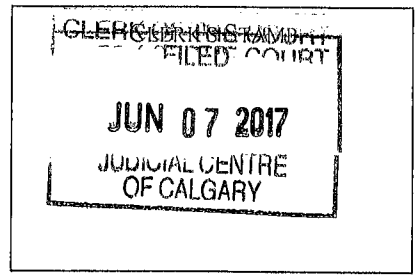

COURT FILE NUMBER	1601-11552
COURT	COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL CENTRE	CALGARY
APPLICANT	NATIONAL BANK OF CANADA, IN ITS CAPACITY AS ADMINISTRATIVE AGENT UNDER THAT CERTAIN AMENDED AND RESTATED CREDIT AGREEMENT DATED JANUARY 15, 2016, AS AMENDED
RESPONDENT	TWIN BUTTE ENERGY LTD.
DOCUMENT	**WRITTEN BRIEF OF ARGUMENT OF THE *AD HOC* COMMITTEE OF DEBENTURE HOLDERS**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	**BENNETT JONES LLP** Barristers and Solicitors 4500, 855 – 2nd Street S.W. Calgary, Alberta T2P 4K7 Attention: Chris Simard/Alexis Teasdale Tel No.: 403-298-4485/3067 Fax No.: 403-265-7219 Client File No. 76739.1

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I. INTRODUCTION

A. The *Ad Hoc* Committee

1. The largest group of creditors of Twin Butte Energy Ltd. ("**Twin Butte**") are the holders of the Twin Butte 6.25% Convertible Unsecured Subordinated Debentures due December 31, 2018 (the "**Debentures**"). The principal amount outstanding under the Debentures (exclusive of interest) is $85,000,000 and the Debenture holders' claims comprise approximately 85% of the total filed unsecured claims against Twin Butte that FTI Consulting Canada Inc., the Receiver of Twin Butte (the "**Receiver**") has either accepted or are under review as at June 6, 2017 (*i.e.* excluding unsecured claims that the Receiver intended to disallow as at that date).

2. This Brief of Argument is being submitted by an *Ad Hoc* Committee of Debenture holders, who hold or represent holders of approximately 24% of the Debentures (the "***Ad Hoc* Committee**"). The *Ad Hoc* Committee is concurrently filing an application, returnable on June 30, 2017, in which the *Ad Hoc* Committee seeks an Order declaring that all proven unsecured claims against Twin Butte should be paid *pari passu* and that the claims of the Debentureholders should not be subordinated to the claims of other unsecured creditors.

3. In the April 27, 2017 Claims Procedure Order granted by Madam Justice Horner, the *Ad Hoc* Committee was granted certain consultation rights in the Claims Procedure. It has the right to receive notice of material claims (claims > $75,000), receive notice of the determination of those claims by the Receiver, and take issue with the Receiver's determination of such claims in a court application.

B. The *Ad Hoc* Committee's Application

4. The *Ad Hoc* Committee submits that the central issue in this application is the *pro rata* or *pari passu* sharing principle. It is a fundamental principle of Canadian insolvency law that all proven claims are to be paid ratably (sometimes referred to as "*pro rata*" or "*pari passu*"). This fundamental principle is enshrined in Section 141 of the *Bankruptcy and Insolvency Act* (the "**BIA**").[1]

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[1] *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3, as amended [TAB 1]

5. Subordinating the proven claim of one creditor to the proven claim of another creditor, is contrary to this fundamental principle. For this reason, subordination is a harsh and extreme remedy that the courts will only impose with great caution. As will be argued in greater detail below, this has resulted in courts only enforcing subordination agreements where the intention to subordinate and the wording used to give effect to such subordination is clear and unambiguous. As such, there is a very high onus of proof on creditors who seek to gain priority for their own claims by subordinating the claims of other creditors.

6. The Indenture entered into between Twin Butte and Valiant Trust Company ("**Valiant**") with respect to the Debentures (the "**Indenture**") contains subordination language in Article 5 (the "**Subordination Provisions**"), providing for the **potential** subordination of the Debentures to what is defined in the Indenture as "Senior Indebtedness".[2] Given that the Receiver holds insufficient funds to repay all unsecured creditors in full, it is anticipated that certain unsecured creditors may attempt to enforce the Subordination Provisions, to gain priority (and payment in full) for their own claims and to subordinate the claims of the Debenture holders.

7. However, for the reasons set out below in detail, any attempts by other creditors to gain priority for their claims over the Debenture holders' claims cannot be successful. One of the primary reasons this is the case, is that the Indenture contains a mechanism in Article 5.7 (the "**Priority Mechanism**") whereby creditors **could have** gained the right to enforce the Subordination Provisions, by requesting a simple priority agreement from Twin Butte, between Twin Butte, Valiant and the specified creditor, which would have provided that certain credit provided by the creditor was determined to qualify as "Senior Indebtedness" and that the creditor was entitled to enforce the Subordination Provisions. However, no creditors took advantage of this procedure. As such, no creditors can enforce the Subordination Provisions.

8. This result is both legally correct, and commercially reasonable. Legally, such a result complies with the *pro rata* principle and is in keeping with the courts' consistent approach, that subordination will not be imposed lightly. It also accords with the commercial purpose of subordination agreements, including the commercial intention apparent in the Subordination

[2] A complete copy of the Indenture is attached as an Appendix to the Eighth Report of FTI Consulting (Canada) Inc., the Court-appointed Receiver of Twin Butte (the "**Receiver**" and the "**Eighth Report**"). Additionally, the provisions of the Indenture referred to in this Brief of Argument, including the entirety of Article 5, the Subordination Provisions, are included as Schedule "A" to this Brief of Argument.

Provisions in the Indenture. The commercial purpose for a debtor like Twin Butte to issue Debentures with a subordination feature, is the potential enhancement of Twin Butte's ability to subsequently obtain credit from other parties. The existence of the Priority Mechanism in the Indenture, which allowed other credit providers to obtain the right to enforce the Subordination Provisions and thereby gain priority over the Debentures, provided a potential benefit to Twin Butte by allowing it to obtain access to additional credit to which it might not otherwise have had access. In other words, the Priority Mechanism operated as an incentive to entice other parties to provide credit to Twin Butte that they would not otherwise have provided.

9. The Receiver has confirmed to the *Ad Hoc* Committee (and has advised that it will confirm to the Court) that no party entered into a priority/subordination agreement with Twin Butte. In other words, no creditor utilized the Priority Mechanism in the Indenture. It logically follows that Twin Butte did not benefit from the Subordination Provisions by obtaining any credit that it would otherwise not have been able to obtain. Given the lack of evidence that any creditors of Twin Butte relied on the Subordination Provisions to provide additional credit to Twin Butte, there is no injustice in applying the strict law of privity of contract and denying other creditors the right to enforce the Subordination Provisions in the Indenture (to which those other creditors are not parties).

10. The commercial rationale for the Subordination Provisions set out above is also corroborated by the manner in which "Senior Indebtedness" is defined in the Indenture. As will be argued below in detail, that definition only includes claims by the types of parties who would voluntarily provide loans, critical goods or services to Twin Butte. In other words, they are the types of parties who might consider, in deciding whether to voluntarily extend or increase credit to Twin Butte, whether they would choose to take advantage of the Subordination Provisions in making their credit-granting decision.

11. There are also equitable considerations in this case. While it is currently not known precisely what recovery will be received by the unsecured creditors of Twin Butte, the Receiver has previously characterized that recovery as "substantial". Thus, unsecured creditors will receive a distribution that is probably greater than the typical recovery of unsecured creditors in court-supervised receivership proceedings. However, it will not be a full recovery. The issue of

whether to subordinate certain unsecured claims to other unsecured claims is a (potential) dispute as **between creditors**. There is no equitable basis in this case to subordinate the proven claims of certain unsecured creditors to those of other unsecured creditors. That is especially so where creditors could have given effect to such subordination by utilizing the Priority Mechanism, but did not.

II. FACTS

12. The *Ad Hoc* Committee understands that the Receiver will be issuing an Eighth Report in connection with this application, which will set out the relevant facts. Those facts can be summarized as follows.

13. The Receiver closed the sale of substantially all of the assets of Twin Butte to West Lake Energy Corp. on March 30, 2017.[3]

14. The Claims Bar Date under the Claims Procedure approved by this Court on April 27, 2017 (the "**Claims Procedure**") was June 1, 2017 (the "**Claims Bar Date**"). The claims filed prior to the Claims Bar Date can be summarized as follows:

(a) secured or trust claims were submitted in the aggregate amount of $1,790,252; and

(b) unsecured claims were submitted in the aggregate amount of $119,952,692. Of that aggregate amount of unsecured claims, $92,671,925 comprise the claims of Debenture holders.

15. The Amended Proof of Claim filed by Computershare Trust Company of Canada ("**Computershare**"), Valiant's successor as Trustee under the Indenture, is also attached as an Appendix to the Eighth Report. Valiant has submitted two different claims on behalf of the Debenture holders in its Amended Proof of Claim: a claim for the debt and accrued interest owing under the Debentures (the "**Debenture Debt Claim**"), and a claim based on Article 2.4(j) of the Indenture (the "**Debenture Damages Claim**").[4] Under Article 2.4(j) of the Indenture (as discussed in greater detail below), Twin Butte was obligated to purchase the Debentures within

[3] Sixth Report of the Receiver, at para. 16
[4] Indenture at Article 1.1, attached as an Appendix to the Eighth Report

30 days of a "Change of Control" (as defined in the Indenture) occurring. The sale of Twin Butte's assets by the Receiver on March 30, 2017 was a Change of Control. Twin Butte did not purchase the Debentures thereafter and its breach of that obligation gives rise to the Debenture Damages Claim.

16. The Subordination Provisions appear in Article 5 of the Indenture. As noted above, Article 5 has been reproduced in its entirety in Schedule "A" to this Written Brief of Argument.

III. ISSUE

17. The sole issue for determination on this application is whether the Receiver should distribute the proceeds of realization to all unsecured creditors (including the Debenture holders) *pari passu*, or whether any unsecured creditors can enforce the Subordination Provisions in the Indenture, to obtain a distribution from the Receiver in priority over the distribution to the Debenture holders.

IV. ANALYSIS

A. The Role of the Receiver on this Application and Notice of the Application to all Potentially Affected Creditors

18. The issue of whether all unsecured creditors should be paid *pari passu* or whether some creditors should be able to enforce the Subordination Provisions is a potential dispute between two groups of unsecured creditors of Twin Butte. The Receiver, an officer of this Honourable Court, is prevented from advocating for the interest of one group of creditors and against the interest of another group of creditors. Court-appointed receivers cannot favour the interest of one creditor over the interest of another creditor[5] but instead have a duty to represent impartially the interests of all creditors, and are obliged to act even-handedly and avoid any real or perceived conflict of interest.[6] Court-appointed Receivers owe fiduciary duties to all creditors.[7]

19. Because the Receiver cannot take part in this inter-creditor dispute, the *Ad Hoc* Committee has taken the extraordinary step, with the assistance of the Receiver, of providing extremely lengthy notice of both its application and its detailed legal position (in this Brief of

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[5] *Canadian Commercial Bank v. Simmons Drilling Ltd.*, 1989 CarswellSask 48 (CA) at para. 26 **[TAB 2]**
[6] *Re YBM Magnex International Inc.*, 2000 CarswellAlta 1068 (QB) at para. 34 **[TAB 3]**
[7] *Toronto Dominion Bank v Crosswinds Golf & Country Club Ltd.* 2002 CarswellOnt 1149 (CA) at para. 15 **[TAB 4]**

Argument), to all creditors who have filed proofs of claim. While the Alberta *Rules of Court* only require five days' notice of a chambers application, the *Ad Hoc* Committee has filed its application and this Brief of Argument many weeks prior to the scheduled hearing date. The Receiver has provided to the *Ad Hoc* Committee the email addresses (where available) or mailing addresses of all creditors who have filed proofs of claim and who are therefore potentially impacted by this application. The *Ad Hoc* Committee has served all those creditors with its application, proposed form of Order and this Brief of Argument.

