2004 CarswellOnt 1842
Ontario Superior Court of Justice [Commercial List]

Air Canada, Re

2004 CarswellOnt 1842, [2004] O.J. No. 1909, [2004] O.T.C. 1169, 130 A.C.W.S. (3d) 899, 2 C.B.R. (5th) 4

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

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

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

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

Farley J.

Heard: March 17, 2004
Judgment: April 5, 2004 *
Docket: 03-CL-4932

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S.R. Rickett for Bayerische Landesbank
David R. Wingfield, Kim Mullin for Tudor Investment Corp. & other Senior Financial Creditors
A. Kauffman for Ad Hoc Committee of various Financial Creditors

Subject: Insolvency

Related Abridgment Classifications

Bankruptcy and insolvency

XIX Companies' Creditors Arrangement Act
XIX.5 Miscellaneous

Headnote

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

Trade creditors of insolvent company and its subsidiaries brought motion for declaration that subordinated debtholders were not entitled to vote or to receive any distribution until claims of all unsecured creditors, including those whose claims were in respect of "borrowed money", had been paid in full and for declaration that any entitlement of subordinated debtholders must be distributed to all unsecured creditors pro rata in relation to their

proven claims — Motion dismissed — Trade creditors did not bargain or pay for any benefit or advantage in respect of subordinated debt nor were they parties to any agreements with respect to that debt — Trade creditors were not designated as third party beneficiaries — It is not appropriate simply to take subordinating creditor out of class to which it belongs and put it in class ranking immediately behind holder of subordination right — Creditors in same class as subordinating creditor should not receive benefit of subordination agreement to which they are not party and on which they are not entitled to rely — There was no problem with subordinated debt being selectively subordinated to senior indebtedness; however, this subordination to "borrowed money" did not result in subordinated debt being subordinated to all unsecured debt, senior indebtedness and non-senior indebtedness alike — Fact that there was subordination did not take away from right to vote by subordinated debtholders.

Table of Authorities

Cases considered by *Farley J.*:

Alternative Fuel Systems Inc., Re (2004), 2004 ABCA 31, 2004 CarswellAlta 64, 24 Alta. L.R. (4th) 1, 47 C.B.R. (4th) 1, 236 D.L.R. (4th) 155 (Alta. C.A.) — referred to

Bank of Montreal v. Dynex Petroleum Ltd. (1997), 1997 CarswellAlta 209, 50 Alta. L.R. (3d) 44, [1997] 6 W.W.R. 104, 31 B.L.R. (2d) 44, 46 C.B.R. (3d) 36, 145 D.L.R. (4th) 499, 202 A.R. 331, 12 P.P.S.A.C. (2d) 183 (Alta. Q.B.) — referred to

Bank of Montreal v. Dynex Petroleum Ltd. (1999), 182 D.L.R. (4th) 640, 1999 CarswellAlta 1271, 74 Alta. L.R. (3d) 219, [2000] 2 W.W.R. 693, 2 B.L.R. (3d) 58, 15 C.B.R. (4th) 5, 15 P.P.S.A.C. (2d) 179, (sub nom. *Bank of Montreal v. Enchant Resources Ltd.*) 255 A.R. 116, (sub nom. *Bank of Montreal v. Enchant Resources Ltd.*) 220 W.A.C. 116, 1999 ABCA 363 (Alta. C.A.) — referred to

Canada Deposit Insurance Corp. v. Canadian Commercial Bank (December 15, 1993), Wachowich J. (Alta. Q.B.) — considered

Gingras automobile Ltée, Re (1962), [1962] S.C.R. 676, 34 D.L.R. (2d) 751, 4 C.B.R. (N.S.) 123, 1962 CarswellQue 27 (S.C.C.) — distinguished

Menegon v. Philip Services Corp. (1999), 1999 CarswellOnt 3240, 11 C.B.R. (4th) 262, 39 C.P.C. (4th) 287 (Ont. S.C.J. [Commercial List]) — referred to

Rico Enterprises Ltd., Re (1994), 24 C.B.R. (3d) 309, 92 B.C.L.R. (2d) 67, 1994 CarswellBC 608 (B.C. S.C. [In Chambers]) — considered

Sammi Atlas Inc., Re (1998), 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]) — referred to

Uniforêt inc., Re (2003), 43 C.B.R. (4th) 254, 2003 CarswellQue 3404, 2003 CarswellQue 1936 (C.S. Que.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 141 — considered

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

MOTION by trade creditors for declaration that subordinated debtholders were not entitled to vote or receive any distribution until claims of all unsecured creditors were paid in full and for declaration that entitlement of subordinated debtholders be distrubuted to unsecured creditors pro rata in relation to their proven claims.

