Ontario Court of Appeal File No. M38600
SCJ Court File No. CV-09-8396-00 CL

COURT OF APPEAL FOR ONTARIO

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A"

Applicants

BOOK OF AUTHORITIES OF THE RESPONDING PARTY, THE CATALYST CAPITAL GROUP INC.

(Motion for Leave to Appeal Brought by GSCP)

March 12, 2010

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TAB "1"

COURT FILE NO.: 09-CL-7950
DATE: 20090723

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

2009 CanLII 39492 (ON S.C.)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF NORTEL NETWORKS CORPORATION, NORTEL NETWORKS LIMITED, NORTEL NETWORKS GLOBAL CORPORATION, NORTEL NETWORKS INTERNATIONAL CORPORATION AND NORTEL NETWORKS TECHNOLOGY CORPORATION

APPLICANTS

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

BEFORE: MORAWETZ J.

COUNSEL: Derrick Tay and Jennifer Stam, for Nortel Networks Corporation, et al

Lyndon Barnes and Adam Hirsh, for the Board of Directors of Nortel Networks Corporation and Nortel Networks Limited

J. Carfagnini and J. Pasquariello, for Ernst & Young Inc., Monitor

M. Starnino, for the Superintendent of Financial Services and Administrator of PBGF

S. Philpott, for the Former Employees

K. Zych, for Noteholders

Pamela Huff and Craig Thorburn, for MatlinPatterson Global Advisors LLC, MatlinPatterson Global Opportunities Partners III L.P. and Matlin Patterson Opportunities Partners (Cayman) III L.P.

David Ward, for UK Pension Protection Fund

Leanne Williams, for Flextronics Inc.

Alex MacFarlane, for the Official Committee of Unsecured Creditors

Arthur O. Jacques and Tom McRae, for Felske & Sylvain (de facto Continuing Employees' Committee)

Robin B. Schwill and Matthew P. Gottlieb, for Nortel Networks UK Limited

A. Kauffman, for Export Development Canada

D. Ullman, for Verizon Communications Inc.

G. Benchetrit, for IBM

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HEARD & DECIDED: **JUNE 29, 2009**

ENDORSEMENT

INTRODUCTION

[1] On June 29, 2009, I granted the motion of the Applicants and approved the bidding procedures (the "Bidding Procedures") described in the affidavit of Mr. Riedel sworn June 23, 2009 (the "Riedel Affidavit") and the Fourteenth Report of Ernst & Young, Inc., in its capacity as Monitor (the "Monitor") (the "Fourteenth Report"). The order was granted immediately after His Honour Judge Gross of the United States Bankruptcy Court for the District of Delaware (the "U.S. Court") approved the Bidding Procedures in the Chapter 11 proceedings.

[2] I also approved the Asset Sale Agreement dated as of June 19, 2009 (the "Sale Agreement") among Nokia Siemens Networks B.V. ("Nokia Siemens Networks" or the "Purchaser"), as buyer, and Nortel Networks Corporation ("NNC"), Nortel Networks Limited ("NNL"), Nortel Networks, Inc. ("NNI") and certain of their affiliates, as vendors (collectively the "Sellers") in the form attached as Appendix "A" to the Fourteenth Report and I also approved and accepted the Sale Agreement for the purposes of conducting the "stalking horse" bidding process in accordance with the Bidding Procedures including, the Break-Up Fee and the Expense Reimbursement (as both terms are defined in the Sale Agreement).

[3] An order was also granted sealing confidential Appendix "B" to the Fourteenth Report containing the schedules and exhibits to the Sale Agreement pending further order of this court.

[4] The following are my reasons for granting these orders.

[5] The hearing on June 29, 2009 (the "Joint Hearing") was conducted by way of video conference with a similar motion being heard by the U.S. Court. His Honor Judge Gross presided over the hearing in the U.S. Court. The Joint Hearing was conducted in accordance with the provisions of the Cross-Border Protocol, which had previously been approved by both the U.S. Court and this court.

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[6] The Sale Agreement relates to the Code Division Multiple Access ("CMDA") business Long-Term Evolution ("LTE") Access assets.

[7] The Sale Agreement is not insignificant. The Monitor reports that revenues from CDMA comprised over 21% of Nortel's 2008 revenue. The CDMA business employs approximately 3,100 people (approximately 500 in Canada) and the LTE business employs approximately 1,000 people (approximately 500 in Canada). The purchase price under the Sale Agreement is $650 million.

BACKGROUND

[8] The Applicants were granted CCAA protection on January 14, 2009. Insolvency proceedings have also been commenced in the United States, the United Kingdom, Israel and France.

[9] At the time the proceedings were commenced, Nortel's business operated through 143 subsidiaries, with approximately 30,000 employees globally. As of January 2009, Nortel employed approximately 6,000 people in Canada alone.

[10] The stated purpose of Nortel's filing under the CCAA was to stabilize the Nortel business to maximize the chances of preserving all or a portion of the enterprise. The Monitor reported that a thorough strategic review of the company's assets and operations would have to be undertaken in consultation with various stakeholder groups.

[11] In April 2009, the Monitor updated the court and noted that various restructuring alternatives were being considered.

[12] On June 19, 2009, Nortel announced that it had entered into the Sale Agreement with respect to its assets in its CMDA business and LTE Access assets (collectively, the "Business") and that it was pursuing the sale of its other business units. Mr. Riedel in his affidavit states that Nortel has spent many months considering various restructuring alternatives before determining in its business judgment to pursue "going concern" sales for Nortel's various business units.

[13] In deciding to pursue specific sales processes, Mr. Riedel also stated that Nortel's management considered:

(a) the impact of the filings on Nortel's various businesses, including deterioration in sales; and

(b) the best way to maximize the value of its operations, to preserve jobs and to continue businesses in Canada and the U.S.

[14] Mr. Riedel notes that while the Business possesses significant value, Nortel was faced with the reality that:

(a) the Business operates in a highly competitive environment;

(b) full value cannot be realized by continuing to operate the Business through a restructuring; and

(c) in the absence of continued investment, the long-term viability of the Business would be put into jeopardy.

[15] Mr. Riedel concluded that the proposed process for the sale of the Business pursuant to an auction process provided the best way to preserve the Business as a going concern and to maximize value and preserve the jobs of Nortel employees.

[16] In addition to the assets covered by the Sale Agreement, certain liabilities are to be assumed by the Purchaser. This issue is covered in a comprehensive manner at paragraph 34 of the Fourteenth Report. Certain liabilities to employees are included on this list. The assumption of these liabilities is consistent with the provisions of the Sale Agreement that requires the Purchaser to extend written offers of employment to at least 2,500 employees in the Business.

[17] The Monitor also reports that given that certain of the U.S. Debtors are parties to the Sale Agreement and given the desire to maximize value for the benefit of stakeholders, Nortel determined and it has agreed with the Purchaser that the Sale Agreement is subject to higher or better offers being obtained pursuant to a sale process under s. 363 of the U.S. Bankruptcy Code and that the Sale Agreement shall serve as a "stalking horse" bid pursuant to that process.

[18] The Bidding Procedures provide that all bids must be received by the Seller by no later than July 21, 2009 and that the Sellers will conduct an auction of the purchased assets on July 24, 2009. It is anticipated that Nortel will ultimately seek a final sales order from the U.S. Court on or about July 28, 2009 and an approval and vesting order from this court in respect of the Sale Agreement and purchased assets on or about July 30, 2009.

[19] The Monitor recognizes the expeditious nature of the sale process but the Monitor has been advised that given the nature of the Business and the consolidation occurring in the global market, there are likely to be a limited number of parties interested in acquiring the Business.

[20] The Monitor also reports that Nortel has consulted with, among others, the Official Committee of Unsecured Creditors (the "UCC") and the bondholder group regarding the Bidding Procedures and is of the view that both are supportive of the timing of this sale process. (It is noted that the UCC did file a limited objection to the motion relating to certain aspects of the Bidding Procedures.)

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[21] Given the sale efforts made to date by Nortel, the Monitor supports the sale process outlined in the Fourteenth Report and more particularly described in the Bidding Procedures.

[22] Objections to the motion were filed in the U.S. Court and this court by MatlinPatterson Global Advisors LLC, MatlinPatterson Global Opportunities Partners III L.P. and Matlin Patterson Opportunities Partners (Cayman) III L.P. (collectively, "MatlinPatterson") as well the UCC.

[23] The objections were considered in the hearing before Judge Gross and, with certain limited exceptions, the objections were overruled.

ISSUES AND DISCUSSION

[24] The threshold issue being raised on this motion by the Applicants is whether the CCAA affords this court the jurisdiction to approve a sales process in the absence of a formal plan of compromise or arrangement and a creditor vote. If the question is answered in the affirmative, the secondary issue is whether this sale should authorize the Applicants to sell the Business.

[25] The Applicants submit that it is well established in the jurisprudence that this court has the jurisdiction under the CCAA to approve the sales process and that the requested order should be granted in these circumstances.

[26] Counsel to the Applicants submitted a detailed factum which covered both issues.

[27] Counsel to the Applicants submits that one of the purposes of the CCAA is to preserve the going concern value of debtors companies and that the court's jurisdiction extends to authorizing sale of the debtor's business, even in the absence of a plan or creditor vote.

[28] The CCAA is a flexible statute and it is particularly useful in complex insolvency cases in which the court is required to balance numerous constituents and a myriad of interests.

[29] The CCAA has been described as "skeletal in nature". It has also been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 45 C.B.R. (5th) 163 (Ont. C.A.) at paras. 44, 61, leave to appeal refused [2008] SCCA 337. ("ATB Financial").

[30] The jurisprudence has identified as sources of the court's discretionary jurisdiction, *inter alia*:

(a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;

(b) the specific provision of s. 11(4) of the CCAA which provides that the court may make an order "on such terms as it may impose"; and

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(c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects. *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.) at para. 43; *Re PSINet Ltd.* (2001), 28 C.B.R. (4th) 95 (Ont. S.C.J.) at para. 5, *ATB Financial, supra,* at paras. 43-52.

[31] However, counsel to the Applicants acknowledges that the discretionary authority of the court under s. 11 must be informed by the purpose of the CCAA.

> Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. *Re Stelco Inc.* (2005), 9 C.B.R. (5th) 135 (Ont. C.A.) at para. 44.

[32] In support of the court's jurisdiction to grant the order sought in this case, counsel to the Applicants submits that Nortel seeks to invoke the "overarching policy" of the CCAA, namely, to preserve the going concern. *Re Residential Warranty Co. of Canada Inc.* (2006), 21 C.B.R. (5th) 57 (Alta. Q.B.) at para. 78.

[33] Counsel to the Applicants further submits that CCAA courts have repeatedly noted that the purpose of the CCAA is to preserve the benefit of a going concern business for all stakeholders, or "the whole economic community":

> The purpose of the CCAA is to facilitate arrangements that might avoid liquidation of the company and allow it to continue in business to the benefit of the whole economic community, including the shareholders, the creditors (both secured and unsecured) and the employees. *Citibank Canada v. Chase Manhattan Bank of Canada* (1991), 5 C.B.R. (3rd) 167 (Ont. Gen. Div.) at para. 29. *Re Consumers Packaging Inc.* (2001) 27 C.B.R. (4th) 197 (Ont. C.A.) at para. 5.

[34] Counsel to the Applicants further submits that the CCAA should be given a broad and liberal interpretation to facilitate its underlying purpose, including the preservation of the going concern for the benefit of all stakeholders and further that it should not matter whether the business continues as a going concern under the debtor's stewardship or under new ownership, for as long as the business continues as a going concern, a primary goal of the CCAA will be met.

[35] Counsel to the Applicants makes reference to a number of cases where courts in Ontario, in appropriate cases, have exercised their jurisdiction to approve a sale of assets, even in the absence of a plan of arrangement being tendered to stakeholders for a vote. In doing so, counsel to the Applicants submits that the courts have repeatedly recognized that they have jurisdiction under the CCAA to approve asset sales in the absence of a plan of arrangement, where such sale is in the best interests of stakeholders generally. *Re Canadian Red Cross Society, supra, Re PSINet, supra, Re Consumers Packaging, supra, Re Stelco Inc.* (2004), 6 C.B.R. (5th) 316 (Ont. S.C.J.) at para. 1, *Re Tiger Brand Knitting Co.* (2005) 9 C.B.R. (5th) 315, *Re Caterpillar*

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Financial Services Ltd. v. Hardrock Paving Co. (2008), 45 C.B.R. (5th) 87 and *Re Lehndorff General Partner Ltd.* (1993), 17 C.B.R. (3rd) 24 (Ont. Gen. Div.).

[36] In *Re Consumers Packaging, supra*, the Court of Appeal for Ontario specifically held that a sale of a business as a going concern during a CCAA proceeding is consistent with the purposes of the CCAA:

> The sale of Consumers' Canadian glass operations as a going concern pursuant to the Owens-Illinois bid allows the preservation of Consumers' business (albeit under new ownership), and is therefore consistent with the purposes of the CCAA.
>
> ...we cannot refrain from commenting that Farley J.'s decision to approve the Owens-Illinois bid is consistent with previous decisions in Ontario and elsewhere that have emphasized the broad remedial purpose of flexibility of the CCAA and have approved the sale and disposition of assets during CCAA proceedings prior to a formal plan being tendered. *Re Consumers Packaging, supra, at paras. 5, 9.*

[37] Similarly, in *Re Canadian Red Cross Society, supra*, Blair J. (as he then was) expressly affirmed the court's jurisdiction to approve a sale of assets in the course of a CCAA proceeding before a plan of arrangement had been approved by creditors. *Re Canadian Red Cross Society, supra*, at paras. 43, 45.

[38] Similarly, in *PSINet Limited, supra*, the court approved a going concern sale in a CCAA proceeding where no plan was presented to creditors and a substantial portion of the debtor's Canadian assets were to be sold. Farley J. noted as follows:

> [If the sale was not approved,] there would be a liquidation scenario ensuing which would realize far less than this going concern sale (which appears to me to have involved a transparent process with appropriate exposure designed to maximize the proceeds), thus impacting upon the rest of the creditors, especially as to the unsecured, together with the material enlarging of the unsecured claims by the disruption claims of approximately 8,600 customers (who will be materially disadvantaged by an interrupted transition) plus the job losses for approximately 200 employees. *Re PSINet Limited, supra*, at para. 3.

[39] In *Re Stelco Inc., supra*, in 2004, Farley J. again addressed the issue of the feasibility of selling the operations as a going concern:

> I would observe that usually it is the creditor side which wishes to terminate CCAA proceedings and that when the creditors threaten to take action, there is a realization that a liquidation scenario will not only have a negative effect upon a CCAA applicant, but also upon its workforce. Hence, the CCAA may be employed to provide stability during a period of necessary financial and operational restructuring – and if a restructuring of the "old company" is not

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> feasible, then there is the exploration of the feasibility of the sale of the operations/enterprise as a going concern (with continued employment) in whole or in part. *Re Stelco Inc, supra*, at para. 1.

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[40] I accept these submissions as being general statements of the law in Ontario. The value of equity in an insolvent debtor is dubious, at best, and, in my view, it follows that the determining factor should not be whether the business continues under the debtor's stewardship or under a structure that recognizes a new equity structure. An equally important factor to consider is whether the case can be made to continue the business as a going concern.

[41] Counsel to the Applicants also referred to decisions from the courts in Quebec, Manitoba and Alberta which have similarly recognized the court's jurisdiction to approve a sale of assets during the course of a CCAA proceeding. *Re Boutique San Francisco Inc.* (2004), 7 C.B.R. (5th) 189 (Quebec S. C.), *Re Winnipeg Motor Express Inc.* (2008), 49 C.B.R. (5th) 302 (Man. Q.B.) at paras. 41, 44, and *Re Calpine Canada Energy Limited* (2007), 35 C.B.R. (5th) (Alta. Q.B.) at para. 75.

[42] Counsel to the Applicants also directed the court's attention to a recent decision of the British Columbia Court of Appeal which questioned whether the court should authorize the sale of substantially all of the debtor's assets where the debtor's plan "will simply propose that the net proceeds from the sale...be distributed to its creditors". In *Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp.* (2008), 46 C.B.R. (5th) 7 (B.C.C.A.) ("*Cliffs Over Maple Bay*"), the court was faced with a debtor who had no active business but who nonetheless sought to stave off its secured creditor indefinitely. The case did not involve any type of sale transaction but the Court of Appeal questioned whether a court should authorize the sale under the CCAA without requiring the matter to be voted upon by creditors.

[43] In addressing this matter, it appears to me that the British Columbia Court of Appeal focussed on whether the court should grant the requested relief and not on the question of whether a CCAA court has the jurisdiction to grant the requested relief.

[44] I do not disagree with the decision in *Cliffs Over Maple Bay*. However, it involved a situation where the debtor had no active business and did not have the support of its stakeholders. That is not the case with these Applicants.

[45] The *Cliffs Over Maple Bay* decision has recently been the subject of further comment by the British Columbia Court of Appeal in *Asset Engineering L.P. v. Forest and Marine Financial Limited Partnership* (2009) B.C.C.A. 319.

[46] At paragraphs 24 - 26 of the *Forest and Marine* decision, Newbury J.A. stated:

> 24. In *Cliffs Over Maple Bay*, the debtor company was a real estate developer whose one project had failed. The company had been dormant for some time. It applied for CCAA protection but described its proposal for restructuring in vague terms that amounted essentially to a plan to "secure sufficient funds" to complete the stalled project (Para. 34). This court, per Tysoe J.A., ruled that although the

Act can apply to single-project companies, its purposes are unlikely to be engaged in such instances, since mortgage priorities are fully straight forward and there will be little incentive for senior secured creditors to compromise their interests (Para. 36). Further, the Court stated, the granting of a stay under s. 11 is "not a free standing remedy that the court may grant whenever an insolvent company wishes to undertake a "restructuring"...Rather, s. 11 is ancillary to the fundamental purpose of the CCAA, and a stay of proceedings freezing the rights of creditors should only be granted in furtherance of the CCAA's fundamental purpose". That purpose has been described in Meridian Developments Inc. v. Toronto Dominion Bank (1984) 11 D.L.R. (4th) 576 (Alta. Q.B.):

> The legislation is intended to have wide scope and allow a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors. [at 580]

25. The Court was not satisfied in *Cliffs Over Maple Bay* that the "restructuring" contemplated by the debtor would do anything other than distribute the net proceeds from the sale, winding up or liquidation of its business. The debtor had no intention of proposing a plan of arrangement, and its business would not continue following the execution of its proposal – thus it could not be said the purposes of the statute would be engaged...

26. In my view, however, the case at bar is quite different from *Cliffs Over Maple Bay*. Here, the main debtor, the Partnership, is at the centre of a complicated corporate group and carries on an active financing business that it hopes to save notwithstanding the current economic cycle. (The business itself which fills a "niche" in the market, has been carried on in one form or another since 1983.) The CCAA is appropriate for situations such as this where it is unknown whether the "restructuring" will ultimately take the form of a refinancing or will involve a reorganization of the corporate entity or entities and a true compromise of the rights of one or more parties. The "fundamental purpose" of the Act – to preserve the *status quo* while the debtor prepares a plan that will enable it to remain in business to the benefit of all concerned – will be furthered by granting a stay so that the means contemplated by the Act – a compromise or arrangement – can be developed, negotiated and voted on if necessary...

[47] It seems to me that the foregoing views expressed in *Forest and Marine* are not inconsistent with the views previously expressed by the courts in Ontario. The CCAA is intended to be flexible and must be given a broad and liberal interpretation to achieve its objectives and a sale by the debtor which preserves its business as a going concern is, in my view, consistent with those objectives.

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[48] I therefore conclude that the court does have the jurisdiction to authorize a sale under the CCAA in the absence of a plan.

[49] I now turn to a consideration of whether it is appropriate, in this case, to approve this sales process. Counsel to the Applicants submits that the court should consider the following factors in determining whether to authorize a sale under the CCAA in the absence of a plan:

(a) is a sale transaction warranted at this time?

(b) will the sale benefit the whole "economic community"?

(c) do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?

(d) is there a better viable alternative?

I accept this submission.

[50] It is the position of the Applicants that Nortel's proposed sale of the Business should be approved as this decision is to the benefit of stakeholders and no creditor is prejudiced. Further, counsel submits that in the absence of a sale, the prospects for the Business are a loss of competitiveness, a loss of value and a loss of jobs.

[51] Counsel to the Applicants summarized the facts in support of the argument that the Sale Transaction should be approved, namely:

(a) Nortel has been working diligently for many months on a plan to reorganize its business;

(b) in the exercise of its business judgment, Nortel has concluded that it cannot continue to operate the Business successfully within the CCAA framework;

(c) unless a sale is undertaken at this time, the long-term viability of the Business will be in jeopardy;

(d) the Sale Agreement continues the Business as a going concern, will save at least 2,500 jobs and constitutes the best and most valuable proposal for the Business;

(e) the auction process will serve to ensure Nortel receives the highest possible value for the Business;

(f) the sale of the Business at this time is in the best interests of Nortel and its stakeholders; and

(g) the value of the Business is likely to decline over time.

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[52] The objections of MatlinPatterson and the UCC have been considered. I am satisfied that the issues raised in these objections have been addressed in a satisfactory manner by the ruling of Judge Gross and no useful purpose would be served by adding additional comment.

[53] Counsel to the Applicants also emphasize that Nortel will return to court to seek approval of the most favourable transaction to emerge from the auction process and will aim to satisfy the elements established by the court for approval as set out in *Royal Bank v. Soundair* (1991), 7 C.B.R. (3rd) 1 (Ont. C.A.) at para. 16.

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DISPOSITION

[54] The Applicants are part of a complicated corporate group. They carry on an active international business. I have accepted that an important factor to consider in a CCAA process is whether the case can be made to continue the business as a going concern. I am satisfied having considered the factors referenced at [49], as well as the facts summarized at [51], that the Applicants have met this test. I am therefore satisfied that this motion should be granted.

[55] Accordingly, I approve the Bidding Procedures as described in the Riedel Affidavit and the Fourteenth Report of the Monitor, which procedures have been approved by the U.S. Court.

[56] I am also satisfied that the Sale Agreement should be approved and further that the Sale Agreement be approved and accepted for the purposes of conducting the "stalking horse" bidding process in accordance with the Bidding Procedures including, without limitation the Break-Up Fee and the Expense Reimbursement (as both terms are defined in the Sale Agreement).

[57] Further, I have also been satisfied that Appendix B to the Fourteenth Report contains information which is commercially sensitive, the dissemination of which could be detrimental to the stakeholders and, accordingly, I order that this document be sealed, pending further order of the court.

[58] In approving the Bidding Procedures, I have also taken into account that the auction will be conducted prior to the sale approval motion. This process is consistent with the practice of this court.

[59] Finally, it is the expectation of this court that the Monitor will continue to review ongoing issues in respect of the Bidding Procedures. The Bidding Procedures permit the Applicants to waive certain components of qualified bids without the consent of the UCC, the bondholder group and the Monitor. However, it is the expectation of this court that, if this situation arises, the Applicants will provide advance notice to the Monitor of its intention to do so.

MORAWETZ J.

Heard and Decided: June 29, 2009

Reasons Released: July 23, 2009

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TAB "2"

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended and in the Matter of a Proposed Plan of Compromise or Arrangement with respect to Stelco Inc., and other Applicants listed in Schedule "A" Application under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 as amended

[Indexed as: Stelco Inc. (Re)]

Court of Appeal for Ontario, Goudge, Feldman and Blair JJ.A.
March 31, 2005

Corporations — Directors — Removal of directors — Jurisdiction of court to remove directors — Restructuring supervised by court under Companies' Creditors Arrangement Act — Supervising judge erring in removing directors based on apprehension that directors would not act in best interests of corporation — In context of restructuring, court not having inherent jurisdiction to remove directors — Removal of directors governed by normal principles of corporate law and not by court's authority under s. 11 of Companies' Creditors Arrangement Act to supervise restructuring — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

Debtor and creditor — Arrangements — Removal of directors — Jurisdiction of court to remove directors — Restructuring supervised by court under the Companies' Creditors Arrangement Act — Supervising judge erring in removing directors based on apprehension that directors would not act in best interests of corporation — In context of restructuring, court not having inherent jurisdiction to remove directors — Removal of directors governed by normal principles of corporate law and not by court's authority under s. 11 of Companies' Creditors Arrangement Act to supervise restructuring — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

On January 29, 2004, Stelco Inc. ("Stelco") obtained protection from creditors under the *Companies' Creditors Arrangement Act* ("*CCAA*"). Subsequently, while a restructuring under the *CCAA* was under way, Clearwater Capital Management Inc. ("Clearwater") and Equilibrium Capital Management Inc. ("Equilibrium") acquired a 20 per cent holding in the outstanding publicly traded common shares of Stelco. Michael Woollcombe and Roland Keiper, who were associated with Clearwater and Equilibrium, asked to be appointed to the Stelco board of directors, which had been depleted as a result of resignations. Their request was supported by other shareholders who, together with Clearwater and Equilibrium, represented about 40 per cent of the common shareholders. On February 18, 2005, the Board acceded to the request and Woollcombe and Keiper were appointed to the Board. On the same day as their appointments, the board of directors began consideration of competing bids that had been received as a result of a court-approved capital raising process that had become the focus of the *CCAA* restructuring.

The appointment of Woollcombe and Keiper to the Board incensed the employees of Stelco. They applied to the court to have the appointments set aside. The employees argued that there was a reasonable apprehension that Woollcombe

and Keiper would not be able to act in the best interests of Stelco as opposed to their own best interests as shareholders. Purporting to rely on the court's inherent jurisdiction and the discretion provided by the *CCAA*, on February 25, 2005, Farley J. ordered Woollcombe and Keiper removed from the Board.

Woollcombe and Keiper applied for leave to appeal the order of Farley J. and if leave be granted, that the order be set aside on the grounds that (a) Farley J. did not have the jurisdiction to make the order under the provisions of the *CCAA*, (b) even if he did have jurisdiction, the reasonable apprehension of bias test had no application to the removal of directors, (c) he had erred in interfering with the exercise by the Board of its business judgment in filling the vacancies on the Board, and (d) in any event, the facts did not meet any test that would justify the removal of directors by a court.

Held, leave to appeal should be granted, and the appeal should be allowed.

The appeal involved the scope of a judge's discretion under s. 11 of the *CCAA*, in the context of corporate governance decisions made during the course of the plan negotiating and approval process of the *CCAA*. In particular, it involved the court's power, if any, to make an order removing directors under s. 11 of the *CCAA*. The order to remove directors could not be founded on inherent jurisdiction. Inherent jurisdiction is a power derived from the very nature of the court as a superior court of law, and it permits the court to maintain its authority and to prevent its process from being obstructed and abused. However, inherent jurisdiction does not operate where Parliament or the legislature has acted and, in the *CCAA* context, the discretion given by s. 11 to stay proceedings against the debtor corporation and the discretion given by s. 6 to approve a plan which appears to be reasonable and fair supplanted the need to resort to inherent jurisdiction. A judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a *CCAA* proceeding. The order in this case could not be founded on inherent jurisdiction because it was designed to supervise the company's process, not the court's process.

The issue then was the nature of the court's power under s. 11 of the *CCAA*. The s. 11 discretion is not open-ended and unfettered. Its exercise was guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. What the court does under s. 11 is establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. In the course of acting as referee, the court has authority to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. The court is not entitled to usurp the role of the directors and management in conducting what are in substance the company's restructuring efforts. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. The court is not catapulted into the shoes of the board of directors or into the seat of the chair of the board when acting in its supervisory role in the restructuring.

The matters relating to the removal of directors did not fall within the court's discretion under s. 11. The fact that s. 11 did not itself provide the authority for a *CCAA* judge to order the removal of directors, however, did not mean that the supervising judge was powerless to make such an order. Section 20 of the *CCAA* offered a gateway to the oppression remedy and other provisions of the *Canada*

Business Corporations Act, R.S.C. 1985, c. C-44 ("*CBCA*") and similar provincial statutes. The powers of a judge under s. 11 of the *CCAA* may be applied together with the provisions of the *CBCA*, including the oppression remedy provisions of that statute.

Court removal of directors is an exceptional remedy and one that is rarely exercised in corporate law. In determining whether directors have fallen foul of their obligations, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office. The evidence in this case was far from reaching the standard for removal, and the record would not support a finding of oppression, even if one had been sought. The record did not support a finding that there was a sufficient risk of misconduct to warrant a conclusion of oppression. Further, Farley J.'s borrowing the administrative law notion of apprehension of bias was foreign to the principles that govern the election, appointment and removal of directors and to corporate governance considerations in general. There was nothing in the *CBCA* or other corporate legislation that envisaged the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment. The issue to be determined was not whether there was a connection between a director and other shareholders or stakeholders, but rather whether there was some conduct on the part of the director that would justify the imposition of a corrective sanction. An apprehension of bias approach did not fit this sort of analysis.