20. In this way, the *Ad Hoc* Committee has ensured that all potentially affected creditors will have ample notice of this application and the opportunity to fully take part in the application, if they wish to do so.

21. In the Eighth Report, the Receiver has advised the Court that it will seek advice and directions with respect to its ability to advocate for one position or another in this inter-creditor issue. The *Ad Hoc* Committee notes, and objects to, the fact that the Receiver already appears to be advocating a position contrary to the interests of Debenture holders and in favour of other creditors, by:

(a) selectively excerpting in the Eighth Report some but not all passages from the Indenture and other documents that touch on the subordination issue; and

(b) selectively emphasizing certain passages in those excerpts;

with the apparent intent of countering the arguments advanced by the *Ad Hoc* Committee. At the hearing of this application, the *Ad Hoc* Committee will argue that such intervention in this potential inter-creditor dispute is impermissible for a Court officer.

B. The *Ad Hoc* Committee's Primary Position – No Unsecured Creditor is Entitled to Priority over the Debenture Holders

22. For the reasons set out below, the *Ad Hoc* Committee submits that no unsecured creditor is entitled to enforce the Subordination Provisions against the Debenture holders. As such, the Receiver should be directed to make a distribution to all unsecured creditors on a *pari passu* basis.

1. The Proper Approach to the Interpretation of Contracts such as the Indenture

23. The legal principles governing the interpretation of written contracts are well-settled:

(a) the purpose of construing a written agreement is to discover and give effect to the real intentions of the parties;

(b) contracting parties are presumed to have intended what they have said in their agreement;

(c) if possible, the parties' intentions are to be found in the context of the agreement as a whole;

(d) contractual language must be given its plain and ordinary meaning, unless to do so would result in absurdity; and

(e) extrinsic evidence (or parol evidence) is inadmissible to contradict a clear written contract, including and particularly one with an "entire agreement" clause.[8]

24. The Supreme Court of Canada has recently confirmed these principles in *Sattva Capital Corp. v. Creston Moly Corp.*[9], stating that:

(a) the interpretation of contracts has evolved towards a practical, common sense approach not dominated by technical rules of construction, and that the overriding concern is to determine the intent of the parties and the scope of their understanding;[10]

(b) it is fundamental that courts must read contracts as a whole and give the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract;[11] and

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[8] *Paddon Hughes Development v Pancontinental Oil*, 1998 ABCA 333, 223 AR 180, leave to appeal to SCC denied, paras. 26 and 27 [**TAB 5**]; *Dow Chemical Canada Inc. v Shell Chemicals Canada Ltd.*, 2010 ABCA 126, 477 AR 112, leave to appeal to SCC denied, para. 20 [**TAB 6**]; *Galichowsky v. Shaw GMC Pontiac Buick Hummer Ltd.*, 2009 ABCA 390, 469 AR 156 para. 18 [**TAB 7**]

[9] *Creston Moly Corp. v. Sattva Capital Corp.*, 2014 SCC 53 [**TAB 8**]

[10] *Sattva, supra* at para. 47 [**TAB 8**]

[11] *Sattva, supra* at para. 47 [**TAB 8**]

(c) ascertaining contractual intention is difficult when looking at words on their own, as words alone do not have an immutable or absolute meaning. Thus, in a commercial contract, the Court should know the commercial purpose of the contract as well as the background, the context and the market in which the parties are operating.[12]

25. Following those principles, it is clear that when the words used in the Indenture are given their plain and ordinary meaning, the clear result is that no unsecured creditors of Twin Butte are entitled to enforce the Subordination Provisions.

2. The Courts Strictly Interpret Subordination Agreements

26. This Honourable Court addressed subordination agreements in *Bank of Montreal v. Dynex Petroleum Ltd.*[13] In that case, the Bank of Montreal had agreed to subordinate its secured debt to the holders of overriding royalties ("**ORRs**"). The debtor, Dynex, had become bankrupt and the Bank and the holders of ORRs were litigating various issues, including the effect of the subordination agreement. Justice Rooke made the point that "it is clear that the subordination must be clear and unequivocal...it being conceded that a vague and non-specific clause is not sufficient".[14]

27. Because the *Dynex* case dealt with the subordination of security interests, it was decided on the basis of the specific provisions of the *Personal Property Security Act* (Alberta) that expressly govern the enforceability of such subordination agreements (those statutory provisions are discussed in detail below). However, the *Ad Hoc* Committee submits that the principle that subordination will only be enforced in clear and unambiguous cases applies equally in cases of unsecured debt subordinations, like the present case. In fact, such considerations apply with even greater force in the case of unsecured claims, because of the lack of legislation providing for the enforcement of unsecured subordination agreements.

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[12] *Sattva, supra* at para. 47 [**TAB 8**]
[13] *Bank of Montreal v. Dynex Petroleum Ltd.*, [1997] 6 WWR 104 [**TAB 9**]
[14] *Dynex, supra* at para. 68 [**TAB 9**]

28. The Alberta Court of Appeal addressed the standard required to enforce a subordination agreement in *Chiips Inc. v. Skyview Hotels Ltd.*[15] In considering the enforceability of a subordination agreement involving secured debts, Justice Foisy stated as follows:[16]

> It would therefore appear, from the above cases, that the Ontario Court of Appeal and the Alberta Court of Queen's Bench accept that subordination clauses can be enforced against the prior security holder if the collateral in question is subject to that subordination (*International Harvester*) and **if the subsequent creditor is of the kind contemplated in the subordination clause** (*Transamerica*).
>
> Applying these cases here, it is my view that the clauses in the debenture are subordination clauses; the only questions remaining are whether the furniture was subject to the subordination, and whether Chiips was the kind of creditor that was contemplated by the clause. The furniture is certainly the subject of the floating charge rather than the fixed charge as indicated by cl. 4.01 which outlines the security taken by the debenture holders. Further, the subordination clauses in the debenture agreement are silent with respect to who the subsequent creditor might be; **if the debenture holders had intended to limit the granting of priority to a particular group of creditors, they should have outlined this limitation in the agreement.** As no such limitation exists it is open for this Court to find that the subordination clause may be enforceable by Chiips as against the debenture holders.
>
> The policy rationale for finding that the clauses in question should be enforceable by Chiips is one of commercial reality. **The whole purpose for including these kinds of clauses in security agreements is to "remove any obstacles the debtor might encounter in acquiring new collateral for the conduct of his business"** (see Ziegel, "The Scope of Section 66*a* of the OPPSA and Effects of Subordination Clause: *Euroclean Canada Inc v Forest Glade Investments Ltd*" (1984), 9 CBLJ 367, at p. 372). Clauses such as those in this case are intended to confer priority on purchase money security interests; without this clause the debtor would not be able to purchase goods on credit as the potential creditor would not be able to get any sort of security from the debtor.
>
> [emphasis added]

29. It is notable that Justice Foisy also confirmed in that case that the commercial purpose for subordination agreements is to allow debtors to obtain additional credit.

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[15] *Chiips Inc. v. Skyview Hotels Ltd.*, 1994 CarswellAlta 350 [TAB 10]
[16] *Chiips, supra* at paras. 26 - 28 [TAB 10]

30. Justice Harradence also commented in *Chiips* on the strict requirements for an enforceable subordination agreement, stating:[17]

> ***Euroclean* sets a very high standard for subordination clauses.** The wording of the *Euroclean* clause contains a very specific waiver of priority. The clause explicitly sets out that purchase charges "shall" rank in priority.
>
> It is understandable that the court found that this clause [in the *Sperry* decision] "falls far short" of an agreement to subordinate the bank's interest. This clause is very vague and does not at any point mention the terms "rank" or "priority".
>
> From the above cases [*Euroclean* and *Sperry*], the parameters are clear. **An explicit and specific waiver clearly gives rise to a valid subordination clause. A vague and non-specific clause is not to be construed as a subordination clause.** The question that arises is simply where on the continuum do the purported subordination clauses in the case at bar lie? [emphasis added]

31. Therefore, the Courts in this province have strongly endorsed the view that to enforce a subordination agreement requires proof on a very high standard and that the subordination clause must be clear and unambiguous. For the reasons set out below, the *Ad Hoc* Committee submits that the Indenture does not provide for subordination on this clear, unambiguous, strict standard.

32. The approach taken by the Courts regarding the strict requirements to establish subordination is similar to the way the Courts approach trust claims in insolvency. That is not surprising, given that trust claims, if proven, also have the effect of prioritizing the claim of one creditor over the claim of another creditor, and thereby upsetting the *pari passu* principle. As stated recently by Master Mason:[18]

> The onus of proving a constructive trust falls upon the claimant and, in a bankruptcy setting, is not lightly undertaken. The evidence must be clear and the standard of proof is high. Given that the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 provides a code by which legislators have balanced the interests of those adversely affected by the bankruptcy, the legal rights of creditors should not be defeated unless it would be unconscionable not to recognize a constructive trust: *McKinnon, Re* [citation omitted].

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[17] *Chiips, supra* at paras. 45, 48 – 49 **[TAB 10]**
[18] *Re Hoard*, 2014 ABQB 426 at paras. 23 – 24 **[TAB 11]**

> The remedy is discretionary and the authorities have expressed reservations as to the availability of a constructive trust where creditors and third party interests are affected: see for example, *McKinnon, Re*; *Melchior v Cable Estate* [citation omitted].

33. The Court in *Re Allan Realty of Guelph Ltd.* enunciated the same principle, that imperative and certain language is necessary to establish the existence of an express trust (or any trust) in insolvency situations:[19]

> ... first, the language of the alleged settlor must be **imperative**; secondly, the subject matter or trust property must be **certain**; thirdly, the objects of the trust must be **certain** ... the alleged settlor ... must employ language which **clearly** shows his intention that the recipient should hold on trust. ... If such **imperative language** exists, it must secondly be shown that the settlor has so **clearly** described the property which is to be subject to the trust that it can be **definitively** ascertained. Thirdly, the objects of the trust must be equally **clearly** delineated. **There must be no uncertainty** as to whether a person is, in fact, a beneficiary. If any one of these three certainties does not exist, the trust fails to come into existence or, to put it differently, is void. [emphasis added]

34. In finding that no express trust had been constituted by the relevant listing documents and agreements of purchase and sale used by the bankrupt brokerage or the applicable Real Estate Board Rules and Regulations, the Court in *Allan Realty* relied in part on the fact that there was "a complete absence of any language directly referable to anything in the nature of a trust", and held:[20]

> ... In reading the various documents and the rules and regulations, and in considering what effect should be given them, I have been mindful of the fact that, obviously, the rights and interests of selling brokers have been the subject of direct consideration by the draftsman. It is apparent that the documents and the rules and regulations have been prepared with legal advice and, no doubt, with consideration directly applied to the rights and interests to which I have just referred. Viewed in that light it is the more apparent, in my view, that nothing in the way of an express trust can be found. Had there been the intention to create a trust such as is now contended for, a trained legal draftsman would not have left it to be arrived at by vague inference. **That certainty or imperative language referred to by the authorities is, in my view, totally lacking.** These considerations also militate against a finding of constructive trust. [emphasis added]

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[19] *Allan Realty of Guelph Ltd, Re*, 1979 CarswellOnt 184, at para 28 **[TAB 12]**
[20] *Ibid.*, at paras 33, 36

3. Onus of Proof

35. In the CCAA proceedings of Stelco Inc.,[21] the Ontario Superior Court of Justice ruled on the onus that applies where creditors seek to enforce subordination agreements to which they are not a party.