***Farley J.*:**

1 Canadian Imperial Bank of Commerce, Greater Toronto Airports Authority, Airbus, Cara Operations Limited and IBM Canada Limited (collectively "Trade Creditors") moved:

(A) for a declaration that the holders of Subordinated Perpetual Debt

(a) 5 3/4 % Subordinated Bonds 1986ff (Swiss fr 200,000,000);

(b) 6 1/4% Subordinated Bonds 1986ff (Swiss fr 300,000,000);

(c) 6 3/8% Interest-Adjustable Subordinated Bonds 1987ff (DM 200,000,000);

(d) Subordinated Loan Agreement (Yen 20,000,000,000); and

(e) Subordinated Loan Agreement (Yen 40,000,000,000)

(collectively "SP Debt") are not entitled to vote or receive any dividend or other distribution from Air Canada unless and until the claims of all unsecured creditors, including those whose claims are in respect of borrowed money, have been paid in full;

(B) a declaration that any entitlement of holders of [SP Debt] must be distributed not to such holders but to all unsecured creditors *pro rata* in relation to their proven claim; and

(C) such further and other relief as this Honourable Court deems just.

2 Air Canada ("AC") moved for an order authorizing it and its subsidiary Applicants under these CCAA proceedings "to incorporate the terms of the settlement reached between certain holders of [AC's] Senior Debt and certain holders of [AC's SP Debt] in the Applicants' plan of compromise or arrangement, to be filed (the "Plan")". This settlement was described by AC as follows at item 5 of the grounds:

5. Negotiations subsequently took place and an agreement has been executed between certain holders of Senior Debt and certain holders of [SP Debt] pursuant to which:

(a) Holders of [SP Debt] shall not be included in a separate class, but rather shall be included in a general class of unsecured creditors;

(b) Notwithstanding the treatment of holders of [SP Debt] as herein proposed, each creditor holding [SP Debt] shall be entitled to vote the face value of its claim in the same manner as all other unsecured creditors;

(c) The holders of [SP Debt] shall be entitled to a distribution under the Plan which provides to them, in the aggregate, on a *pro rata* basis, twenty-six percent (26%) of the aggregate distribution which would otherwise be made to them if they were not subordinated to Senior Debt;

(d) Seventy-four percent (74%) of the aggregate distribution which would otherwise be made to the holders of [SP Debt] if they were not subordinated to Senior Debt, shall be distributed, on a *pro rata* basis, to the holders of Senior Debt, in addition to all other distributions to which they are entitled as unsecured creditors under the Plan;

(e) For certainty, a party entitled to a distribution in accordance with the foregoing shall be entitled to receive a corresponding portion of all direct or indirect benefits which may accrue to or be enjoyed by unsecured creditors pursuant to any rights offering, over-subscription mechanism or otherwise; and

(f) The mechanism described above shall allow for the distributions set forth above to occur without the necessity of the holders of Senior Debt or Air Canada enforcing the subordination covenants directly against the holders of [SP Debt].

3 Certain investors ("DM Bondholders") who hold or represent the beneficial holders of approximately 26 million DM of the Deutsche Mark Bonds ("DM Bonds") asserted that since there was no winding-up, liquidation or dissolution of AC, then the subordination of the DM Bonds was not triggered. They relied on the fact that s. 8(2) of the terms of the DM Bonds reads as follows:

S. 8(2) Upon any winding-up, liquidation or dissolution of the Borrower, whether in bankruptcy, insolvency, receivership or other proceedings including special Act of Parliament or upon an assignment for the benefit of creditors or any other sequestering of the assets and liabilities of the Borrower or otherwise.

