pursuant to a process, other than the process contemplated by the Claims Process Order, to be established by the Court and reflecting the procedural considerations discussed herein.

Wilton-Siegel J.

Wilton-Siegel J.

Date: August 13, 2015

Schedule "A"

3. The Union's Objection is based on a number of grounds:

   (a) USS's secured claim is based on security interests effectively granted by USS to itself, at a time when there was no independent board of directors or advisors, for insufficient consideration, and in a manner which amounted to an improper preference and/or fraudulent conveyance;

   (b) a significant portion of USS's "debt" is really in the nature of equity an should be re-characterized as such. For instance:

      (i) much of the debt was incurred to acquire Stelco Inc.;

      (ii) USS completely controlled USSC;

      (iii) USS was the sole source of USSC's financing;

      (iv) USS provided commercially unreasonable interest and repayment terms;

      (v) USS had no reasonable expectation of repayment on the purported loans; and

      (vi) USSC was significantly undercapitalized throughout the years following its acquisition by USS;

   (c) USS has acted in a manner that is oppressive, unfairly prejudicial to, and unfairly disregards the interests of the Union's members in respect of all of USSC's obligations. USS has failed to:

      (i) comply with its obligations to the federal and provincial government to maintain and/or increase production levels;

      (ii) make good faith efforts to run USSC as a viable business, managed in Canada;

      (iii) maintain the viability of the USW pension plans; and

      (iv) avoid incurring debts which would give USS repayment priority over USSC's other creditors or which would seriously dilute any recovery by them on their claims;

   (d) USS has engaged in business practices which breached legally binding undertakings it provided to the Canadian government, and which undermined USSC's ability to meet its obligations to the employees, retirees and beneficiaries of the USW pension plans (collectively, the "Beneficiaries"). USS's conduct in this regard is in breach of fiduciary

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duties that it owed to the Beneficiaries by virtue of its role as administrator of the Pension Plans, including:

(i) failing to meet its undertakings to the Canadian government with respect to production and employment levels;

(ii) directing USSC's operations in a way which caused it to incur significant debts;

(iii) diverting production from Canadian facilities to its American facilities; and

(iv) locking out the Union's members in order to slow down Canadian production rather than for genuine labour relations purposes.

4. USS controlled USSC to further its own interests, to the detriment of USSC's business, its employees, pensioners, and other stakeholders. This conduct directly affects the validity of many or all of USS's claims. It would be inequitable to allow USS's claims in these circumstances, at the expense of USSC's other creditors, and in particular the Union and Beneficiaries. Its claims should be disallowed in their entirety, reduced, or subordinated to the claims of the Union and the Beneficiaries.

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

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

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.

(each an "**Applicant**", and collectively, the "**Applicants**")

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

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