36. Stelco had issued certain debentures pursuant to two trust indenture agreements that were beneficially owned by institutional holders and individuals (the "**Debentures**" and the "**Debentureholders**"). Stelco had also issued convertible unsecured subordinated debentures to certain noteholders pursuant to a trust indenture with CIBC Mellon Trust Company, which were held by other investors (the "**Notes**" and the "**Noteholders**"). In the Note Indenture, CIBC Mellon on behalf of the Noteholders had expressly agreed to subordinate their right of repayment to payment in full of "Senior Debt".

37. Stelco's CCAA Plan of Compromise and Arrangement was approved and the distributions payable to the Noteholders under the Plan (the "**Turnover Proceeds**") were delivered to the CCAA Monitor to be held in trust, pending resolution of the subordination issue.

38. Justice Wilton-Siegel addressed the issue of onus and stated as follows:

> I do not think it is possible, as the Debentureholders argue, to characterize their claims as a shield to prevent appropriation of assets by the Noteholders to which they are not entitled. While the circumstances of a debtor not enforcing subordination provisions directly may be novel, **there is no question that the onus in this proceeding rests with the Debentureholders to establish that they are entitled to enforce the Subordination Provisions**...[22] [emphasis added]

39. The same allocation of onus applies in this case. The fundamental principle of *pari passu* distribution governs these receivership proceedings, as it does all insolvency proceedings in Canada. The Subordination Provisions and the Priority Mechanism provided a possible method by which other creditors of Twin Butte could seek to enforce the Indenture, to which they are not parties, to gain priority for their own claims. If creditors wish to achieve this result, they have the onus of convincing the Court, on the high standard applicable to subordination agreements, why they should be entitled to enforce a contract to which they are not parties.

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[21] *Re Stelco Inc.*, 2006 CarswellOnt 4857 [**TAB 13**], affirmed for different reasons at 2007 ONCA 483 [**TAB 14**]
[22] *Stelco*, *supra* at para. 74 [**TAB 13**]

40. There is no injustice to those creditors in applying the standard of proof endorsed by this Honourable Court and the onus endorsed in *Stelco*. It is for this very reason that the *Ad Hoc* Committee has made certain to give ample notice of its application to all potentially affected creditors.

4. Privity of Contract – No Unsecured Creditor can Benefit from the Subordination Provisions in the Indenture Because They are Not Parties to the Indenture

(a) The Rule of Privity of Contract

41. In *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, [23] Justice Iacobucci for the majority of the Supreme Court of Canada stated:

> The doctrine of privity of contract has been stated by many different authorities sometimes with varying effect. Broadly speaking, it stands for the proposition that a contract cannot, as a general rule, confer rights or impose obligations arising under it on any person except the parties to it...It is now widely recognized that this doctrine has two very distinct components or aspects. On the one hand, it precludes parties to a contract from imposing liabilities or obligations on third parties. **On the other, it prevents third parties from obtaining rights or benefits under a contract; it refuses to recognize a *jus quaesitum tertio* or a *jus tertii*. This latter aspect has not only applied to deny complete strangers from enforcing contractual provisions but has also applied in cases where the contract attempts, either expressly or impliedly to confer benefits on a third party.** In other words, it has equally applied in cases involving third party beneficiaries.[24] [emphasis added]

42. The issue of privity is central in the case of subordination agreements such as the Indenture. As with most subordination agreements, the Indenture was entered into only between two parties: the debtor Twin Butte and Valiant, as representative of the Debentureholders. Other creditors who may wish to enforce the Subordination Provisions in the Indenture against the Debentureholders are not parties to the Indenture. Therefore, they must establish that they have a right to enforce an agreement to which they are not party, which brings them squarely up against the doctrine of privity of contract.

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[23] *London Drugs Ltd. v. Kuehne & Nagel International Ltd.*, 1992 CarswellBC 315 **[TAB 15]**
[24] *London Drugs*, *supra* at para. 201 **[TAB 15]**

(b) Legislation Respecting Privity and Subordination

43. Provincial Legislatures in Canada have enacted specific legislation to make subordination agreements related to **secured** debts enforceable by third parties who are not party to such subordination agreements. For example, in the *Personal Property Security Act* (Alberta), s. 40 states:[25]

> **Subordination of interest**
>
> 40 A secured party may, in a security agreement or otherwise, subordinate the secured party's security interest to any other interest, and the subordination is effective according to its terms between the parties and may be enforced by a third party if the third party is the person or one of a class of persons for whose benefit the subordination was intended.

44. Thus, the common-law privity of contract requirement, which prevents non-parties to agreements from enforcing those agreements, has been specifically overridden by legislation in the context of subordination of **secured** debts. Third parties are given a clear statutory right to enforce an agreement to which they are not privy, and which they could not enforce at common law, as long as they were intended to benefit from such subordination.

45. In contrast, Parliament has **not** enacted similar provisions regarding privity and the subordination of **unsecured** debts. Parliament has turned its mind to the postponement of other types of unsecured claims, in sections 137 through 141 of the BIA:[26]

> 137 (1) A creditor who, at any time before the bankruptcy of a debtor, entered into a transaction with the debtor and who was not at arm's length with the debtor at that time is not entitled to claim a dividend in respect of a claim arising out of that transaction until all claims of the other creditors have been satisfied, unless the transaction was in the opinion of the trustee or of the court a proper transaction.
>
> ...
>
> 139 Where a lender advances money to a borrower engaged or about to engage in trade or business under a contract with the borrower that the lender shall receive a rate of interest varying with the profits or shall receive a share of the profits arising from carrying on the trade or business, and the borrower subsequently becomes bankrupt, the lender of

[25] *Personal Property Security Act* (Alberta), RSA 2000, c. P-7 **[TAB 16]**. The other Provincial Legislatures have all enacted equivalent provisions in their respective PPSAs.
[26] *BIA*, *supra* **[TAB 1]**

> the money is not entitled to recover anything in respect of the loan until the claims of all other creditors of the borrower have been satisfied.
>
> 140 Where a corporation becomes bankrupt, no officer or director thereof is entitled to have his claim preferred as provided by section 136 in respect of wages, salary, commission or compensation for work done or services rendered to the corporation in any capacity.
>
> ...
>
> 141 Subject to this Act, all claims proved in a bankruptcy shall be paid rateably.

46. Thus, Parliament has chosen a different approach for **unsecured** debts than that followed by the provincial legislatures with respect to **secured** debts. Parliament has enshrined the *pro rata* principle in s. 141. It has also specified certain limited situations in which that principle will not apply, and instead where certain specified types of unsecured claims will be postponed (non-arm's length claims, silent partner's claims and equity claims). Notably, in contrast to the Provincial Legislatures, Parliament:

(a) has **not** legislated that unsecured debt subordination agreements are effective; and

(b) has **not** overridden the common-law rule of privity of contract by legislating that non-parties can enforce unsecured debt subordination agreements.

47. The maxim of statutory interpretation *expressio unius est exclusio alterius* ("to express one thing is to exclude another") is applicable in these circumstances. As explained in *Sullivan on the Construction of Statutes*:[27]

> [a]n implied exclusion argument lies whenever there is reason to believe that if the legislature had meant to include a particular thing within its legislation, it would have referred to that thing expressly. Because of this expectation, the legislature's failure to mention the thing becomes grounds for inferring that it was deliberately excluded. [...] The force of the implication depends on the strength and legitimacy of the expectation of express reference. The better the reason for anticipating express reference to a thing, the more telling the silence of the legislature.

[27] *Sullivan on the Construction of Statutes*, 6th ed. (LexisNexis Canada Inc.: Markham, 2014), at §§8.89, 8.90 **[TAB 17]**

48. As noted by the Federal Court of Appeal in applying this maxim, where a statute specifies one or more exceptions to a general rule, other exceptions are not to be read in, as a presumption is created that the silence is deliberate and reflects an intention to exclude items not mentioned, especially where the language of an act is precise and detailed, as it is in the BIA.[28] Parliament has created certain specific exceptions to the *pari passu* sharing rule, but has not included subordination agreements in those exceptions.

49. The "expectation of an express reference" in relation to unsecured debt subordination agreements is supported not only by the highly codified nature of the BIA and the exclusive jurisdiction of Parliament to legislate with respect to insolvency, but also by the decision of the Provincial Legislatures to codify a blanket exception to the doctrine of privity with respect to **secured** debt subordinations in personal property security legislation. Parliament's decision not to legislate an express exception to the *pari passu* rule for unsecured debt subordination agreements is telling, and must be taken to be deliberate.

50. Therefore, with respect to subordination agreements regarding unsecured debt, such as the Subordination Provisions in the Indenture, the privity of contract principle applies fully and is a bar to any third party creditors who seek to enforce subordination agreements entered into between debtors and subordinating creditors.

(c) Jurisprudence Respecting Privity and Subordination

51. The only Canadian insolvency decision that has considered the issue of privity of contract in the context of an unsecured debt subordination agreement in a reasoned manner is *Re Stelco Inc.*[29]

52. In that case, the Noteholders argued that because the Debentureholders were not parties to the Note Indenture, they had no privity of contract and could not enforce the subordination provisions in the Note Indenture. The Debentureholders argued that, despite their lack of privity, they were third party beneficiaries of the subordination provisions in the Note Indenture, and could therefore enforce the Note Indenture on that basis. The Ontario Court of Appeal found that the Debentureholders could enforce the Note Indenture, but only because the Note Indenture

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[28] *Canadian Private Copying Collective v Canadian Storage Media Alliance*, 2004 FCA 424, at paras 96-97 **[TAB 18]**
[29] *Stelco, supra* **[TAB 13]**

established a trust for the benefit of the Debentureholders. The Court based its decision on "the well-known proposition that parties to a contract can constitute one party a trustee for a third party of a right under the contract and thereby confer on the third party a right enforceable by it in equity."[30] Therefore, as beneficiaries of a trust expressly established under the Note Indenture, the Debentureholders were entitled to enforce their rights as beneficiaries, despite the fact that they were not parties to the Note Indenture.

53. The provision in the Note Indenture upon which the Ontario Court of Appeal based its decision expressly contemplated that in insolvency proceedings of Stelco, payments to the Noteholders would be "held in trust for the benefit of, and will be paid over" to the Debentureholders.[31] The entirety of the provision in the Stelco Note Indenture dealing with distributions on insolvency is set out in Schedule "B" to this Brief of Argument.

54. It is notable that the Indenture in this case contains no such trust provision in the provision addressing subordination and distributions in insolvency proceedings (see Article 5.2 of the Indenture, Schedule "A" to this Brief of Argument). As such, this case is factually distinguishable from *Re Stelco*.