There is no reference to "reorganization" in addition to "winding-up, liquidation or dissolution" as is the case of the SF Bonds or the Yen Loan Agreements:

SF Bonds s. 7

Upon any distribution of assets of the Company (other than such as is referred to in Section 8(2) and in respect of which the Principal Paying Agent has not exercised its rights contained in Section 8(22) or upon any dissolution, winding up, liquidation or reorganization of the Company, whether in bankruptcy, insolvency, reorganization, receivership or other proceedings or upon any assignment for the benefit of creditors of any other sequestering of the assets and liabilities of the Company or otherwise,

Yen Loan Agreements para. 6.4.2

Upon any distribution of assets of the Borrower (other than such as is referred to in Clause 10(h) where the surviving company assumes all the obligations of the Borrower) upon any dissolution, winding up, liquidation or reorganization of the Borrower, whether in bankruptcy, insolvency, reorganization or receivership proceedings or upon an assignment for the benefit of creditors or any other sequestering of the assets and liabilities of the Borrower or otherwise in or upon any similar or analogous proceedings or event: -

No explanation was given for the difference in language so we are left in the dark as to whether it was intentional on a negotiated basis or simply inadvertent drafting.

4 Each of the SP Debt instruments contains subordination provisions. While all the provisions are not identical, they are substantially similar. The following are definitions from the November 14, 1989 Yen Loan Agreement:

"Indebtedness" - the principal, premium, if any, and unpaid interest (including interest accrued after the commencement of any reorganization or bankruptcy proceedings) or any indebtedness of the Borrower for borrowed money, whether by way of loan or evidenced by a bond, debenture, note or other evidence of indebtedness and whether secured or unsecured, including indebtedness for borrowed money of others guaranteed by the Borrower;

> "Senior Indebtedness" - means all Indebtedness, present or future, which is not expressly subordinated to or ranking *pari passu* with the Loan whether by operation of law or otherwise, in the event of a winding-up, liquidation or dissolution, whether voluntary or involuntary, whether by operation of Law or by reason of insolvency legislation;

5 The end result is that upon the happening of the relevant triggering event, the holders of the SP Debt have contractually agreed that they will be subordinated to Senior Indebtedness. The Trade Creditors assert that there will be untold difficulty in determining what is "borrowed money" as this is an undefined term. With respect, I disagree as not every term has to be defined in an agreement in order to determine its meaning and it would not appear to me to be all that difficult to draw the line if, as and when that becomes necessary.

6 The Trade Creditors also submit that as among the unsecured debt, as the unsecured SP Debt is subordinated to Senior Indebtedness (also unsecured), then the doctrine of subordination requires that the SP Debt be subordinated to all unsecured debt - (that is, not only the Senior Indebtedness but also all unsecured debt). They rely upon what they say is "a fundamental principle of Canadian insolvency law that, excepting only specifically enumerated preferred creditors, all unsecured creditors are entitled to *pro rata* distribution" and that this principle is reflected in s. 141 of the *Bankruptcy and Insolvency Act* ("BIA"):

> S.141 Subject to this Act, all claims proved in a bankruptcy shall be paid rateably.

However, this is a CCAA insolvency proceeding not a BIA one. The jurisprudence in CCAA proceedings is that any plans of arrangement are treated as contracts amongst the parties (including the minority voting against) and that the court in a sanction hearing will review the creditor approved plan to see if it is fair, reasonable and equitable, wherein equitable does not necessarily mean equal. See *Alternative Fuel Systems Inc., Re* (2004), 24 Alta. L.R. (4th) 1 (Alta. C.A.); *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]).