For these reasons, Farley J. erred in declaring the appointment of Woollcombe and Keiper as directors of Stelco of no force and effect, and the appeal should be allowed.

Cases referred to

Alberta Pacific Terminals Ltd. (Re), [1991] B.C.J. No. 1065, 8 C.B.R. (3d) 99 (S.C.); *Algoma Steel Inc. (Re)*, [2001] O.J. No. 1943, 147 O.A.C. 291, 25 C.B.R. (4th) 194 (C.A.); *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78, [2003] O.J. No. 71, 39 C.B.R. (4th) 5 (C.A.), revg in part [2001] O.J. No. 5046, 30 C.B.R. (4th) 163 (S.C.J.); *Babcock & Wilcox Canada Ltd. (Re)* [2000] O.J. No. 786, 18 C.B.R. (4th) 157, 5 B.L.R. (3d) 75 (S.C.J.); *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, 57 D.L.R. (3d) 1, 5 N.R. 515, [1976] 1 W.W.R. 1, 20 C.B.R. (N.S.) 240; *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, [1995] S.C.J. No. 29, 25 O.R. (3d) 480*n*, 128 D.L.R. (4th) 73, 187 N.R. 241, 24 B.L.R. (2d) 161; *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, [1991] O.J. No. 683, 45 O.A.C. 320, 80 D.L.R. (4th) 161, 1 B.L.R. (2d) 225 (C.A.); *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2004] O.J. No. 4722, 1 B.L.R. (4th) 186 (S.C.J.); *Chef Ready Foods Ltd. v. Hongkong Bank of Canada*, [1990] B.C.J. No. 2384, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136, 4 C.B.R. (3d) 311 (C.A.); *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.* [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187, 2003 BCCA 344, 13 B.C.L.R. (4th) 236 (C.A.); *Country Style Foods Services Inc. (Re)*, [2002] O.J. No. 1377, 158 O.A.C. 30 (C.A.); *Dylex Ltd. (Re)*, [1995] O.J. No. 595, 31 C.B.R. (3d) 106 (Gen. Div.); *Ivaco Inc. (Re)*, [2004] O.J. No. 2483, 3 C.B.R. (5th) 33 (S.C.J.); *Lehndorff General Partner Ltd. (Re)*, [1993] O.J. No. 14, 9 B.L.R. (2d) 275, 17 C.B.R. (3d) 24 (Gen. Div.); *London Finance Corp. Ltd. v. Banking Service Corp. Ltd.*, [1922] O.J. No. 378, 23 O.W.N. 138 (H.C.); *Olympia & York Developments Ltd. (Re)* (1993), 12 O.R. (3d) 500, [1993] O.J. No. 545, 17 C.B.R. (3d) 1 (Gen. Div.) (*sub nom. Olympia & York Dev. v. Royal Trust Co.*); *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, 244 D.L.R. (4th) 564, 2004 SCC 68, 49 B.L.R. (3d) 165, 4 C.B.R. (5th) 215; *R. v. Sharpe*, [2001] 1 S.C.R. 45, [2001]

S.C.J. No. 3, 88 B.C.L.R. (3d) 1, 194 D.L.R. (4th) 1, [2001] 6 W.W.R. 1, 86 C.R.R. (2d) 1, 150 C.C.C. (3d) 321, 39 C.R. (5th) 72, [2001] SCC 2; *Richtree Inc. (Re)* (2005), 74 O.R. (3d) 174, [2005] O.J. No. 251, 7 C.B.R. (5th) 294 (S.C.J.); *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, [1998] S.C.J. No. 2, 36 O.R. (3d) 418*n*, 154 D.L.R. (4th) 193, 221 N.R. 241, 50 C.B.R. (3d) 163, 33 C.C.E.L. (2d) 173, 98 CLLC 210-006 (*sub nom. Ontario Ministry of Labour v. Rizzo & Rizzo Shoes Ltd., Adrien v. Ontario Ministry of Labour*); *Royal Oak Mines Inc. (Re)*, [1999] O.J. No. 864, 7 C.B.R. (4th) 293, 96 O.T.C. 279 (Gen. Div.); *Sammi Atlas Inc. (Re)*, [1998] O.J. No. 1089, 3 C.B.R. (4th) 171 (Gen. Div.); *Stephenson v. Vokes* (1896), 27 O.R. 691, [1896] O.J. No. 191 (H.C.J.); *Westar Mining Ltd. (Re)*, [1992] B.C.J. No. 1360, 14 C.B.R. (3d) 88, 70 B.C.L.R. (2d) 6, [1992] 6 W.W.R. 331 (S.C.)

Statutes referred to

Canada Business Corporations Act, R.S.C. 1985, c. C-44, ss. 2 [as am.], 102 [as am.], 106(3) [as am], 109(1) [as am.], 111 [as am.], 122(1) [as am.], 145 [as am.], 241 [as am.]

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APPLICATION for leave to appeal and, if leave is granted, an appeal from the order of Farley J., reported at [2005] O.J. No. 729, 7 C.B.R. (5th) 307 (S.C.J.), removing two directors from the board of directors of Stelco Inc.

Jeffrey S. Leon and *Richard B. Swan*, for appellants Michael Woollcombe and Roland Keiper.

Kenneth T. Rosenberg and *Robert A. Centa*, for respondent United Steelworkers of America.

Murray Gold and *Andrew J. Hatnay*, for respondent Retired Salaried Beneficiaries of Stelco Inc., CHT Steel Company Inc., Stelpipe Ltd., Stelwire Ltd. And Welland Pipe Ltd.

Michael C.P. McCreary and *Carrie L. Clynick*, for USWA Locals 5328 and 8782.

John R. Varley, for Active Salaried Employee Representative.

Michael Barrack, for Stelco Inc.

Peter Griffin, for Board of Directors of Stelco Inc.

K. Mahar, for Monitor.

David R. Byers, for CIT Business Credit, Agent for DIP Lender.

The judgment of the court was delivered by

BLAIR J.A.: —

Part I — Introduction

[1] Stelco Inc. and four of its wholly-owned subsidiaries obtained protection from their creditors under the *Companies' Creditors Arrangement Act* (the "*CCAA*")[1] on January 29, 2004. Since that time, the Stelco Group has been engaged in a high profile, and sometimes controversial, process of economic restructuring. Since October 2004, the restructuring has revolved around a court-approved capital raising process which, by February 2005, had generated a number of competitive bids for the Stelco Group.

[2] Farley J., an experienced judge of the Superior Court Commercial List in Toronto, has been supervising the *CCAA* process from the outset.

[3] The appellants, Michael Woollcombe and Roland Keiper, are associated with two companies — Clearwater Capital Management Inc. and Equilibrium Capital Management Inc. — which, respectively, hold approximately 20 per cent of the outstanding publicly traded common shares of Stelco. Most of these shares have been acquired while the *CCAA* process has been ongoing, and Messrs. Woollcombe and Keiper have made it clear publicly that they believe there is good shareholder value in Stelco in spite of the restructuring. The reason they are able to take this position is that there has been a solid turn around in worldwide steel markets, as a result of which Stelco, although remaining in insolvency protection, is earning annual operating profits.

[4] The Stelco board of directors (the "Board") has been depleted as a result of resignations, and in January of this year Messrs. Woollcombe and Keiper expressed an interest in being appointed to the Board. They were supported in this request by other shareholders who, together with Clearwater and Equilibrium, represent about 40 per cent of the Stelco common shareholders. On February 18, 2005, the Board appointed the appellants directors. In announcing the appointments publicly, Stelco said in a press release:

> After careful consideration, and given potential recoveries at the end of the company's restructuring process, the Board responded favourably to the requests by making the appointments announced today.
>
> Richard Drouin, Chairman of Stelco's Board of Directors, said: "I'm pleased to welcome Roland Keiper and Michael Woollcombe to the Board. Their

1 R.S.C. 1985, c. C-36, as amended.

experience and their perspective will assist the Board as it strives to serve the best interests of all our stakeholders. We look forward to their positive contribution."

[5] On the same day, the Board began its consideration of the various competing bids that had been received through the capital raising process.

[6] The appointments of the appellants to the Board incensed the employee stakeholders of Stelco (the "Employees"), represented by the respondent Retired Salaried Beneficiaries of Stelco and the respondent United Steelworkers of America ("USWA"). Outstanding pension liabilities to current and retired employees are said to be Stelco's largest long-term liability — exceeding several billion dollars. The Employees perceive they do not have the same, or very much, economic leverage in what has sometimes been referred to as "the bare knuckled arena" of the restructuring process. At the same time, they are amongst the most financially vulnerable stakeholders in the piece. They see the appointments of Messrs. Woollcombe and Keiper to the Board as a threat to their well being in the restructuring process because the appointments provide the appellants, and the shareholders they represent, with direct access to sensitive information relating to the competing bids to which other stakeholders (including themselves) are not privy.

[7] The Employees fear that the participation of the two major shareholder representatives will tilt the bid process in favour of maximizing shareholder value at the expense of bids that might be more favourable to the interests of the Employees. They sought and obtained an order from Farley J. removing Messrs. Woollcombe and Keiper from their short-lived position of directors, essentially on the basis of that apprehension.

[8] The Employees argue that there is a reasonable apprehension the appellants would not be able to act in the best interests of the corporation — as opposed to their own best interests as shareholders — in considering the bids. They say this is so because of prior public statements by the appellants about enhancing shareholder value in Stelco, because of the appellants' linkage to such a large shareholder group, because of their earlier failed bid in the restructuring, and because of their opposition to a capital proposal made in the proceeding by Deutsche Bank (known as the "Stalking Horse Bid"). They submit further that the appointments have poisoned the atmosphere of the restructuring process, and that the Board made the appointments under threat of facing a potential shareholders' meeting where the members of the Board would be replaced en masse.

[9] On the other hand, Messrs. Woollcombe and Keiper seek to set aside the order of Farley J. on the grounds that (a) he did not have the jurisdiction to make the order under the provisions of the *CCAA*, (b) even if he did have jurisdiction, the reasonable apprehension of bias test applied by the motion judge has no application to the removal of directors, (c) the motion judge erred in interfering with the exercise by the Board of its business judgment in filling the vacancies on the Board, and (d) the facts do not meet any test that would justify the removal of directors by a court in any event.

[10] For the reasons that follow, I would grant leave to appeal, allow the appeal and order the reinstatement of the applicants to the Board.

Part II — Additional Facts

[11] Before the initial *CCAA* order on January 29, 2004, the shareholders of Stelco had last met at their annual general meeting on April 29, 2003. At that meeting they elected 11 directors to the Board. By the date of the initial order, three of those directors had resigned, and on November 30, 2004, a fourth did as well, leaving the company with only seven directors.

[12] Stelco's articles provide for the Board to be made up of a minimum of ten and a maximum of 20 directors. Consequently, after the last resignation, the company's corporate governance committee began to take steps to search for new directors. They had not succeeded in finding any prior to the approach by the appellants in January 2005.

[13] Messrs. Woollcombe and Keiper had been accumulating shares in Stelco and had been participating in the *CCAA* proceedings for some time before their request to be appointed to the Board, through their companies, Clearwater and Equilibrium. Clearwater and Equilibrium are privately held, Ontario-based investment management firms. Mr. Keiper is the president of Equilibrium and associated with Clearwater. Mr. Woollcombe is a consultant to Clearwater. The motion judge found that they "come as a package".

[14] In October 2004, Stelco sought court approval of its proposed method of raising capital. On October 19, 2004, Farley J. issued what has been referred to as the Initial Capital Process Order. This order set out a process by which Stelco, under the direction of the Board, would solicit bids, discuss the bids with stakeholders, evaluate the bids and report on the bids to the court.

[15] On November 9, 2004, Clearwater and Equilibrium announced they had formed an investor group and had made a

capital proposal to Stelco. The proposal involved the raising of $125 million through a rights offering. Mr. Keiper stated at the time that he believed "the value of Stelco's equity would have the opportunity to increase substantially if Stelco emerged from *CCAA* while minimizing dilution of its shareholders." The Clearwater proposal was not accepted.

[16] A few days later, on November 14, 2004, Stelco approved the Stalking Horse Bid. Clearwater and Equilibrium opposed the Deutsche Bank proposal. Mr. Keiper criticized it for not providing sufficient value to existing shareholders. However, on November 29, 2004, Farley J. approved the Stalking Horse Bid and amended the Initial Capital Process Order accordingly. The order set out the various channels of communication between Stelco, the monitor, potential bidders and the stakeholders. It provided that members of the Board were to see the details of the different bids before the Board selected one or more of the offers.

[17] Subsequently, over a period of two and a half months, the shareholding position of Clearwater and Equilibrium increased from approximately five per cent as at November 19, to 14.9 per cent as at January 25, 2005, and finally to approximately 20 per cent on a fully diluted basis as at January 31, 2005. On January 25, Clearwater and Equilibrium announced that they had reached an understanding jointly to pursue efforts to maximize shareholder value at Stelco. A press release stated:

> Such efforts will include seeking to ensure that the interests of Stelco's equity holders are appropriately protected by its board of directors and, ultimately, that Stelco's equity holders have an appropriate say, by vote or otherwise, in determining the future course of Stelco.

[18] On February 1, 2005, Messrs. Keiper and Woollcombe and other representatives of Clearwater and Equilibrium met with Mr. Drouin and other Board members to discuss their views of Stelco and a fair outcome for all stakeholders in the proceedings. Mr. Keiper made a detailed presentation, as Mr. Drouin testified, "encouraging the Board to examine how Stelco might improve its value through enhanced disclosure and other steps". Mr. Keiper expressed confidence that "there was value to the equity of Stelco", and added that he had backed this view up by investing millions of dollars of his own money in Stelco shares. At that meeting, Clearwater and Equilibrium requested that Messrs. Woollcombe and Keiper be added to the Board and to Stelco's restructuring committee. In this respect, they were supported by other shareholders holding about another 20 per cent of the company's common shares.

[19] At paras. 17 and 18 of his affidavit, Mr. Drouin, summarized his appraisal of the situation:

> 17. It was my assessment that each of Mr. Keiper and Mr. Woollcombe had personal qualities which would allow them to make a significant contribution to the Board in terms of their backgrounds and their knowledge of the steel industry generally and Stelco in particular. In addition I was aware that their appointment to the Board was supported by approximately 40 per cent of the shareholders. In the event that these shareholders successfully requisitioned a shareholders meeting they were in a position to determine the composition of the entire Board.
>
> 18. I considered it essential that there be continuity of the Board through the *CCAA* process. I formed the view that the combination of existing Board members and these additional members would provide Stelco with the most appropriate board composition in the circumstances. The other members of the Board also shared my views.

[20] In order to ensure that the appellants understood their duties as potential Board members and, particularly that "they would no longer be able to consider only the interests of shareholders alone but would have fiduciary responsibilities as a Board member to the corporation as a whole", Mr. Drouin and others held several further meetings with Mr. Woollcombe and Mr. Keiper. These discussions "included areas of independence, standards, fiduciary duties, the role of the Board Restructuring Committee and confidentiality matters". Mr. Woollcombe and Mr. Keiper gave their assurances that they fully understood the nature and extent of their prospective duties, and would abide by them. In addition, they agreed and confirmed that:

(a) Mr. Woollcombe would no longer be an advisor to Clearwater and Equilibrium with respect to Stelco;

(b) Clearwater and Equilibrium would no longer be represented by counsel in the *CCAA* proceedings; and

(c) Clearwater and Equilibrium then had no involvement in, and would have no future involvement, in any bid for Stelco.

[21] On the basis of the foregoing — and satisfied "that Messrs. Keiper and Woollcombe would make a positive contribution to the various issues before the Board both in [the] restructuring and the ongoing operation of the business" — the Board made the appointments on February 18, 2005.

[22] Seven days later, the motion judge found it "appropriate, just, necessary and reasonable to declare" those appointments "to be of no force and effect" and to remove Messrs. Woollcombe and Keiper from the Board. He did so not on the basis of any actual conduct on the part of the appellants as directors of Stelco but

because there was some risk of anticipated conduct in the future. The gist of the motion judge's rationale is found in the following passage from his reasons (at para. 23):

> In these particular circumstances and aside from the Board feeling coerced into the appointments for the sake of continuing stability, I am not of the view that it would be appropriate to wait and see if there was any explicit action on behalf of K and W while conducting themselves as Board members which would demonstrate that they had not lived up to their obligations to be "neutral". They may well conduct themselves beyond reproach. But if they did not, the fallout would be very detrimental to Stelco and its ability to successfully emerge. What would happen to the bids in such a dogfight? I fear that it would be trying to put Humpty Dumpty back together again. The same situation would prevail even if K and W conducted themselves beyond reproach but with the Board continuing to be concerned that they not do anything seemingly offensive to the bloc. The risk to the process and to Stelco in its emergence is simply too great to risk the wait and see approach.

Part III — Leave to Appeal

[23] Because of the "real time" dynamic of this restructuring project, Laskin J.A. granted an order on March 4, 2005, expediting the appellants' motion for leave to appeal, directing that it be heard orally and, if leave be granted, directing that the appeal be heard at the same time. The leave motion and the appeal were argued together, by order of the panel, on March 18, 2005.

[24] This court has said that it will only sparingly grant leave to appeal in the context of a *CCAA* proceeding and will only do so where there are "serious and arguable grounds that are of real and significant interest to the parties": *Country Style Food Services Inc. (Re)*, [2002] O.J. No. 1377, 158 O.A.C. 30 (C.A.), at para. 15. This criterion is determined in accordance with a four-pronged test, namely,

(a) whether the point on appeal is of significance to the practice;

(b) whether the point is of significance to the action;

(c) whether the appeal is *prima facie* meritorious or frivolous;

(d) whether the appeal will unduly hinder the progress of the action.

[25] Counsel agree that (d) above is not relevant to this proceeding, given the expedited nature of the hearing. In my view, the tests set out in (a) – (c) are met in the circumstances, and as such, leave should be granted. The issue of the court's jurisdiction to intervene in corporate governance issues during a *CCAA* restructuring, and the scope of its discretion in doing so, are questions of considerable importance to the practice and on

which there is little appellate jurisprudence. While Messrs. Woollcombe and Keiper are pursuing their remedies in their own right, and the company and its directors did not take an active role in the proceedings in this court, the Board and the company did stand by their decision to appoint the new directors at the hearing before the motion judge and in this court, and the question of who is to be involved in the Board's decision-making process continues to be of importance to the *CCAA* proceedings. From the reasons that follow it will be evident that in my view the appeal has merit.

[26] Leave to appeal is therefore granted.

Part IV — The Appeal

The Positions of the Parties

[27] The appellants submit that,

(a) in exercising its discretion under the *CCAA*, the court is not exercising its "inherent jurisdiction" as a superior court;

(b) there is no jurisdiction under the *CCAA* to remove duly elected or appointed directors, notwithstanding the broad discretion provided by s. 11 of that Act; and that,

(c) even if there is jurisdiction, the motion judge erred:

  (i) by relying upon the administrative law test for reasonable apprehension of bias in determining that the directors should be removed;

  (ii) by rejecting the application of the "business judgment" rule to the unanimous decision of the Board to appoint two new directors; and,

  (iii) by concluding that Clearwater and Equilibrium, the shareholders with whom the appellants are associated, were focussed solely on a short-term investment horizon, without any evidence to that effect, and therefore concluding that there was a tangible risk that the appellants would not be neutral and act in the best interests of Stelco and all stakeholders in carrying out their duties as directors.

[28] The respondents' arguments are rooted in fairness and process. They say, first, that the appointment of the appellants as directors has poisoned the atmosphere of the *CCAA* proceedings and, second, that it threatens to undermine the even-handedness and integrity of the capital raising process, thus jeopardizing the

ability of the court at the end of the day to approve any compromise or arrangement emerging from that process. The respondents contend that Farley J. had jurisdiction to ensure the integrity of the *CCAA* process, including the capital raising process Stelco had asked him to approve, and that this court should not interfere with his decision that it was necessary to remove Messrs. Woollcombe and Keiper from the Board in order to ensure the integrity of that process. A judge exercising a supervisory function during a *CCAA* proceeding is owed considerable deference: *Re Algoma Steel Inc.*, [2001] O.J. No. 1943, 25 C.B.R. (4th) 194 (C.A.), at para. 8.

[29] The crux of the respondents' concern is well-articulated in the following excerpt from para. 72 of the factum of the Retired Salaried Beneficiaries:

> The appointments of Keiper and Woollcombe violated every tenet of fairness in the restructuring process that is supposed to lead to a plan of arrangement. One stakeholder group — particular investment funds that have acquired Stelco shares during the *CCAA* itself — have been provided with privileged access to the capital raising process, and voting seats on the Corporation's Board of Directors and Restructuring Committee. No other stakeholder has been treated in remotely the same way. To the contrary, the salaried retirees have been completely excluded from the capital raising process and have no say whatsoever in the Corporation's decision-making process.

[30] The respondents submit that fairness, and the perception of fairness, underpin the *CCAA* process, and depend upon effective judicial supervision: see *Re Olympia & York Development Ltd.* (1993), 12 O.R. (3d) 500, [1993] O.J. No. 545 (Gen. Div.); *Re Ivaco Inc.*, [2004] O.J. No. 2483, 3 C.B.R. (5th) 33 (S.C.J.), at paras. 15-16. The motion judge reasonably decided to remove the appellants as directors in the circumstances, they say, and this court should not interfere.

Jurisdiction

[31] The motion judge concluded that he had the power to rescind the appointments of the two directors on the basis of his "inherent jurisdiction" and "the discretion given to the court pursuant to the *CCAA*". He was not asked to, nor did he attempt to rest his jurisdiction on other statutory powers imported into the *CCAA*.

[32] The *CCAA* is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: *Babcock & Wilcox Canada Ltd. (Re)*, [2000] O.J. No. 786, 5 B.L.R. (3d) 75 (S.C.J.), at para. 11. See also, *Chef Ready Foods Ltd. v. Hong Kong Bank of Canada*, [1990] B.C.J. No. 2384, 4 C.B.R. (3d) 311 (C.A.), at p. 320 C.B.R.; *Re Lehndorff General Partners Ltd.*, [1993] O.J. No. 14,

17 C.B.R. (3d) 24 (Gen. Div.). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the *CCAA*, as the source of judicial power in a *CCAA* proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see *Re Dylex Ltd.*, [1995] O.J. No. 595, 31 C.B.R. (3d) 106 (Gen. Div. (Commercial List)), *Royal Oak Mines Inc. (Re)*, [1999] O.J. No. 864, 7 C.B.R. (4th) 293 (Gen. Div. (Commercial List)); and *Westar Mining Ltd. (Re)*, [1992] B.C.J. No. 1360, 70 B.C.L.R. (2d) 6 (S.C.).

[33] It is not necessary, for purposes of this appeal, to determine whether inherent jurisdiction is excluded for all supervisory purposes under the *CCAA*, by reason of the existence of the statutory discretionary regime provided in that Act. In my opinion, however, the better view is that in carrying out his or her supervisory functions under the legislation, the judge is not exercising inherent jurisdiction but rather the statutory discretion provided by s. 11 of the *CCAA* and supplemented by other statutory powers that may be imported into the exercise of the s. 11 discretion from other statutes through s. 20 of the *CCAA*.

Inherent jurisdiction

[34] Inherent jurisdiction is a power derived "from the very nature of the court as a superior court of law", permitting the court "to maintain its authority and to prevent its process being obstructed and abused". It embodies the authority of the judiciary to control its own process and the lawyers and other officials connected with the court and its process, in order "to uphold, to protect and to fulfill the judicial function of administering justice according to law in a regular, orderly and effective manner". See I.H. Jacob, "The Inherent Jurisdiction of the Court" (1970) 23 Current Legal Problems 27-28. In *Halsbury's Laws of England*, 4th ed. (London: LexisNexis UK, 1973–), vol. 37, at para. 14, the concept is described as follows:

> In sum, it may be said that the inherent jurisdiction of the court is a virile and viable doctrine, and has been defined as being the reserve or fund of powers, a residual source of powers, which the court may draw upon as necessary whenever it is just or equitable to do so, in particularly to ensure the observation of the due process of law, to prevent improper vexation or oppression, to do justice between the parties and to secure a fair trial between them.

[35] In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the legislature has acted. As Farley J. noted in *Royal Oak Mines, supra*, inherent jurisdiction is "not limitless; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should

not be brought into play" (para. 4). See also, *Baxter Student Housing Ltd. v. College Housing Co-operative Ltd.*, [1976] 2 S.C.R. 475, 57 D.L.R. (3d) 1, at p. 480 S.C.R.; *Richtree Inc. (Re)* (2005), 74 O.R. (3d) 174, [2005] O.J. No. 251 (S.C.J.).

[36] In the *CCAA* context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In that regard, I agree with the comment of Newbury J.A. in *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc.*, [2003] B.C.J. No. 1335, 43 C.B.R. (4th) 187 (C.A.), at para. 46, that:

> . . . the court is not exercising a power that arises from its nature as a superior court of law, but is exercising the discretion given to it by the *CCAA*. . . . This is the discretion, given by s. 11, to stay proceedings against the debtor corporation and the discretion, given by s. 6, to approve a plan which appears to be reasonable and fair, to be in accord with the requirements and objects of the statute, and to make possible the continuation of the corporation as a viable entity. It is these considerations the courts have been concerned with in the cases discussed above,[2] rather than the integrity of their own process.

[37] As Jacob observes, in his article "The Inherent Jurisdiction of the Court", *supra*, at p. 25:

> The inherent jurisdiction of the court is a concept which must be distinguished from the exercise of judicial discretion. These two concepts resemble each other, particularly in their operation, and they often appear to overlap, and are therefore sometimes confused the one with the other. There is nevertheless a vital juridical distinction between jurisdiction and discretion, which must always be observed.

[38] I do not mean to suggest that inherent jurisdiction can never apply in a *CCAA* context. The court retains the ability to control its own process, should the need arise. There is a distinction, however — difficult as it may be to draw — between the *court's* process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the *company's* process, on the other hand. The court simply supervises the latter

2 The reference is to the decisions in *Dyle*, *Royal Oak Mines* and *Westar*, cited above.

process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose".[3] Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a *CCAA* proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process.

The section 11 discretion

[39] This appeal involves the scope of a supervisory judge's discretion under s. 11 of the *CCAA*, in the context of corporate governance decisions made during the course of the plan negotiating and approval process and, in particular, whether that discretion extends to the removal of directors in that environment. In my view, the s. 11 discretion — in spite of its considerable breadth and flexibility — does not permit the exercise of such a power in and of itself. There may be situations where a judge in a *CCAA* proceeding would be justified in ordering the removal of directors pursuant to the oppression remedy provisions found in s. 241 of the *Canada Business Corporation Act*, R.S.C. 1985, c. C-44 ("*CBCA*"), and imported into the exercise of the s. 11 discretion through s. 20 of the *CCAA*. However, this was not argued in the present case, and the facts before the court would not justify the removal of Messrs. Woollcombe and Keiper on oppression remedy grounds.

[40] The pertinent portions of s. 11 of the *CCAA* provide as follows:

> *Powers of court*
>
> 11(1) Notwithstanding anything in the *Bankruptcy and Insolvency Act* or the *Winding-up Act*, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.
>
> . . . . .
>
> *Initial application court orders*
>
> (3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days.
>
> (*a*) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);

3 See para. 43, *infra*, where I elaborate on this distinction.

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Other than initial application court orders

(4) A court may, on an application in respect of a company other than an initial application, make an order on such terms as it may impose,

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

(*b*) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and

(*c*) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

. . . . .

Burden of proof on application

(6) The court shall not make an order under subsection (3) or (4) unless

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

(*b*) in the case of an order under subsection (4), the applicant also satisfied the court that the applicant has acted, and is acting, in good faith and with due diligence.

[41] The rule of statutory interpretation that has now been accepted by the Supreme Court of Canada, in such cases as *R. v. Sharpe*, [2001] 1 S.C.R. 45, [2001] S.C.J. No. 3, at para. 33, and *Rizzo & Rizzo Shoes Ltd. (Re)*, [1998] 1 S.C.R. 27, [1998] S.C.J. No. 2, at para. 21, is articulated in E.A. Driedger, *The Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983) as follows:

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

See also Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Toronto: Butterworths, 2002), at p. 262.

[42] The interpretation of s. 11 advanced above is true to these principles. It is consistent with the purpose and scheme of the *CCAA*, as articulated in para. 38 above, and with the fact that corporate governance matters are dealt with in other statutes. In addition, it honours the historical reluctance of courts to intervene in such matters, or to second-guess the business decisions

made by directors and officers in the course of managing the business and affairs of the corporation.

[43] Mr. Leon and Mr. Swan argue that matters relating to the removal of directors do not fall within the court's discretion under s. 11 because they fall outside of the parameters of the court's role in the restructuring process, in contrast to the company's role in the restructuring process. The court's role is defined by the "on such terms as may be imposed" jurisdiction under sub-paras. 11(3)(*a*)–(*c*) and 11(4)(*a*)–(*c*) of the *CCAA* to stay, or restrain, or prohibit proceedings against the company during the "breathing space" period for negotiations and a plan. I agree.