55. The motions court whose decision had been appealed in *Re: Stelco* had purported to allow the Debentureholders to enforce the Note Indenture not on the basis of the trust provisions therein, but rather by applying a "relaxation" of the privity of contract rule. The Supreme Court of Canada had previously addressed the very limited situations in which the doctrine of privity contract could be relaxed, in *London Drugs*[32] and *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*[33]

56. In the *London Drugs* case, the appellant London Drugs had purchased a valuable transformer and stored it with the respondent Kuehne & Nagel. The contract between those parties limited Kuehne & Nagel's liability for losses to $40. Employees of Kuehne & Nagel damaged the transformer, and the quantum of the damages far exceeded $40. At trial, the Court limited London Drugs' judgment against Kuehne & Nagel to $40 but found the employees

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[30] *Stelco, supra* at para. 24 [**TAB 14**]
[31] *Stelco, supra* at para. 18, Article 6.2(3) of the Note Indenture [**TAB 14**]
[32] *London Drugs, supra* [**TAB 15**]
[33] *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, 1999 CarswellBC 1927 [**TAB 19**]

personally liable for the full extent of the (substantial) damages. On appeal, the employees argued that, although they were not parties to the contract between London Drugs and Kuehne & Nagel, they should be entitled to rely on the $40 limitation of liability in that contract. Iacobucci J. for the majority of the Supreme Court considered the history of the doctrine of privity of contract and whether the doctrine could be relaxed in the specific case before the Court. He stated as follows:[34]

> Without doubt, major reforms to the rule denying third parties the right to enforce contractual provisions made for their benefit must come from the legislature. Although I have strong reservations about the rigid retention of a doctrine that has undergone systematic and substantial attack, privity of contract is an established principle in the law of contracts and should not be discarded lightly. Simply to abolish the doctrine of privity or to ignore it, without more, would represent a major change to the common law involving complex and uncertain ramifications. This Court has in the past indicated an unwillingness to sanction judge-made changes of this magnitude:...

57. Ultimately, the majority of the Court endorsed a very limited relaxation of the doctrine of privity, limited to the specific circumstances of the case before it. Iacobucci J. stated for the majority:

> In the end, the narrow question before this Court is: in what circumstances should employees be entitled to benefit from a limitation of liability clause found in a contract between their employer and the plaintiff (customer)? Keeping in mind the comments made earlier and the circumstances of this appeal, I am of the view that employees may obtain such a benefit if the following requirements are satisfied:
>
> 1) the limitation of liability clause must, either expressly or impliedly, extend its benefit to the employees (or employee) seeking to rely on it; and
>
> 2) the employees (or employee) seeking the benefit of the limitation of liability clause must have been acting in the course of their employment *and* must have been performing the very services provided for in the contract between their employer and the plaintiff (customer) when the loss occurred.

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[34] *London Drugs, supra* at para. 238 **[TAB 15]**

> Although these requirements, if satisfied, permit a departure from the strict application of the doctrine of privity of contract, they represent an incremental change to the common law.[35]

58. Thus, the Supreme Court of Canada endorsed a very limited relaxation of the doctrine of privity, in the context of employee/employer relationships. The Court made very clear that only incremental and fact-specific changes can be made by the courts under the principled exception to the privity doctrine.[36]

59. In *Fraser River*, the Supreme Court dealt with the same issue again, in the context of a commercial/insurance dispute. Fraser River had chartered one of its vessels to Can-Dive and the vessel sunk while in Can-Dive's custody. Fraser River's insurer paid Fraser River for its loss and then an action was commenced against Can-Dive to advance the subrogated claim of the insurer. Can-Dive argued that it was entitled to enforce a waiver in the insurance policy that waived the insurer's subrogation rights against any charterers, despite the fact that Can-Dive was not a party to the insurance policy.

60. The Supreme Court considered the limited relaxation of the doctrine of privity previously enunciated in the *London Drugs* case, stating as follows:

> In order to distinguish mere strangers to a contract from those in the position of third-party beneficiaries, the Court first established a threshold requirement whereby the parties to the contract must have intended the relevant provision to confer a benefit on the third party. In other words, an employer and its customer may agree to extend, either expressly or by implication, the benefit of any limitation of liability clause to the employees. In the circumstances of *London Drugs*, the customer had full knowledge that the storage services contemplated by the contract would be provided not only by the employer, but by the employees as well. In the absence of any clear indication to the contrary, the Court held that the necessary intention to include coverage for the employees was implied in the terms of the agreement. The employees, therefore, as third-party beneficiaries, could seek to rely on the limitation clause to avoid liability for the loss to the customer's property.
>
> The Court further held, however, that the intention to extend the benefit of a contractual provision to the actions of a third-party beneficiary was irrelevant unless the actions in question came within the scope of

[35] *London Drugs*, *supra* at para. 258 **[TAB 15]**
[36] *London Drugs*, *supra* at para. 242 **[TAB 15]**

> agreement between the initial parties. Accordingly, the second aspect of the functional inquiry was whether the employees were acting in the course of their employment when the loss occurred, and whether in so acting they were performing the very services specified in the contract between their employer and its customer. Based on uncontested findings of fact, it was clear that the damage to the customer's transformer occurred when the employees were acting in the course of their employment to provide the very storage services specified in the contract.[37]

61. The Supreme Court made it clear in both *London Drugs* and *Fraser River* that privity could only be relaxed to provide a "shield" to defend the non-party from a claim being made against that non-party.[38]

62. In *Re Stelco*, the motions court appealed from had found that the Debentureholders could enforce the Note Indenture despite their status as non-parties, by applying the relaxation of privity doctrine from the *London Drugs* and *Fraser River* cases.[39] Notably, the claims of the Debentureholders were clearly included in the definition of Senior Debt in the Note Indenture, and this fact was actually conceded by the Noteholders. Also, the Debentureholders had purchased the Debentures from *Stelco* pursuant to formal written contracts. However, the Ontario Court of Appeal did not endorse the lower court's relaxation of the privity rule. As set out above, the Court of Appeal decided the case exclusively on the basis of the trust provisions in the Note Indenture. With respect to the motion judge's relaxation of the privity doctrine, the Court of Appeal said this:

> For the reasons that follow, we agree with the motion judge that while they are not parties to the Note Indenture between Stelco and the Noteholders, the Senior Debt Holders can rely on trust principles to provide an exception to the privity of contract doctrine, entitling them to enforce the Turnover Provisions in the Note Indenture that constitutes the Noteholders trustees of the Turnover Proceeds for the Senior Debt Holders once the Noteholders receive those Proceeds. It is therefore unnecessary for us to decide whether the trial judge erred in allowing the Senior Debt Holders to enforce the Indenture as third party beneficiaries by extending to this case the principled exception to privity of contract found in *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*[40] [citation omitted]

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[37] *Fraser River*, *supra* at paras. 28 – 29 **[TAB 19]**
[38] *London Drugs*, *supra* at para. 261 **[TAB 15]** and *Fraser River*, *supra* at para. 44 **[TAB 19]**
[39] *Stelco*, *supra* at paras. 72 – 76 **[TAB 13]**
[40] *Stelco*, *supra* at para. 16 **[TAB 14]**

63. The Alberta Courts have stringently upheld the rule that privity cannot be relaxed to allow it to be used as a sword rather than a shield. Mr. Justice Macleod affirmed this principle recently in *Liu v. Calgary Chinatown Development Foundation.*[41] There, the Plaintiffs were residential tenants in a building owned by the Calgary Chinatown Development Foundation ("**CCDF**"). CCDF had entered into an Operating Agreement with Canada Mortgage and Housing Corporation ("**CMHC**"), the mortgage lender on the building. The Operating Agreement contained various provisions regarding how the residential rental rates in the building were to be indexed to the income of the residential tenants. While the Operating Agreement stipulated that those indexing provisions would also be incorporated into the residential tenancy agreements with the tenants, that had not been done.

64. The residential tenant plaintiffs sought to enforce the provisions of the Operating Agreement regarding the indexing of their rental payments, despite the fact that they were not parties to the Operating Agreement.

65. Justice Macleod considered the doctrine of the relaxation of privity of contract, as set out in *Fraser River* and *London Drugs*, and stated as follows:[42]

> The Supreme Court has held that third party beneficiaries may enforce benefits conferred upon them in a contract to which they are not a party if:
>
> (a) the parties to the contract intended to extend the benefit in question to the third parties seeking to rely on the contractual provision; and
>
> (b) the activity performed by the third parties seeking to rely on the provision is the very activity contemplated as coming within the scope of the contract in general, or the provisions in particular, as determined by reference to the intention of the parties.
>
> On its face, the two-prongs of the test are met here.
>
> **Courts have imposed limits on the application of the exception. One of those is that it not be used as a sword; it may only be used as a shield.** That reasoning is rather awkward here because while on one hand the Appellants are the aggressors in the litigation, on the other hand what they seek to do is to prevent CCDF from charging higher rent.

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[41] *Liu v. Calgary Chinatown Development Foundation*, 2017 ABQB 149 [**TAB 20**]
[42] *Liu, supra* at paras. 28 – 32 [**TAB 20**]

> However, the appellate courts in our country are reluctant to disregard the doctrine of privity and they have made it clear that the exception should only be applied to avoid injustice: *London Drugs* at 446.
>
> The Appellants argue that this is a clear case where the benefits were intended to extend to the tenants who were renting subsidized accommodation in Bowside Manor. While that may be so, argues CCDF, the Operating Agreement does not provide for enforcement by the tenants and the remedy for failing to comply with the agreement is exercisable only by the parties to it.
>
> **At first blush, the Appellants have a strong argument that they should receive the benefit which was negotiated for them by CMHC. But upon a close examination of the facts of this case, the application of the doctrine of privity does not result in an injustice.** I say this for the following reasons:
>
> > 1. The Operating Agreement contemplates separate enforceable residential tenancy agreements which were indeed entered into. There is no evidence before me that the Appellants relied on the terms of the Operating Agreement prior to entering into their individual residential tenancy agreements. The Appellants did, however, rely on CMHC to perform its duty to monitor CCDF's activities and ensure that CCDF was offering subsidized housing.
> >
> > ...
>
> [emphasis added]

66. Similarly, in *Parwinn Developments Ltd. v. 375069 Alberta Ltd.*[43], this Honourable Court refused to apply the relaxation of privity doctrine where it would have been used as a sword rather than a shield.[44]

67. In summary, the only reasoned insolvency case in Canada that has allowed third party beneficiaries to enforce an unsecured debt subordination clause in an agreement to which they were not parties, is the Ontario Court of Appeal decision in *Re Stelco*. The Court relied on the existence of a trust provision in the Note Indenture that is not present in the Indenture in this case. Therefore, the Court of Appeal did not effect a subordination by recognizing that the Debentureholders had privity of contract, or by relaxing the privity rule. The Court simply applied the well-established rule that third party beneficiaries can enforce a trust agreement.

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[43] *Parwinn Developments Ltd. v. 375069 Alberta Ltd.*, 2000 ABQB 31 **[TAB 21]**
[44] *Parwinn, supra* at para. 33 **[TAB 21]**

This Honourable Court has consistently ruled that the relaxation of the privity doctrine cannot be applied in circumstances where it would be used as a sword rather than a shield. In this case, the application of the relaxation of privity doctrine would indeed amount to its use by unsecured creditors as a sword, to upset the *pro rata* sharing principle and subordinate the claims of the largest creditor group in this receivership, the Debenture holders. That result would be contrary to the applicable law, as set out above.

(d) Privity and the Priority Mechanism in the Indenture

68. As has been referred to above, there is an additional and very important distinguishing feature present in this case, namely Article 5.7 of the Indenture, the Priority Mechanism. Article 5.7 states:[45]

> **5.7 Confirmation of Subordination**
>
> Each holder of Debentures by his acceptance thereof authorizes and directs the Debenture Trustee on his behalf to take such action as may be necessary or appropriate to effect the subordination as provided in this Article 5 and appoints the Debenture Trustee his attorney-in-fact for any and all such purposes. This power of attorney, being coupled with an interest and rights, shall be irrevocable. Upon request of the Corporation, and upon being furnished with an Officer's Certificate stating that one or more named Persons are Senior Creditors, and specifying the maximum amount and nature of the Senior Indebtedness of such Senior Creditors, the Debenture Trustee shall enter into a written agreement or agreements, as the Senior Creditor may reasonably request, with the Corporation and the Person or Persons named in such Officer's Certificate providing that such Person or Persons are entitled to all the rights and benefits of this Article 5 as a Senior Creditor specified in such Officer's Certificate and in such agreement, which may include, among other things, an agreement not to amend the provisions of this Article 5 and the definitions herein without the consent of such Senior Creditor. Such agreement shall be conclusive evidence that the indebtedness specified therein is Senior Indebtedness. However, nothing herein shall impair the rights of any Senior Creditor who has not entered into such an agreement.