7 The Trade Creditors rely upon *Re Maxwell Communications Corporation PLC*, [1993] 1 W.L.R. 1402 where at pp. 1411-2 in approving the proposed distribution, Vinelott J. concluded that a bilateral subordination between a debtor and a creditor can be effective:

> The question is whether this underlying consideration of public policy should similarly invalidate an agreement between a debtor and a creditor postponing or subordinating the claim of the creditor to the claims of other unsecured creditors and preclude the waiver or subordination of the creditor's claim after the commencement of a bankruptcy or winding up. I do not think that it does. It seems to me plain that after the commencement of a bankruptcy or a winding up a creditor must be entitled to waive his debt just as he is entitled to decline to submit a proof.
>
> If the creditor can waive his right altogether I can see no reason why he should not waive his right to prove, save to the extent of any assets remaining after the debts of other unsecured creditors have been paid in full; . . .
>
> So also, if the creditor can waive his right to prove or agree the postponement of his debt after the commencement of the bankruptcy or winding up, I can see no reason why he should not agree with the debtor that his debt will not be payable or will be postponed or subordinated in the event of a bankruptcy or winding up.
>
> (emphasis by Trade Creditors)

However, I would caution that this quote must be taken in context; similarly for the second Vinelott J. quote. Then in reliance upon Vinelott J.'s views at p. 1416, the Trade Creditors submitted in their factum:

> 20. Accordingly, the Court gave effect to the bilateral subordination provisions as a waiver of the credit to its entitlement to receive any distribution until **all unsecured** creditor claims have been paid in full.

> 21. In giving effect to the subordination, the Court distinguished on the facts previous decisions of the English courts that had addressed arrangements that disturbed rateable distribution among unsecured creditors. The Court, however endorsed the fundamental principle that a debtor cannot validly contract with one unsecured creditor for any advantage denied to other unsecured creditors.

Vinelott J. stated at p. 1416:

> [If] the clearance arrangements had had the effect contended for by Air France they would clearly have put a member of the clearance arrangements in a position which would have been better than the position of other unsecured creditors. The arrangements would therefore unquestionably have infringed a fundamental principle of bankruptcy law, which is reflected in but not derived from section 302 or its predecessor, that a creditor cannot validly contract with his debtor that he will enjoy some advantage in a bankruptcy or winding-up which is denied to other creditors.
>
> In my judgment I am not compelled by the decisions of the House of Lords in the *Halesowen* and *British Eagle* cases, or by the decisions of the Court of Appeal in those cases or in *Rolls Razor Ltd. v. Cox*, [1967] 1 Q.B. 552, to conclude that a contract between a company and a creditor, providing for the debt due to the creditor to be subordinated in the insolvent winding up of the company to other unsecured debt, is rendered void by the insolvency legislation.
>
> (emphasis by Trade Creditors)

8 The Trade Creditors went on at paras. 23-24 of their factum:

> 23. However, also consistent with the decision of the English Court in *Maxwell* and cases enforcing the policy of rateable distribution among unsecured creditors which were accepted in *Maxwell*, such agreement cannot be enforced to provide an unsecured creditor (or any subset of unsecured creditors) an advantage in an insolvency proceeding which is denied to other unsecured creditors. Put simply, the [SP Debt] holders are free to waive claims if they choose, but neither they nor the debtor can direct that the resulting benefit shall be distributed preferentially to some unsecured creditors and not others.
>
> 24. Treating the holders of [SP Debt] as being subordinated to all unsecured creditors is consistent with key principles of Canadian insolvency law and with the terms of the subordination itself. Such holders should not be entitled to receive any dividend until creditors with "borrowed money" claims are paid in full. As claims arising from "borrowed money"; in the case, are unsecured claims, they are entitled to receive *pro rata* distributions under Air Canada's plan of arrangement with all other unsecured creditors and will be paid in full **only** when all other unsecured claims are paid in full.