[44] What the court does under s. 11 is to establish the boundaries of the playing field and act as a referee in the process. The company's role in the restructuring, and that of its stakeholders, is to work out a plan or compromise that a sufficient percentage of creditors will accept and the court will approve and sanction. The corporate activities that take place in the course of the workout are governed by the legislation and legal principles that normally apply to such activities. In the course of acting as referee, the court has great leeway, as Farley J. observed in *Lehndorff*, *supra*, at para. 5, "to make order[s] so as to effectively maintain the status quo in respect of an insolvent company while it attempts to gain the approval of its creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors". But the s. 11 discretion is not open-ended and unfettered. Its exercise must be guided by the scheme and object of the Act and by the legal principles that govern corporate law issues. Moreover, the court is not entitled to usurp the role of the directors and management in conducting what are in substance *the company's* restructuring efforts.

[45] With these principles in mind, I turn to an analysis of the various factors underlying the interpretation of the s. 11 discretion.

[46] I start with the proposition that at common law directors could not be removed from office during the term for which they were elected or appointed: *London Finance Corp. Ltd. v. Banking Service Corp. Ltd.*, [1922] O.J. No. 378, 23 O.W.N. 138 (H.C.); *Stephenson v. Vokes*, [1896] O.J. No. 191, 27 O.R. 691 (H.C.J.). The authority to remove must therefore be found in statute law.

[47] In Canada, the *CBCA* and its provincial equivalents govern the election, appointment and removal of directors, as well as providing for their duties and responsibilities. Shareholders elect directors, but the directors may fill vacancies that occur on the board of directors pending a further shareholders meeting:

CBCA, ss. 106(3) and 111.[4] The specific power *to remove* directors is vested in the shareholders by s. 109(1) of the *CBCA*. However, s. 241 empowers the court — where it finds that oppression as therein defined exists — to "make any interim or final order it thinks fit", including (s. 241(3)(*e*)) "an order appointing directors in place of or in addition to all or any of the directors then in office". This power has been utilized to remove directors, but in very rare cases, and only in circumstances where there has been actual conduct rising to the level of misconduct required to trigger oppression remedy relief: see, for example, *Catalyst Fund General Partner I Inc. v. Hollinger Inc.*, [2004] O.J. No. 4722, 1 B.L.R. (4th) 186 (S.C.J.).

[48] There is therefore a statutory scheme under the *CBCA* (and similar provincial corporate legislation) providing for the election, appointment *and removal* of directors. Where another applicable statute confers jurisdiction with respect to a matter, a broad and undefined discretion provided in one statute cannot be used to supplant or override the other applicable statute. There is no legislative "gap" to fill. See *Baxter Student Housing Ltd. v. College Housing Cooperative Ltd., supra*, at p. 480 S.C.R.; *Royal Oak Mines Inc. (Re), supra*; and *Richtree Inc. (Re), supra*.

[49] At para. 7 of his reasons, the motion judge said:

> The board is charged with the standard duty of "manage[ing], [*sic*] or supervising the management, of the business and affairs of the corporation": s. 102(1) *CBCA*. *Ordinarily the Court will not interfere with the composition of the board of directors. However, if there is good and sufficient valid reason to do so, then the Court must not hesitate to do so to correct a problem.* The directors should not be required to constantly look over their shoulders for this would be the sure recipe for board paralysis which would be so detrimental to a restructuring process; thus interested parties should only initiate a motion where it is reasonably obvious that there is a problem, actual or poised to become actual.

(Emphasis added)

[50] Respectfully, I see no authority in s. 11 of the *CCAA* for the court to interfere with the composition of a board of directors on such a basis.

[51] Court removal of directors is an exceptional remedy, and one that is rarely exercised in corporate law. This reluctance is rooted in the historical unwillingness of courts to interfere with the internal management of corporate affairs and in the court's well-established deference to decisions made by directors and officers in

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4 It is the latter authority that the directors of Stelco exercised when appointing the appellants to the Stelco Board.

the exercise of their business judgment when managing the business and affairs of the corporation. These factors also bolster the view that where the *CCAA* is silent on the issue, the court should not read into the s. 11 discretion an extraordinary power — which the courts are disinclined to exercise in any event — except to the extent that that power may be introduced through the application of other legislation, and on the same principles that apply to the application of the provisions of the other legislation.

The oppression remedy gateway

[52] The fact that s. 11 does not itself provide the authority for a *CCAA* judge to order the removal of directors does not mean that the supervising judge is powerless to make such an order, however. Section 20 of the *CCAA* offers a gateway to the oppression remedy and other provisions of the *CBCA* and similar provincial statutes. Section 20 states:

> 20. The provisions of this Act may be applied together with the provisions of any Act of Parliament or of the legislature of any province that authorizes or makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

[53] The *CBCA* is legislation that "makes provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them". Accordingly, the powers of a judge under s. 11 of the *CCAA* may be applied together with the provisions of the *CBCA*, including the oppression remedy provisions of that statute. I do not read s. 20 as limiting the application of outside legislation to the provisions of such legislation dealing specifically with the sanctioning of compromises and arrangements between the company and its shareholders. The grammatical structure of s. 20 mandates a broader interpretation and the oppression remedy is, therefore, available to a supervising judge in appropriate circumstances.

[54] I do not accept the respondents' argument that the motion judge had the authority to order the removal of the appellants by virtue of the power contained in s. 145(2)(*b*) of the *CBCA* to make an order "declaring the result of the disputed election or appointment" of directors. In my view, s. 145 relates to the procedures underlying disputed elections or appointments, and not to disputes over the composition of the board of directors itself. Here, it is conceded that the appointment of Messrs. Woollcombe and Keiper as directors complied with all relevant statutory requirements. Farley J. quite properly did not seek to base his jurisdiction on any such authority.

The level of conduct required

[55] Colin Campbell J. recently invoked the oppression remedy to remove directors, without appointing anyone in their place, in *Catalyst Fund General Partner I Inc. v. Hollinger Inc., supra.* The bar is high. In reviewing the applicable law, C. Campbell J. said (para. 68):

> Director removal is *an extraordinary remedy* and certainly should be *imposed most sparingly.* As a starting point, I accept the basic proposition set out in Peterson, "Shareholder Remedies in Canada".[5]
>
> > SS. 18.172 *Removing and appointing directors to the board is an extreme form of judicial intervention.* The board of directors is elected by the shareholders, vested with the power to manage the corporation, and appoints the officers of the company who undertake to conduct the day-to-day affairs of the corporation. [Footnote omitted.] It is clear that the board of directors has control over policymaking and management of the corporation. *By tampering with a board, a court directly affects the management of the corporation.* If a reasonable balance between protection of corporate stakeholders and the freedom of management to conduct the affairs of the business in an efficient manner is desired, altering the board of directors should be *a measure of last resort.* The order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or directors would remedy the oppressive conduct without a receiver or receiver-manager.

(Emphasis added)

[56] C. Campbell J. found that the continued involvement of the Ravelston directors in the *Hollinger* situation would "significantly impede" the interests of the public shareholders and that those directors were "motivated by putting their interests first, not those of the company" (paras. 82-83). The evidence in this case is far from reaching any such benchmark, however, and the record would not support a finding of oppression, even if one had been sought.

[57] Everyone accepts that there is no evidence the appellants have conducted themselves, as directors — in which capacity they participated over two days in the bid consideration exercise — in anything but a neutral fashion, having regard to the best interests of Stelco and all of the stakeholders. The motion judge acknowledged that the appellants "may well conduct themselves beyond reproach". However, he simply decided there was a risk — a reasonable apprehension — that Messrs. Woollcombe and Keiper would not live up to their obligations to be neutral in the future.

5 Dennis H. Peterson, *Shareholder Remedies in Canada*, looseleaf (Markham: LexisNexis — Butterworths, 1989), at 18-47.

[58] The risk or apprehension appears to have been founded essentially on three things: (1) the earlier public statements made by Mr. Keiper about "maximizing shareholder value"; (2) the conduct of Clearwater and Equilibrium in criticizing and opposing the Stalking Horse Bid; and (3) the motion judge's opinion that Clearwater and Equilibrium — the shareholders represented by the appellants on the Board — had a "vision" that "usually does not encompass any significant concern for the long-term competitiveness and viability of an emerging corporation", as a result of which the appellants would approach their directors' duties looking to liquidate their shares on the basis of a "short-term hold" rather than with the best interests of Stelco in mind. The motion judge transposed these concerns into anticipated predisposed conduct on the part of the appellants as directors, despite their apparent understanding of their duties as directors and their assurances that they would act in the best interests of Stelco. He therefore concluded that "the risk to the process and to Stelco in its emergence [was] simply too great to risk the wait and see approach".

[59] Directors have obligations under s. 122(1) of the *CBCA* (a) to act honestly and in good faith with a view to the best interest of the corporation (the "statutory fiduciary duty" obligation), and (b) to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances (the "duty of care" obligation). They are also subject to control under the oppression remedy provisions of s. 241. The general nature of these duties does not change when the company approaches, or finds itself in, insolvency: *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, at paras. 42-49.

[60] In *Peoples* the Supreme Court noted that "the interests of the corporation are not to be confused with the interests of the creditors or those of any other stakeholders" (para. 43), but also accepted "as an accurate statement of the law that in determining whether [directors] are acting with a view to the best interests of the corporation it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments and the environment" (para. 42). Importantly as well — in the context of "the shifting interest and incentives of shareholders and creditors" — the court stated (para. 47):

> In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in

its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders.

[61] In determining whether directors have fallen foul of those obligations, however, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office. Although the motion judge concluded that there was a risk of harm to the Stelco process if Messrs. Woollcombe and Keiper remained as directors, he did not assess the level of that risk. The record does not support a finding that there was a sufficient risk of sufficient misconduct to warrant a conclusion of oppression. The motion judge was not asked to make such a finding, and he did not do so.

[62] The respondents argue that this court should not interfere with the decision of the motion judge on grounds of deference. They point out that the motion judge has been case-managing the restructuring of Stelco under the *CCAA* for over 14 months and is intimately familiar with the circumstances of Stelco as it seeks to restructure itself and emerge from court protection.

[63] There is no question that the decisions of judges acting in a supervisory role under the *CCAA*, and particularly those of experienced commercial list judges, are entitled to great deference: see *Algoma Steel Inc. v. Union Gas Ltd.* (2003), 63 O.R. (3d) 78, [2003] O.J. No. 71 (C.A.), at para. 16. The discretion must be exercised judicially and in accordance with the principles governing its operation. Here, respectfully, the motion judge misconstrued his authority, and made an order that he was not empowered to make in the circumstances.

[64] The appellants argued that the motion judge made a number of findings without any evidence to support them. Given my decision with respect to jurisdiction, it is not necessary for me to address that issue.

The business judgment rule

[65] The appellants argue as well that the motion judge erred in failing to defer to the unanimous decision of the Stelco directors in deciding to appoint them to the Stelco Board. It is well-established that judges supervising restructuring proceedings — and courts in general — will be very hesitant to second-guess the business decisions of directors and management. As the Supreme Court of Canada said in *Peoples, supra*, at para. 67:

> Courts are ill-suited and should be reluctant to second-guess the application of business expertise to the considerations that are involved in corporate decision making . . .

[66] In *Brant Investments Ltd. v. KeepRite Inc.* (1991), 3 O.R. (3d) 289, [1991] O.J. No. 683 (C.A.), at p. 320 O.R., this court adopted the following statement by the trial judge, Anderson J.:

> Business decisions, honestly made, should not be subjected to microscopic examination. There should be no interference simply because a decision is unpopular with the minority.[6]

[67] McKinlay J.A. then went on to say [at p. 320 O.R.]:

> There can be no doubt that on an application under s. 234[7] the trial judge is required to consider the nature of the impugned acts and the method in which they were carried out. That does not meant that the trial judge should substitute his own business judgment for that of managers, directors, or a committee such as the one involved in assessing this transaction. Indeed, it would generally be impossible for him to do so, regardless of the amount of evidence before him. He is dealing with the matter at a different time and place; it is unlikely that he will have the background knowledge and expertise of the individuals involved; he could have little or no knowledge of the background and skills of the persons who would be carrying out any proposed plan; and it is unlikely that he would have any knowledge of the specialized market in which the corporation operated. In short, he does not know enough to make the business decision required.

[68] Although a judge supervising a *CCAA* proceeding develops a certain "feel" for the corporate dynamics and a certain sense of direction for the restructuring, this caution is worth keeping in mind. See also *Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., supra*; *Sammi Atlas Inc. (Re)*, [1998] O.J. No. 1089, 3 C.B.R. (4th) 171 (Gen. Div.); *Olympia & York Developments Ltd. (Re), supra*; *Re Alberta Pacific Terminals Ltd.*, [1991] B.C.J. No. 1065, 8 C.B.R. (4th) 99 (S.C.). The court is not catapulted into the shoes of the board of directors, or into the seat of the chair of the board, when acting in its supervisory role in the restructuring.

[69] Here, the motion judge was alive to the "business judgment" dimension in the situation he faced. He distinguished the application of the rule from the circumstances, however, stating at para. 18 of his reasons:

> With respect I do not see the present situation as involving the "management of the business and affairs of the corporation", but rather as a quasi-constitutional aspect of the corporation entrusted albeit to the Board pursuant to s. 111(1) of the *CBCA*. I agree that where a board is actually engaged in the business of a judgment situation, the board should be given appropriate deference. However, to the contrary in this situation, I do not see it as a

6 Or, I would add, unpopular with other stakeholders.

7 Now s. 241.

situation calling for (as asserted) more deference, but rather considerably less than that. With regard to this decision of the Board having impact upon the capital raising process, as I conclude it would, then similarly deference ought not to be given.

[70] I do not see the distinction between the directors' role in "the management of the business and affairs of the corporation" (*CBCA*, s. 102) — which describes the directors' overall responsibilities — and their role with respect to a "quasi-constitutional aspect of the corporation" (*i.e.*, in filling out the composition of the board of directors in the event of a vacancy). The "affairs" of the corporation are defined in s. 2 of the *CBCA* as meaning "the relationships among a corporation, its affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate". Corporate governance decisions relate directly to such relationships and are at the heart of the Board's business decision-making role regarding the corporation's business *and* affairs. The dynamics of such decisions, and the intricate balancing of competing interests and other corporate-related factors that goes into making them, are no more within the purview of the court's knowledge and expertise than other business decisions, and they deserve the same deferential approach. Respectfully, the motion judge erred in declining to give effect to the business judgment rule in the circumstances of this case.

[71] This is not to say that the conduct of the Board in appointing the appellants as directors may never come under review by the supervising judge. The court must ultimately approve and sanction the plan of compromise or arrangement as finally negotiated and accepted by the company and its creditors and stakeholders. The plan must be found to be fair and reasonable before it can be sanctioned. If the Board's decision to appoint the appellants has somehow so tainted the capital raising process that those criteria are not met, any eventual plan that is put forward will fail.

[72] The respondents submit that it makes no sense for the court to have jurisdiction to declare the process flawed only after the process has run its course. Such an approach to the restructuring process would be inefficient and a waste of resources. While there is some merit in this argument, the court cannot grant itself jurisdiction where it does not exist. Moreover, there are a plethora of checks and balances in the negotiating process itself that moderate the risk of the process becoming irretrievably tainted in this fashion — not the least of which is the restraining effect of the prospect of such a consequence. I do not think that this argument can prevail. In addition, the court at all times retains its broad and

flexible supervisory jurisdiction — a jurisdiction which feeds the creativity that makes the *CCAA* work so well — in order to address fairness and process concerns along the way. This case relates only to the court's exceptional power to order the removal of directors.

The reasonable apprehension of bias analogy

[73] In exercising what he saw as his discretion to remove the appellants as directors, the motion judge thought it would be useful to "borrow the concept of reasonable apprehension of bias . . . with suitable adjustments for the nature of the decision making involved" (para. 8). He stressed that "there was absolutely no allegation against [Mr. Woollcombe and Mr. Keiper] of any actual 'bias' or its equivalent" (para. 8). He acknowledged that neither was alleged to have done anything wrong since their appointments as directors, and that at the time of their appointments the appellants had confirmed to the Board that they understood and would abide by their duties and responsibilities as directors, including the responsibility to act in the best interests of the corporation and not in their own interests as shareholders. In the end, however, he concluded that because of their prior public statements that they intended to "pursue efforts to maximize shareholder value at Stelco", and because of the nature of their business and the way in which they had been accumulating their shareholding position during the restructuring, and because of their linkage to 40 per cent of the common shareholders, there was a risk that the appellants would not conduct themselves in a neutral fashion in the best interests of the corporation as directors.

[74] In my view, the administrative law notion of apprehension of bias is foreign to the principles that govern the election, appointment and removal of directors, and to corporate governance considerations in general. Apprehension of bias is a concept that ordinarily applies to those who preside over judicial or quasi-judicial decision-making bodies, such as courts, administrative tribunals or arbitration boards. Its application is inapposite in the business decision-making context of corporate law. There is nothing in the *CBCA* or other corporate legislation that envisages the screening of directors in advance for their ability to act neutrally, in the best interests of the corporation, as a prerequisite for appointment.

[75] Instead, the conduct of directors is governed by their common law and statutory obligations to act honestly and in good faith with a view to the best interests of the corporation, and to exercise the care, diligence and skill that a reasonably

prudent person would exercise in comparable circumstances (*CBCA*, s. 122(1)(*a*) and (*b*)). The directors also have fiduciary obligations to the corporation, and they are liable to oppression remedy proceedings in appropriate circumstances. These remedies are available to aggrieved complainants — including the respondents in this case — but they depend for their applicability on the director having engaged in conduct justifying the imposition of a remedy.

[76] If the respondents are correct, and reasonable apprehension that directors may not act neutrally because they are aligned with a particular group of shareholders or stakeholders is sufficient for removal, all nominee directors in Canadian corporations, and all management directors, would automatically be disqualified from serving. No one suggests this should be the case. Moreover, as Iacobucci J. noted in *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, [1995] S.C.J. No. 29, at para. 35, "persons are assumed to act in good faith unless proven otherwise". With respect, the motion judge approached the circumstances before him from exactly the opposite direction. It is commonplace in corporate/commercial affairs that there are connections between directors and various stakeholders and that conflicts will exist from time to time. Even where there are conflicts of interest, however, directors are not removed from the board of directors; they are simply obliged to disclose the conflict and, in appropriate cases, to abstain from voting. The issue to be determined is not whether there is a connection between a director and other shareholders or stakeholders, but rather whether there has been some conduct on the part of the director that will justify the imposition of a corrective sanction. An apprehension of bias approach does not fit this sort of analysis.

Part V — Disposition

[77] For the foregoing reasons, then, I am satisfied that the motion judge erred in declaring the appointment of Messrs. Woollcombe and Keiper as directors of Stelco of no force and effect.

[78] I would grant leave to appeal, allow the appeal and set aside the order of Farley J. dated February 25, 2005.

[79] Counsel have agreed that there shall be no costs of the appeal.

Order accordingly.

TAB "3"

In the Matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended and in the Matter of a Proposed Plan in the Compromise or Arrangement with respect to Stelco Inc., and other Applicants Listed in Schedule "A"

[Indexed as: Stelco Inc. (Re) (No. 2)]

Court of Appeal for Ontario, Feldman J.A. (In Chambers)
April 12, 2005

Debtor and creditor — Companies' Creditors Arrangement Act — Court of Appeal holding that supervising judge in Companies' Creditors Arrangement Act proceedings had no jurisdiction under that Act to order removal of directors of company unless oppression remedy applied — Employees of company seeking leave to appeal that judgment — Employees bringing motion for stay of execution of order of Court of Appeal pending decision of Supreme Court of Canada on leave application — Motion dismissed — Court of Appeal having jurisdiction under s. 65.1(1) of Supreme Court Act to consider motion for stay — Issue of court's jurisdiction to remove directors being serious and important — Both sides claiming that they would suffer irreparable harm if board was not composed as they wished during restructuring process — Because restructuring process was proceeding, grant of stay would effectively reinstate order of supervising judge and exclude two directors from process — Interests of justice requiring that no stay be ordered — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 — Supreme Court Act, R.S.C. 1985, c. S-26.

The Court of Appeal reversed the decision of the supervising judge in proceedings under the *Companies' Creditors Arrangement Act* ("*CCAA*") in which he ordered the removal of two directors from the board of the Company. The Court of Appeal held that the judge had no jurisdiction under the *CCAA* to remove directors unless the oppression remedy applied, which it did not. The applicants represented retired and active salaried employees of the Company. They sought leave to appeal the judgment of the Court of Appeal to the Supreme Court of Canada, and brought a motion for an order under s. 65.1 of the *Supreme Court Act*, for a stay of execution of the order pending the decision of the Supreme Court on the leave application.

Held, the motion should be dismissed.

The Court of Appeal had jurisdiction under s. 65.1(1) of the *Supreme Court Act* to consider the stay application pending the Supreme Court's decision whether to grant leave to appeal. It was only when leave had been granted that s. 15(3) of the *CCAA* applied.

The issue of the jurisdiction of the court to remove directors was a serious and important one. Both sides said they would suffer irreparable harm if the board was not composed as they wished during the next few months of the restructuring process and that the balance of convenience therefore favoured their side. As the restructuring was proceeding, the issue would be moot by the time the appeal was heard. A stay would effectively implement the decision of the supervising judge to remove two directors from the board, a decision which the Court of Appeal held that the judge had no jurisdiction to make. The interests of justice required that no stay be granted at this time.

Cases referred to

Circuit World Corp. v. Lesperance, [1997] O.J. No. 2081, 33 O.R. (3d) 674, 100 O.A.C. 221 (C.A.); *Confederation Treasury Services Ltd. (Trustee of) v. Ernst & Young*, [1997] 2 S.C.R. 5, [1997] S.C.J. No. 79; *Country Style Food Services Inc. (Re)*, [2002] O.J. No. 1377, 158 O.A.C. 30; *International Corona Resources Ltd. v. Lac Minerals Ltd.*, [1986] O.J. No. 2128, 21 C.P.C. (2d) 252 (C.A.); *Multitech Warehouse Direct Inc. (Re)* [1995] A.J. No. 663, 32 Alta. L.R. (3d) 62 (C.A.); *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311, [1994] S.C.J. No. 17, 54 C.P.R. (3d) 114, 20 C.R.R. (2d) D-7, 111 D.L.R. (4th) 385; *Steinberg Inc. (Re)*, [1993] Q.J. No. 860 (C.A.); *Stelco Inc. (Re)* (2005), 75 O.R. (3d) 5, [2005] O.J. No. 1171, 9 C.B.R. (5th) 135, 196 O.A.C. 142 (C.A.); *Stelco Inc. (Re)*, [2005] O.J. No. 802, 8 C.B.R. (5th) 150 (C.A.); *Stelco Inc. (Re)*, [2005] O.J. No. 730, 7 C.B.R. (5th) 310 (S.C.J.)

Statutes referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 15 [as am.], 58(1) [as am.]
Supreme Court Act, R.S.C. 1985, c. S-26, ss. 65 [as am.], 65.1(1) [as am.]

MOTION for a stay pending appeal.

Murray Gold and *Andrew J. Hatnay*, for applicants Retired Salaried Beneficiaries of Stelco Inc., CHT Steel Company Inc., Stelpipe Ltd., Stelwire Ltd. and Welland Pipe Ltd.
John R. Varley, for applicants Active Salaried Employee Representative.
Richard B. Swan, for respondents Michael Woollcombe and Roland Keiper.
Michael Barrack, for Stelco Inc.
Lawrence Thacker, for respondent Board of Directors of Stelco Inc.
Kyla Mahar, for the Monitor.

[1] FELDMAN J.A. (In Chambers): — The applicants representing the retired salaried employees and the active salaried employees of Stelco Inc. (the "Company") have sought leave to appeal the judgment of this court, ((2005), 75 O.R. (3d) 5, [2005] O.J. No. 1171 (C.A.)) dated March 31, 2005, to the Supreme Court of Canada. In that judgment, this court reversed the decision of the supervising judge in the *CCAA* proceedings where he ordered the removal of two directors from the board of the Company. This court held that the judge had no jurisdiction under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "*CCAA*") to remove directors of a company unless the oppression remedy applied, which it did not in the case.

[2] The applicants now move for an order under s. 65.1(1) of the *Supreme Court Act*, R.S.C. 1985, c. S-26 staying the execution of

the order of this court pending the decision of the Supreme Court on the leave application. They intend to join with their application for leave to appeal an application for an expedited determination of the leave motion. The effect of any stay would be to reinstate the order of the supervising judge until such time as the Supreme Court determines whether it will grant leave to appeal the judgment of this court.

[3] The motion for a stay is opposed by the two directors, by the Company and by the board of directors of the Company. The monitor appeared on the motion but took no position on it. One of the unions that had sought the original order and responded on the appeal, the United Steelworkers of America, did not appear or take a position on the stay motion.

[4] The first issue raised by the respondents in their material is the jurisdiction of this court to grant a stay. Section 65.1(1) of the *Supreme Court Act* provides:

> 65.1(1) The Court, the court appealed from or a judge of either of those courts may, on the request of the party who has served and filed a notice of application for leave to appeal, order that proceedings be stayed with respect to the judgment from which leave to appeal is being sought, on the terms deemed appropriate.

[5] The Supreme Court's jurisprudence since the amendment of the section in 1994 makes it clear that when leave to appeal to the Supreme Court is sought, applications for a stay of the decision being appealed are to be brought routinely at first instance to the court appealed from rather than to the Supreme Court. See *Confederation Treasury Services Ltd. (Trustee of) v. Ernst & Young*, [1997] 2 S.C.R. 5, [1997] S.C.J. No. 79. That was done in this case. The respondent's factum, however, referred to s. 15(3) of the *CCAA*, suggesting that that section may have the effect of conferring exclusive jurisdiction on the Supreme Court to grant stays on applications for leave to appeal under the *CCAA*. The matter was clarified to my satisfaction in oral argument.

[6] Section 15(3) of the *CCAA* provides:

> 15(3) No appeal to the Supreme Court of Canada shall operate as a stay of proceedings unless and to the extent ordered by that Court.

That section does not refer to applications for leave to appeal but only to appeals.

[7] Under s. 65(1) of the *Supreme Court Act*, when a notice of appeal is served and filed along with security as required, there is, with some exceptions, an automatic stay of execution in the cause. Section 15(3) of the *CCAA* states that under that Act there is no stay of execution on an appeal, "unless and to the extent ordered by that Court [the Supreme Court of Canada]". These

sections deal only with stays actually on appeal. Once leave has been granted, s. 58(1)(*b*) of the *Supreme Court Act* provides that a notice of appeal shall be served and filed. By my reading, it is only when that step is taken that s. 15(3) of the *CCAA* applies.

[8] I conclude, therefore, that this court does have jurisdiction under s. 65.1(1) of the *Supreme Court Act* to consider this application for a stay pending the Supreme Court's decision whether to grant leave to appeal.

[9] The next issue is the application of the three-pronged test from *RJR-MacDonald Inc. v. Canada (Attorney General)*, [1994] 1 S.C.R. 311, [1994] S.C.J. No. 17: (1) whether there is a serious question to be tried, (2) whether the applicant will suffer irreparable harm if the stay is not granted, [and] (3) the balance of convenience.

[10] The threshold for the first prong of the test, a serious issue to be tried, is normally set fairly low, in that it is often described as a question that is not frivolous. However, counsel for the respondent Company relied on para. 51 [p. 338 S.C.R.] of the *RJR-MacDonald* judgment, which describes two exceptions to that rule, one of which is where the effect of the stay will be tantamount to a final determination of the action because of timing issues. It is submitted that that is the case in this matter, because the restructuring process is proceeding and the board of directors is meeting to develop a plan of arrangement with the target date for presentation of the plan being May 30, 2005. By granting a stay, the effect would be to reinstate the order of the supervising judge and to exclude the two directors from the board while the process is proceeding.

[11] The respondent Company submits that in assessing the potential merit of the proposed appeal, for the purposes of determining whether to grant a stay in these circumstances, this court must be of the view both that leave to appeal is likely to be granted by the Supreme Court, and also that the appeal will be successful and the Supreme Court will reverse the decision of this court. I cannot accept this submission. Clearly, it would be anomalous indeed for this court, and particularly for a member of the panel that heard and decided the appeal, to be of the view that the decision is likely to be reversed on appeal. Nor can this court know or assess whether this will be one of the relatively few cases in which the Supreme Court will decide to grant leave to appeal, given that many factors go into its decisions on leave with the relative importance of the question at issue in the case being only one of them.