69. As noted above, there was no Priority Mechanism present in the Note Indenture in *Re Stelco* (or, if there was, it was not considered by either the Ontario Superior Court of Justice or the Ontario Court of Appeal).

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[45] Indenture at Article 5.7, Appendix to the Eighth Report

70. The Priority Mechanism demonstrates that the parties to the Indenture turned their minds to the question of privity and how third party creditors could gain an entitlement to enforce the Subordination Provisions. The key element in the Priority Mechanism is the phrase "to take such action as may be necessary or appropriate to **effect** the subordination as provided in this Article 5". The plain meaning of the phrase "to effect" is to do something to bring about a particular result. Webster's Third New International Dictionary defines "effect", in part, as "something that is produced by an agent or cause: something that follows immediately from an antecedent" and "to cause to come into being". "Effective" is defined, in part, as "capable of bringing about an effect : productive of results", and "taking effect".[46] Similarly, Black's Law Dictionary defines the words "effect" and "effective" (in part) as follows:[47]

> **effect**, *n.* ... **1.** Something produced by an agent or cause; a result, outcome, or consequence. ... .
>
> **effect**, ***vb.*** ... To bring about; to make happen ... .
>
> **effective**, *adj.* ... **1.** (Of a statute, order, contract, etc.) in operation at a given time ... .

71. Applying this plain meaning to the usage of "to effect" in Article 5.7 of the Indenture suggests that the phrase "to effect the subordination" was intended to mean that the subordination as provided in Article 5 does **not** operate **automatically**, rather it only operates if some condition or antecedent is first fulfilled or occurs in order to trigger the operation of the subordination. The only "thing" to be done in Article 5.7 is entering into a formal written agreement with a Senior Creditor, "providing that such Person or Persons are entitled to all the rights and benefits of this Article 5 as a Senior Creditor." It follows logically that if that thing is not done, the subordination in Article 5 will not operate with respect to that Senior Creditor.

72. This interpretation is consistent with jurisdictional interpretation of the word "effect" in contractual contexts. In *Pagliaroli v. Industrial Alliance Insurance and Financial Services Inc.*[48] the Ontario Superior Court considered the meaning of the phrase "take effect" in the context of an insurance policy. The Court held that the phrase "take effect" was synonymous with come "into force", and was interpreted to mean the date on which the policy came into force, in the

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[46] *Webster's Third New International Dictionary, sub verbo* "effect", "effective" [**TAB 22**]
[47] *Black's Law Dictionary*, 10th ed, *sub verbo* "effect", "effective" [**TAB 23**]
[48] *Pagliaroli v. Industrial Alliance Insurance and Financial Services Inc.*, 2012 ONSC 6862 at paras. 36 – 38 [**TAB 24**]

sense of when the insurer was at risk under the policy. The Court's decision turned on its determination of what conditions had to be fulfilled before the policy came "into force" (*i.e.* what antecedents had to occur to trigger the effectiveness of the policy).

73. Therefore, the *Ad Hoc* Committee submits that to give full effect to the plain and ordinary meaning of the word "effect" in Article 5.7 of the Indenture, the proper interpretation of the clause is that the Priority Mechanism provides a means by which non-party unsecured creditors could make the subordination **effective** for their benefit. It follows logically that if they chose not to take advantage of the Priority Mechanism, the subordination would **not be** made effective for their benefit.

74. It is also notable that the Priority Mechanism could have been invoked entirely at the unilateral insistence of a non-party creditor. In Article 5.7, the Debentureholders irrevocably directed Valiant to enter into a written agreement with Twin Butte and the non-party creditor, making the subordination effective. Neither Valiant nor Twin Butte had any discretion or ability to refuse, subject to Twin Butte being satisfied that the creditor qualified as a Senior Creditor and providing an officer's certificate to that effect to Valiant. If a non-party creditor invoked the Priority Mechanism and requested its benefit, Valiant and Twin Butte would have been obligated to comply with that request, subject to the requirements set out above.

75. The Priority Mechanism and the requirement that non-party creditors had to invoke it to be able to enforce the Subordination Provisions, not only gives effect to the plain and ordinary meaning of the words used in Article 5.7, but is also commercially reasonable and in keeping with the commercial purpose of the Subordination Provisions. As noted above, the commercial purpose of subordination agreements is to incentivize other creditors to extend credit, or more credit, to the debtor. If a creditor decided to extend credit to Twin Butte on the basis of the Subordination Provisions, it would have been a simple matter to invoke the Priority Mechanism to formalize and evidence that arrangement and also to confirm that such creditor in fact qualified as a Senior Creditor and the credit that they extended qualified as "Senior Indebtedness".

76. As noted above, the Receiver has confirmed to the *Ad Hoc* Committee (and has advised that it will confirm to the Court) that no party entered into a priority/subordination agreement

with Twin Butte. Therefore, no non-party creditors invoked the Priority Mechanism, as Twin Butte did not enter into any agreements with non-party creditors as contemplated in Article 5.7. Again, this provides further proof that no non-party creditors relied on the Subordination Provisions in the Indenture to provide credit or provide additional credit to Twin Butte. Therefore, no injustice will result from not enforcing the Subordination Provisions for the benefit of non-party creditors of Twin Butte.

77. Given the clear objective intention set out in Article 5.7 of the Indenture and given that no non-party creditors chose to avail themselves of the Priority Mechanism, it is not unjust or unfair in any way to simply apply the *pro rata* sharing principle among all the unsecured creditors in this case, including the Debenture holders. There is no equitable rationale to relax the privity of contract rule here. Non-party creditors had a simple way, in the Priority Mechanism, to take advantage of the Subordination Provisions. None chose to do so. Accordingly, it would not be equitable to subordinate the Debenture holders to any such non-party creditors.

5. The Proper Construction of the Indenture

(a) The Debenture Damages Claim is Not Subordinated in the Indenture

78. As noted above, the holders of the Debentures have two separate and legally distinct claims against Twin Butte, both of which were filed by Computershare in the Claims Procedure.[49] First, the Debenture holders have a debt claim as against Twin Butte based on the principal and accrued interest owed under the Debentures; the Debenture Debt Claim. Additionally, the Debenture holders have a damages claim flowing from Article 2.4(j) of the Indenture; the Debenture Damages Claim. The relevant provisions of Article 2.4(j) are set out in Schedule "A" to this Written Brief of Argument. In summary, the Debenture Damages Claim arises because within 30 days of the occurrence of a Change of Control, Twin Butte was obligated to make an offer to purchase the Debentures at an Offer Price of 100% of the principal amount thereof, together with accrued and unpaid interest on the Change of Control Purchase Date (which is between 30 and 60 days following the Change of Control). "Change of Control" is defined in Article 1.1 of the Indenture and includes the sale of Twin Butte's assets by the

[49] Amended Proof of Claim filed by Valiant on June 1, 2017, Appendix to the Eighth Report

Receiver to HOC. That sale closed on March 30, 2017. For the purposes of the Amended Proof of Claim filed on behalf of the Debenture holders, Computershare has assumed a Change of Control Purchase Date of May 29, 2017.

79. Obviously, Twin Butte did not make a Change of Control Purchase Offer to the Debenture holders in accordance with Article 2.4(j) of the Indenture. As such, it breached its obligation under that Article, giving rise to the Debenture Damages Claim.

80. This alternative Debenture Damages Claim is important, because it is clear that nowhere in the Indenture is this Debenture Damages Claim purported to be subordinated. The operative subordination provision is set out in Article 5.2 of the Indenture. It states:

> Upon any distribution of the assets of [Twin Butte] upon ... receivership proceedings ...:
>
> (a) all Senior Indebtedness shall first be paid indefeasibly in full, or provision made for such payment, in cash before any payment is made on account of the principal of or interest on or any other liability or obligation **in respect of the indebtedness** evidenced by the Debentures; [emphasis added]

81. While the Debenture Debt Claim **is** a "liability or obligation in respect of the indebtedness evidenced by the Debentures", the Debenture Damages Claim is **not**. It is a liability or obligation in respect of Twin Butte's failure to offer to purchase the Debentures.

82. The wording in Article 5.2(a) is very important and the use of the words "liability or obligation in respect of the indebtedness" was clearly intentional and deliberate, since different wording was used in Article 5.2(c) of the Indenture. That article states:

> Upon any distribution of the assets of [Twin Butte] upon ... receivership proceedings ...:
>
> ...
>
> (c) the Senior Creditors or a receiver or a receiver-manager of the Corporation or of all or part of its assets or any other enforcement agent may sell, mortgage, or otherwise dispose of the Corporation's assets in whole or in part, free and clear of all **Debenture Liabilities** and without the approval of the Debentureholders or the

> Debenture Trustee or any requirement to account to the Debenture Trustee or the Debentureholders. [emphasis added]

83. "Debenture Liabilities" is defined in Article 1.1 of the Indenture as follows:

> "**Debenture Liabilities**" means the indebtedness, liabilities and obligations of the Corporation under Debentures issued under this Indenture, including on account of principal, interest or otherwise but excluding the issuance of Common Shares upon any conversion pursuant to Article 6, upon any redemption pursuant to Article 4, or at maturity pursuant to Article 4;

84. Therefore, "Debenture Liabilities" is defined broadly, and includes both the Debenture Debt Claim and the Debenture Damages Claim. Article 5.2(c) provides that a Receiver can sell all of Twin Butte's assets free and clear of all those broadly-defined obligations to the Debenture holders and without having to seek the Debentureholders' approval. However, Article 5.2(a) of the Indenture is equally clear that any subordination to Senior Indebtedness **is not** a subordination of all Debenture Liabilities. Rather, it is only a subordination of liabilities or obligations in **respect of indebtedness** evidenced by the Debentures. In other words, the Debenture Debt Claim, but not the Debenture Damages Claim.

85. Had the parties intended to provide for the subordination of the Debenture Debt Claim **and** the Debenture Damages Claim, they would have used the term "Debenture Liabilities" in Article 5.2(a). They did not. To give full effect to the plain and ordinary meaning of all the words used in Article 5.2 and to give meaning to each word used, it is submitted that the Court should conclude that Debenture Damages Claim is not subordinated to Senior Indebtedness. For this reason alone, the *Ad Hoc* Committee submits that the Court should direct that all proven, unsecured claims should be paid *pro rata*, with no claim being subordinated or being given priority.

86. Even if this Honourable Court does not agree that the Debenture Damages Claim is excluded from the operative subordination clause in Article 5.2(a), the inconsistency between Article 5.2(a) and Article 5.2(c) demonstrates that the Subordination Provisions do not meet the "clear and unequivocal" standard required by Canadian courts. On this basis alone, there can be no enforceable subordination of the Debentures.

(b) The Subordination Provisions are Contrary to Insolvency Law

87. There is a further inconsistency in the Subordination Provisions that also calls into question their enforceability.

88. The list of the types of claims against Twin Butte that comprise "Senior Indebtedness" includes "(i) all declared but unpaid dividends or distributions". When the most recent amendments to the BIA were enacted in 2009 (which predated the Indenture), these types of claims were clearly legislated to be "equity claims" and were therefore subordinated to all creditor claims.[50] As defined in s. 2 of the BIA:

> "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);

and

> "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;

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[50] *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229 [**TAB 25**]; *Bul River Mineral Corp., Re*, 2014 BCSC 1732 [**TAB 26**]

89. As noted above, all equity claims are postponed to all non-equity claims under the BIA, in s. 140.1. The exact same definitions and postponement was also enacted in s.2 of the *Companies' Creditors Arrangement Act* (the "**CCAA**").