9 With respect, I disagree. The Trade Creditors did not bargain or pay for any benefit or advantage in respect of the SP Debt nor are they parties to any agreements in respect thereto and it is important to observe that they have not been designated as third party beneficiaries (nor have they asserted that they were). The cases cited by the Trade Creditors would not appear to me to have much if any relevance to the situation in this case. *Ex parte MacKay* (1873), 8 Ch App 643 dealt with a situation where a creditor had bargained with the debtor for additional rights upon the bankruptcy of that debtor. *British Eagle International Airlines Ltd. v. Compagnie Nationale Air France*, [1975] 1 W.L.R. 780 (HL) involved the applicability of the laws of bankruptcy to the existence of mutual debts existing as of the date of bankruptcy. *Gingras automobile Ltée, Re* (1962), 34 D.L.R. (2d) 751 (S.C.C.) deals with the legal question of paramountcy. *Hamilton and others v. Law Debenture Trustee Ltd. and others*, [2001] 2 BCLC 159 (Ch Div); *Maxwell supra*; *Re British & Commonwealth Holdings PLC (No. 3)*, [1992] 1 WLR 672 (Ch Div) each dealt with instruments that had rights on their face that were subordinated to the rights of all other creditors.

10 Even within a bankruptcy context there is no impediment to a creditor agreeing to subordinate his claim to that of another creditor. See *Rico Enterprises Ltd., Re* (1994), 24 C.B.R. (3d) 309 (B.C. S.C. [In Chambers]) where Tysoe J. observed at pp. 322-3:

> . . . If one creditor subordinates its claim to the claim of another party without subordinating to other claims ranking in priority to the claim of the other party, it is my view that a distribution of the assets of the bankrupt debtor should be made as if there was no subordination except to the extent that the share of the distribution to which the subordinating creditor would otherwise be entitled should be paid to the party in whose favour the subordination was granted.
>
> It is not appropriate to simply take the subordinating creditor out of the class to which it belongs and put it in the class ranking immediately behind the holder of the subordination right. I say this for two reasons. First, the creditors in the same class as the subordinating creditor should not receive the benefit of a subordination agreement to which they are not a party and on which they are not entitled to rely. They would receive a windfall benefit by the removal of the subordinating creditor from their class in the event that there were insufficient monies to fully pay their class because the total indebtedness of the class would be reduced and the pro rata distribution would be increased. Second, if the parties to the subordination agreement turned their minds to it, they would inevitably agree that the subordinating creditor should receive its normal share of the distribution and give it to the party in whose favour the subordination was granted. The party receiving the subordination would agree because it would be paid a portion of a distribution to a higher class of creditor that it would not otherwise receive and the subordinating creditor would agree because it would not receive the money in either event.

See also *Bank of Montreal v. Dynex Petroleum Ltd.* (1997), 145 D.L.R. (4th) 499 (Alta. Q.B.) at p. 529; (reversed on appeal on other grounds [1999 CarswellAlta 1271 (Alta. C.A.)]); Roy Goode, *Legal Problems of Credit and Security*, 3rd ed. (Sweet & Maxwell: London, 2003) at p. 55. It would seem to me that a guide-lining principle should be that as discussed in A.R. Keay, *MacPherson's Law of Company Liquidation* (London; Sweet & Maxwell, 2001) at p. 717:

> However, they [the courts] would permit a liquidator to distribute according to an agreement made along the lines of the latter situation providing that to do so would not adversely affect any creditor not a party to the agreement, *i.e.*, creditors not involved in the subordination agreement would not receive less under that agreement than would have been received if distributions had been made on a *pari passu* basis.

See also J.L. Lopes, "Contractual Subordinations and Bankruptcy" (1980), 97 No. 3 *Banking Law Journal*, 204 at p. 206.

> At the conclusion of the bankruptcy proceedings, a dividend is allocated to all unsecured creditors, including the subordinated creditor, on a pro rata basis. The dividend allocated to the subordinated creditor is paid over to the senior creditor, to the extent of its claim, with the subordinated creditor retaining the remainder of the dividend if the senior creditor is paid in full.* This process neither affects the amount of claims against the debtor nor the dividend paid to unsecured creditors. (*See, e.g., *In re* Associated Gas & Elec. Co., 53 F. Supp. 107, 114 (S.D.N.Y. 1943).)