[12] Having said that, in *CCAA* proceedings this court, following other appellate courts, has said that leave will be granted

only sparingly where there are "serious and arguable grounds that are of real and significant interest to the parties": *Re Country Style Food Services Inc.*, [2002] O.J. No. 1377, 158 O.A.C. 30, at para. 15; *Re Multitech Warehouse Direct Inc.*, [1995] A.J. No. 663, 32 Alta. L.R. (3d) 62 (C.A.), at para. 3; *Re Steinberg Inc.*, [1993] Q.J. No. 860 (C.A.). In its decision of March 31, 2005, this court granted leave to appeal because the case involved the court's jurisdiction in *CCAA* proceedings to intervene in corporate governance decisions, a matter of importance in the conduct of *CCAA* restructuring proceedings and a matter on which there was little appellate authority. The issue remains an important one, and therefore qualifies under the ordinary test as a serious issue to be tried.

[13] I next turn to the question of irreparable harm to the applicants. The applicants claim that the denial of a stay "threatens the successful restructuring of Stelco". They say that the two disputed directors, who are or represent substantial shareholders of the company, are motivated to boost share prices in the short term rather than seek a viable long-term restructuring plan. They raise the spectre of the eventual bankruptcy of Stelco, even if it emerges from the current *CCAA* protection, if the restructuring plan is not viable for the long term. Finally, they say that the reinstatement of the two directors "has caused a return of the lack of confidence in Stelco's *CCAA* restructuring process among the Salaried Retirees and other key stakeholders". They conclude that if the stakeholders are distrustful, they will negotiate not for a good faith plan but instead for remedies that maximize their own positions, which will result in a flawed plan and, eventually, the future bankruptcy of the Company.

[14] These concerns about the alleged selfish motivation of the two directors and the "poisoned atmosphere" of the restructuring process were also raised by the applicants as the basis for upholding the decision of the supervising judge to remove the two directors. On the issue of the potential misconduct of the directors in carrying out their duties during the restructuring, this court in its March 31, 2005 decision, observed that on the record there was no evidence of improper conduct of the two directors, and that the supervising judge concluded only that there was a risk that they would not live up to their obligations in the future. This court then held at para. 61 that: "[i]n determining whether directors have fallen foul of those obligations, however, more than some risk of anticipated misconduct is required before the court can impose the extraordinary remedy of removing a director from his or her duly elected or appointed office" and "[t]he

record does not support a finding that there was a sufficient risk of sufficient misconduct to warrant a conclusion of oppression".

[15] This court also addressed the concern that the process would now become flawed and tainted by observing, at paras. 71 and 72, that the *CCAA* court retains its supervisory power and jurisdiction over both the ultimate approval of the plan as well as the ongoing *CCAA* process itself, to ensure fairness and approval of the best plan possible for the future viability of the company.

[16] The applicants essentially say that they retain the same fear for the future of the process and of the Company that they have felt and expressed since the two new directors were elected to the board. Although this court has addressed these concerns by pointing out that they are only speculative, it is understandable that if the applicants continue to perceive a concern with the ongoing fairness of the process as it goes forward while they await the decision of the Supreme Court on the leave motion, that they would view that concern as irreparable harm to them as stakeholders in that process.

[17] The third criterion for a stay is the balance of convenience. The applicants say that the balance of convenience favours a stay. First, they say that the stay will be of relatively short duration as they expect a decision from the Supreme Court on the leave motion on an expedited basis within three to four months. Second, their position is that the stay will restore the *status quo* as it was before the two directors were appointed to the board. Third, they argue that Stelco's board can proceed to do its work without the new directors so that there is no prejudice to the board or to the restructuring process in the interim.

[18] The respondents' position is that the applicants will suffer no irreparable harm if a stay is not granted and that the balance of convenience strongly favours denying a stay. They point to the fact that the applicants sought the original motion before the supervising judge to remove the two directors on the basis of urgency. The need to remove any uncertainty was acknowledged to be important and a cogent reason for this court to hear and decide the appeal from the order of the supervising judge on an expedited basis ([2005] O.J. No. 802, 8 C.B.R. (5th) 150 (C.A.)). They argue that it is inconsistent with the position taken all along in this proceeding to now say that a period of three to four months (or possibly longer) of further uncertainty is acceptable or fair to the parties or the restructuring process.

[19] Further, the board is currently actively meeting and developing a restructuring plan, as directed by the restructuring judge in his reasons ([2005] O.J. No. 730, 7 C.B.R. (5th) 310 (S.C.J.). The respondents say that the issue of the constitution of the board of

the Company during this process is the very issue that was considered of such importance that it had to be dealt with on an urgent basis by this court. They argue that if the process now proceeds at this key juncture without the two directors who have been held to be properly on the board, it will inevitably cause significant inconvenience to both the board and to the restructuring process itself.

[20] It appears that the next few months will be a critical period in the restructuring process. If that is not the case, as counsel for one of the applicants suggested, then the importance of the stay is minimized. However, on the basis that the board is now going to proceed to develop a viable restructuring plan following the rejection of all bids that arose from the capital raising process, this is a crucial time. The question, therefore, is which *status quo* should be put in place during this time? Each side says that the balance of convenience favours the composition of the board with which that side is most comfortable during this period.

[21] In applying the three-part test, the court is to balance the three factors in a way that addresses the interests of justice in all the circumstances. See: *Circuit World Corp. v. Lesperance* (1997), 33 O.R. (3d) 674, [1997] O.J. No. 2081 (C.A.); *International Corona Resources Ltd. v. Lac Minerals Ltd.*, [1986] O.J. No. 2128, 21 C.P.C. (2d) 252 (C.A.).

[22] In this case, the issue of the jurisdiction of the court to remove directors is a serious and important issue. Both sides say they will suffer irreparable harm if the board is not composed as they want during the next few months of the restructuring process and that the balance of convenience therefore favours their side. If the next few months are crucial, then the stay itself (or the denial of the stay) will implement the effective result of the appeal. Certainly by the time any appeal is heard in the normal course, the issue for these parties will be moot.

[23] On the basis that the restructuring is proceeding and that the next few months may well be critical, I then turn to the interests of justice in all the circumstances: is it just that the applicants should be granted a stay that would effectively implement the decision of the supervising judge to remove the two directors from the board, when this court has held that the judge had no jurisdiction to make that order? Or is it just that the decision of this court, which sets aside an order made without jurisdiction, be implemented until the Supreme Court decides whether to grant leave to appeal (and if so, whether to grant a stay at that time)? Viewing the matter in this way, I am compelled to the conclusion that the interests of justice require that no stay be ordered at this time.

[24] The applicants raise again in their material, as they did on the appeal, the concern that by gaining a position on the board, the two shareholder representatives have been given an unequal advantage and role in the restructuring process to the exclusion of other stakeholders, and that this causes both actual unfairness and the perception of unfairness in the current restructuring process. As was stated in this court's March 31, 2005 decision, the supervising judge has wide powers under the *CCAA* to ensure that the process is fair and equitable and is structured to ensure that the sanctioned plan is fair and reasonable. The purpose is for a new viable economic entity to emerge from protection. Because the supervising judge has the power and the creative scope to craft other ways to alleviate the concerns of the applicants, as well as the ultimate power of approval of the plan, the irreparable harm that the applicants perceive in terms of the perception of a poisoned atmosphere is potentially "reparable" within the restructuring process.

[25] For the reasons set out, the motion for a stay of this court's decision of March 31, 2005, pending the decision of the Supreme Court whether to grant leave to appeal, is dismissed. The parties advised that there should be no costs of this motion.

Motion dismissed.

Her Majesty the Queen v. Walsh

[Indexed as: R. v. Walsh]

Court of Appeal for Ontario, Feldman J.A. (in Chambers)
February 18, 2005

Criminal law — Bail — Bail pending appeal — Jurisdiction — Accused on parole seeking release on bail pending appeal — Accused convicted of possession and distributing child pornography — Accused wanting to suspend parole condition prohibiting him from having access to computers and Internet — Accused released on parole in "custody" for purposes of s. 679 of Criminal Code — Accused granted bail with supervised access to computers and Internet for employment purposes — Criminal Code, R.S.C. 1985, c. C-46, s. 679.

The accused was sentenced to two years less a day in prison and three years' probation for creating and distributing child pornography. After serving several months of his sentence, he was released on parole. He appealed his conviction and sentence, and brought an application for bail pending appeal. He wanted a condition of his parole that restricted his access to computers to be suspended because he wished to pursue a career in computers.

TAB "4"

[Indexed as: **Ivaco Inc., Re**]

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF IVACO INC. AND THE APPLICANTS LISTED IN SCHEDULE "A"

Ontario Superior Court of Justice [Commercial List]

Cumming J.

Heard: June 9, 2004

Judgment: June 10, 2004

Docket: 03-CL-5145

M.P. Gottlieb for Applicants
Michael E. Barrack, Geoff R. Hall for QIT
E. Lamek for National Bank of Canada
Peter Howard for Monitor, Ernst & Young Inc.
D.V. MacDonald for Bank of Nova Scotia
J.T. Porter for UBS
Ken Rosenberg for United Steel Workers of Canada

Bankruptcy and insolvency —— Proposal — Companies' Creditors Arrangement Act — Arrangements — Approval by court — Miscellaneous issues —— Company began proceedings under Companies Creditors Arrangement Act — Company sought directions on possible sale proposal — Corporate restructuring officer to be part of sales process — Parties agreed that monitor could observe negotiations between QIT and bidders, and that disclosure be made of supply agreement between QIT and company — Corporate restructuring officer was required to understand all aspects of possible sale.

Statutes considered:

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

RULING regarding arrangement under *Companies' Creditors Arrangement Act.*

***Cumming J.*:**

The Motion

1 The moving party Applicants, Ivaco Rolling Mills Limited Partnership, comprising some eight affiliated corporations ("IRM"), seek directions from the Court in respect of the sales process for its business under the *Companies' Creditors Arrangement Act* ("*CCAA*"). The motion raises an important issue relating to the respective roles of the Monitor and Chief Restructuring Officer in that

process. The Court provided a decision at the conclusion of the hearing, with reasons to follow.

Background

2 IRM is engaged in the steel manufacturing and processing business in Canada. QIT-Fer Et Titane Inc. ("QIT") is a major supplier to IRM of steel billets pursuant to a long-standing supply agreement. QIT is also a major unsecured creditor of IRM, being owed some $62 million.

3 The Applicants obtained an Initial Order under the *CCAA* September 16, 2003. A Chief Restructuring Officer ("CRO") was appointed October 24, 2003.

4 On December 11, 2003 this Court authorized IRM to pursue a dual-track restructuring process: one track is a stand-alone restructuring plan; the second track is the pursuit of a sales process.

5 The Monitor, the CRO and the unsecured creditors of IRM have a concern that QIT seeks a way whereby it will be paid the monies owing to it by IRM outside the parameter of the *CCAA* proceeding. The record gives some force to this concern.

6 A Court Order dated March 22, 2004 authorized a limited number of prospective purchasers to submit offers for the assets of one or more of the Applicants. Some four bidders have now submitted proposals in this regard. Understandably, it is a condition of the proposals that the bidders be able to satisfy themselves as to the nature and status of the historical and existing relationship between QIT and IRM and the nature of any relationship for the future between a buyer of IRM's business and QIT.

7 The concern that has been raised by the Monitor, CRO and a number of IRM's creditors is that QIT may seek to enter into a relationship with a bidder whereby QIT could achieve some recovery of IRM's pre-filing debt of $62 million at the expense of other unsecured creditors.

8 Any purchaser of IRM requires a supply contract with QIT as there are no apparent competitors for its product sold to IRM. The concern is that QIT could insist upon a supply arrangement with the bidder at an unreasonably high price with the bidder offering an unreasonably low price for the assets of IRM. The creditors, Monitor, and the Applicants are concerned that QIT might enter into a supply arrangement with a bidder at the expense of IRM by virtue of the price for IRM's assets being lower than would otherwise be the case in a normal market transaction.

9 Meetings have been set up to take place between the bidders, the Applicants through the CRO, the Monitor and QIT with a view to determining whether any one or more bidder can achieve a supply agreement with QIT within a context of a satisfactory unconditional bid by that bidder for the assets of one or more of the Applicants.

The Issue

10 Several issues raised at the outset of the motion were settled by agreement as discussions progressed. It is not necessary to discuss these settled issues. The settled position provides that the Monitor can observe the negotiations to take place between QIT and each bidder. The settled position also provides that disclosure can be made to bidders of the existing supply agreement between IRM and QIT.

11 A single issue remained for determination by the Court at the conclusion of the hearing, being whether or not the CRO was to be part of the sales process. QIT took the position that the CRO should not be part of the process. The Applicants, the Monitor and the other major unsecured creditors all took the position that the CRO should be part of the sales process. Only QIT, supported by the United Steel Workers of Canada, took the contrary view.

12 The only support for QIT came from the United Steel Workers of Canada, being the Union representing the workers of IRM through a collective bargaining agreement. The position expressed by counsel for the Union was that the continuity of IRM's business is critical to the direct welfare of its employees and is of indirect benefit to the community at large. There is a clear public interest in the welfare of the workers. Undoubtedly, that is a correct, and important observation.

13 Thus, counsel for the Union argued further, the Court should accede to the position of QIT even though it might result in a failure to maximize the value of the IRM assets through the *CAA* proceeding. In my view, the Union's quite proper concern for the welfare of the workers cannot justify trumping the concern of creditors that they be treated fairly. Nor would it ever be in the broader notion of the public interest to allow a sales process perceived to be unfair to go forward. The public policy underlying the *CCAA* and its objectives would be undermined. Indeed, it might well be that any proposed sale would not then garner the requisite support of creditors required for approval under the *CCAA*. It might be that the business of IRM is more likely to fail, to the ultimate disadvantage of its workers, through a compromise to the integrity of the sales process. In any event, the Court could not sanction a proposed plan of compromise that was the result of an unfair process.

14 QIT professes that if the CRO takes part in the negotiations between the bidders and QIT that this will necessarily inhibit the sales process. QIT claims this will be so because bidders will be reluctant to provide confidential information to QIT, and vice-versa, while recognizing that the CRO may then use that information to enhance an alternative stand-alone restructuring plan and consequentially advise against acceptance of the bidder's proposal.

Disposition

15 There are certain fundamentals to a *CCAA* proceeding relevant to a determination of the issue at hand. First, there cannot be a sales process whereby one unsecured creditor secures a secret benefit or advantage over the other unsecured creditors. Such a result would be the equivalent of providing a preference for that creditor. Fairness to all the creditors is a prerequisite to a satisfactory sales process. Second, the sales process must be seen to be fair. That is, there must be transparency.

16 Third, the sales process is to be determined by the Court after considering the advice of the Monitor and the position of the Applicants and their creditors. The sales process is not dictated by a supplier *qua* supplier. It may be the supplier does not wish to participate in the sales process given the nature of the process. That is for the supplier to determine in its own self-interest. In the situation at hand, QIT conceivably might say that it would rather lose its supplier relationship with IRM or a successor, to its apparent significant economic detriment, than proceed in the sales process.

17 The CRO's attendance and participation in the sales process is critical because he is the independent party who must understand all the various bids and weigh each against the possibility of a stand-alone restructuring. He must ultimately make recommendations that engender confidence as being advanced on the best information and advice possible. The CRO is an active part of the negotiations in the sales process. He is not involved as a relatively passive observer in the manner of the Monitor.

18 The sales process has been determined by the Applicants with the approval of the Court. The CRO represents the Applicants in that process. The intended sales process is one of trilateral negotiations. If QIT, IRM or any bidder wishes to discontinue such negotiations at any time that is, of course, that party's right. It is in the obvious self-interest of IRM, QIT, and any bidder to maintain the existing QIT to IRM (or successor) supply relationship. It would seem to be a win — win — win situation to come to a tripartite agreement. While no one can be ordered to enter into any new agreement every participant is required to engage in a sales process that is fair and is seen to be fair. The CRO is involved with the purpose of achieving the best result for the Applicants and a result which will be approved by the requisite number of creditors.

19 Turning to the instant situation, there are a number of Applicants with different unsecured creditors for different Applicants. It is necessary that any negotiated sale (or restructuring) take into account such complexities so that fairness is achieved for all the creditors (and is seen to be achieved.)

20 QIT proposed that the CRO would be excluded from the negotiations unless his presence was requested by either a bidder or by QIT. I disagree. In my view, the CRO has the right to attend and participate throughout the entirety of the negotiations in the sales process. In the event that a discrete issue arises in the

context of a particular bidder's negotiations with QIT, such that there is disagreement as to whether the Monitor or CRO should be absent, then the further direction of the Court can be sought in the context of that specific issue. This will allow for QIT's expressed concerns for bidders in the negotiation process to be taken into account, should this be necessary. It is noted incidentally that no bidder has come forward in the hearing at hand to support QIT in respect of its expressed concerns about the sales process.

21 Absent some compelling, exceptional factor to the contrary (not seen here), in my view, the Court should accept an applicant's proposed sales process under the *CCAA*, when it has been recommended by the Monitor and is supported by the disinterested major creditors. The Court has the discretion to stipulate a variation to such a proposed sales process plan. However, the exercising of such discretion would seem appropriate in only very exceptional circumstances.

22 An Order will issue in the form attached hereto as Annex "A". There are no costs granted to any party.

Order accordingly.

ANNEX "A"

Court File No. 03-CL-5145

ONTARIO SUPERIOR COURT OF JUSTICE COMMERCIAL LIST

THE HONOURABLE MR. JUSTICE CUMMING

WEDNESDAY, THE 9th DAY OF JUNE, 2004

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF IVACO INC. AND THE APPLICANTS LISTED IN SCHEDULE "A"

ORDER

THIS MOTION, made by the Applicants for directions with respect to the sales process in respect of discussions involving QIT Fer et Titane Inc. ("QIT"), was heard this day at 393 University, Toronto.

ON READING the Notice of Motion, the Tenth Report of the Monitor, Ernst & Young Inc., the Affidavit of Randall C. Benson, the Affidavit of Gary A. O'Brien, and the Supplementary Affidavit of Randall C. Benson, and on hearing the submissions of counsel for the Applicants, the Monitor, QIT, the Informal Committee of Noteholders, the United Steelworkers of America, the Bank of Nova Scotia, the National Bank of Canada and UBS Securities LLC:

1. THIS COURT ORDERS that the time for service of the Notice of Motion and the Motion Record herein is abridged so that the motion is properly returnable

today, and that any requirement for service of the Notice of Motion and of the Motion Record upon any party not served is dispensed with.

2. THIS COURT ORDERS that the sales process in respect of discussions involving QIT shall be governed by the following procedure:

(a) QIT shall have seven days from the date of this Order to meet with the bidders who have submitted final proposals in the second round of the sales process authorized by order of this court dated March 22, 2004. The Monitor and CRO shall have the right to attend and participate in all such meetings. At the conclusion of the seven day period, QIT shall inform the Monitor of those bidders with whom it is prepared to conduct further negotiations. After considering the views of QIT and the Applicants, the Monitor shall identify to the Applicants and QIT the bidders with whom further negotiations shall occur (the "Bidders"). If either QIT or the Applicants disagree with the Monitor then they may apply to the court for directions.

(b) After the Bidders have been identified, QIT shall disclose relevant portions of the long-term supply agreement dated April 15, 1999 between QIT and Ivaco Rolling Mills Limited Partnership ("IRM") which QIT claims has been terminated and which the Applicants claim has not been terminated (the "Agreement") to the Bidders, under appropriate confidentiality arrangements. QIT and the Monitor shall have discussions to determine what portions of the Agreement are relevant and to determine appropriate confidentiality arrangements. If they cannot agree, they shall seek further directions from the court. Further, if the Applicants do not agree with the determination of QIT and the Monitor as to what portions of the Agreement are relevant, they shall be at liberty to apply to the court for further directions regarding the disclosure of the Agreement. This order shall be without prejudice to the Applicants' position that the Agreement is not confidential and that it may disclose the entire Agreement.

(c) QIT shall then undertake negotiations with the Bidders. The Monitor and CRO shall be entitled to attend and participate in these negotiations so as to be in a position to report to the court on the outcome of them. No other parties shall participate in the negotiations, except that at the request of either QIT or a Bidder technical personnel from the Applicants will be entitled to participate in order to give necessary technical assistance. If the parties cannot agree on the appropriate participation of additional persons they shall seek further directions from the court. At the request of QIT and a Bidder, the Monitor may in its discretion absent itself from parts of negotiations which it considers best to proceed privately. If the Monitor refuses such request, QIT or the Bidder may apply to the court for directions. At the request of QIT or a Bidder, the CRO may in his discretion absent himself from parts of negotiations which he considers best to proceed privately. If the CRO refuses such request, QIT or the Bidder may apply to the court for directions.

(d) The negotiations and meetings referred to shall be conducted under appropriate confidentiality arrangements.

SCHEDULE "A"

APPLICANTS FILING FOR CCAA

1. Ivaco Inc.
2. Ivaco Rolling Mills Inc.
3. Ifastgroupe Inc.
4. IFC (Fasteners) Inc.
5. Ifastgroupe Realty Inc.
6. Docap (1985) Corporation
7. Florida Sub One Holdings, Inc.
8. 3632610 Canada Inc.

TAB "5"

2000 CarswellOnt 3117

Ontario Realty Corp. v. P. Gabriele & Sons Ltd.

Ontario Realty Corporation, Plaintiff and P. Gabriele & Sons Limited, Gabbro Construction Ltd., Gabriel Environmental Services Inc., 1331679 Ontario Limited, Pierino Gabriele, Frank Angelo Gabriele, Antonio Gabriele, Sirman Associates Limited, Ivan A. Sirman, Progressive Environmental Inc., Cynthia D.I. Stiles, 1287512 Ontario Limited, Integrated Property Solutions Inc., Robert W. Allan, Environmental and Development Solutions Ltd., 780551 Ontario Limited c.o.b., Master Environmental Services, 891602 Ontario Inc. c.o.b., Tri-Spade, Vincent Catalfo, Ross Farewell, Kent Banting and Tate Street Capital Inc., Defendants

Ontario Superior Court of Justice [Commercial List]

Farley J.

Heard: July 28, 2000
Judgment: August 21, 2000
Docket: 00-CL-3726

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Counsel: *Kenneth Prehogan* and *K.A. Boniface*, for Plaintiff.

Peter R. Greene and *Meredith L. Hayward*, for Defendant/Moving Party, 981602 Ontario Inc. c.o.b. Tri-Spade.

John E. Callaghan, for Defendants/Moving Parties, P. Gabriele & Sons Limited, Gabbro Construction Ltd., Gabriel Environmental Services Inc., 1331679 Ontario Limited, Pierino Gabriele, Frank Angelo Gabriele, Antonio Gabriele.

Tom Curry and *Darryl Cruz*, for Ministry of the Attorney General.

Christopher H. Wirth, for Non-Parties, Mauro Tonietto, Michael Zentil.

Jeffrey J. Long, for Unnamed Non-Party.

Subject: Public; Property; Contracts

Public authorities --- Crown corporations — General

Ontario Realty Corporation was created by statute to manage Crown owned real estate — Corporation brought action for fraud against former employees and various contractors and purchasers — Fraud involved series of transactions including bid rigging and secret commissions — Defendants brought motion to dismiss action on ground of legal incapacity — Motion dismissed — Corporation by law and implicitly contracted as agent for Crown — Corporation did not declare in contracts that it was acting as principal — Only Crown as principal

could sue for breach of contract or tort — Corporation had independent cause of action for damage to its own interests — Capital Investment Plan Act, 1993, S.O. 1993, c. 23, ss. 2(4), 24(1), 58(10) — Ministry of Government Services Act, R.S.O. 1990, c. M.25, s. 14.

Cases considered by *Farley J.*:

"Albazero" (The) (Cargo Owners) v. "Albazero" (The) (1976), [1977] A.C. 774, [1976] 2 W.L.R. 419, [1976] 3 All E.R. 129, [1976] 2 Lloyd's Rep. 467 (U.K. H.L.) — applied

Collins Safety Inc. v. Act Safety Inc. (1998), 41 O.R. (3d) 596 (Ont. Gen. Div.) — considered

Darlington Borough Council v. Wiltshier Northern Ltd. (1994), 1 W.L.R. 68 (Eng. Q.B.) — considered

Montgomerie v. United Kingdom Mutual Steamship Assn., [1891] 1 Q.B. 370 (Eng. Q.B.) — considered

Pielsticker v. Gray, [1947] O.W.N. 625, [1947] 3 D.L.R. 249, [1947] O.R. 149 (Ont. C.A.) — considered

Statutes considered:

Capital Investment Plan Act, 1993, S.O. 1993, c. 23

s. 2(2) — referred to

s. 2(4) — referred to

s. 3(4) — referred to

s. 24 — considered

s. 24(1) — considered

s. 24(2) — considered

s. 24(3) — considered

s. 24(5) — considered

s. 58 — referred to

s. 74 — referred to

Executive Council Act, R.S.O. 1990, c. E.25

s. 6 — considered

Interpretation Act, R.S.O. 1990, c. I.11

s. 27(a) — considered

Ministry of Government Services Act, R.S.O. 1990, c. M.25

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s. 1 "Government" — referred to

s. 1 "Government related agency" — referred to

s. 1 "Minister" — referred to

s. 1 "public work" — referred to

s. 6(1) — referred to

s. 6(3) — referred to

s. 8(5) [am. 1999, c. 9, s. 139(1)] — referred to

s. 9 — referred to

s. 12 — considered

s. 12(1) — considered

s. 12(2) — considered

s. 13 — considered

s. 14 — referred to

s. 16 — referred to

s. 19 [am. 1999, c. 9, s. 141] — referred to

Ontario Land Corporation Act, R.S.O. 1990, c. O.23

Generally — referred to

s. 13 — referred to

Rules considered:

Rules of Civil Procedure, R.R.O. 1990, Reg. 194

R. 21.01(1)(a) — considered

R. 21.01(3)(b) — considered

R. 21.01(3)(d) — considered

R. 25.11 — considered

MOTION by defendants for order dismissing action of Ontario Realty Corporation on ground of legal incapacity.

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Farley J.:

1 The defendant 981602 Ontario Inc. c.o.b. Tri-Spade ("Tri-Spade") moved for an order dismissing the action of the plaintiff Ontario Realty Corporation ("ORC") on the ground that the ORC is without legal capacity to commence or continue this action and, in the alternative, for an order determining the question of law whether the ORC as agent of Her Majesty the Queen in Right of Ontario ("Crown") has any cause of action in its own right on the facts pleaded. The defendants P. Gabriele & Sons Limited, Gabbro Construction Ltd., Gabriel Environmental Services Inc., 1331679 Ontario Limited, Pierino Gabriele, Frank Angelo Gabriele and Antonio Gabriele (collectively "GG") moved for a similar order. For this motion at least, the GG defendants appear content to have themselves treated as a group entity.

2 The ORC is a Crown corporation. Tri-Spade and GG assert that it is a "wrong party"; if any action were to be brought against them, they state that it should have been brought by the Crown as represented by the Attorney General of Ontario ("AG"). On April 19, 2000 by Notice of Action ("N/A"), the ORC commenced an action alleging fraud on behalf of these defendants *inter alia* in relation to alleged bid rigging of environmental clean-up contracts for lands owned by the Crown. The Statement of Claim ("S/C") dated May 19, 2000 substantially expanded the scope of the action to not only include contracts relating to environmental clean-up but also to the sale of lands by the Crown. The May 19, 2000 S/C has not been served upon the defendants, but rather it has been provided to them "informally" as a courtesy with an indication that it was expected that the S/C would be amended further. Tri-Spade responded with its Statement of Defence ("S/D") although not obliged to do so. By motion served on these defendants the day before this hearing, the ORC requested orders to allow it to amend its S/C (*inter alia* by expanding the number of and content regarding the alleged fraudulent land deals) and to allow it to add the Crown as represented by the AG *nunc pro tunc*. This motion was adjourned in light of the obvious prejudice caused by such short service. I would again remind the profession and the public that the Commercial List is not a hurry-up court but rather a scheduled court which takes into account the realities of real time litigation (as opposed to autopsy litigation).

3 The N/A in its totality states as to the Claim:

1. The Plaintiff's claim arises from a series of fraudulent transactions, fraudulent misrepresentations, and breaches of contract, committed by the Defendants, specifically:

(a) fraudulent bidding for the Phase III Environmental Consulting Contract on the Markham, Pickering and West Duffins Creek Properties;

(b) fraudulent bidding for the Phase III Environmental Clean-Up Contract for the Markham, Pickering and West Duffins Creek Properties;

(c) fraudulent bidding for the Phase III Environmental Consulting Contract for the Dryden Tree Nursery;

(d) clean-up work not done or not completed on the Markham, Pickering and West Duffins Creek Properties;

(e) fraudulent invoicing for Environmental Clean-Up on the Hurontario/Derry Road Property; and

(f) fraudulent invoicing and kick-backs — 605 King Street East, Toronto.

The Plaintiff seeks damages with respect to the same.

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2. The Plaintiff will be seeking an Anton Piller Order against the Defendants.