90. In *Re Nelson Financial Group Ltd.*, Justice Pepall of the Ontario Superior Court of Justice found that the claims of preferred shareholders for declared but unpaid dividends and requests for redemption were equity claims within the meaning of section 2 of the CCAA. She stated that the language of s. 2 of the CCAA was clear and unambiguous and equity claims included a claim for dividends.[51]

91. Therefore, the inclusion of sub-category (i) within the definition of "Senior Indebtedness" in the Indenture is inconsistent with current insolvency law and is unenforceable. Subordination agreements cannot override or subvert statutory schemes of distribution.

C. The *Ad Hoc* Committee's Alternative Secondary Position – If the Court Determines that Some Unsecured Creditors can Enforce the Subordination Provisions, that is a very Limited Group

92. For all the reasons set out above, it is the primary position of the *Ad Hoc* Committee that no unsecured creditors can enforce the Subordination Provisions. However, if this Honourable Court disagrees with that submission, it must determine whether any particular types of unsecured creditors are entitled to enforce the Subordination Provisions. For the reasons set out above, the *Ad Hoc* Committee submits that the only unsecured creditors who could enforce the Subordination Provisions are those who can prove that they invoked the Priority Mechanism.

93. The Eighth Report seems to suggest that subordination is an "all or nothing" proposition: suggesting either that the Debentures will not be subordinated at all, or they will be subordinated to all unsecured claims. That is both contrary to law and contrary to the facts of this case, as explained below. The Indenture itself contains very long, complicated and verbose definitions delineating, among other things, who is and is not a Senior Creditor holding Senior Indebtedness.

94. The Ontario Superior Court of Justice considered the broader issue of what group of creditors could benefit from subordination in *Re Air Canada*.[52] In that case, the debtor company

[51] *Nelson, supra* at para. 34 [**TAB 25**]
[52] *Re Air Canada*, [2004] O.J. No. 1909 [**TAB 27**]

was in CCAA proceedings and certain holders of "Subordinated Perpetual Debt" (the "**SP Debtholders**") were arguing that the Court should enforce a settlement agreement between themselves, the debtor and other creditors, pursuant to which the holders of SP Debt would be included in a general class of unsecured creditors under Air Canada's CCAA Plan. Certain trade creditors (the "**Trade Creditors**") argued that the SP Debtholders should not be in the single unsecured creditor class but instead that their claim should be subordinated to unsecured creditors, including the Trade Creditors. The Trade Creditors were relying on subordination provisions in the SP Debt instruments (which provided for the subordination of the SP Debt to certain claims defined as "Senior Indebtedness").

95. Justice Farley held that the SP Debt was validly and effectively subordinated to the Senior Indebtedness.[53] Next, he determined what creditors would be entitled to benefit from the subordination, by considering the definition of "Senior Indebtedness" in the SP Debt instruments. "Senior Indebtedness" was defined essentially to include all **borrowed money** that was not expressly subordinated to, or *pari passu* with, the SP Debt. Therefore, the debt of the Trade Creditors who were trying to take advantage of the subordination provisions, was **not** included in the definition of "Senior Indebtedness". Their debt arose by virtue of their provision of goods or services to Air Canada, not because Air Canada had borrowed money from them.

96. Therefore, Justice Farley held that while the subordination of the SP Debt to the "Senior Indebtedness" was valid and enforceable as against the SP Debt holders, the SP Debt was **not** subordinated to **all** unsecured debt. The only parties who could benefit from the subordination were those who were expressly covered in a very clear, broad and simple definition in the subordination agreement.

97. This approach is in keeping with the strict construction approach taken by Canadian courts with respect to the enforcement of subordination agreements.

98. Article 5.2 of the Indenture states that the type of creditor claims to which the claims of Debenture holders are potentially subordinated (for the reasons set out above, the *Ad Hoc* Committee submits that only the Debenture Debt Claim is covered by this Article) is "Senior Indebtedness". That term is defined in Article 1.1 of the Indenture as follows:

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[53] *Ibid*, at para. 14 [**TAB 27**]

> "**Senior Indebtedness**" means all obligations, liabilities and indebtedness of the Corporation which would, in accordance with GAAP, be classified upon a consolidated balance sheet of the Corporation as liabilities of the Corporation and, whether or not so classified, shall include (without duplication): (a) indebtedness of the Corporation for borrowed money; (b) obligations of the Corporation evidenced by bonds, debentures, notes or other similar instruments; (c) obligations of the Corporation arising pursuant or in relation to bankers' acceptances, letters of credit, letters of guarantee, performance bonds and surety bonds (including payment and reimbursement obligations in respect thereof) or indemnities issued in connection therewith; (d) obligations of the Corporation under any swap, hedging or other similar contracts or arrangements; (e) obligations of the Corporation under Guarantees, indemnities, assurances, legally binding comfort letters or other contingent obligations relating to the Senior Indebtedness or other obligations of any other Person which would otherwise constitute Senior Indebtedness within the meaning of this definition; (f) all indebtedness of the Corporation representing the deferred purchase price of any property including, without limitation, purchase money mortgages; (g) accounts payable to trade creditors; (h) all renewals, extensions and refinancing of any of the foregoing; (i) all declared but unpaid dividends or distributions; and (j) all costs and expenses incurred by or on behalf of any Senior Creditor in enforcing payment or collection of any such Senior Indebtedness, including enforcing any security interest securing the same. "Senior Indebtedness" shall not include any indebtedness that would otherwise be Senior Indebtedness if it is expressly stated to be subordinate to or rank pari passu with the Debentures;

99. The Latin maxim *expressio unius est exclusio alterius*, previously described above, applies to this definition. The definition lists as items (a) – (g) and (i) certain types or categories of claims (items (h) and (j) are merely ancillary clauses, covering any renewals of, and the costs incurred in enforcing or collecting, the types of claims described in clauses (a) – (g) and (i)). Because items (a) – (g) and (i) are a list that mentions certain specific things, but omits other things, the maxim dictates that the omissions must be considered to be intentional and meaningful.

100. Broadly speaking, there are four types of claims included in the definition:

(a) items (a) through (d) and item (f) all relate to claims for borrowed money, or credit extended to purchase property. All such claims were repaid in full when the Receiver repaid the amounts owed to Twin Butte's lending syndicate;

(b) item (e) relates to guarantees provided by Twin Butte. The *Ad Hoc* Committee is aware of no existing guarantee claims;

(c) item (g) relates to accounts payable for goods and services provided by trade creditors on credit; and

(d) item (i), for the reasons set out above, relates to an "equity claim" as defined in the BIA, which cannot be paid out until all unsecured claims have been paid in full.

101. Including each of these categories of claims in the definition of "Senior Indebtedness" (setting aside the equity claims in item (i) which are unenforceable and contrary to the BIA, for the reasons set out above), is consistent with the commercial purpose behind the Subordination Provisions. These categories of claims are held by the types of creditors who would all have a voluntary choice to extend credit to Twin Butte. Lenders and parties selling property to Twin Butte on credit obviously have the choice of providing credit, or not. Parties taking guarantees from Twin Butte have the choice of entering into the guarantee transaction (a form of credit support) rather than requiring immediate payment or some other form of credit support, or not. Trade creditors have the choice of extending credit to Twin Butte for the goods and services they provide, or requiring immediate payment (COD) or some other form of security.

102. Therefore, these are the types of creditor groups to whom the Subordination Provisions and the Priority Mechanism were directed. Because those groups had the choice to extend or to not extend credit to Twin Butte, and the choice as to how much credit to extend, they could have chosen to take advantage of the Priority Mechanism. Twin Butte agreed to the Priority Mechanism and presumably could have used it to incentivize parties to advance credit that they might not otherwise have advanced (the fact that none of them did so does not change the logic behind their inclusion in the definition of "Senior Indebtedness"; the fact remains that they **could**

have invoked the Priority Mechanism to give effect to and allow them to enforce the Subordination Provisions).

103. As an overall comment, the *Ad Hoc* Committee submits that this definition of Senior Indebtedness is not clear, simple and unambiguous (unlike the equivalent definitions in the subordination agreements considered in the *Air Canada* and *Stelco* cases). Had the intention of the parties to the Indenture been to clearly subordinate all of Twin Butte's obligations to the Debenture holders, they could have drafted a clear, simple and broad definition of Senior Indebtedness. They did not. It is also notable that the Priority Mechanism provided a simple way for a creditor to clarify its position, or not, as the holder of Senior Indebtedness. The fact that no creditors did so, combined with the unclear wording in the definition of "Senior Indebtedness" again reinforces the conclusion that the claims of the Debenture holders should not be subordinated to any other unsecured creditor claims.

104. Obviously, the *Ad Hoc* Committee has limited direct knowledge of the particulars of other creditors' claims. The *Ad Hoc* Committee is also unaware at this time whether any other creditors will choose to appear at the hearing of this matter and attempt to assert that they are entitled to enforce the Subordination Provisions. As such, the *Ad Hoc* Committee reserves the right to reply to any materials that may be filed by creditors seeking to enforce the Subordination Provisions.

D. If this Honourable Court Orders that Some Unsecured Creditors can take the Benefit of the Subordination Provisions, How Should the Subordination be Effected?

105. If this Honourable Court does not accept the submission of the *Ad Hoc* Committee that no creditors can enforce the Subordination Provisions, the Court must determine the mechanism by which any subordination that it orders, could be carried into effect.

106. In the *Air Canada* case, Justice Farley endorsed the following formula to achieve that end: [54]

> a dividend is allocated to all unsecured creditors, including the subordinated creditor, on a pro rata basis. The dividend allocated

[54] *Air Canada, supra* at para. 10 [**TAB 27**]

> to the subordinated creditor is paid over to the senior creditor, to the extent of its claim, with the subordinated creditor retaining the reminder 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 the unsecured creditors.

E. The Quantum and Merits of Material Proofs of Claim

107. The *Ad Hoc* Committee reserves the right, in accordance with the Claims Procedure, to object to the quantum or merits of any submitted proof of claim exceeding $75,000, to which the *Ad Hoc* Committee has not expressly agreed. Given that this Brief of Argument is being filed so promptly after the Claims Bar Date, the Receiver has not yet formally indicated its position with respect to all such proofs of claim.

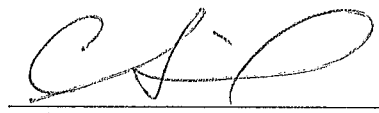
V. RELIEF SOUGHT

108. The *Ad Hoc* Committee respectfully requests that this Honourable Court grant its application and declare that the Receiver shall make distributions to all unsecured creditors, including the Debenture holders, on a *pari passu* basis.

ALL OF WHICH IS RESPECTFULLY SUBMITTED at Calgary, Alberta this 7th day of June, 2017.

BENNETT JONES LLP

Estimated Time for Argument: 45 minutes

Per: 

Chris Simard and Alexis Teasdale
Counsel for the *Ad Hoc* Committee

SCHEDULE "A"

RELEVANT PROVISIONS FROM THE INDENTURE

1.1 Definitions

...