11 It seems to me that what should be looked at with respect to the settlement is the substance and not the form, although it does seem to me that it would be better for form to follow substance. In essence, what the settlement provides for (the settlement to provide some certainty of the result and therefore avoid the uncertainty of the claim by that the SP Debt subordination provision may not be effective vis-à-vis the Senior Indebtedness and the issue of whether the SP Debt would be entitled to a separate class with the possibility of a veto being exercised by this class against a plan of reorganization, otherwise acceptable to the other creditors) is that the SP Debt would receive its rateable share of "proceeds" under the proposed plan but as a result of the agreement between the adherents to the settlement, then the SP Debt adherents would transfer 74% of their proceeds to the benefit of the Senior Indebtedness and retain 26%. It would also appear that the same result could obtain with a partial assignment of SP Debt claims or a declaration of trust in favour of the Senior Indebtedness, with the *quid pro quo* being that there be no subordination as to the remaining 26% beneficially owned by the holders of the SP Debt.

12 There was no problem with this type of subordination arrangement in *Horne v. Chester & Fein Property Developments Pty Ltd. and Ors* (1986), 11 ACLR 485 (Vic SC) at pp. 489-90 where Southwell J. stated:

> In the speech of Viscount Dilhorne, there is a discussion of a number of authorities, of which "the weight of opinion expressed ... appears to me to be in favour of the conclusion that it is not possible to contract out of s 31". However, there, and, so far as I have seen in most other relevant cases, the term "contract out" is used in circumstances where the contract relied upon is one, the performance of which, upon later insolvency, would adversely affect other creditors who were not parties to the contract. Viscount Dilhorne referred with approval at 805 to *dicta* of Hallett J. in *Victoria Products Ltd. v. Tosh & Co. Ltd.* (1940), 165 L.T. 78 where His Honour said that "... an attempt to leave outside that process some particular item is one which should be regarded as against the policy of the insolvency laws ..."
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> Repeatedly, over the years, "the policy of the insolvency laws" has formed the basis of decision. That policy, as it appears to me, was never intended to alter the rights and obligations of parties freely entering into a contract, unless the performance of the contract would, upon insolvency, adversely affect the right of strangers to the contract. Authority for that proposition is to be found in *Ex parte Holthausen*; *Re Scheibler* (1874) LR 9 Ch App 722 at 726-7 (referred to by Lord Morris in his dissenting speech in *British Eagle* at 770-1).

13 In *Canada Deposit Insurance Corp. v. Canadian Commercial Bank* [(December 15, 1993), Wachowich J. (Alta. Q.B.)] (unreported decision of Wachowich J. CQBA released December 15, 1993), the governments of Canada and Alberta waived their Crown priority on insolvency in favour of all other unsecured creditors, reducing themselves to *pari passu* ranking. But the CDIC also waived any Crown priority that it may have arising from its status as an agent of the government of Canada and it also subordinated its claim in favour of some but not all of the other unsecured creditors (including trade creditors). As put by the Bayerische Landesbank group in their factum at para. 65:

> 65. Justice Wachowich correctly dismissed the objection made to him that the selective nature of the subordination offended the *pari passu* principle. He approved a distribution in which it was first determined what the ordinary shares of all unsecured creditors were and then the *pari passu* recovery by CDIC attributable to its claim was redirected to those creditors to whom CDIC (here, the [SP Debt] holders), the corresponding enhanced recovery went to those unsecured creditors who were intended to enjoy the benefit of the subordination covenant (here, holders of the Senior Indebtedness) and the effect on the other unsecured creditors (here, the trades) was neutral.

14 In the end result I do not see that there is any problem with the SP Debt being selectively subordinated to the Senior Indebtedness. This subordination to that "borrowed money" does not result in the SP Debt being subordinated to all the unsecured debt, Senior Indebtedness and non-Senior Indebtedness alike.

15 With respect to the right to vote, I do not see that the fact that there is a subordination takes away or detracts from the right to vote by holders of the SP Debt. See *Menegon v. Philip Services Corp.* (Ont. S.C.J. [Commercial List]) at paras. 38, 53. At para. 21 of *Uniforêt inc., Re*, [2003] Q.J. No. 9328 (C.S. Que.), Tingley J. stated:

> 21. For a plan of arrangement to succeed, an insolvent company must secure the approval of all classes of its creditors, even those who have subordinated their claims to all other creditors, as is the case with the debenture holders.