3. The Plaintiff will seek a Certificate of Pending Litigation against lands sold by the ORC to various Defendants.

4. The Plaintiff proposes that this action be tried in the City of Toronto, Ontario.

4 Trispade has dealt with its R. 21.01(3)(b) and R. 21.01(1)(a) motion on the basis of the May 19, 2000 S/C being operative with its S/D being served. GG on the other hand dealt with its motion essentially on the basis of the N/A and included the grounds of R. 21.01(3)(d). These Rules are as follows:

R. 21.01(3) A defendant may move before a judge to have an action stayed or dismissed on the ground that,

. . . . .

(b) the plaintiff is without legal capacity to commence or continue the action or the defendant does not have the legal capacity to be sued;

..., or

(d) the action is frivolous or vexatious or is otherwise and abuse of the process of the court,

and the judge may make an order or grant judgment accordingly.

R. 21.01(1) A party may move before a judge,

(a) for the determination, before trial, of a question of law raised by a pleading in an action where the determination of the question may dispose of all or part of the action, substantially shorten the trial or result in a substantial saving of costs...

5 Based upon a cross-examination of Tony Miele, President of the ORC, it was asserted that the ORC did not own any assets, including any land, at the material time. It may be a better and fairer interpretation of his testimony that the ORC did not own any of the Crown lands which it managed and from time to time was involved in leasing or selling, with it being left open as to whether the ORC had other assets including which I might term "office equipment" (for example, filing cabinets and computers). It appears clear from the S/C that the lands at issue were owned by the Crown. The ORC in turn has asserted that various former employees of the ORC who are named as defendants were involved with the other defendants in various fraudulent activities as to environmental clean-up contracts and as to contracts involving the sale of surplus Crown lands. In that respect the ORC in this motion emphasized that it was harmed by the fraudulent activities of its then employees who were said to be operating in conjunction with the other defendants. It was alleged that the moving parties were so involved in some of these fraudulent activities (although it is curious to note that the ORC chief investigator, Craig Malcolm ("Malcolm"), the Director of Forensic Accounting and Investigation Services, a division of Grant Thornton LLP, Chartered Accountants and Management Consultants, suspected as of June 2, 2000 at his cross-examination that Damian Spadafora, the sole office, director, shareholder, and employee of Tri-Spade, had nothing to do with an alleged fraudulent bid for environmental clean-up work submitted to the ORC via its consultant, the defendant Sirman Associates Limited).

6 I would have though that it would be more difficult to make the legislative path more complicated as op-

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posed to making this maze simpler. There may be exceptionally good reasons for it to be structured as it is; however, given its multiple steps (including forward, side and backwards), it seems that it may be a trap for the unwary. I would also note that the AG unsuccessfully attempted to become an *amicus curiae* on April 19, 2000 when it elected voluntarily to proceed on that path, giving up its quest for intervenor status. It now appears that the AG, now represented by Messrs. Curry and Cruz, is of the view that it should have been a party/plaintiff from the very start.

7 On November 15, 1993, the Ontario *Land Corporation Act* was repealed by S. 74 of the *Capital Investment Plan Act*, 1993, S.O. 1993, c. 23 ("*CIP Act*"). Section 13 of that now repealed legislation provided that the Corporation (the "predecessor" to the ORC) was to have vested in it such right, title and interest in real and personal property which was previously vested in the Crown and any of its boards, commissions and agencies as the Cabinet deemed necessary or advisable so as to allow that corporation to carry out its objects.

8 The *CIP Act* was an omnibus piece of legislation. The material provisions of it which affect the ORC are as follows:

> S. 2(2) The Ontario Land Corporation is continued as a corporation without share capital under the name Ontario Realty Corporation in English...
>
> .....
>
> (4) Subject to Section 24, a corporation is, for all its purposes, an agent of Her Majesty and its powers may be exercised only as an agent of Her Majesty.
>
> 3(4) The Chair of the Management Board of Cabinet is the minister responsible for the administration of this Act in respect of the Ontario Realty Corporation.
>
> 24(1) A corporation may declare in writing in any of its contracts, securities or instruments that it is not acting as an agent of Her Majesty for the purpose of the contract, security or instrument.
>
> (2) A corporation that makes a declaration under subsection (1) shall be deemed not to be an agent of Her Majesty for the purpose of the contract, security or instrument, and Her Majesty is not liable for any liabilities or obligations incurred by the corporation under the contract, security or instrument.
>
> (3) No proceeding shall be commenced against the Crown in respect of any act or omission of a corporation or its officers, directors or employees.
>
> .....
>
> (5) The Minister of Finance shall pay from the Consolidated Revenue Fund the amount of any judgment against a corporation that remains unpaid after the corporation has made all reasonable efforts, <u>including liquidating its assets</u>, to pay the amount of the judgment. [emphasis added]
>
> 58(1) Without limiting the powers or capacities of the Ontario Realty Corporation, its objects include providing to the Government of Ontario and its programs, and to others, services and financing related to real property and to improvements to real property.
>
> (2) The Lieutenant Governor in Council may by order establish additional objects for the Corporation.

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9 The *Ministry of Government Services Act*, R.S.O. 1990, c. M. 25 ("*MGS Act*") contains the following:

S. 1 In this Act,

"Government" means the Government of Ontario and any ministry or agency thereof and the Crown in right of Ontario and any agency thereof;

"Government related agency" includes Ontario Hydro, the Ontario Transportation Development Corporation, the Ontario Food Terminal Board, any public institution that is assisted by money appropriated by the Legislature and a corporation with or without share capital, the controlling interest of which is owned by the Crown in right of Ontario or whose bonds or debentures are guaranteed by the Crown in right of Ontario;

"Minister" means the Minister of Government Services;

"public work" means any real property or interest therein belonging to the Government that was acquired by lease or otherwise including any building or structure made, built, constructed, erected, extended, enlarged, repaired, improved or formed for the public purposes of the Government or at the expense of the Government and including all appointments, furnishings and equipment installed or placed in or on or used in connection with such property that belong to the Government but does not include any work for which money is appropriated by the Legislature as a subsidy.

6(1) It is the responsibility of the Minister and he or she has power, in accordance with section 8, to acquire, lease and dispose of public works.

6(3) Despite subsections (1) and (2), the Lieutenant Governor in Council may, for such period and under such terms and conditions as he or she considers suitable, assign any of the responsibilities or powers of the Minister or of the Ministry under this section to another minister.

8(5) Any disposal by the Minister or by the Ontario Realty Corporation of real property, or any interest therein, by way of grant, sale, lease or otherwise, is subject to the approval of the Lieutenant Governor in Council.

9(1) Except as otherwise provided in any other Act or by the Lieutenant Governor in Council, all public works and all property, or any interest therein, belonging to the Government shall vest in the Crown.

(2) Except as otherwise provided in any other Act or by the Lieutenant Governor in Council, all real property, or any interest therein, belonging to the Government shall be under the control of the Minister.

12(1) The Minister, for an in the name of the Crown, may enter into any contract or agreement that he or she considers advisable for the purpose of carrying out this Act.

(2) The employees of the Ministry under the direction of the Minister and the Deputy Minister may enter into contracts or agreements for an in the name of the Crown to carry out the responsibilities of the Ministry under this Act.

13 Contracts respecting any public works or property, under the control of the Ministry, entered into by the Minister, or by any other person duly authorized to enter into the same, enure to the benefit of the Crown and may be enforced as if entered into with the Crown under this Act.

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14 All actions and other proceedings for the enforcement of any contract for the recovery of damages for any tort or breach of contract or for the trial of any right in respect of property, under the control of the Ministry shall be instituted in the name of the Attorney General.

16 Before a contract is entered into for and in the name of the Crown in respect of the construction, renovation or repair of a public work, the Ministry shall invite tenders therefor except,....

19(1) Where, under this or any other Act, power or authority is granted to or vested in the Minister, other than the power to expropriate, he or she may in writing delegate that power or authority to the Deputy Minister, or to any employee of the Ministry, subject to such limitations, restrictions, conditions and requirements as the Minister may set out in the delegation.

(2) The Minister may delegate his or her responsibility and powers under subsections 6(1) and 8(1) and (2) to the Ontario Realty Corporation, subject to such conditions as the Minister may impose.

(3) The Minister may assign to the Ontario Realty Corporation the responsibilities and powers of the Minister, the Deputy Minister and the Ministry under clauses 6(2)(a) and (b), subject to such conditions as the Minister may impose.

(4) Despite the *Executive Council Act*, an agreement that is signed by a person authorized to do so by a delegation or an assignment made under this section has the same effect as if the agreement had been signed by the Minister.

(5) In this section, "Ontario Realty Corporation" means the Ontario Realty Corporation continued by subsection 2(2) of the *Capital Investment Plan Act, 1993*.

(underlining shows 1999 amendments; the 1999 amendments are subsequent to the contracts in question)

10 Order in Council 356/99 (approved and ordered February 3, 1993) provided that all of the powers and duties assigned to the Minister of Government Services were assigned and transferred to the Chair of the Management Board of Cabinet.

11 *The Executive Council Act*, R.S.O. 1990, c. E. 25 ("*EC Act*") provided that:

6. No deed or contract in respect of any matter under the control or direction of a minister is binding on Her Majesty or shall be deemed to be the act of such minister unless it is signed by the minister or is approved by the Lieutenant Governor in Council.

12 Order in Council 3364/94 (approved and ordered November 30, 1994) provided that pursuant to S. 6 of the *EC Act*:

the Chief Executive Officer of the Ontario Realty Corporation be authorized to execute such deeds, contracts and other documents on behalf of the Chair of the Management Board of Cabinet as would otherwise require the signature, approval or direction of the Minister under section 6 of the Ministry of Government Services Act.

And the Chief Executive Officer be authorized to further delegate the execution of such documents to staff of the Ontario Realty Corporation as the Chief Executive Officer deems fit.

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13 Section 27(a) of the *Interpretation Act*, R.S.O. 1990, c. I. 11 vests in a corporation: "[the] power to sue and be sued, to contract and be contracted with by its corporate name".

14 GG takes umbrage that Malcolm in his April 19, 2000 affidavit, sworn the same day as the hearing for the Anton Piller Order stated that there was no appraisal for the Hurontario/Derry Road property in the ORC files whereas a copy was located by GG counsel. It appears that the located copy was obtained from the files of the third party appraiser and received by Grant Thorton LLP on that same day April 19th. It would not appear that this appraisal came to Malcolm's attention until after the Anton Piller hearing. Given the extent of the work and the bulk of the files involved, I would think it unreasonable in these circumstances to assume that this appraisal would have instantly come to Malcolm's attention. One has to recognize the natural limits of the capacity of an individual human being.

15 The ORC points out that it is described in the sense of name definition in many of the subject contracts as "owner". That fact alone, in my view, is entirely irrelevant. A whimsical drafter of the contract could have name defined ORC as "Old Real Cuspidor" or as "ORCA" (thereby adding "A" to the name definition I have in these reasons ascribed to it). Neither would have made the ORC by that act alone either a spittoon or a killer whale.

16 Further, in my view, s. 27(a) of the *Interpretation Act*, does not for the purposes of this motion come into play. Reflected upon, it deals with a procedural element and not a substantive one. The corporation may "deal" in its own name; this is in contrast to a requirement that it "deal" in the name of its directors/shareholders/members operating as the corporation. This provision is an evolutionary vestige in the historical development of "the corporation" in legal terms.

17 I would observe that generally the contracts in the record are not models of clarity and precision. However it appears that none of them have taken the precaution of declaring in words equivalent to S. 24 of the *CIP Act* that:

> Pursuant to S. 24 of the *CIP Act*, ORC declares that it is not acting as agent...

or

> ORC states that it is acting as principal in this contract...

Thus there is no explicit declaration as to which ORC can rely to take its position that it was contracting in its own right and not as agent of the Crown.

18 Has it done so implicitly? An analysis of the documentation in the record produces a mixed result. The ORC is variously described as owning the land which is to be subject of a tender; but there are also references to the Province being the owner. The contracts involving the ORC and third parties appears to have as a standard clause the following or its equivalent:

> Ontario Realty Corporation hereby certifies that the property and/or services ordered under this agreement are purchased for the use of the Crown in Right of Ontario and therefore, are not subject to the Goods and Services Tax (G.S.T.).

The *pro forma* (standard form) contract of the ORC indicates that the ORC has the obligation to pay the contract price. An agreement between Sirman Associates Limited and the ORC dated August 21, 1998 provides in para-

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graph 4.5 that:

Any written notice provided for or to be given under this Agreement, if given by the Consultant to the Owner shall be considered to be sufficiently given if delivered or mailed to the Minister by prepaid registered post addressed to:

Ontario Realty Corporation

Real Estate Branch

15th Floor, 777 Bay Street

Toronto, Ontario

M4G 2E5

Attention: Ross M. Farewell

Project Manager

[emphasis added]

19 A purchase order dated May 25, 1999 was issued by the Management Board Secretariat for invoicing to that Secretariat by Gabriel Environmental Inc. [sic] but the "shipment" was to the ORC. The purchase order is described as "Ontario Government Purchase Order" and it contains language certifying that the purchase is by the Secretariat for the use of the Crown and therefore not subject to GST. Invoices appear to have gone to the Secretariat (e.g., those enclosed by Sirman Associates Limited by letter dated August 12, 1999 to the ORC which enclosed invoices were from Gabriel Environmental Inc [sic] to the Secretariat). Other invoices were sent by Sirman Associates Limited to the ORC (e.g., July 8, 1999).

20 The Hurontario/Derry Road site was sold by "Her Majesty the Queen in right of Ontario, as represented by the Chair of Management Board of Cabinet" to P. Gabriele & Sons Ltd. by agreement of purchase and sale dated March, 1997. In that agreement the vendor (the Crown) agrees that it will clean up the site in accordance with the environmental standards before closing. There is reference to title to this land being held in "the name of Her Majesty the Queen in right of the Province of Ontario represented by the *Minister of Transportation* for the Province of Ontario" [emphasis added]. There is no reference to the ORC by name, although notice to the vendor is allowed to be given to it at "777 Bay Street, 15th Floor, Toronto,, M5H 2E5 attention: Mr. John Falcioni, Marketing Coordinator, Marketing Section, Real Estate Branch, Property Development Division", which would, on the surface, appear to be the same address as the ORC as referred to in the Sirman agreement of August 21, 1998. P. Gabriele & Sons Limited, the purchaser, was then retained to do that clean-up. It invoiced the ORC on October 3, 1997 $39,000 for such clean-up work. In a statement of adjustments as of November 7, 1997, the purchaser (P. Gabriele & Sons Limited) was allowed $39,000 against the purchase price for this clean up work. The closing took place later that week. On February 6, 1998 Gabriel Environmental Inc. [sic] invoiced the ORC for $39,000 for the same clean-up work. References have been made to Gabriel Environmental Inc. [sic]; there apparently is no such corporation by this name, although one of the GG defendants is "Gabriel Environmental *Services* Inc." [emphasis added].

21 As can be seen from the foregoing the overall record is spotty as to the question of who is the true prin-

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cipal in the contracts — the ORC or the Crown. While there is some support for that being the ORC with the documentation issued by Sirman Associates Limited, Gabriel Environmental Inc. [sic] and P. Gabriele & Sons Ltd., one must recognize that this is documentation flowing towards the governmental entities involved. While one is familiar with the axiom that everyone is presumed to know the law, I doubt that very many people in this Province, both inside and outside of government, are knowledgeable about the intricacies of the maze regarding government and how and by whom it may be dealt. I think it fair to observe that it is unlikely that any of the moving parties here, prior to the Anton Piller Order issuing, had a review of the legislation such as I have had in this hearing. The pattern of the documentation issued by the governmental entities (or which they signed and likely had a significant role in preparing) would appear on this record to support the proposition that the ORC was not implicitly contracting as principal — but rather implicitly it was contracting as agent for the Crown. I pause to note here that this concept is rather ill defined in my view; dividing lines are fuzzy and the implications rather murky. Given the ultimate liability of the Crown in the sense of it being responsible ultimately for payment if the ORC does not make good, it would appear essentially that this labyrinth is a procedural one — and not a substantive one. On a substantive basis, one would be inclined to conclude that it is a distinction, without a difference. One would also note that s. 24(5) recognizes explicitly that a corporation such as the ORC does have assets.

22 The N/A is as demonstrated, an exceptionally bare-boned notice of its claim against the defendants. However, it is clear that it is intended to catch up all the defendants including the moving parties here. The allegation was that through "a series of fraudulent transactions, fraudulent misrepresentation, and breaches of contract, committed by the defendants [going on to specify six general categories]" the ORC was harmed. Implicit in this pleading is that the actions of the defendants were joint to varying degrees as to various of the situations. The May 19, 2000 S/C carried on this concept and immediately after paragraph 26 where it was said that:

> 26. As employees of ORC, Catalfo, Farewell and Banting owed a duty of care and fiduciary duty to ORC to act honestly and in the best interests of ORC.

The ORC went on at paragraphs 27-29 to give an "overview of the claim". This was as follows:

27. ORC states that the Defendants have been engaged in a course of conduct and series of transactions the effect of which were to defraud ORC. ORC is not aware yet of all of the transactions and of all the parties involved in the fraud, but its investigation into the fraud continues. ORC will provide further particulars when they become available. Except for documents seized pursuant to an Anton Piller Order, the documents and information demonstrating the fraud are in the possession of the Defendants. Some of the documents seized have not been reviewed by ORC or its investigators since they are under seal. Documents not sealed are still being reviewed. Many documents are missing from ORC's files for the fraudulent transactions.

28. At this time, there are four types of transactions of which ORC is aware that were fraudulent:

> (a) rigged bids were submitted for environmental consulting and remediation conducted by on or more of the Defendants;
>
> (b) environmental remediation conducted by one or more of the Defendants and which was paid for by ORC, was not completed properly or at all, and test results and reports were falsified;
>
> (c) inflated invoices were submitted to and paid by ORC for environmental work done by one or more of the Defendants; and

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(d) illegal secret commissions were paid to former ORC employees.

29. In addition to the activities set out in paragraph 28, the Gabriele Companies purchased many properties from Her Majesty the Queen in Right of the Province of Ontario, which sales were administered by ORC. These transactions are characterized by suspicious circumstances when combined with the fraudulent activities summarized in paragraph 28, demonstrate that these real estate transactions were or are part of a scheme to defraud the ORC. [emphasis added]

23 Paragraph 28 gives some information as to the four types of categories of transactions which the ORC considers fraudulent. All involve an allegation of dishonesty — the first three, paragraph 28 (a), (b) and (c) indicating that the transactions were conducted by "one or more of the Defendants". While paragraph 28 (d) does not specify that the illegal secret commissions were paid by "one or more of the Defendants", this would appear a natural conclusion in the circumstances.

24 It would be artificial not to take some cognizance of the Fresh as Amended Statement of Claim which was short served on the moving parties just on the eve of this hearing. In this the ORC was moving to have the AG added as a party plaintiff with the two plaintiffs (the ORC and the Crown as represented by the AG), apparently jointly, claiming damages against the defendants. The "Overview" in this pleading has been truncated down to:

Overview

2. The Ontario Realty Corporation ("ORC") is the manager of Her Majesty the Queen in Right of Ontario's ("HMQ") real estate assets. In a series of transactions beginning in 1994 and continuing through 1999, the Plaintiffs were defrauded by the Defendant ORC employees and those outside contractors and purchasers named below in the manner and at the times particularized herein. The impugned transactions include:

(a) rigging of bids submitted for environmental consulting remediation contracts and a property sale;

(b) failure to conduct or complete environmental remediation contracted for and fraudulently misrepresenting the completion of same;

(c) falsification of test results and reports;

(d) false invoicing to ORC for environmental consulting and clean-up work;

(e) secret commissions and personal benefits to ORC employees and consultants; and

(f) collusion between certain ORC employees and purchasers of properties resulting in the sale of HMQ lands, followed by unjustifiable reductions in the purchase price or mortgage back, or other gratuitous concessions.

It then goes on to describe the plaintiffs as follows:

Plaintiffs

(a) The Ontario Realty Corporation

3. The Ontario Realty Corporation is a corporation established by statute which provides Ontario govern-

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ment ministries, agencies, boards and commissions with realty services, portfolio and asset management, property development and management services. The ORC's mandate is to manage HMQ's real estate assets. The President of the ORC reports directly to the ORC Board of Directors which reports to the Chair of the Management Board of Cabinet. The ORC currently manages 25,000 hectares of real estate, including 8,000 buildings. The ORC's portfolio has a value of over 5 billion dollars. Among the ORC's activities is the sale of properties which are surplus to provincial requirements.

4. ORC acted as agent for HMQ in respect of the sale of certain lands as described in greater detail below. ORC also entered into agreements with various of the defendants to improve lands owned by HMQ and other agencies by conducting environmental site investigations and clean-up.

(b) Her Majesty the Queen in Right of Ontario

5. HMQ is, or was, the sole or joint owner of certain of the properties at issue in this matter and is the party for whose benefit the contracts referred to below were entered into.

6. The Attorney General is the chief law officer and a minister of HMQ. The attorney General is responsible for the conduct and regulation of all litigation for and against HMQ or any ministry or agency of the Ontario Government in respect of any subject within the authority or jurisdiction of the legislature.

25 In *Pielsticker v. Gray*, [1947] O.R. 149 (Ont. C.A.), Laidlaw, J.A. stated at paragraph 5 that he was bound by the authorities he cited including *Montgomerie v. United Kingdom Mutual Steamship Assn.*, [1891] 1 Q.B. 370 (Eng. Q.B.). At paragraph 3 he quoted Wright J. at page 371 of *Montgomerie* as follows:

> There is no doubt whatever as to the general rule as regards an agent, that where a person contracts as agent for a principal the contract is the contract of the principal, and not that of the agent; and, prima facie, at common law the only person who may sue is the principal, and the only person who can be sued is the principal. To that rule there are, of course, many exceptions.

While Wright, J. referred to a number of exceptions it does not appear he was exhaustive. See also *Bowstead and Reynolds on Agency*, (16th ed. 1996; Sweet & Maxwell, London) at page 548.

Bowstead and Reynolds go on to state at pages 555-6:

> Agent suing on behalf of principal. Another group of old cases suggests that the agent can in general sue on behalf of his disclosed principal and recover his principal's loss. They should be viewed with extreme caution. Many date from a time when there was no method of assigning legal choses in action, communications did not make it easy for foreign contracting parties to sue in England, contract rights under bills of lading were not transferable, and the central contractual doctrines now accepted had not been fully worked out. The distinction between a right of suit and a right to recover substantial damages was not taken in some of these early cases. However the matter would have been viewed at the time, it is submitted that most of them would not now be followed or would be otherwise explained. An action brought for another by an agent authorised to do so should nowadays be brought in the name of the principal.
>
> To modern eyes the correct analysis must be that where the agent is a party to the, or a contract with the third party he has the right to sue on it. The question then arises as to what he can recover. It was affirmed in the leading case of *"Albazero" (The)* that the measure of damages for breach of contract is "generally the

> financial loss which the plaintiff has sustained by reason of the defendant's failure to perform the contract according to its terms." But there are exceptions to this rule that the plaintiff can only recover his own loss. First, trustees can recover the loss suffered by their beneficiaries. This is a matter of equity.[58]

The rest of the exceptions do not appear to have any relevance here. Footnote 58 indicates: "It may sometimes be relevant that the agent is a *constructive* trustee: see per Dillon, L.J. in *Darlington Borough Council v. Wiltshier Northern Ltd.* (1994), 1 W.L.R. 68 (Eng. Q.B.), 75". I do not see that the ORC is acting in a trust capacity viz a viz the Crown. It is agreed that the Crown could sue in its own right.

26 Tri-Spade referred to *Collins Safety Inc. v. Act Safety Inc.* (1998), 41 O.R. (3d) 596 (Ont. Gen. Div.) where Taliano, J. at page 598 dismissed the plaintiff's action (wherein the plaintiff was suing on a promissory note which it had transferred to a third party) since the plaintiff had no legal capacity to prosecute the action.

27 The ORC also relies on *Bowstead supra* at pages 550-576, specifically citing the introductory view of Article 100:

> An agent who makes a contract on his principal's behalf is liable to or entitled to sue the third party in accordance with the terms of any contractual engagement, whether upon the same contract or upon some independent contract, into which he has entered.[18]

Footnote 18 states: "See Comment". The Comment then takes up pages 550-76 including the portion at pages 555-6 relied on by the moving parties. When one analyzes the whole of Article 100, I am of the opinion in circumstances such as we have here that the better and more modern view is that an agent is able to sue as to a contractual arrangement only (i) where that specific right to sue is given to the agent in the contract itself; (ii) where the agent is acting in a trust relationship with its principal so that the principal would not have the capacity to sue; or (iii) where the contract gives the agent certain rights of its own, separate from the rights of its principal, vis-à-vis the defendant.

28 The ORC also relies upon an excerpt from *Halsbury's Law of England* (4th ed., reissued 1990; Butterworths, London), Vol. 1, Section 179:

> 179. Right to enforce contract. Any person who makes a contract in his own name without disclosing the existence of a principal, or who, though disclosing the fact that he is acting as an agent on behalf of a principal, renders himself personally liable on the contract, is entitled to enforce it against the other contracting party, notwithstanding that the principal has renounced the contract. [emphasis added]

29 However, I do not see this as operative in this case given that the ORC is an agent of the Crown as per S. 2(4) of the *CIP Act*. Given the lack of any express or implied declaration pursuant to S. 24(1), I do not see that the ORC is "personally liable on the contract". The ORC also relies upon s. 14(1) of the *MGS Act* as it says that that section should be interpreted in conjunction with S. 12(1), (2) and S. 13. The ORC emphasized that S. 13 contained permissive language:

> 13. Contracts respecting any public works or property, under the control of the Ministry, entered into by the Minister, or by any other person duly authorized to enter into the same, enure to the benefit of the Crown and may be enforced as if entered into with the Crown under this Act. [emphasis added by the ORC]

I am of the view that this is a misreading of the permissive language. Rather, contracts entered into by author-

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ized persons may be enforced by the Crown (as specified in S. 14(1)).

30 However, I do not see that as the end of matters. This hearing was restricted or limited to whether or not the ORC has the capacity to be a plaintiff (it is unfortunate that given the haste in which the matter evolved that there does not appear to have been sufficient communication and co-ordination so this hearing could have dealt with all related matters, including the motion to add the AG as a party plaintiff and amend the S/C). It did not proceed as to a more surgical exercise pursuant to Rule 25.11 whereby offending portions may be excised, leaving the remainder. Rather the hearing dealt with whether the ORC should be knocked out completely; that is, on an all or nothing basis.

31 Thus I think it appropriate to step back and take a wider view of the pleadings over and above the narrow principal-agent contractual one — and in fact over and above the tortious elements related in substance to the properties in question. Rather the relationship of the ORC and its former employee defendants appears to have been ignored after an initial, almost perfunctory, acknowledgement that the ORC had an interest in ensuring that its employees acted not only legally but properly in accordance with the policies and procedures of the ORC. The maintenance of that regime would be necessary and integral to the ORC carrying out its mandate. In that respect vis-à-vis its employees, the ORC is operating as a "principal".

32 Thus let us take into account the N/A and the May 19, 2000 S/C (whether or not expanded upon as to the ORC alone in the proposed Fresh as Amended Statement of Claim). These pleadings allege (I would emphasize that what we are dealing with here are merely allegations) that the defendants overall, in varying degrees (that is, not all may have been engaged in each and every specific (isolated) transaction) in the various circumstances, acted together to the detriment of the ORC in carrying out its mandate of managing the operations of dealing with Crown lands, including acting as agent (as I have concluded the ORC must be acting pursuant to the statutes and orders in council when applied to the circumstances alleged). The alleged scam is said by the ORC to have involved its former employees as to furtherance of the fraud — and not merely in some peripheral way. In that respect it appears to me that the ORC has been directly injured if such allegations are proven. I see no reason why the ORC *itself* would not be permitted to sue for damages it has thereby suffered. This would appear to follow the principal indicated in *"Albazero" (The) (Cargo Owners) v. "Albazero" (The)*, [1976] 3 All E.R. 129 (U.K. H.L.) at p. 132 where Lord Diplock stated:

> The general rule in English law today as to the measure of damages recoverable for the invasion of a legal right, whether by breach of a contract or by commission of a tort, is that damages are compensatory. Their function is to put the person whose right has been invaded in the same position as if it had been respected so far as the award of a sum of money can do so.

33 The ORC alleges that not only were its former employees engaged in the scam but also that the other defendants, including the moving parties, were participants in fraudulent bidding, fraudulent invoicing, false clean-up work (i.e., clean-up work contracted for and confirmed to have been completed but not so completed) and kickbacks to the former employees. Thus the ORC alleges that the other defendants have participated in a scheme which has harmed the ORC. In that respect, and only in that respect, I am of the view that the ORC may sue in its own right as a party plaintiff. Since this was an all or nothing motion based on whether the ORC had the capacity in these circumstances to be a plaintiff, I would dismiss the motions of the moving parties.