"**Change of Control**" means:

(a) the acquisition by any Person or group of Persons acting jointly or in concert (within the meaning of MI 62-104 and in Ontario, the *Securities Act* (Ontario) and OSC Rule 62-504) of ownership of, or voting control or direction over, more than 50% of the issued and outstanding Common Shares; or

(b) the sale or other transfer of all or substantially all of the consolidated assets of the Corporation;

however, a "Change of Control" shall not include a sale, merger, reorganization, arrangement, combination or other similar transaction if the previous holders of Common Shares immediately prior to such transaction hold at least 50% of the voting control or direction in such merged, reorganized, arranged, combined or other continuing entity (and in the case of a sale of all or substantially all of the assets, in the entity which has acquired such assets) immediately following completion of such transaction;

...

"**Debenture Liabilities**" means the indebtedness, liabilities and obligations of the Corporation under Debentures issued under this Indenture, including on account of principal, interest or otherwise but excluding the issuance of Common Shares upon any conversion pursuant to Article 6, upon any redemption pursuant to Article 4, or at maturity pursuant to Article 4;

...

"**Senior Indebtedness**" means all obligations, liabilities and indebtedness of the Corporation which would, in accordance with GAAP, be classified upon a consolidated balance sheet of the Corporation as liabilities of the Corporation and, whether or not so classified, shall include (without duplication): (a) indebtedness of the Corporation for borrowed money; (b) obligations of the Corporation evidenced by bonds, debentures, notes or other similar instruments; (c) obligations of the Corporation arising pursuant or in relation to bankers' acceptances, letters of credit, letters of guarantee, performance bonds and surety bonds (including payment and

reimbursement obligations in respect thereof) or indemnities issued in connection therewith; (d) obligations of the Corporation under any swap, hedging or other similar contracts or arrangements; (e) obligations of the Corporation under Guarantees, indemnities, assurances, legally binding comfort letters or other contingent obligations relating to the Senior Indebtedness or other obligations of any other Person which would otherwise constitute Senior Indebtedness within the meaning of this definition; (f) all indebtedness of the Corporation representing the deferred purchase price of any property including, without limitation, purchase money mortgages; (g) accounts payable to trade creditors; (h) all renewals, extensions and refinancing of any of the foregoing; (i) all declared but unpaid dividends or distributions; and (j) all costs and expenses incurred by or on behalf of any Senior Creditor in enforcing payment or collection of any such Senior Indebtedness, including enforcing any security interest securing the same. "Senior Indebtedness" shall not include any indebtedness that would otherwise be Senior Indebtedness if it is expressly stated to be subordinate to or rank pari passu with the Debentures;

...

2.4 Form and Terms of the Initial Debentures

(j) Within 30 days following the occurrence of a Change of Control, the Corporation shall be obligated to offer to purchase all Initial Debentures then outstanding. The terms and conditions of such obligation are set forth below:

(i) Within 30 days following the occurrence of a Change of Control, and subject to the provisions and conditions of this Section 2.7(j), the Corporation shall deliver to the Debenture Trustee a notice in writing stating that there has been a Change of Control and specifying the date on which such Change of Control occurred and the circumstances or events giving rise to such Change of Control together with an offer in writing (the "**Change of Control Purchase Offer**") to purchase, on the Change of Control Purchase Date (as defined below) all (or any portion actually tendered to such offer) of the Initial Debentures then outstanding from the holders thereof at a price per Initial Debenture equal to 100% of the principal amount thereof together with accrued and unpaid interest thereon up to but not including the Change of Control Purchase Date (the "**Offer Price**"). The Debenture Trustee will promptly

thereafter deliver, by prepaid courier or mail, the Change of Control Purchase Offer to the holders of all Initial Debentures then outstanding, at their addresses appearing in the registers of holders of Initial Debentures maintained by the Debenture Trustee.

(ii) The Change of Control Purchase Offer shall specify the date (the "**Expiry Date**") and time (the "**Expiry Time**") on which the Change of Control Purchase Offer shall expire which date and time shall not, unless otherwise required by Applicable Securities Legislation, be earlier than the close of business on the 30th day and not later than the close of business on the 60th day following the date on which such Change of Control Purchase Offer is delivered or mailed by or on behalf of the Debenture Trustee as provided above.

...

(v) The Change of Control Purchase Offer shall specify a date (the "**Change of Control Purchase Date**") no later than the third Business Day following the Expiry Date on which the Corporation shall take up and pay for all Initial Debentures duly tendered in acceptance of the Change of Control Purchase Offer. If such Change of Control Purchase Date is after a record date for the payment of interest on the Initial Debentures but on or prior to an Interest Payment Date, then the interest payable on such date will be paid to the holder of record of the Initial Debentures on the relevant record date.

(vi) The Corporation shall, on or before 1:00 p.m. (Calgary time), on the Business Day immediately prior to the Change of Control Purchase Date, pay to the Debenture Trustee by wire transfer or such other means as may be acceptable to the Debenture Trustee an amount of money sufficient to pay the aggregate Offer Price in respect of all Initial Debentures duly tendered to the Change of Control Purchase Offer (less any tax required by law to be deducted). The Debenture Trustee, on behalf of the Corporation, will pay the Offer Price to the holders of Initial Debentures in the respective amounts to which they are entitled in accordance with the Change of Control Purchase Offer as aforesaid.

...

ARTICLE 5
SUBORDINATION OF DEBENTURES

5.1 Applicability of Article

The Debenture Liabilities shall be subordinated and postponed and subject in right of payment, to the extent and in the manner hereinafter set forth in this Article 5 and in Section 2.4(e), to the prior full and final payment of all Senior Indebtedness of the Corporation and any Subsidiary of the Corporation, and each holder of any such Debenture by his acceptance thereof, whether directly or on his behalf, agrees to and shall be bound by the provisions of this Article 5.

5.2 Order of Payment

Upon any distribution of the assets of the Corporation upon any dissolution, winding up, total liquidation or reorganization of the Corporation (whether in bankruptcy, insolvency or receivership proceedings, or upon an "assignment for the benefit of creditors" or any other marshalling of the assets and liabilities of the Corporation, or otherwise):

(a) all Senior Indebtedness shall first be paid indefeasibly in full, or provision made for such payment, in cash before any payment is made on account of the principal of or interest on or any other liability or obligation in respect of the indebtedness evidenced by the Debentures;

(b) any payment or distribution of assets of the Corporation, whether in cash, property or securities, to which the holders of the Debentures or the Debenture Trustee on behalf of such holders would be entitled except for the provisions of this Article 5 shall be paid or delivered by the trustee in bankruptcy, receiver, assignee for the benefit of creditors, or other liquidating agent making such payment or distribution, directly to the Senior Creditors to the extent necessary to pay all Senior Indebtedness in full after giving effect to any concurrent payment or distribution, or provision therefor, to the holders of such Senior Indebtedness; and

(c) the Senior Creditors or a receiver or a receiver-manager of the Corporation or of all or part of its assets or any other enforcement agent may sell, mortgage, or otherwise dispose of the Corporation's assets in whole or in part, free and clear of all Debenture Liabilities and without the approval of the Debentureholders or the Debenture Trustee or any requirement to account to the Debenture Trustee or the Debentureholders.

The rights and priority of the Senior Indebtedness and the subordination pursuant hereto shall not be affected by:

(i) whether or not the Senior Indebtedness is secured;

(ii) the time, sequence or order of creating, granting, executing, delivering of, or registering, perfecting or failing to register or perfect any security notice, caveat, financing statement or other notice in respect of any Senior Security;

(iii) the time or order of the attachment, perfection or crystallization of any security constituted by any Senior Security;

(iv) the taking of any collection, enforcement or realization proceedings pursuant to any Senior Security;

(v) the date of obtaining of any judgment or order of any bankruptcy court or any court administering bankruptcy, insolvency or similar proceedings as to the entitlement of the Senior Creditors or any of them or the Debentureholders or any of them to any money or property of the Corporation;

(vi) the failure to exercise any power or remedy reserved to the Senior Creditors under any Senior Security or to insist upon a strict compliance with any terms thereof;

(vii) whether any Senior Security is now perfected, hereafter ceases to be perfected, is avoidable by any trustee in bankruptcy or like official or is otherwise set aside, invalidated or lapses;

(viii) the date of giving or failing to give notice to or making demand upon the Corporation;

(ix) any amendment, modification, increase, extension, renewal, replacement of any Senior Indebtedness or Senior Security; or

(x) any other matter whatsoever.

5.3 Subrogation to Rights of Holders of Senior Indebtedness

Subject to the prior payment in full of all Senior Indebtedness, the holders of the Debentures shall be subrogated to the rights of the holders of Senior Indebtedness to receive payments or distributions of assets of the Corporation to the extent of the application thereto of such payments or other assets which would have been received by the holders of the Debentures but for the provisions hereof until the principal of, premium, if any, on and interest on the Debentures shall be paid in full, and no such payments or distributions to the holders of the Debentures of cash, property or securities, which otherwise would be payable or distributable to the holders of the Senior Indebtedness, shall, as between the Corporation, its creditors (other than holders of Senior Indebtedness) and the holders of Debentures, be deemed to be a payment by the Corporation to the former holders of the Senior Indebtedness or on account of the repaid Senior Indebtedness, it being understood that the provisions of this Article 5 are and are intended solely for the purpose of defining the relative rights of the holders of the Debentures, on the one hand, and the holders of Senior Indebtedness, on the other hand.

The Debenture Trustee, for itself and on behalf of each of the Debentureholders, acknowledges and agrees that the Senior Creditors may enforce the provisions of the Senior Security and exercise any rights and remedies thereunder, all in such order, at such times and in such manner as they may determine in the exercise of their sole discretion, including, without limitation, any right to take or retake control or possession of the collateral, to hold, prepare for sale, process, sell, lease, dispose of, or liquidate the collateral, to incur expenses in connection with such disposition, and to exercise all the rights and remedies of a secured creditor under applicable law.

5.4 Obligation to Pay Not Impaired

Nothing contained in this Article 5 or elsewhere in this Indenture or in the Debentures is intended to or shall impair, as between the Corporation, its creditors other than the holders of Senior Indebtedness, and the holders of the Debentures, the obligation of the Corporation, which is absolute and unconditional, to pay to the holders of the Debentures the principal of, premium, if any, on and interest on the Debentures, as and when the same shall become due and payable in accordance with their terms, or affect the relative rights of the holders of the Debentures and creditors of the Corporation other than the holders of the Senior Indebtedness, nor shall anything herein or therein prevent the Debenture Trustee or the holder of any Debenture from exercising all remedies otherwise permitted by applicable law upon default under this Indenture, subject to the rights, if any, under this Article 5 of the holders of Senior Indebtedness.

5.5 No Payment if Senior Indebtedness in Default

Upon the maturity of any Senior Indebtedness by lapse of time, acceleration or otherwise, or an enforcement of any Senior Indebtedness, then, except as provided in Section 5.8, all such Senior Indebtedness shall first be paid in full, or shall first have been duly provided for, before any payment is made on account of the Debenture Liabilities.