16 The Trade Creditors motion is dismissed.

17 The issue of whether the AC Applicants can incorporate the terms of the subject settlement or some equivalent thereof in a Plan to be proposed is in my view a matter for them to decide, but in general, I see no impediment to their doing so provided that they take into account all relevant factors.

18 That leaves the issue of the position of the DM Bonds in light of the fact that s. 8(2) of their Indenture does not refer to "reorganization" in the same way as the other issues of the SP Debt does. Again, one must look at this provision in context. Allow me to set out the provisions of s. 8(1)(2)(5) and (7):

8. Subordination and Status; Listing

(1) The payment of principal and interest on the Bonds and Coupons is hereby expressly subordinated, to the extent and in the manner hereinafter set forth, in right of payment to the prior payments in full of all Senior Indebtedness of the Borrower. The term "Senior Indebtedness" shall mean all indebtedness, present or future, which is not expressly subordinated to or ranking *pari passu* with the Bonds, whether by operation of law or otherwise, in the event of a winding-up, liquidation or dissolution, whether voluntary or involuntary, whether by operation of law or by reason of insolvency legislation. The term "Indebtedness" shall mean the principal, premium, if any, and unpaid interest (including interest accrued after the commencement of any reorganization or bankruptcy proceeding) on any indebtedness of the Borrower for borrowed money, whether evidence by a bond, debenture, note or other evidence of indebtedness whether secured or unsecured, including indebtedness for borrowed money of others guaranteed by the Borrower and including the Bonds and Coupons contemplated hereby.

(emphasis added)

(2) Upon any winding-up, liquidation or dissolution of the Borrower, whether in bankruptcy, insolvency, receivership or other proceedings including special Act of Parliament or upon an assignment for the benefit of creditors or any other sequestering of the assets and liabilities of the Borrower or otherwise,

(a) the holders of all Senior Indebtedness shall be entitled to receive payment in full of all sums on account of Senior Indebtedness (including payment of or provision for any unmatured, contingent or unliquidated Senior Indebtedness) before the holders of Bonds or Coupons are entitled to receive any payment of interest or principal; and

(b) any payment or distribution of assets of the Borrower of any kind or character, whether in cash, property or securities, to which the holder of Bonds or Coupons would be entitled except for the provisions of this § 8 shall be paid by the liquidation trustee or agent or other person making such payment or distribution, whether a trustee in bankruptcy, a receiver or liquidating trustee or otherwise, directly to the holders of Senior Indebtedness or their representative or representatives or to the trustee or trustees under any indenture under which any instrument evidencing any of such Senior Indebtedness may have been issued, rateably according to the aggregate amounts remaining unpaid on account of the principal of, premium, if any, and interest on the Senior Indebtedness, held or represented by each, to the extent necessary to make payment in full of all Senior Indebtedness remaining unpaid, after giving effect to any concurrent payment or distribution to the holders of such Senior Indebtedness; and

(c) subject to the payment in full of all due Senior Indebtedness holders of Bonds or Coupons shall be subrogated *pro rata* (based on respective amounts paid for the benefit of the holders of Senior Indebtedness) with the holder of other Indebtedness to the rights of the holders of Senior Indebtedness to receive payments or distributions of cash, property or securities of the Borrower applicable to Senior Indebtedness until the Bonds and Coupons shall be paid in full and no such payments or distributions to the holders of Bonds or Coupons of cash, property or securities otherwise distributable to the holders of Senior Indebtedness shall, as between the Borrower, its creditors other than the holders of Senior Indebtedness, and the holders of Bonds or Coupons be deemed to be a payment by the Borrower to the holders of Bonds or Coupons, or for their account. It is understood that the provisions of this § 8 are and are intended solely for the purpose of defining the relative rights of the holders of Bonds or Coupons and the holders of other *pari passu* Indebtedness, on the one hand, and the holders of Senior Indebtedness, on the other hand.