34 I may be spoken to at the next scheduled hearing if these parties are not able to agree on costs, if any.

35 As a side note, I would think it helpful and in the interest of justice, but particularly in the interests of all

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parties, if this process did not get bogged down in procedural motions. The Court relies upon parties as represented by their counsel to work out matters outside of court so that the truly thorny substantive matters can be addressed in a timely fashion. As I understand the true wish of all concerned here is to get on with the substantive matters.

Motion dismissed.

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TAB "6"

REPORTS OF CASES

DETERMINED IN

ONTARIO COURTS

Royal Bank of Canada v. Soundair Corp., Canadian Pension Capital Ltd. and Canadian Insurers Capital Corp.

[Indexed as: Royal Bank of Canada v. Soundair Corp.]

Court of Appeal for Ontario, Goodman, McKinlay and Galligan JJ.A.
July 3, 1991

d **Debtor and creditor — Receivers — Court-appointed receiver accepting offer to purchase assets against wishes of secured creditors — Receiver acting properly and prudently — Wishes of creditors not determinative — Court approval of sale confirmed on appeal.**

Air Toronto was a division of Soundair. In April 1990, one of Soundair's creditors, the Royal Bank, appointed a receiver to operate Air Toronto and sell it e as a going concern. The receiver was authorized to sell Air Toronto to Air Canada, or, if that sale could not be completed, to negotiate and sell Air Toronto to another person. Air Canada made an offer which the receiver rejected. The receiver then entered into negotiations with Canadian Airlines International (Canadian); two subsidiaries of Canadian, Ontario Express Ltd. and Frontier Airlines Ltd., made an offer to purchase on March 6, 1991 (the OEL offer). Air Canada and a creditor f of Soundair, CCFL, presented an offer to purchase to the receiver on March 7, 1991 through 922, a company formed for that purpose (the 922 offer). The receiver declined the 922 offer because it contained an unacceptable condition and accepted the OEL offer. 922 made a second offer, which was virtually identical to the first one except that the unacceptable condition had been removed. In proceedings before Rosenberg J., an order was made approving the sale of Air Toronto to OEL g and dismissing the 922 offer. CCFL appealed.

Held, the appeal should be dismissed.

Per Galligan J.A.: When deciding whether a receiver has acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer, and should be very cautious before h deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. The decision to sell to OEL was a sound one in the circumstances faced by the receiver on March 8, 1991. Prices in other offers received after the receiver has agreed to a sale have relevance only if they show that the price contained in the accepted offer was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. If they do not do so, they should not be considered upon a motion to confirm a sale recommended

by a court-appointed receiver. If the 922 offer was better than the OEL offer, it was only marginally better and did not lead to an inference that the disposition strategy of the receiver was improvident.

a

While the primary concern of a receiver is the protecting of the interests of creditors, a secondary but important consideration is the integrity of the process by which the sale is effected. The court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

b

The failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto did not result in the process being unfair, as there was no proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL.

c

The fact that the 922 offer was supported by Soundair's secured creditors did not mean that the court should have given effect to their wishes. Creditors who asked the court to appoint a receiver to dispose of assets (and therefore insulated themselves from the risks of acting privately) should not be allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale by the receiver. If the court decides that a court-appointed receiver has acted providently and properly (as the receiver did in this case), the views of creditors should not be determinative.

d

Per McKinlay J.A. (concurring in the result): While the procedure carried out by the receiver in this case was appropriate, given the unfolding of events and the unique nature of the assets involved, it was not a procedure which was likely to be appropriate in many receivership sales.

e

Per Goodman J.A. (dissenting): The fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. The creditors in this case were convinced that acceptance of the 922 offer was in their best interest and the evidence supported that belief. Although the receiver acted in good faith, the process which it used was unfair insofar as 922 was concerned and improvident insofar as the secured creditors were concerned.

f

Cases referred to

g

Beauty Counsellors of Canada Ltd. (Re) (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.); *British Columbia Development Corp. v. Spun Cast Industries Inc.* (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.); *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.); *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 22 C.P.C. (2d) 131, 67 C.B.R. (N.S.) 320 (note), 39 D.L.R. (4th) 526 (H.C.J.); *Salima Investments Ltd. v. Bank of Montreal* (1985), 41 Alta. L.R. (2d) 58, 65 A.R. 372, 59 C.B.R. (N.S.) 242, 21 D.L.R. (4th) 473 (C.A.); *Selkirk (Re)* (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.); *Selkirk (Re)* (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.)

h

Statutes referred to

Employment Standards Act, R.S.O. 1980, c. 137
a *Environmental Protection Act*, R.S.O. 1980, c. 141

APPEAL from the judgment of the General Division, Rosenberg J., May 1, 1991, approving the sale of an airline by a receiver.

J.B. Berkow and *Steven H. Goldman*, for appellants.
b *John T. Morin*, Q.C., for Air Canada.
L.A.J. Barnes and *Lawrence E. Ritchie*, for Royal Bank of Canada.
Sean F. Dunphy and *G.K. Ketcheson* for Ernst & Young Inc., receiver of Soundair Corp., respondent.
W.G. Horton, for Ontario Express Ltd.
c *Nancy J. Spies*, for Frontier Air Ltd.

GALLIGAN J.A.:—This is an appeal from the order of Rosenberg J. made on May 1, 1991 (Gen. Div.). By that order, he approved the sale of Air Toronto to Ontario Express Limited and Frontier d Air Limited and he dismissed a motion to approve an offer to purchase Air Toronto by 922246 Ontario Limited.

It is necessary at the outset to give some background to the dispute. Soundair Corporation (Soundair) is a corporation engaged in the air transport business. It has three divisions. One of them is Air Toronto. Air Toronto operates a scheduled airline from e Toronto to a number of mid-sized cities in the United States of America. Its routes serve as feeders to several of Air Canada's routes. Pursuant to a connector agreement, Air Canada provides some services to Air Toronto and benefits from the feeder traffic provided by it. The operational relationship between Air Canada f and Air Toronto is a close one.

In the latter part of 1989 and the early part of 1990, Soundair was in financial difficulty. Soundair has two secured creditors who have an interest in the assets of Air Toronto. The Royal Bank of Canada (the Royal Bank) is owed at least $65,000,000. The appel- g lants Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively called CCFL) are owed approximately $9,500,000. Those creditors will have a deficiency expected to be in excess of $50,000,000 on the winding-up of Soundair.

On April 26, 1990, upon the motion of the Royal Bank, O'Brien h J. appointed Ernst & Young Inc. (the receiver) as receiver of all of the assets, property and undertakings of Soundair. The order required the receiver to operate Air Toronto and sell it as a going concern. Because of the close relationship between Air Toronto and Air Canada, it was contemplated that the receiver would

obtain the assistance of Air Canada to operate Air Toronto. The order authorized the receiver:

> (b) to enter into contractual arrangements with Air Canada to retain a manager or operator, including Air Canada, to manage and operate Air Toronto under the supervision of Ernst & Young Inc. until the completion of the sale of Air Toronto to Air Canada or other person . . .

Also because of the close relationship, it was expected that Air Canada would purchase Air Toronto. To that end, the order of O'Brien J. authorized the receiver:

> (c) to negotiate and do all things necessary or desirable to complete a sale of Air Toronto to Air Canada and, if a sale to Air Canada cannot be completed, to negotiate and sell Air Toronto to another person, subject to terms and conditions approved by this Court.

Over a period of several weeks following that order, negotiations directed towards the sale of Air Toronto took place between the receiver and Air Canada. Air Canada had an agreement with the receiver that it would have exclusive negotiating rights during that period. I do not think it is necessary to review those negotiations, but I note that Air Canada had complete access to all of the operations of Air Toronto and conducted due diligence examinations. It became thoroughly acquainted with every aspect of Air Toronto's operations.

Those negotiations came to an end when an offer made by Air Canada on June 19, 1990, was considered unsatisfactory by the receiver. The offer was not accepted and lapsed. Having regard to the tenor of Air Canada's negotiating stance and a letter sent by its solicitors on July 20, 1990, I think that the receiver was eminently reasonable when it decided that there was no realistic possibility of selling Air Toronto to Air Canada.

The receiver then looked elsewhere. Air Toronto's feeder business is very attractive, but it only has value to a national airline. The receiver concluded reasonably, therefore, that it was commercially necessary for one of Canada's two national airlines to be involved in any sale of Air Toronto. Realistically, there were only two possible purchasers whether direct or indirect. They were Air Canada and Canadian Airlines International.

It was well known in the air transport industry that Air Toronto was for sale. During the months following the collapse of the negotiations with Air Canada, the receiver tried unsuccessfully to find viable purchasers. In late 1990, the receiver turned to Canadian Airlines International, the only realistic alternative. Negotiations began between them. Those negotiations led to a letter of intent dated February 11, 1991. On March 6, 1991, the

receiver received an offer from Ontario Express Limited and Frontier Airlines Limited, who are subsidiaries of Canadian Airlines International. This offer is called the OEL offer.

In the meantime, Air Canada and CCFL were having discussions about making an offer for the purchase of Air Toronto. They formed 922246 Ontario Limited (922) for the purpose of purchasing Air Toronto. On March 1, 1991, CCFL wrote to the receiver saying that it proposed to make an offer. On March 7, 1991, Air Canada and CCFL presented an offer to the receiver in the name of 922. For convenience, its offers are called the 922 offers.

The first 922 offer contained a condition which was unacceptable to the receiver. I will refer to that condition in more detail later. The receiver declined the 922 offer and on March 8, 1991, accepted the OEL offer. Subsequently, 922 obtained an order allowing it to make a second offer. It then submitted an offer which was virtually identical to that of March 7, 1991, except that the unacceptable condition had been removed.

The proceedings before Rosenberg J. then followed. He approved the sale to OEL and dismissed a motion for the acceptance of the 922 offer. Before Rosenberg J., and in this court, both CCFL and the Royal Bank supported the acceptance of the second 922 offer.

There are only two issues which must be resolved in this appeal. They are:

(1) Did the receiver act properly when it entered into an agreement to sell Air Toronto to OEL?

(2) What effect does the support of the 922 offer by the secured creditors have on the result?

I will deal with the two issues separately.

I. DID THE RECEIVER ACT PROPERLY IN AGREEING TO SELL TO OEL?

Before dealing with that issue there are three general observations which I think I should make. The first is that the sale of an airline as a going concern is a very complex process. The best method of selling an airline at the best price is something far removed from the expertise of a court. When a court appoints a receiver to use its commercial expertise to sell an airline, it is inescapable that it intends to rely upon the receiver's expertise and not upon its own. Therefore, the court must place a great deal of confidence in the actions taken and in the opinions formed by the receiver. It should also assume that the receiver is acting properly unless the contrary is clearly shown. The second obser-

vation is that the court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver. The third observation which I wish to make is that the conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court.

The order of O'Brien J. provided that if the receiver could not complete the sale to Air Canada that it was "to negotiate and sell Air Toronto to another person". The court did not say how the receiver was to negotiate the sale. It did not say it was to call for bids or conduct an auction. It told the receiver to negotiate and sell. It obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially in the discretion of the receiver. I think, therefore, that the court should not review minutely the process of the sale when, broadly speaking, it appears to the court to be a just process.

As did Rosenberg J., I adopt as correct the statement made by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.), at pp. 92-94 O.R., pp. 531-33 D.L.R., of the duties which a court must perform when deciding whether a receiver who has sold a property acted properly. When he set out the court's duties, he did not put them in any order of priority, nor do I. I summarize those duties as follows:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.
2. It should consider the interests of all parties.
3. It should consider the efficacy and integrity of the process by which offers are obtained.
4. It should consider whether there has been unfairness in the working out of the process.

I intend to discuss the performance of those duties separately.

1. *Did the receiver make a sufficient effort to get the best price and did it act providently?*

Having regard to the fact that it was highly unlikely that a commercially viable sale could be made to anyone but the two national airlines, or to someone supported by either of them, it is my view that the receiver acted wisely and reasonably when it negotiated only with Air Canada and Canadian Airlines International. Furthermore, when Air Canada said that it would submit no further offers and gave the impression that it would not participate further in the receiver's efforts to sell, the only course reasonably open to the receiver was to negotiate with Canadian

Airlines International. Realistically, there was nowhere else to go but to Canadian Airlines International. In doing so, it is my opinion that the receiver made sufficient efforts to sell the airline.

When the receiver got the OEL offer on March 6, 1991, it was over ten months since it had been charged with the responsibility of selling Air Toronto. Until then, the receiver had not received one offer which it thought was acceptable. After substantial efforts to sell the airline over that period, I find it difficult to think that the receiver acted improvidently in accepting the only acceptable offer which it had.

On March 8, 1991, the date when the receiver accepted the OEL offer, it had only two offers, the OEL offer which was acceptable, and the 922 offer which contained an unacceptable condition. I cannot see how the receiver, assuming for the moment that the price was reasonable, could have done anything but accept the OEL offer.

When deciding whether a receiver had acted providently, the court should examine the conduct of the receiver in light of the information the receiver had when it agreed to accept an offer. In this case, the court should look at the receiver's conduct in the light of the information it had when it made its decision on March 8, 1991. The court should be very cautious before deciding that the receiver's conduct was improvident based upon information which has come to light after it made its decision. To do so, in my view, would derogate from the mandate to sell given to the receiver by the order of O'Brien J. I agree with and adopt what was said by Anderson J. in *Crown Trust v. Rosenberg, supra*, at p. 112 O.R., p. 551 D.L.R.:

> Its decision was made as a matter of business judgment *on the elements then available to it*. It is of the very essence of a receiver's function to make such judgments and in the making of them to act seriously and responsibly so as to be prepared to stand behind them.
>
> If the court were to reject the recommendation of the Receiver in any but the most exceptional circumstances, it would materially diminish and weaken the role and function of the Receiver both in the perception of receivers and in the perception of any others who might have occasion to deal with them. It would lead to the conclusion that the decision of the Receiver was of little weight and that the real decision was always made upon the motion for approval. That would be a consequence susceptible of immensely damaging results to the disposition of assets by court-appointed receivers.

(Emphasis added)

I also agree with and adopt what was said by Macdonald J.A. in *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), at p. 11 C.B.R., p. 314 N.S.R.:

> In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances *at the time existing* it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement.

(Emphasis added)

On March 8, 1991, the receiver had two offers. One was the OEL offer which it considered satisfactory but which could be withdrawn by OEL at any time before it was accepted. The receiver also had the 922 offer which contained a condition that was totally unacceptable. It had no other offers. It was faced with the dilemma of whether it should decline to accept the OEL offer and run the risk of it being withdrawn, in the hope that an acceptable offer would be forthcoming from 922. An affidavit filed by the president of the receiver describes the dilemma which the receiver faced, and the judgment made in the light of that dilemma:

> 24. An asset purchase agreement was received by Ernst & Young on March 7, 1991 which was dated March 6, 1991. This agreement was received from CCFL in respect of their offer to purchase the assets and undertaking of Air Toronto. Apart from financial considerations, which will be considered in a subsequent affidavit, the *Receiver determined that it would not be prudent to delay acceptance of the OEL agreement to negotiate a highly uncertain arrangement with Air Canada and CCFL*. Air Canada had the benefit of an "exclusive" in negotiations for Air Toronto and had clearly indicated its intention to take itself out of the running while ensuring that no other party could seek to purchase Air Toronto and maintain the Air Canada connector arrangement vital to its survival. The CCFL offer represented a radical reversal of this position by Air Canada at the eleventh hour. However, it contained a significant number of conditions to closing which were entirely beyond the control of the Receiver. As well, the CCFL offer came less than 24 hours before signing of the agreement with OEL which had been negotiated over a period of months, at great time and expense.

(Emphasis added)

I am convinced that the decision made was a sound one in the circumstances faced by the receiver on March 8, 1991.

I now turn to consider whether the price contained in the OEL offer was one which it was provident to accept. At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after ten months of trying to sell the airline, is strong evidence that the price in it was reasonable. In a deteriorating economy, I doubt that it would have been wise to wait any longer.

I mentioned earlier that, pursuant to an order, 922 was permitted to present a second offer. During the hearing of the

appeal, counsel compared at great length the price contained in the second 922 offer with the price contained in the OEL offer.
a Counsel put forth various hypotheses supporting their contentions that one offer was better than the other.

It is my opinion that the price contained in the 922 offer is relevant only if it shows that the price obtained by the Receiver in the OEL offer was not a reasonable one. In *Crown Trust v.*
b *Rosenberg, supra*, Anderson J., at p. 113 O.R., p. 551 D.L.R., discussed the comparison of offers in the following way:

> No doubt, as the cases have indicated, situations might arise where the disparity was so great as to call in question the adequacy of the mechanism which had produced the offers. It is not so here, and in my view that is substantially an end of the matter.

c In two judgments, Saunders J. considered the circumstances in which an offer submitted after the receiver had agreed to a sale should be considered by the court. The first is *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.), at p. 247:

> If, for example, in this case there had been a second offer of a substantially
> d higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out his function of endeavouring to obtain the best price for the property.

The second is *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.), at p. 243:

> e If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate.

In *Re Selkirk* (1987), 64 C.B.R. (N.S.) 140 (Ont. Bkcy.), at p.
f 142, McRae J. expressed a similar view:

> The court will not lightly withhold approval of a sale by the receiver, particularly in a case such as this where the receiver is given rather wide discretionary authority as per the order of Mr. Justice Trainor and, of course, where the receiver is an officer of this court. Only in a case where there seems to be some unfairness in the process of the sale or *where there are substantially higher offers which would tend to show that the sale was*
> g *improvident* will the court withhold approval. It is important that the court recognize the commercial exigencies that would flow if prospective purchasers are allowed to wait until the sale is in court for approval before submitting their final offer. This is something that must be discouraged.

(Emphasis added)

h What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the

receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered *bona fide* into an agreement with the receiver, can only lead to chaos, and must be discouraged.

If, however, the subsequent offer is so substantially higher than the sale recommended by the receiver, then it may be that the receiver has not conducted the sale properly. In such circumstances, the court would be justified itself in entering into the sale process by considering competitive bids. However, I think that that process should be entered into only if the court is satisfied that the receiver has not properly conducted the sale which it has recommended to the court.

It is necessary to consider the two offers. Rosenberg J. held that the 922 offer was slightly better or marginally better than the OEL offer. He concluded that the difference in the two offers did not show that the sale process adopted by the receiver was inadequate or improvident.

Counsel for the appellants complained about the manner in which Rosenberg J. conducted the hearing of the motion to confirm the OEL sale. The complaint was, that when they began to discuss a comparison of the two offers, Rosenberg J. said that he considered the 922 offer to be better than the OEL offer. Counsel said that when that comment was made, they did not think it necessary to argue further the question of the difference in value between the two offers. They complain that the finding that the 922 offer was only marginally better or slightly better than the OEL offer was made without them having had the opportunity to argue that the 922 offer was substantially better or significantly better than the OEL offer. I cannot understand how counsel could have thought that by expressing the opinion that the 922 offer was better, Rosenberg J. was saying that it was a significantly or substantially better one. Nor can I comprehend how counsel took the comment to mean that they were foreclosed from arguing that the offer was significantly or substantially better. If there was some misunderstanding on the part of counsel, it should have been raised before Rosenberg J. at the time. I am sure that if it had been, the misunderstanding would have been cleared up quickly. Nevertheless, this court permitted extensive argument dealing with the comparison of the two offers.

The 922 offer provided for $6,000,000 cash to be paid on closing with a royalty based upon a percentage of Air Toronto profits over a period of five years up to a maximum of $3,000,000. The OEL offer provided for a payment of $2,000,000 on closing with a royalty paid on gross revenues over a five-year period. In the short term, the 922 offer is obviously better because there is substantially more cash up front. The chances of future returns are substantially greater in the OEL offer because royalties are paid on gross revenues while the royalties under the 922 offer are paid only on profits. There is an element of risk involved in each offer.

The receiver studied the two offers. It compared them and took into account the risks, the advantages and the disadvantages of each. It considered the appropriate contingencies. It is not necessary to outline the factors which were taken into account by the receiver because the manager of its insolvency practice filed an affidavit outlining the considerations which were weighed in its evaluation of the two offers. They seem to me to be reasonable ones. That affidavit concluded with the following paragraph:

> 24. On the basis of these considerations the Receiver has approved the OEL offer and has concluded that it represents the achievement of the highest possible value at this time for the Air Toronto division of SoundAir.

The court appointed the receiver to conduct the sale of Air Toronto and entrusted it with the responsibility of deciding what is the best offer. I put great weight upon the opinion of the receiver. It swore to the court which appointed it that the OEL offer represents the achievement of the highest possible value at this time for Air Toronto. I have not been convinced that the receiver was wrong when he made that assessment. I am, therefore, of the opinion that the 922 offer does not demonstrate any failure upon the part of the receiver to act properly and providently.

It follows that if Rosenberg J. was correct when he found that the 922 offer was in fact better, I agree with him that it could only have been slightly or marginally better. The 922 offer does not lead to an inference that the disposition strategy of the receiver was inadequate, unsuccessful or improvident, nor that the price was unreasonable.

I am, therefore, of the opinion that the receiver made a sufficient effort to get the best price and has not acted improvidently.

2. *Consideration of the interests of all parties*

It is well established that the primary interest is that of the creditors of the debtor: see *Crown Trust Co. v. Rosenberg, supra,* and *Re Selkirk* (1986, Saunders J.), *supra*. However, as Saunders J. pointed out in *Re Beauty Counsellors, supra,* at p. 244 C.B.R., "it is not the only or overriding consideration".

In my opinion, there are other persons whose interests require consideration. In an appropriate case, the interests of the debtor must be taken into account. I think also, in a case such as this, where a purchaser has bargained at some length and doubtless at considerable expense with the receiver, the interests of the purchaser ought to be taken into account. While it is not explicitly stated in such cases as *Crown Trust Co. v. Rosenberg, supra, Re Selkirk* (1986, Saunders J.), *supra, Re Beauty Counsellors, supra, Re Selkirk* (1987, McRae J.), *supra*, and *Cameron, supra,* I think they clearly imply that the interests of a person who has negotiated an agreement with a court-appointed receiver are very important.

In this case, the interests of all parties who would have an interest in the process were considered by the receiver and by Rosenberg J.

3. *Consideration of the efficacy and integrity of the process by which the offer was obtained*

While it is accepted that the primary concern of a receiver is the protecting of the interests of the creditors, there is a secondary but very important consideration and that is the integrity of the process by which the sale is effected. This is particularly so in the case of a sale of such a unique asset as an airline as a going concern.

The importance of a court protecting the integrity of the process has been stated in a number of cases. First, I refer to *Re Selkirk* (1986), *supra*, where Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.
>
> In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in *Cameron v. Bank of N.S.* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), where he said at p. 11:
>
> > In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is

reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a finding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard — this would be an intolerable situation.

While those remarks may have been made in the context of a bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

In *Salima Investments Ltd. v. Bank of Montreal* (1985), 41 Alta. L.R. (2d) 58, 21 D.L.R. (4th) 473 (C.A.), at p. 61 Alta. L.R., p. 476 D.L.R., the Alberta Court of Appeal said that sale by tender is not necessarily the best way to sell a business as an ongoing concern. It went on to say that when some other method is used which is provident, the court should not undermine the process by refusing to confirm the sale.

Finally, I refer to the reasoning of Anderson J. in *Crown Trust Co. v. Rosenberg, supra*, at p. 124 O.R., pp. 562-63 D.L.R.:

While every proper effort must always be made to assure maximum recovery consistent with the limitations inherent in the process, no method has yet been devised to entirely eliminate those limitations or to avoid their consequences. *Certainly it is not to be found in loosening the entire foundation of the system. Thus to compare the results of the process in this case with what might have been recovered in some other set of circumstances is neither logical nor practical.*

(Emphasis added)

It is my opinion that the court must exercise extreme caution before it interferes with the process adopted by a receiver to sell an unusual asset. It is important that prospective purchasers know that, if they are acting in good faith, bargain seriously with a receiver and enter into an agreement with it, a court will not lightly interfere with the commercial judgment of the receiver to sell the asset to them.

Before this court, counsel for those opposing the confirmation of the sale to OEL suggested many different ways in which the receiver could have conducted the process other than the way which he did. However, the evidence does not convince me that the receiver used an improper method of attempting to sell the airline. The answer to those submissions is found in the comment of Anderson J. in *Crown Trust Co. v. Rosenberg, supra*, at p. 109 O.R., p. 548 D.L.R.:

The court ought not to sit as on appeal from the decision of the Receiver,

> reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise.

It would be a futile and duplicitous exercise for this court to examine in minute detail all of the circumstances leading up to the acceptance of the OEL offer. Having considered the process adopted by the receiver, it is my opinion that the process adopted was a reasonable and prudent one.

4. *Was there unfairness in the process?*

As a general rule, I do not think it appropriate for the court to go into the minutia of the process or of the selling strategy adopted by the receiver. However, the court has a responsibility to decide whether the process was fair. The only part of this process which I could find that might give even a superficial impression of unfairness is the failure of the receiver to give an offering memorandum to those who expressed an interest in the purchase of Air Toronto.

I will outline the circumstances which relate to the allegation that the receiver was unfair in failing to provide an offering memorandum. In the latter part of 1990, as part of its selling strategy, the receiver was in the process of preparing an offering memorandum to give to persons who expressed an interest in the purchase of Air Toronto. The offering memorandum got as far as draft form, but was never released to anyone, although a copy of the draft eventually got into the hands of CCFL before it submitted the first 922 offer on March 7, 1991. A copy of the offering memorandum forms part of the record and it seems to me to be little more than puffery, without any hard information which a sophisticated purchaser would require in order to make a serious bid.

The offering memorandum had not been completed by February 11, 1991. On that date, the receiver entered into the letter of intent to negotiate with OEL. The letter of intent contained a provision that during its currency the receiver would not negotiate with any other party. The letter of intent was renewed from time to time until the OEL offer was received on March 6, 1991.

The receiver did not proceed with the offering memorandum because to do so would violate the spirit, if not the letter, of its letter of intent with OEL.

I do not think that the conduct of the receiver shows any unfairness towards 922. When I speak of 922, I do so in the context that Air Canada and CCFL are identified with it. I start by saying that the receiver acted reasonably when it entered into

exclusive negotiations with OEL. I find it strange that a company, with which Air Canada is closely and intimately involved, would say that it was unfair for the receiver to enter into a time-limited agreement to negotiate exclusively with OEL. That is precisely the arrangement which Air Canada insisted upon when it negotiated with the receiver in the spring and summer of 1990. If it was not unfair for Air Canada to have such an agreement, I do not understand why it was unfair for OEL to have a similar one. In fact, both Air Canada and OEL in its turn were acting reasonably when they required exclusive negotiating rights to prevent their negotiations from being used as a bargaining lever with other potential purchasers. The fact that Air Canada insisted upon an exclusive negotiating right while it was negotiating with the receiver demonstrates the commercial efficacy of OEL being given the same right during its negotiations with the receiver. I see no unfairness on the part of the receiver when it honoured its letter of intent with OEL by not releasing the offering memorandum during the negotiations with OEL.

Moreover, I am not prepared top find that 922 was in any way prejudiced by the fact that it did not have an offering memorandum. It made an offer on March 7, 1991, which it contends to this day was a better offer than that of OEL. 922 has not convinced me that if it had an offering memorandum its offer would have been any different or any better than it actually was. The fatal problem with the first 922 offer was that it contained a condition which was completely unacceptable to the receiver. The receiver properly, in my opinion, rejected the offer out of hand because of that condition. That condition did not relate to any information which could have conceivably been in an offering memorandum prepared by the receiver. It was about the resolution of a dispute between CCFL and the Royal Bank, something the receiver knew nothing about.

Further evidence of the lack of prejudice which the absence of an offering memorandum has caused 922 is found in CCFL's stance before this court. During argument, its counsel suggested, as a possible resolution of this appeal, that this court should call for new bids, evaluate them and then order a sale to the party who put in the better bid. In such a case, counsel for CCFL said that 922 would be prepared to bid within seven days of the court's decision. I would have thought that, if there were anything to CCFL's suggestion that the failure to provide an offering memorandum was unfair to 922, it would have told the court that it needed more information before it would be able to make a bid.

I am satisfied that Air Canada and CCFL have, and at all times had, all of the information which they would have needed to make what to them would be a commercially viable offer to the receiver. I think that an offering memorandum was of no commercial consequence to them, but the absence of one has since become a valuable tactical weapon.

It is my opinion that there is no convincing proof that if an offering memorandum had been widely distributed among persons qualified to have purchased Air Toronto, a viable offer would have come forth from a party other than 922 or OEL. Therefore, the failure to provide an offering memorandum was neither unfair nor did it prejudice the obtaining of a better price on March 8, 1991, than that contained in the OEL offer. I would not give effect to the contention that the process adopted by the receiver was an unfair one.