In case of a circumstance constituting a default or event of default with respect to any Senior Indebtedness permitting (either at that time or upon notice, lapse of time or satisfaction of other condition precedent) a Senior Creditor to demand payment or accelerate the maturity thereof where the notice of such default or event of default has been given by or on behalf of the holders of Senior Indebtedness to the Corporation or the Corporation otherwise has knowledge thereof, unless and until such default or event of default shall have been cured or waived or ceased to exist, no payment (by purchase of Debentures or otherwise) shall be made by the Corporation with respect to the Debenture Liabilities and neither the Debenture Trustee nor the holders of Debentures shall be entitled to demand, accelerate, institute proceedings for the collection of (which shall, for certainty include proceedings related to an adjudication or declaration as to the insolvency or bankruptcy of the Corporation and other similar creditor proceedings), or receive any payment or benefit (including without limitation by set-off, combination of accounts or otherwise in any manner whatsoever) on account of the Debentures after the happening of such a default or event of default (except as provided in Section 5.8), and unless and until such default or event of default shall have been cured or waived or ceased to exist, such payments shall be held in trust for the benefit of, and, if and when such Senior Indebtedness shall have become due and payable, shall be paid over to, the Senior Creditor holding such Senior Indebtedness until all such Senior Indebtedness shall have been paid in full, after giving effect to any concurrent

payment or distribution to the holders of such Senior Indebtedness; provided, however, that, subject to the priorities and rights of the Senior Creditors under this Article 5, the foregoing shall in no way prohibit, restrict or prevent the Debenture Trustee from taking such actions as may be necessary to preserve claims of the Debenture Trustee and/or the holders of the Debentures under this Indenture in any bankruptcy, reorganization or insolvency proceeding (including, without limitation, the filing of proofs of claim in any such bankruptcy, reorganization or insolvency proceedings by or against the Corporation or its Subsidiaries and exercising its rights to vote as an unsecured creditor under any such bankruptcy, reorganization or insolvency proceedings commenced by or against the Corporation or its Subsidiaries). The fact that any payment hereunder is prohibited by this Section 5.5 shall not prevent the failure to make such payment from being an Event of Default hereunder.

5.6 Payment on Debentures Permitted

Nothing contained in this Article 5 or elsewhere in this Indenture, or in any of the Debentures, shall affect the obligation of the Corporation to make, or prevent the Corporation from making, at any time except as prohibited by Section 5.2 or Section 5.5, any payment of principal of, premium, if any, on or interest on the Debentures as the same may become due. The fact that any such payment is prohibited by Section 5.2 or Section 5.5 shall not prevent the failure to make such payment from being an Event of Default hereunder. Nothing contained in this Article 5 or elsewhere in this Indenture, or in any of the Debentures, shall prevent the conversion of the Debentures or, except as prohibited by Section 5.2 or Section 5.5, the application by the Debenture Trustee of any moneys deposited with the Debenture Trustee hereunder for such purpose, to the payment of or on account of the Debenture Liabilities.

5.7 Confirmation of Subordination

Each holder of Debentures by his acceptance thereof authorizes and directs the Debenture Trustee on his behalf to take such action as may be necessary or appropriate to effect the subordination as provided in this Article 5 and appoints the Debenture Trustee his attorney-in-fact for any and all such purposes. This power of attorney, being coupled with an interest and rights, shall be irrevocable. Upon request of the Corporation, and upon being furnished with an Officer's Certificate stating that one or more named Persons are Senior Creditors, and specifying the maximum amount and nature of the Senior Indebtedness of such Senior Creditors, the Debenture Trustee shall enter into a written agreement or agreements, as the Senior Creditor may reasonably request, with the Corporation and the Person or Persons named in such Officer's Certificate providing that such Person or Persons are entitled to all the rights and benefits of this Article 5 as a Senior Creditor specified in such Officer's Certificate and in such agreement, which may include, among other things, an agreement not to amend the provisions of this Article 5 and the definitions herein without the consent of such Senior Creditor. Such agreement shall be conclusive evidence that the indebtedness specified therein is Senior Indebtedness. However, nothing herein shall impair the rights of any Senior Creditor who has not entered into such an agreement.

5.8 Knowledge of Debenture Trustee

Notwithstanding the provisions of this Article 5, the Debenture Trustee will not be charged with knowledge of the existence of any fact that would prohibit the making of any payment of monies to or by the Debenture Trustee, or the taking of any other action by the Debenture Trustee, unless and until the Debenture Trustee has received written notice thereof from the Corporation, any Debentureholder or any Senior Creditor.

5.9 Debenture Trustee May Hold Senior Indebtedness

The Debenture Trustee is entitled to all the rights set forth in this Article 5 with respect to any Senior Indebtedness at the time held by it, to the same extent as any other holder of Senior Indebtedness, and nothing in this Indenture deprives the Debenture Trustee of any of its rights as such holder.

5.10 Rights of Holders of Senior Indebtedness Not Impaired

No right of any present or future holder of any Senior Indebtedness to enforce the subordination herein will at any time or in any way be prejudiced or impaired by any act or failure to act on the part of the Corporation or by any non-compliance by the Corporation with the terms, provisions and covenants of this Indenture, regardless of any knowledge thereof which any such holder may have or be otherwise charged with.

5.11 Altering the Senior Indebtedness

The holders of the Senior Indebtedness have the right to extend, renew, revise, restate, modify or amend the terms of the Senior Indebtedness (including, without limitation, increasing the principal amount of the Senior Indebtedness) or such Senior Security therefor and to release, sell or exchange such security and otherwise to deal freely with the Corporation and its Subsidiaries, all without notice to or consent of the Debentureholders or the Debenture Trustee and without affecting the liabilities and obligations of the parties to this Indenture or the Debentureholders or the Debenture Trustee.

5.12 Additional Indebtedness

This Indenture does not restrict the Corporation or any Subsidiary of the Corporation from incurring additional indebtedness for borrowed money or otherwise (including, without limitation, Senior Indebtedness) or mortgaging, pledging or charging its real (immoveable) or personal (moveable) property or properties to secure any indebtedness or other financing.

5.13 Right of Debentureholder to Receive Common Shares Not Impaired

The subordination of the Debenture Liabilities to the Senior Indebtedness and the provisions of this Article 5 do not impair in any way the right of a Debentureholder to receive Common Shares in respect of principal and interest upon any conversion pursuant to Article 6 or upon any redemption pursuant to Article 4.

5.14 Invalidated Payments

In the event that any of the Senior Indebtedness shall be paid in full and subsequently, for whatever reason, such formerly paid or satisfied Senior Indebtedness becomes unpaid or unsatisfied, the terms and conditions of this Article 5 shall be reinstated and the provisions of this Article 5 shall again be operative until all Senior Indebtedness is repaid in full, provided that such reinstatement shall not give the Senior Creditors any rights or recourses against the Debenture Trustee or the Debentureholders for amounts paid to the Debentureholders subsequent to such payment or satisfaction in full and prior to such reinstatement.

5.15 Contesting Security

The Debenture Trustee, for itself and on behalf of the Debentureholders, agrees that it shall not contest or bring into question the validity, perfection or enforceability of any of the Senior Indebtedness, the Senior Security or the relative priority of the Senior Security.

5.16 Obligations Created by Article 5

The Corporation and the Debenture Trustee, in its capacity as trustee hereunder and not in its corporate personal capacity, agree, and each holder by its acceptance of a Debenture likewise agrees, that:

(a) the provisions of this Article 5 are an inducement and consideration to each holder of Senior Indebtedness to give or continue credit to the Corporation, the Corporation's Subsidiaries or others or to acquire Senior Indebtedness; and

(b) each holder of Senior Indebtedness may accept the benefit of this Article 5 on the terms and conditions set forth in this Article 5 by giving or continuing credit to the Corporation, the Corporation's Subsidiaries or others or by having outstanding or acquiring Senior Indebtedness, in each case without notice to the Debenture Trustee and without establishing actual reliance on this Article 5.

SCHEDULE "B"

RELEVANT PROVISIONS FROM THE NOTE INDENTURE IN *Re: Stelco*

6.2 Distribution on Insolvency or Winding-up

In the event of any insolvency or bankruptcy proceedings, or any receivership, liquidation, reorganization or other similar proceedings relative to the Corporation, or to its property or assets, or in the event of any proceedings for voluntary liquidation, dissolution or other winding-up of the Corporation:

(1) the holders of all Senior Debt will first be entitled to receive payment in full of the principal thereof, premium (or any other amount payable under such Senior Debt), if any, and interest due thereon, before the Debentureholders will be entitled to receive any payment or distribution of any kind or character, whether in cash, property or securities, which may be payable or deliverable in any such event in respect of any of the Debentures;

(2) any payment by, or distribution of assets of the Corporation of any kind or character, whether in cash, property or securities (other than securities of the Corporation or any other company provided for by a plan of reorganization or readjustment the payment of which is subordinate, at least to the extent provided in this Article 6 with respect to the Debentures, to the payment of all Senior Debt, provided that (i) the Senior Debt is assumed by the new company, if any, resulting from such reorganization or readjustment, and (ii) without prejudice to the rights of such holders with respect to any such plan (including without limitation as to whether or not to approve same and on what conditions to do so), the rights of the holders of Senior Debt are not altered adversely by such reorganization or readjustment) to which the Debentureholders or the Trustee would be entitled, except for the provisions of this Article 6, will be paid or delivered by the Person making such payment or distribution, whether a trustee in bankruptcy, a receiver, a receiver-manager, a liquidator or otherwise, directly to the holders of Senior Debt or their representative or representatives or to the trustee or trustees under any indenture under which any instruments evidencing any of such Senior Debt may have been issued, rateably according to the aggregate amounts remaining unpaid on account of the Senior Debt held or represented by each, to the extent necessary to make payment in full of all Senior Debt remaining unpaid after giving effect to any concurrent payment or distribution (or provision therefore) to the holders of such Senior Debt; and

(3) subject to Section 6.6, if, notwithstanding the foregoing, any payment by, or distribution of assets of, the Corporation of any kind or character

whether in cash, property or securities (other than securities of the Corporation as reorganized or readjusted or securities of the Corporation or any other company provided for by a plan of reorganization or readjustment the payment of which is subordinate, at least to the extent provided in this Article 6 with respect to the Debentures, to the payment of all Senior Debt, provided that (i) the Senior Debt is assumed by the new company, if any, resulting from such reorganization or readjustment and (ii) without prejudice to the rights of such holders with respect to any such plan (including without limitation as to whether or not to approve same and on what conditions to do so), the rights of the holders of Senior Debt are not altered adversely by such reorganization or readjustment), is received by the Trustee or the Debentureholders before all Senior Debt is paid in full, such payment or distribution will be held in trust for the benefit of, and will be paid over the holders of such Senior Debt or their representative or representatives or to the Trustee or trustees under any indenture under which any instruments evidencing any of such Senior Debt may have been issued, rateably as aforesaid, for application to the payment of all Senior Debt remaining unpaid until such Senior Debt has been paid in full, after giving effect to any concurrent payment or distribution (or provision therefore) to the holders of such Senior Debt.

[Emphasis added.]

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4. *Toronto Dominion Bank v Crosswinds Golf & Country Club Ltd.* 2002 CarswellOnt 1149 (CA)
5. *Paddon Hughes Development v Pancontinental Oil*, 1998 ABCA 333, 223 AR 180, leave to appeal to SCC denied
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7. *Galichowsky v. Shaw GMC Pontiac Buick Hummer Ltd.*, 2009 ABCA 390, 469 AR 156
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9. *Bank of Montreal v. Dynex Petroleum Ltd.*, [1997] 6 WWR 104
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17. *Sullivan on the Construction of Statutes*, 6th ed. (LexisNexis Canada Inc.: Markham, 2014)
18. *Canadian Private Copying Collective v Canadian Storage Media Alliance*, 2004 FCA 424
19. *Fraser River Pile & Dredge Ltd. v. Can-Dive Services Ltd.*, 1999 CarswellBC 1927
20. *Liu v. Calgary Chinatown Development Foundation*, 2017 ABQB 149
21. *Parwinn Developments Ltd. v. 375069 Alberta Ltd.*, 2000 ABQB 31

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23. *Black's Law Dictionary*, 10th ed.

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25. *Nelson Financial Group Ltd., Re*, 2010 ONSC 6229

26. *Bul River Mineral Corp., Re*, 2014 BCSC 1732

27. *Re Air Canada*, [2004] O.J. No. 1909