(5) No payment by the Borrower on the Bonds or Coupons (whether upon redemption or repurchase, or otherwise) shall be made if, at the due time o f such payment or immediately after giving effect thereto, (a) there

> shall exist a default in the payment of principal, premium, if any, sinking fund or interest with respect to any Senior Indebtedness, or (b) there shall have occurred an event of default (other than a default in the payment of principal, premium, if any, sinking fund or interest) with respect to any Senior Indebtedness, as defined therein or in the instrument under which the same is outstanding, permitting the holders thereof or any trustee under any such instrument to accelerate the maturity thereof, and such event of default shall not have been cured or waived or shall not have ceased to exist (except payments made if the Bonds are redeemed or acquired prior to the happening of such default or event of default).
>
> (7) The Borrower undertakes vis-à-vis the Trustee for the benefit of the holders of Bonds and Coupons that until such time as the Bonds or Coupons have been completely repaid the Borrower will ensure that the Bonds rank and will rank *pari passu* with all unsecured and subordinated Indebtedness of the Borrower other than Indebtedness preferred by law.

19 It is not instantly obvious as to which provision "hereafter" refers to as there is no specific section reference in the same way as is specified in sections 1(2), 2(1), 3(1), 3(2), 9(3) and 10(3) of the DM Bond terms. It was posited by the Bayerische Landesbank group that "hereafter" may refer to (i) the remainder of s. 8(1); (ii) s. 8(2); (iii) the entire subsequent balance of s. 8; or (iv) the entire balance of the DM Bond terms. As the balance of s. 8(1) consists of definitions of "Senior Indebtedness" and "Indebtedness", this would speak to the "extent" of the subordination of the DM Bonds but would not address the manner in which they are subordinated.

20 Section 8 does contain a description of how distributions are to be applied as between holders of Senior Indebtedness and holders of the DM Bonds in the event of AC being wound-up, liquidated or dissolved and there is a distribution of its assets. Thus s. 8(2) can be read as addressing the "manner" of the subordination in those particular circumstances of such a winding-up, liquidation or dissolution. However is s. 8(2) the exclusive trigger in respect of subordination? It should be kept in mind that there is no "magic words or formula" to invoke a subordination. As well, as indicated above, there are other references to specific provisions of the terms so as to direct the reader to a specific spot. It should be observed that s. 8(2) is not the only provision in the balance of s. 8 which deals with the subject of subordination as s. 8(3), (4), (5), (6) and (7) contain additional procedural or other provisions addressing in some sense the "manner" of subordination. Is there a conflict with s. 8(5) or (7) if "hereafter" refers only to s. 8(1) and (2)?

21 Section 8(5) provides that the subordination of the DM Bonds is effective if AC fails to make any payment to any holder of the Senior Indebtedness, when due, without any reference to whether or not this default in timely payment gives rise to, or occurs in the course of, any form of insolvency proceedings. There has been a default in the payment of interest due on the Senior Indebtedness since some time prior to the CCAA filing in April, 2003. The DM Bondholders assert that this default will be cured as it is expected that the amounts due on the Senior Indebtedness will be satisfied upon implementation of a Sanctioned Plan (and in this respect I note that there is no time limit for cure to take place contained in s. 8(5)). However this presupposes that the Plan mechanism would indeed cure the default. However in the context of s. 8(5), I do not see that such compromise of the right of holders of Senior Indebtedness to be paid acts as a cure which would otherwise inactivate the form of subordination which s. 8(5) provides. Thus it would seem to me that at the present time, the failure to pay amounts due on the Senior Indebtedness has caused a default which has triggered the subordination provisions of s. 8(5). This trigger aspect is not dependent upon there being a "reorganization".

22 Section 8(7) provides that the DM Bonds are to rank *pari passu* with all unsecured subordination Indebtedness of AC which would include the other issues of SP Debt. If the DM Bonds were not to rank equally with the rest of the SP Debt, then s. 8(7) would be rendered meaningless.

23 It therefore seems to me that the DM Bonds are to be treated at this time as SP Debt which is to be treated in the same way as the other issues of SP Debt which are all presently subordinated to the Senior Indebtedness.

24 Orders to issue accordingly.

Motion dismissed.

Footnotes

* A corrigendum issued by the court on June 18, 2004 has been incorporated herein.