There are two statements by Anderson J. contained in *Crown Trust Co. v. Rosenberg, supra*, which I adopt as my own. The first is at p. 109 O.R., p. 548 D.L.R.:

> The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

The second is at p. 111 O.R., p. 550 D.L.R.:

> It is equally clear, in my view, though perhaps not so clearly enunciated, that it is only in an exceptional case that the court will intervene and proceed contrary to the Receiver's recommendations if satisfied, as I am, that the Receiver has acted reasonably, prudently and fairly and not arbitrarily.

In this case the receiver acted reasonably, prudently, fairly and not arbitrarily. I am of the opinion, therefore, that the process adopted by the receiver in reaching an agreement was a just one.

In his reasons for judgment, after discussing the circumstances leading to the 922 offer, Rosenberg J. said this [at p. 31 of the reasons]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

I agree.

The receiver made proper and sufficient efforts to get the best price that it could for the assets of Air Toronto. It adopted a reasonable and effective process to sell the airline which was fair to all persons who might be interested in purchasing it. It is my opinion, therefore, that the receiver properly carried out the

mandate which was given to it by the order of O'Brien J. It follows that Rosenberg J. was correct when he confirmed the sale a to OEL.

II. THE EFFECT OF THE SUPPORT OF THE 922 OFFER BY THE TWO SECURED CREDITORS

As I noted earlier, the 922 offer was supported before b Rosenberg J., and in this court, by CCFL and by the Royal Bank, the two secured creditors. It was argued that, because the interests of the creditors are primary, the court ought to give effect to their wish that the 922 offer be accepted. I would not accede to that suggestion for two reasons.

c The first reason is related to the fact that the creditors chose to have a receiver appointed by the court. It was open to them to appoint a private receiver pursuant to the authority of their security documents. Had they done so, then they would have had control of the process and could have sold Air Toronto to whom d they wished. However, acting privately and controlling the process involves some risks. The appointment of a receiver by the court insulates the creditors from those risks. But insulation from those risks carries with it the loss of control over the process of disposition of the assets. As I have attempted to explain in these reasons, when a receiver's sale is before the court for confirmation e the only issues are the propriety of the conduct of the receiver and whether it acted providently. The function of the court at that stage is not to step in and do the receiver's work or change the sale strategy adopted by the receiver. Creditors who asked the court to appoint a receiver to dispose of assets should not be f allowed to take over control of the process by the simple expedient of supporting another purchaser if they do not agree with the sale made by the receiver. That would take away all respect for the process of sale by a court-appointed receiver.

There can be no doubt that the interests of the creditor are an g important consideration in determining whether the receiver has properly conducted a sale. The opinion of the creditors as to which offer ought to be accepted is something to be taken into account. But, if the court decides that the receiver has acted properly and providently, those views are not necessarily determinative. h Because, in this case, the receiver acted properly and providently, I do not think that the views of the creditors should override the considered judgment of the receiver.

The second reason is that, in the particular circumstances of this case, I do not think the support of CCFL and the Royal Bank of

the 922 offer is entitled to any weight. The support given by CCFL can be dealt with summarily. It is a co-owner of 922. It is hardly surprising and not very impressive to hear that it supports the offer which it is making for the debtors' assets.

The support by the Royal Bank requires more consideration and involves some reference to the circumstances. On March 6, 1991, when the first 922 offer was made, there was in existence an inter-lender agreement between the Royal Bank and CCFL. That agreement dealt with the share of the proceeds of the sale of Air Toronto which each creditor would receive. At the time, a dispute between the Royal Bank and CCFL about the interpretation of that agreement was pending in the courts. The unacceptable condition in the first 922 offer related to the settlement of the interlender dispute. The condition required that the dispute be resolved in a way which would substantially favour CCFL. It required that CCFL receive $3,375,000 of the $6,000,000 cash payment and the balance, including the royalties, if any, be paid to the Royal Bank. The Royal Bank did not agree with that split of the sale proceeds.

On April 5, 1991, the Royal Bank and CCFL agreed to settle the interlender dispute. The settlement was that if the 922 offer was accepted by the court, CCFL would receive only $1,000,000 and the Royal Bank would receive $5,000,000 plus any royalties which might be paid. It was only in consideration of that settlement that the Royal Bank agreed to support the 922 offer.

The Royal Bank's support of the 922 offer is so affected by the very substantial benefit which it wanted to obtain from the settlement of the interlender dispute that, in my opinion, its support is devoid of any objectivity. I think it has no weight.

While there may be circumstances where the unanimous support by the creditors of a particular offer could conceivably override the proper and provident conduct of a sale by a receiver, I do not think that this is such a case. This is a case where the receiver has acted properly and in a provident way. It would make a mockery out of the judicial process, under which a mandate was given to this receiver to sell this airline, if the support by these creditors of the 922 offer were permitted to carry the day. I give no weight to the support which they give to the 922 offer.

In its factum, the receiver pointed out that, because of greater liabilities imposed upon private receivers by various statutes such as the *Employment Standards Act*, R.S.O. 1980, c. 137, and the *Environmental Protection Act*, R.S.O. 1980, c. 141, it is likely that more and more the courts will be asked to appoint receivers

in insolvencies. In those circumstances, I think that creditors who ask for court-appointed receivers and business people who choose a to deal with those receivers should know that if those receivers act properly and providently their decisions and judgments will be given great weight by the courts who appoint them. I have decided this appeal in the way I have in order to assure business people who deal with court-appointed receivers that they can have b confidence that an agreement which they make with a court-appointed receiver will be far more than a platform upon which others may bargain at the court approval stage. I think that persons who enter into agreements with court-appointed receivers, following a disposition procedure that is appropriate c given the nature of the assets involved, should expect that their bargain will be confirmed by the court.

The process is very important. It should be carefully protected so that the ability of court-appointed receivers to negotiate the best price possible is strengthened and supported. Because this d receiver acted properly and providently in entering into the OEL agreement, I am of the opinion that Rosenberg J. was right when he approved the sale to OEL and dismissed the motion to approve the 922 offer.

I would, accordingly, dismiss the appeal. I would award the e receiver, OEL and Frontier Airlines Limited their costs out of the Soundair estate, those of the receiver on a solicitor-and-client scale. I would make no order as to the costs of any of the other parties or interveners.

MCKINLAY J.A. (concurring in the result):—I agree with f Galligan J.A. in result, but wish to emphasize that I do so on the basis that the undertaking being sold in this case was of a very special and unusual nature. It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future g confidence of business persons in their dealings with receivers. Consequently, in all cases, the court should carefully scrutinize the procedure followed by the receiver to determine whether it satisfies the tests set out by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 39 D.L.R. (4th) 526 (H.C.J.). h While the procedure carried out by the receiver in this case, as described by Galligan J.A., was appropriate, given the unfolding of events and the unique nature of the assets involved, it is not a procedure that is likely to be appropriate in many receivership sales.

I should like to add that where there is a small number of creditors who are the only parties with a real interest in the proceeds of the sale (*i.e.*, where it is clear that the highest price attainable would result in recovery so low that no other creditors, shareholders, guarantors, *etc.*, could possibly benefit therefrom), the wishes of the interested creditors should be very seriously considered by the receiver. It is true, as Galligan J.A. points out, that in seeking the court appointment of a receiver, the moving parties also seek the protection of the court in carrying out the receiver's functions. However, it is also true that in utilizing the court process the moving parties have opened the whole process to detailed scrutiny by all involved, and have probably added significantly to their costs and consequent shortfall as a result of so doing. The adoption of the court process should in no way diminish the rights of any party, and most certainly not the rights of the only parties with a real interest. Where a receiver asks for court approval of a sale which is opposed by the only parties in interest, the court should scrutinize with great care the procedure followed by the receiver. I agree with Galligan J.A. that in this case that was done. I am satisfied that the rights of all parties were properly considered by the receiver, by the learned motions court judge, and by Galligan J.A.

GOODMAN J.A. (dissenting):—I have had the opportunity of reading the reasons for judgment herein of Galligan and McKinlay JJ.A. Respectfully, I am unable to agree with their conclusion.

The case at bar is an exceptional one in the sense that upon the application made for approval of the sale of the assets of Air Toronto two competing offers were placed before Rosenberg J. Those two offers were that of Frontier Airlines Ltd. and Ontario Express Limited (OEL) and that of 922246 Ontario Limited (922), a company incorporated for the purpose of acquiring Air Toronto. Its shares were owned equally by Canadian Pension Capital Limited and Canadian Insurers Capital Corporation (collectively CCFL) and Air Canada. It was conceded by all parties to these proceedings that the only persons who had any interest in the proceeds of the sale were two secured creditors, *viz.*, CCFL and the Royal Bank of Canada (the Bank). Those two creditors were unanimous in their position that they desired the court to approve the sale to 922. We were not referred to nor am I aware of any case where a court has refused to abide by the unanimous wishes of the only interested creditors for the approval of a specific offer made in receivership proceedings.

In *British Columbia Development Corp. v. Spun Cast Industries Inc.* (1977), 5 B.C.L.R. 94, 26 C.B.R. (N.S.) 28 (S.C.),
a Berger J. said at p. 95 B.C.L.R., p. 30 C.B.R.:

> Here all of those with a financial stake in the plant have joined in seeking the court's approval of the sale to Fincas. This court does not having a roving commission to decide what is best for investors and businessmen when they have agreed among themselves what course of action they should follow. It is their money.

b I agree with that statement. It is particularly apt to this case. The two secured creditors will suffer a shortfall of approximately $50,000,000. They have a tremendous interest in the sale of assets which form part of their security. I agree with the finding of Rosenberg J., Gen. Div., May 1, 1991, that the offer of 922 is
c superior to that of OEL. He concluded that the 922 offer is marginally superior. If by that he meant that mathematically it was likely to provide slightly more in the way of proceeds it is difficult to take issue with that finding. If on the other hand he meant that having regard to all considerations it was only marginally
d superior, I cannot agree. He said in his reasons [pp. 17-18]:

> I have come to the conclusion that knowledgeable creditors such as the Royal Bank would prefer the 922 offer even if the other factors influencing their decision were not present. No matter what adjustments had to be made, the 922 offer results in more cash immediately. Creditors facing the type of loss the Royal Bank is taking in this case would not be anxious to rely on
> e contingencies especially in the present circumstances surrounding the airline industry.

I agree with that statement completely. It is apparent that the difference between the two offers insofar as cash on closing is concerned amounts to approximately $3,000,000 to $4,000,000. The
f Bank submitted that it did not wish to gamble any further with respect to its investment and that the acceptance and court approval of the OEL offer, in effect, supplanted its position as a secured creditor with respect to the amount owing over and above the down payment and placed it in the position of a joint entrepreneur but one with no control. This results from the fact that
g the OEL offer did not provide for any security for any funds which might be forthcoming over and above the initial downpayment on closing.

In *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303 (C.A.), Hart J.A., speaking for the majority of
h the court, said at p. 10 C.B.R., p. 312 N.S.R.:

> Here we are dealing with a receiver appointed at the instance of one major creditor, who chose to insert in the contract of sale a provision making it subject to the approval of the court. This, in my opinion, shows an intention on behalf of the parties to invoke the normal equitable doctrines which place

> the court in the position of looking to the interests of all persons concerned before giving its blessing to a particular transaction submitted for approval. In these circumstances the court would not consider itself bound by the contract entered into in good faith by the receiver but would have to look to the broader picture to see that the contract was for the benefit of the creditors as a whole. When there was evidence that a higher price was readily available for the property the chambers judge was, in my opinion, justified in exercising his discretion as he did. Otherwise he could have deprived the creditors of a substantial sum of money.

This statement is apposite to the circumstances of the case at bar. I hasten to add that in my opinion it is not only price which is to be considered in the exercise of the judge's discretion. It may very well be, as I believe to be so in this case, that the amount of cash is the most important element in determining which of the two offers is for the benefit and in the best interest of the creditors.

It is my view, and the statement of Hart J.A. is consistent therewith, that the fact that a creditor has requested an order of the court appointing a receiver does not in any way diminish or derogate from his right to obtain the maximum benefit to be derived from any disposition of the debtor's assets. I agree completely with the views expressed by McKinlay J.A. in that regard in her reasons.

It is my further view that any negotiations which took place between the only two interested creditors in deciding to support the approval of the 922 offer were not relevant to the determination by the presiding judge of the issues involved in the motion for approval of either one of the two offers nor are they relevant in determining the outcome of this appeal. It is sufficient that the two creditors have decided unanimously what is in their best interest and the appeal must be considered in the light of that decision. It so happens, however, that there is ample evidence to support their conclusion that the approval of the 922 offer is in their best interests.

I am satisfied that the interests of the creditors are the prime consideration for both the receiver and the court. In *Re Beauty Counsellors of Canada Ltd.* (1986), 58 C.B.R. (N.S.) 237 (Ont. Bkcy.) Saunders J. said at p. 243:

> This does not mean that a court should ignore a new and higher bid made after acceptance where there has been no unfairness in the process. The interests of the creditors, while not the only consideration, are the prime consideration.

I agree with that statement of the law. In *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. Bkcy.) Saunders J. heard an application

for court approval for the sale by the sheriff of real property in bankruptcy proceedings. The sheriff had been previously ordered to list the property for sale subject to approval of the court. Saunders J. said at p. 246 C.B.R.:

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interests of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with the commercial efficacy and integrity.

I am in agreement with that statement as a matter of general principle. Saunders J. further stated that he adopted the principles stated by Macdonald J.A. in *Cameron, supra,* at pp. 92-94 O.R., pp. 531-33 D.L.R., quoted by Galligan J.A. in his reasons. In *Cameron,* the remarks of Macdonald J.A. related to situations involving the calling of bids and fixing a time limit for the making of such bids. In those circumstances the process is so clear as a matter of commercial practice that an interference by the court in such process might have a deleterious effect on the efficacy of receivership proceedings in other cases. But Macdonald J.A. recognized that even in bid or tender cases where the offeror for whose bid approval is sought has complied with all requirements a court might not approve the agreement of purchase and sale entered into by the receiver. He said at pp. 11-12 C.B.R., p. 314 N.S.R.:

> There are, of course, many reasons why a court might not approve an agreement of purchase and sale, viz., where the offer accepted is so low in relation to the appraised value as to be unrealistic; or, where the circumstances indicate that insufficient time was allowed for the making of bids or that inadequate notice of sale by bid was given (where the receiver sells property by the bid method); or, where it can be said that the proposed sale is not in the best interest of either the creditors or the owner. Court approval must involve the delicate balancing of competing interests and not simply a consideration of the interests of the creditors.

The deficiency in the present case is so large that there has been no suggestion of a competing interest between the owner and the creditors.

I agree that the same reasoning may apply to a negotiation process leading to a private sale but the procedure and process applicable to private sales of a wide variety of businesses and undertakings with the multiplicity of individual considerations applicable and perhaps peculiar to the particular business is not so clearly established that a departure by the court from the process adopted by the receiver in a particular case will result in commercial chaos to the detriment of future receivership

proceedings. Each case must be decided on its own merits and it is necessary to consider the process used by the receiver in the present proceedings and to determine whether it was unfair, improvident or inadequate.

It is important to note at the outset that Rosenberg J. made the following statement in his reasons [p. 15]:

> On March 8, 1991 the trustee accepted the OEL offer subject to court approval. The receiver at that time had no other offer before it that was in final form or could possibly be accepted. The receiver had at the time the knowledge that Air Canada with CCFL had not bargained in good faith and had not fulfilled the promise of its letter of March 1. The receiver was justified in assuming that Air Canada and CCFL's offer was a long way from being in an acceptable form and that Air Canada and CCFL's objective was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada.

In my opinion there was no evidence before him or before this court to indicate that Air Canada with CCFL had not bargained in good faith and that the receiver had knowledge of such lack of good faith. Indeed, on this appeal, counsel for the receiver stated that he was not alleging Air Canada and CCFL had not bargained in good faith. Air Canada had frankly stated at the time that it had made its offer to purchase which was eventually refused by the receiver that it would not become involved in an "auction" to purchase the undertaking of Air Canada and that, although it would fulfil its contractual obligations to provide connecting services to Air Toronto, it would do no more than it was legally required to do insofar as facilitating the purchase of Air Toronto by any other person. In so doing Air Canada may have been playing "hard ball" as its behaviour was characterized by some of the counsel for opposing parties. It was nevertheless merely openly asserting its legal position as it was entitled to do.

Furthermore there was no evidence before Rosenberg J. or this court that the receiver had assumed that Air Canada and CCFL's objective in making an offer was to interrupt the finalizing of the OEL agreement and to retain as long as possible the Air Toronto connector traffic flowing into Terminal 2 for the benefit of Air Canada. Indeed, there was no evidence to support such an assumption in any event although it is clear that 922 and through it CCFL and Air Canada were endeavouring to present an offer to purchase which would be accepted and/or approved by the court in preference to the offer made by OEL.

To the extent that approval of the OEL agreement by Rosenberg J. was based on the alleged lack of good faith in

bargaining and improper motivation with respect to connector traffic on the part of Air Canada and CCFL, it cannot be supported.

I would also point out that, rather than saying there was no other offer before it that was final in form, it would have been more accurate to have said that there was *no unconditional* offer before it.

In considering the material and evidence placed before the court I am satisfied that the receiver was at all times acting in good faith. I have reached the conclusion, however, that the process which he used was unfair insofar as 922 is concerned and improvident insofar as the two secured creditors are concerned.

Air Canada had been negotiating with Soundair Corporation for the purchase from it of Air Toronto for a considerable period of time prior to the appointment of a receiver by the court. It had given a letter of intent indicating a prospective sale price of $18,000,000. After the appointment of the receiver, by agreement dated April 30, 1990, Air Canada continued its negotiations for the purchase of Air Toronto with the receiver. Although this agreement contained a clause which provided that the receiver "shall not negotiate for the sale . . . of Air Toronto with any person except Air Canada", it further provided that the receiver would not be in breach of that provision merely by receiving unsolicited offers for all or any of the assets of Air Toronto. In addition, the agreement, which had a term commencing on April 30, 1990, could be terminated on the fifth business day following the delivery of a written notice of termination by one party to the other. I point out this provision merely to indicate that the exclusivity privilege extended by the Receiver to Air Canada was of short duration at the receiver's option.

As a result of due diligence investigations carried out by Air Canada during the month of April, May and June of 1990, Air Canada reduced its offer to 8.1 million dollars conditional upon there being $4,000,000 in tangible assets. The offer was made on June 14, 1990 and was open for acceptance until June 29, 1990.

By amending agreement dated June 19, 1990 the receiver was released from its covenant to refrain from negotiating for the sale of the Air Toronto business and assets to any person other than Air Canada. By virtue of this amending agreement the receiver had put itself in the position of having a firm offer in hand with the right to negotiate and accept offers from other persons. Air Canada in these circumstances was in the subservient position. The receiver, in the exercise of its judgment and discretion,

allowed the Air Canada offer to lapse. On July 20, 1990 Air Canada served a notice of termination of the April 30, 1990 agreement.

Apparently as a result of advice received from the receiver to the effect that the receiver intended to conduct an auction for the sale of the assets and business of the Air Toronto Division of Soundair Corporation, the solicitors for Air Canada advised the receiver by letter dated July 20, 1990 in part as follows:

> Air Canada has instructed us to advise you that it does not intend to submit a further offer in the auction process.

This statement together with other statements set forth in the letter was sufficient to indicate that Air Canada was not interested in purchasing Air Toronto in the process apparently contemplated by the receiver at that time. It did not form a proper foundation for the receiver to conclude that there was no realistic possibility of selling Air Toronto to Air Canada, either alone or in conjunction with some other person, in different circumstances. In June 1990 the receiver was of the opinion that the fair value of Air Toronto was between $10,000,000 and $12,000,000.

In August 1990 the receiver contacted a number of interested parties. A number of offers were received which were not deemed to be satisfactory. One such offer, received on August 20, 1990, came as a joint offer from OEL and Air Ontario (an Air Canada connector). It was for the sum of $3,000,000 for the good will relating to certain Air Toronto routes but did not include the purchase of any tangible assets or leasehold interests.

In December 1990 the receiver was approached by the management of Canadian Partner (operated by OEL) for the purpose of evaluating the benefits of an amalgamated Air Toronto/Air Partner operation. The negotiations continued from December of 1990 to February of 1991 culminating in the OEL agreement dated March 8, 1991.

On or before December, 1990, CCFL advised the receiver that it intended to make a bid for the Air Toronto assets. The receiver, in August of 1990, for the purpose of facilitating the sale of Air Toronto assets, commenced the preparation of an operating memorandum. He prepared no less than six draft operating memoranda with dates from October 1990 through March 1, 1991. None of these were distributed to any prospective bidder despite requests having been received therefor, with the exception of an early draft provided to CCFL without the receiver's knowledge.

During the period December 1990 to the end of January 1991,

the receiver advised CCFL that the offering memorandum was in the process of being prepared and would be ready soon for distribution. He further advised CCFL that it should await the receipt of the memorandum before submitting a formal offer to purchase the Air Toronto assets.

By late January CCFL had become aware that the receiver was negotiating with OEL for the sale of Air Toronto. In fact, on February 11, 1991, the receiver signed a letter of intent with OEL wherein it had specifically agreed not to negotiate with any other potential bidders or solicit any offers from others.

By letter dated February 25, 1991, the solicitors for CCFL made a written request to the Receiver for the offering memorandum. The receiver did not reply to the letter because he felt he was precluded from so doing by the provisions of the letter of intent dated February 11, 1991. Other prospective purchasers were also unsuccessful in obtaining the promised memorandum to assist them in preparing their bids. It should be noted that exclusivity provision of the letter of intent expired on February 20, 1991. This provision was extended on three occasions, *viz.*, February 19, 22 and March 5, 1991. It is clear that from a legal standpoint the receiver, by refusing to extend the time, could have dealt with other prospective purchasers and specifically with 922.

It was not until March 1, 1991 that CCFL had obtained sufficient information to enable it to make a bid through 922. It succeeded in so doing through its own efforts through sources other than the receiver. By that time the receiver had already entered into the letter of intent with OEL. Notwithstanding the fact that the receiver knew since December of 1990 that CCFL wished to make a bid for the assets of Air Toronto (and there is no evidence to suggest that at any time such a bid would be in conjunction with Air Canada or that Air Canada was in any way connected with CCFL) it took no steps to provide CCFL with information necessary to enable it to make an intelligent bid and, indeed, suggested delaying the making of the bid until an offering memorandum had been prepared and provided. In the meantime by entering into the letter of intent with OEL it put itself in a position where it could not negotiate with CCFL or provide the information requested.

On February 28, 1991, the solicitors for CCFL telephoned the receiver and were advised for the first time that the receiver had made a business decision to negotiate solely with OEL and would not negotiate with anyone else in the interim.

By letter dated March 1, 1991 CCFL advised the receiver that it intended to submit a bid. It set forth the essential terms of the bid and stated that it would be subject to customary commercial provisions. On March 7, 1991 CCFL and Air Canada, jointly through 922, submitted an offer to purchase Air Toronto upon the terms set forth in the letter dated March 1, 1991. It included a provision that the offer was conditional upon the interpretation of an interlender agreement which set out the relative distribution of proceeds as between CCFL and the Royal Bank. It is common ground that it was a condition over which the receiver had no control and accordingly would not have been acceptable on that ground alone. The receiver did not, however, contact CCFL in order to negotiate or request the removal of the condition although it appears that its agreement with OEL not to negotiate with any person other than OEL expired on March 6, 1991.

The fact of the matter is that by March 7, 1991, the receiver had received the offer from OEL which was subsequently approved by Rosenberg J. That offer was accepted by the receiver on March 8, 1991. Notwithstanding the fact that OEL had been negotiating the purchase for a period of approximately three months the offer contained a provision for the sole benefit of the purchaser that it was subject to the purchaser obtaining:

> . . . a financing commitment within 45 days of the date hereof in an amount not less than the Purchase Price from the Royal Bank of Canada or other financial institution upon terms and conditions acceptable to them. In the event that such a financing commitment is not obtained within such 45 day period, the purchaser or OEL shall have the right to terminate this agreement upon giving written notice of termination to the vendor on the first Business Day following the expiry of the said period.

The purchaser was also given the right to waive the condition.

In effect the agreement was tantamount to a 45-day option to purchase excluding the right of any other person to purchase Air Toronto during that period of time and thereafter if the condition was fulfilled or waived. The agreement was, of course, stated to be subject to court approval.

In my opinion the process and procedure adopted by the receiver was unfair to CCFL. Although it was aware from December 1990 that CCFL was interested in making an offer, it effectively delayed the making of such offer by continually referring to the preparation of the offering memorandum. It did not endeavour during the period December 1990 to March 7, 1991 to negotiate with CCFL in any way the possible terms of purchase and sale agreement. In the result no offer was sought from CCFL by the receiver prior to February 11, 1991 and thereafter it put

itself in the position of being unable to negotiate with anyone other than OEL. The receiver, then, on March 8, 1991 chose to accept an offer which was conditional in nature without prior consultation with CCFL (922) to see whether it was prepared to remove the condition in its offer.

I do not doubt that the receiver felt that it was more likely that the condition in the OEL offer would be fulfilled than the condition in the 922 offer. It may be that the receiver, having negotiated for a period of three months with OEL, was fearful that it might lose the offer if OEL discovered that it was negotiating with another person. Nevertheless it seems to me that it was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to it. The potential loss was that of an agreement which amounted to little more than an option in favour of the offeror.

In my opinion the procedure adopted by the receiver was unfair to CCFL in that, in effect, it gave OEL the opportunity of engaging in exclusive negotiations for a period of three months notwithstanding the fact that it knew CCFL was interested in making an offer. The receiver did not indicate a deadline by which offers were to be submitted and it did not at any time indicate the structure or nature of an offer which might be acceptable to it.

In his reasons Rosenberg J. stated that as of March 1, CCFL and Air Canada had all the information that they needed and any allegations of unfairness in the negotiating process by the receiver had disappeared. He said [p. 31]:

> They created a situation as of March 8, where the receiver was faced with two offers, one of which was in acceptable form and one of which could not possibly be accepted in its present form. The receiver acted appropriately in accepting the OEL offer.

If he meant by "acceptable in form" that it was acceptable to the receiver, then obviously OEL had the unfair advantage of its lengthy negotiations with the receiver to ascertain what kind of an offer would be acceptable to the receiver. If, on the other hand, he meant that the 922 offer was unacceptable in its form because it was conditional, it can hardly be said that the OEL offer was more acceptable in this regard as it contained a condition with respect to financing terms and conditions "*acceptable to them*".

It should be noted that on March 13, 1991 the representatives of 922 first met with the receiver to review its offer of March 7, 1991 and at the request of the receiver withdrew the inter-lender

condition from its offer. On March 14, 1991 OEL removed the financing condition from its offer. By order of Rosenberg J. dated March 26, 1991, CCFL was given until April 5, 1991 to submit a bid and on April 5, 1991, 922 submitted its offer with the inter-lender condition removed.

In my opinion the offer accepted by the receiver is improvident and unfair insofar as the two creditors are concerned. It is not improvident in the sense that the price offered by 922 greatly exceeded that offered by OEL. In the final analysis it may not be greater at all. The salient fact is that the cash down payment in the 922 offer constitutes approximately two-thirds of the contemplated sale price whereas the cash down payment in the OEL transaction constitutes approximately 20 to 25 per cent of the contemplated sale price. In terms of absolute dollars, the down payment in the 922 offer would likely exceed that provided for in the OEL agreement by approximately $3,000,000 to $4,000,000.

In *Re Beauty Counsellors of Canada Ltd., supra*, Saunders J. said at p. 243 C.B.R.:

> If a substantially higher bid turns up at the approval stage, the court should consider it. Such a bid may indicate, for example, that the trustee has not properly carried out its duty to endeavour to obtain the best price for the estate. In such a case the proper course might be to refuse approval and to ask the trustee to recommence the process.

I accept that statement as being an accurate statement of the law. I would add, however, as previously indicated, that in determining what is the best price for the estate the receiver or court should not limit its consideration to which offer provides for the greater sale price. The amount of down payment and the provision or lack thereof to secure payment of the balance of the purchase price over and above the down payment may be the most important factor to be considered and I am of the view that is so in the present case. It is clear that that was the view of the only creditors who can benefit from the sale of Air Toronto.

I note that in the case at bar the 922 offer in conditional form was presented to the receiver before it accepted the OEL offer. The receiver in good faith, although I believe mistakenly, decided that the OEL offer was the better offer. At that time the receiver did not have the benefit of the views of the two secured creditors in that regard. At the time of the application for approval before Rosenberg J. the stated preference of the two interested creditors was made quite clear. He found as a fact that knowledgeable creditors would not be anxious to rely on contingencies in the present circumstances surrounding the airline industry. It is

reasonable to expect that a receiver would be no less knowledgeable in that regard and it is his primary duty to protect the interests of the creditors. In my view it was an improvident act on the part of the receiver to have accepted the conditional offer made by OEL and Rosenberg J. erred in failing to dismiss the application of the receiver for approval of the OEL offer. It would be most inequitable to foist upon the two creditors who have already been seriously hurt more unnecessary contingencies.

Although in other circumstances it might be appropriate to ask the receiver to recommence the process, in my opinion, it would not be appropriate to do so in this case. The only two interested creditors support the acceptance of the 922 offer and the court should so order.

Although I would be prepared to dispose of the case on the grounds stated above, some comment should be addressed to the question of interference by the court with the process and procedure adopted by the receiver.

I am in agreement with the view expressed by McKinlay J.A. in her reasons that the undertaking being sold in this case was of a very special and unusual nature. As a result the procedure adopted by the receiver was somewhat unusual. At the outset, in accordance with the terms of the receiving order, it dealt solely with Air Canada. It then appears that the receiver contemplated a sale of the assets by way of auction and still later contemplated the preparation and distribution of an offering memorandum inviting bids. At some point, without advice to CCFL, it abandoned that idea and reverted to exclusive negotiations with one interested party. This entire process is not one which is customary or widely accepted as a general practice in the commercial world. It was somewhat unique having regard to the circumstances of this case. In my opinion the refusal of the court to approve the offer accepted by the receiver would not reflect on the integrity of procedures followed by court-appointed receivers and is not the type of refusal which will have a tendency to undermine the future confidence of business persons in dealing with receivers.

Rosenberg J. stated that the Royal Bank was aware of the process used and tacitly approved it. He said it knew the terms of the letter of intent in February 1991 and made no comment. The Royal Bank did, however, indicate to the receiver that it was not satisfied with the contemplated price nor the amount of the down payment. It did not, however, tell the receiver to adopt a different process in endeavouring to sell the Air Toronto assets. It is not

TAB "7"

Ventas, Inc. et al. v. Sunrise Senior Living Real Estate Investment Trust et al.

[Indexed as: Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust]

Court of Appeal for Ontario, Blair, MacFarland and LaForme JJ.A.
March 23, 2007

Contracts — Interpretation and construction — Vendor's board of trustees offering to sell its assets through auction process and entering into Confidentiality Agreements with interested bidders which contained Standstill Agreements preventing each prospective acquiring party from attempting hostile unsolicited takeover bid — Vendor signing purchase agreement with one bidder subject to unitholder approval — Second bidder then submitting superior bid — Application judge not erring in interpreting purchase agreement as imposing obligation on vendor to enforce its Standstill Agreement with second bidder and as precluding it from considering acquisition proposal submitted by that bidder.

Sunrise was a Canadian public real estate investment fund which owned and invested in senior living communities. It undertook a strategic sale process of its assets. Both HCPI and Ventas were interested in bidding, and each was required to enter into a Confidentiality Agreement with Sunrise in order to prevent non-public information exchanged by the parties from being publicly disclosed. The Confidentiality Agreements contained restrictions preventing each prospective acquiring party from attempting a hostile (unsolicited) takeover bid (the "Standstill Agreements"). Ventas submitted a successful bid to acquire all of the assets for a price of $15 per unit, subject to shareholder approval. HCPI withdrew from the auction process and did not bid at that time. Instead, it put forward a post-auction bid, after it knew what Ventas had offered, of $18 per unit. Ventas brought an application for a declaration that Sunrise was required to enforce the Standstill Agreement it had entered into with HCPI, thereby preventing it from considering the HCPI Proposal. The application was granted. Sunrise and HCPI appealed.

Held, the appeal should be dismissed.

The application judge was correct in interpreting s. 4.4 of the Purchase Agreement as imposing an obligation on Sunrise to enforce the Standstill Agreement between it and HCPI, thus precluding it from considering the acquisition proposal submitted by HCPI following the close of the auction and after the Ventas bid had been accepted. She found this to be objectively reasonable and a form of protection afforded to Ventas as part of the package negotiated between it and Sunrise. The application judge did not fail to consider the factual matrix underlying the negotiation of the Purchase Agreement and did not fail to give effect to the "commercial sense" component of contract interpretation. The application judge was sensitive to the fiduciary out provisions of the Agreement that permitted other *bona fide* written unsolicited Acquisition Proposals. In her view, this was balanced, objectively and reasonably, by the requirement that Sunrise ensure enforcement of Standstill Agreements that had been signed as part of the auction process in order to protect the successful bidder. This interpretation made commercial sense. It was unnecessary to adopt the principle gleaned from some American authorities that the target vendor can place no limits on the directors' right to consider superior offers and that any provision to the contrary is invalid and unenforceable. That was not what happened in this case. The trustees did not contract away their fiduciary obligations. Rather, they complied with

them by setting up an auction process that was designed to maximize the unit price obtained for Sunrise's assets, in a fashion resembling a "shotgun" clause, by requiring bidders to come up with their best price in the second round, subject to a fiduciary out clause that allowed them to consider superior offers from anyone save only those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid. The application judge viewed "*bona fide*" as meaning acting "in good faith; sincere; genuine", and found that the HCPI Acquisition Proposal was not *bona fide* because it was made in breach of the HCPI Standstill Agreement. The application judge did not err in her assessment and use of the term "*bona fide*".

Cases referred to

ACE Ltd. v. Capital Re Corp., 747 A. 2d. 95 (Del. Ch. 1999); *BG Checo International Ltd. v. British Columbia Hydro & Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1, 7 B.C.L.R. (2d) 145, 99 D.L.R. (4th) 577, 147 N.R. 81, [1993] 2 W.W.R. 321, 14 C.C.L.T. (2d) 233; *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, [1979] S.C.J. No. 133, 112 D.L.R. (3d) 49, 32 N.R. 488, [1980] I.L.R. ¶1-1176; *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, [1998] O.J. No. 1886, 160 D.L.R. (4th) 131, 38 B.L.R. (2d) 196 (Gen. Div.); *Eli Lilly and Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, [1998] S.C.J. No. 59, 161 D.L.R. (4th) 1, 227 N.R. 201, 80 C.P.R. (3d) 321; *Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc.*, [1998] O.J. No. 4368, 114 O.A.C. 357 (C.A.); *Maple Leaf Foods Inc. v. Schneider Corp.* (1998), 42 O.R. (3d) 177, [1998] O.J. No. 4142, 44 B.L.R. (2d) 115 (C.A.); *Paramount Communications, Inc. v. QVC Network Inc.*, 637 A. 2d 34 (Del. 1994); *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744, [1992] O.J. No. 2692, 9 D.L.R. (4th) 153, 29 R.P.R. (2d) 60 (C.A.); *Toronto (City) v. W.H. Hotel Ltd.*, [1966] S.C.R. 434, [1966] S.C.J. No. 23, 56 D.L.R. (2d) 539; *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)* (1999), 45 O.R. (3d) 417, [1999] O.J. No. 3290, 178 D.L.R. (4th) 634, 50 B.L.R. (2d) 64 (C.A.), affg [1998] O.J. No. 2637, 40 B.L.R. (2d) 1 (Gen. Div.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325, [2005] O.J. No. 1885, 197 O.A.C. 264, 4 B.L.R. (4th) 324 (C.A.)

Authorities referred to

McCamus, J.D., *The Law of Contracts* (Toronto: Irwin Law, 2005)

APPEAL from the order of Pepall J., [2007] O.J. No. 908, 156 A.C.W.S. (3d) 343 (S.C.J.), allowing an application for a declaration that the vendor was prevented by its agreement with the applicant from considering a bid submitted by the respondent.

Peter F.C. Howard and *Eliot Kolers*, for appellants Sunrise Senior Living Real Estate Investment Trust, Sunrise REIT Trust, and Sunrise REIT GP Inc.

Jeffrey S. Leon and *Derek J. Bell*, for appellants Health Care Property Investors, Inc.

Mark A. Gelowitz and *Laura K. Fric*, for respondents Ventas, Inc. and numbered companies.

Luis G. Sarabia and *Cynthia Spry*, for respondent Sunrise Senior Living Inc.

The judgment of the court was delivered by

BLAIR J.A.: —

Overview

[1] Sunrise REIT is a Canadian public real estate investment trust whose units are traded on the Toronto Stock Exchange. It owns and invests in senior living communities in Canada and the United States. In September 2006, Sunrise's board of trustees determined that a strategic sale process of its assets would be beneficial to its unitholders, thus effectively putting Sunrise "in play" on the public markets.

[2] To carry out this plan, the Trustees developed a two-stage auction process with a view to maximizing the value of Sunrise's units. Ventas, Inc. ("Ventas") and Health Care Property Investors, Inc. ("HCPI") were two of seven initially interested prospective purchasers in the auction process. They emerged from the preliminary round as the only two potential bidders asked to participate in the final round.

[3] Ventas submitted a successful bid to acquire all of Sunrise's assets for a total purchase price of $1,137,712,410 (representing a price of $15 per unit), subject to unitholder approval. HCPI withdrew from the auction process and did not bid at that time. Instead, it put forward a post-auction bid — after it knew what Ventas had offered — "topping up" the Ventas offer by 20 per cent to $18 per unit. This increased offer represents an additional $227.5 million for the unitholders, who are to meet on March 30, 2007, to consider the Ventas proposal.

[4] Hence the urgency of this appeal.

[5] The appeal turns on the interpretation of the terms of the purchase agreement executed by Sunrise and Ventas following acceptance of the Ventas bid. The issue is whether Sunrise is obliged to enforce the terms of a prior standstill agreement entered into between it and HCPI in the course of the auction process and which prohibits HCPI from making an offer for the Sunrise assets without Sunrise's consent. If the answer to that question is "Yes", Sunrise will be precluded from considering or accepting the richer HCPI offer pending the unitholders' meeting.

[6] Following an urgent application, determined on March 6, 2007, Justice Pepall answered the foregoing question in the affirmative. Sunrise and HCPI appeal from that decision. Ventas supports it.

[7] For the reasons that follow, I would dismiss the appeal and uphold the decision of the application judge.

Facts

[8] As mentioned above, Sunrise owns and invests in senior living communities in Canada and the United States. The properties are managed by Sunrise Senior Living, Inc. ("SSL"), a U.S. public company whose shares are traded on the New York Stock Exchange.

[9] HCPI is a self-administered real estate investment trust that also invests in healthcare facilities. Ventas is a U.S.-based health care real estate investment trust whose shares are listed on the New York Stock Exchange.

[10] In September 2006, after Sunrise's board of trustees determined that a strategic sale process of the Trust's assets would be beneficial to its unitholders, it began an auction process with a view to maximizing unitholder value.

[11] Parties who were interested in acquiring Sunrise (including HCPI and Ventas) were required to enter into a confidentiality agreement with it in order to prevent non-public information exchanged by the parties from being publicly disclosed (the "Confidentiality Agreements"). The Confidentiality Agreements contained restrictions preventing each prospective acquiring party from attempting a hostile (unsolicited) takeover bid (the "Standstill Agreements").

[12] Although the parties' Confidentiality Agreements were largely similar, Ventas's Standstill Agreement was worded differently from HCPI's in that the Ventas standstill ceased to apply if, among other things, Sunrise entered into an agreement to sell more than 20 per cent of its assets to a third party. Notably, HCPI's Standstill Agreement did not contain a similar termination clause.

[13] On November 21, 2006, Sunrise invited potential bidders to submit bids in the non-binding preliminary round of an auction. After the first round of bids, Sunrise invited HCPI and Ventas to engage in further negotiations and on December 29, 2006, it invited them to submit final binding bids in the second round of the auction by January 8, 2007. Sunrise waived the Standstill Agreements with those bidders for that purpose, and HCPI and Ventas were expressly told not to assume that the "winning" bid was assured of actually acquiring Sunrise at the price agreed upon or that they would be given an opportunity to rebid, renegotiate, or improve the terms of their proposal.

[14] Ventas submitted a second bid on January 8, but HCPI withdrew from the auction and did not.

[15] On January 14, 2007, Ventas and Sunrise signed an agreement contemplating the purchase by Ventas of all of Sunrise's assets for a total purchase price of $1,137,712,410 (representing a price of $15 per Unit), subject to Unitholder approval (the

"Purchase Agreement"). This price represented a 35.8 per cent premium over the closing price of the units on January 12, 2007. The Purchase Agreement contemplated subsequent third-party unsolicited bids and allowed Sunrise to accept such a bid if it was financially superior to Ventas's bid.

[16] On January 17, 2007, Sunrise notified HCPI of the agreement with Ventas and asked for the return of Sunrise's confidential materials. In the letter, Sunrise's solicitor reminded HCPI of the terms of the Confidentiality Agreement it signed in November 2006.

[17] On February 14, 2007, HCPI submitted a proposal to acquire all of Sunrise's assets for $18 per unit (the "HCPI Proposal"), conditional on HCPI's ability to reach a management agreement with SSL. Sunrise treated the HCPI Proposal as an unsolicited third-party bid, but it concluded that it was not in a position to determine whether the bid was a superior bid because of the SSL condition.

[18] The Confidentiality Agreements entered into in the course of the auction process contained a provision prohibiting prospective purchasers from communicating with SSL. This was because SSL was viewed as a possible bidder. Following the preliminary round of the auction, in late November 2006, and after realizing that SSL was not an interested purchaser, Sunrise had authorized its financial advisors to arrange to allow HCPI and Ventas to contact SSL for purposes of the second round of bidding. On February 15, 2007, however — after learning of the HCPI Proposal — Ventas advised Sunrise that, if it permitted communications between SSL and HCPI, Sunrise would be in breach of the Purchase Agreement. It did not assert that HCPI would be in breach of its Standstill Agreement because it apparently assumed that HCPI's Standstill Agreement was worded similarly to the Ventas Standstill Agreement, which meant that the restraint on an unsolicited bid was no longer enforceable since Sunrise had entered into an agreement with a third party.

[19] On February 18, 2007, Sunrise served application materials upon Ventas, HCPI and SSL indicating its intention to seek the court's interpretation of the Purchase Agreement, specifically on the issue of communications between HCPI and SSL. It is at this point that Ventas learned of the specific terms of HCPI's Confidentiality Agreement and realized that HCPI's Standstill Agreement did not contain the same termination clause as Ventas's Standstill Agreement. On February 21, 2007, Ventas brought the within application seeking a declaration that Sunrise was required to enforce its Standstill Agreement with HCPI, thereby preventing it from considering the HCPI Proposal.

[20] The application judge found that Sunrise had agreed with Ventas that it would enforce existing Standstill Agreements and that any bid made in breach of an existing Standstill Agreement would not be *bona fide*. She then concluded that Sunrise was required to enforce the Standstill Agreement with HCPI and that HCPI did not have prior written consent to submit its bid. She dismissed Sunrise's application on the grounds that the issue was moot in light of her earlier conclusion.

The Provisions of the Agreement

[21] Section 4 of the Purchase Agreement deals generally with the covenants of the parties. Section 4.4 deals with Sunrise's "Covenants Regarding Non-Solicitation". Because of their importance, I reproduce the provisions of s. 4.4 in their entirety (the underlining is mine):

> 4.4(1) Following the date hereof, Sunrise REIT shall not, directly or indirectly, through any trustee, officer, director, agent or Representative of Sunrise REIT or any of its Subsidiaries, and shall not permit any such Person to,
>
> (i) solicit, initiate, encourage or otherwise facilitate (including by way of furnishing information or entering into any form of agreement, arrangement or understanding or providing any other form of assistance) the initiation of any inquiries or proposals regarding, or other action that constitutes, or may reasonably be expected to lead to, an actual or potential Acquisition Proposal,
>
> (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries,
>
> (iii) approve, recommend or remain neutral with respect to, or propose publicly to approve, recommend or remain neutral with respect to, any Acquisition Proposal,
>
> (iv) accept or enter into any agreement, arrangement or understanding, related to any Acquisition Proposal (other than a confidentiality agreement contemplated in Section 4.4(2)), or
>
> (v) withdraw, modify or qualify, or publicly propose to withdraw, modify or qualify, in any manner adverse to the Purchasers, the approval or recommendation of the Board (including any committee thereof) of this Agreement or the transactions contemplated hereby.
>
> (2) Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from complying with Sunrise REIT's disclosure obligations under applicable Laws with regard to a *bona fide* written, unsolicited Acquisition Proposal or, following the receipt of any such Acquisition Proposal from a third party (that did not result from a breach of this Section 4.4), from furnishing or disclosing non-public information to such Person if and only to the extent that:

(i) the Board believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal if consummated could reasonably be expected to result in a Superior Proposal; and

(ii) such third party has entered into a confidentiality agreement containing terms in the aggregate no more favourable to such third party than those in the Confidentiality Agreement as are then in effect in accordance with its terms.

(3) Notwithstanding anything, contained in Section 4.4(1), until the Unitholder Approval, nothing shall prevent the Board from withdrawing or modifying, or proposing publicly to withdraw or modify its approval and recommendation of the transactions contemplated by this Agreement, or accepting, approving or recommending or entering into any agreement, understanding or arrangement providing for a *bona fide* written, unsolicited Acquisition Proposal (that did not result from a breach of this Section 4.4) ("Proposed Agreement") if and only to the extent that:

(i) it has provided the Purchasers with a copy of all of the documents relating to the Acquisition Proposal,

(ii) the Board, believes in good faith (after consultation with its financial advisor and legal counsel) that such Acquisition Proposal constitutes a Superior Proposal and has promptly notified the Purchasers of such determination,

(iii) a period of at least five Business Days (the "Matching Period") has elapsed following the later of (x) the date the Purchasers received written notice advising the Purchasers that the Board has resolved, subject to compliance with this Section 4.4(3), to withdraw, modify its approval and recommendation of the transactions contemplated by this Agreement or accept, approve or recommend or enter into a Proposed Agreement in respect of such Superior Proposal and (y) the date the Purchasers received a copy of the documentation related to such Superior Proposal pursuant to Section 4.4(3)(i),

(iv) if the Purchasers have proposed to amend the transactions contemplated under this Agreement in accordance with Section 4.4(6), the Board has again made the determination in Section 4.4(3)(ii) taking into account such proposed amendments, and

(v) if Sunrise REIT proposes to enter into a Proposed Agreement (other than a confidentiality agreement referred to in Section 4.4(2)) after complying with this Section 4.4(3), Sunrise REIT shall have complied with Section 5.2 and 5.3. For the purposes of this Section 4.4(3) the preparation and delivery of a directors' circular pursuant to Section 99 of the *Securities Act* relating to an Acquisition Proposal shall be deemed to be a qualification, withdrawal or modification, of the Board's recommendation of the transactions contemplated hereby unless the Board expressly, and without qualification, reaffirms its recommendation of the transactions contemplated hereby in such disclosure.

(4) If the expiry of the Matching Period referred to in Section 4.4(3)(iii) falls on a date which is less than five Business Days prior to the Unitholder Meeting,

Sunrise REIT shall, at the request of the Purchasers, adjourn the Unitholder Meeting to a date that is not more than 10 Business Days following such expiry date.

(5) Sunrise REIT acknowledges and agrees that each successive amendment to any Acquisition Proposal shall constitute a new Acquisition Proposal for purposes of section 4.4.

(6) During the Matching Period, the Purchasers shall have the right, but not the obligation, to propose to amend the terms of this Agreement. The Trustees will review any proposal by the Purchasers to amend the terms of this Agreement in good faith in order to determine (after consultation with their financial advisor and legal counsel) whether the transactions contemplated by this Agreement, taking into account the Purchasers' proposed amendments would, if consummated in accordance with its terms, result in the Superior Proposal ceasing to be a Superior Proposal. If the Trustees so determine, Sunrise REIT will enter into an amending agreement with the Purchasers reflecting such proposed amendment.

(7) Sunrise REIT shall, as promptly as practicable, notify the Purchasers of any relevant details relating to any Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or any amendments to any Acquisition Proposal (including the identity of the parties and all material terms thereof), or any request for non-public information relating to Sunrise REIT or any of its Subsidiaries in connection with an Acquisition Proposal or inquiry that could reasonably be expected to lead to any Acquisition Proposal, or for access to the properties, books or records of Sunrise REIT or any of its Subsidiaries by any Person that informs Sunrise REIT or such Subsidiary that it is considering making, or has made, an Acquisition Proposal, or inquiry that could reasonably be expected to lead to any Acquisition Proposal, in each case which any of Sunrise REIT, any of its Subsidiaries or any officer, trustee, director, employee or Representative may receive after the date hereof relating to an Acquisition Proposal. Sunrise REIT shall promptly and fully keep the Purchasers informed of the status on a current basis, including any change to any of the terms, of any such Acquisition Proposal.

(8) Sunrise REIT shall

(i) ensure that its officers and Trustees and its Subsidiaries and their respective officers and directors and any Representatives retained by it or its Subsidiaries in connection herewith are aware of the provisions of this Section 4.4, and Sunrise REIT shall be responsible for any breach of this Section 4.4 by its [*sic*] and its Subsidiaries' officers, directors, trustees or representatives;

(ii) immediately cease and cause to be terminated any existing activities, discussions or negotiations with any parties conducted heretofore with respect to any Acquisition Proposal;

(iii) require all Persons other than the Purchasers who have been furnished with confidential information regarding Sunrise REIT or its Subsidiaries in connection with the solicitation of or discussion regarding any Acquisition Proposal within 12 months prior to the date hereof promptly to return or destroy such information, in accordance with and subject to the terms of the confidentiality agreement entered into with such Persons;

(iv) terminate access for all Persons (other than the Purchasers and its Representatives) of the electronic dataroom accessible through Merrill Datasite's website; and

(v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties.

[22] The Purchase Agreement defines "Acquisition Proposal" and "Superior Proposal" as follows:

> "Acquisition Proposal" means any proposal or offer made by any Person other than the Purchasers (or any affiliate of the Purchasers or any Person acting jointly and/or in concert with the Purchasers or any affiliate of the Purchasers) with respect to the acquisition, directly or indirectly, of assets, securities or ownership interests of or in Sunrise REIT or any of its Subsidiaries representing 20% or more of the consolidated assets of Sunrise REIT and its Subsidiaries taken as a whole, in a single transaction or a series of transactions, or, of equity interests representing a 20% or greater economic interest in Sunrise REIT or such Subsidiaries taken as a whole, in a single transaction or a series of transactions pursuant to any merger, amalgamation, tender offer, share exchange, business combination, liquidation, dissolution, recapitalization, take-over or non-exempt issuer bid, amendment to the Declaration of Trust, redemption of units, extraordinary distribution, sale, lease, exchange, mortgage, pledge, transfer, purchase, or issuance as consideration or similar transaction or series of transactions involving Sunrise REIT or any of such Subsidiaries or any other transaction the consummation of which would reasonably expected to impede, interfere with, prevent or materially delay the transactions contemplated hereby.
>
> "Superior Proposal" means any unsolicited *bona fide* written Acquisition Proposal made by a third party that in the good faith determination of the Trustees, after consultation with its financial advisors and with outside counsel:
>
> (a) is reasonably capable of being completed without undue delay having regard to financial, legal, regulatory and other matters;
>
> (b) in respect of which adequate arrangements have been made to ensure that the required funds will be available to effect payment in full of the consideration; and
>
> (c) would, if consummated in accordance with its terms, result in a transaction more favourable to Unitholders from a financial point of view (including financing terms, any termination fee or expenses reimbursement payable under this Agreement, any conditions to the consummation thereof) than the transactions contemplated by this Agreement; provided, however, that for purposes of this definition the references in the definition of Acquisition Proposal to "20%" shall be deemed to be references to "100%".

Analysis

[23] The central issue on this appeal, as it was before the application judge, is whether the provisions of s. 4.4 of the Purchase Agreement impose an obligation on Sunrise to enforce the Standstill

Agreement between it and HCPI, thus precluding it from considering the Acquisition Proposal submitted by HCPI following the close of the auction and after the Ventas bid had been accepted. In my view, they do.

[24] Counsel accept that the application judge correctly outlined the principles of contractual interpretation applicable in the circumstances of this case. I agree. Broadly stated — without reproducing in full the relevant passages from her reasons (paras. 29-34) in full — she held that a commercial contract is to be interpreted,

(a) as a whole, in a manner that gives meaning to all of its terms and avoids an interpretation that would render one or more of its terms ineffective;[1]

(b) by determining the intention of the parties in accordance with the language they have used in the written document and based upon the "cardinal presumption" that they have intended what they have said;[2]

(c) with regard to objective evidence of the factual matrix underlying the negotiation of the contract, but without reference to the subjective intention of the parties;[3] and (to the extent there is any ambiguity in the contract),

(d) in a fashion that accords with sound commercial principles and good business sense, and that avoid a commercial absurdity.[4]

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1 *BG Checo International Ltd. v. British Columbia Hydro and Power Authority*, [1993] 1 S.C.R. 12, [1993] S.C.J. No. 1, at pp. 23-24 S.C.R.; *Scanlon v. Castlepoint Development Corp.* (1992), 11 O.R. (3d) 744, [1992] O.J. No. 2692 (C.A.), at p. 770 O.R.

2 *Toronto-Dominion Bank v. Leigh Instruments Ltd. (Trustee of)*, [1998] O.J. No. 2637, 40 B.L.R. (2d) 1 (Gen. Div.), at para. 403, affd (1999), 45 O.R. (3d) 417, [1999] O.J. No. 3290 (C.A.); *Venture Capital USA Inc. v. Yorkton Securities Inc.* (2005), 75 O.R. (3d) 325, [2005] O.J. No. 1885 (C.A.), at para. 26; *Eli Lilly & Co. v. Novopharm Ltd.*, [1998] 2 S.C.R. 129, [1998] S.C.J. No. 59, at pp. 166-68 S.C.R. ("*Eli Lilly*").

3 *Eli Lilly, ibid.* at p. 166 S.C.R.; *Kentucky Fried Chicken Canada, a Division of Pepsi-Cola Canada Ltd. v. Scott's Food Services Inc.*, [1998] O.J. No. 4368, 114 O.A.C. 357 (C.A.), at paras. 25-27 ("*Kentucky Fried Chicken*").

4 *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, [1979] S.C.J. No. 133, at p. 901 S.C.R.; *Kentucky Fried Chicken, ibid.*

[25] The appellants assert, however, that the application judge misapplied the principles of contractual interpretation that she had properly enunciated. They say she did so essentially,

(a) by misapprehending the interplay between ss. 4.4(1), 4.4(2), 4.4(3) and 4.4(8)(v) of the Purchase Agreement and, in particular by failing to appreciate, and to reconcile, the differences between the wording of ss. 4.4(1) and 4.4(8), and more generally,

(b) by failing to understand the "architecture" of s. 4.4 of the Purchase Agreement and to consider it against the background of the factual matrix in which the Agreement was negotiated.

[26] I do not agree.

The application judge's reasoning

[27] The thrust of the application judge's reasoning in this regard is found at paras. 35, 36, 38 and 39 of her reasons:

> Sunrise REIT expressly and unambiguously agreed that it would not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties. The standstill enforcement obligations are found in sections 4.4(1) and 4.4(8) of the Purchase Agreement.
>
> Sections 4.4(2) and 4.4(3) address Sunrise REIT's obligations with regard to "a *bona fide* written, unsolicited Acquisition Proposal (that did not result from a breach of this section 4.4)." Sections 4.4(2) and 4.4(3) are prefaced with the words "notwithstanding anything contained in section 4.4(1)." Sections 4.4(2) and (3) do not say "notwithstanding anything contained in section 4.4(1) or 4.4(8)." If it had been the parties' contractual intention to exempt the circumstances described in sections 4.4(2) and (3) from the operation of section 4.4(8), they could have so provided but they did not. Similarly, unlike sections 4.7 and 4.8 which commence with the words "notwithstanding any other term of the Agreement", sections 4.4(2) and 4.4(3) do not use this language.
>
> . . . . .
>
> It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. This was part of the package negotiated between it and Sunrise REIT.
>
> Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with the context of the transaction including the auction process which was the genesis of the Purchase Agreement. The Purchase Agreement does not preclude *bona fide* written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement

> operated to permit such a proposal. It simply precludes a proposal from anyone who is in breach of its standstill agreement. While creative, I view Sunrise REIT's and HCP's interpretation arguments to be strained. They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole.

(Footnote omitted)

The scheme and interpretation of section 4.4

[28] I agree with the application judge that an important purpose of this part of the Purchase Agreement is to ensure the enforcement of standstill agreements entered into by previous players in the auction process. The negotiating context demonstrates that Ventas has been skilful in protecting its own position with respect to competition and standstills — unlike the HCPI Standstill, the Ventas/Sunrise Standstill Agreement expired at the conclusion of the auction — and it is objectively reasonable, given this background, that it would seek protection against competition from those who were unsuccessful in the auction, particularly its [principal] competitor.

[29] From Sunrise's perspective, the safety valve lies in the unitholders' meeting. If the unitholders believe that there is a more favourable offer available — one worth the risk of rejecting the Ventas proposal — they may well vote to reject the Ventas proposal at their meeting on March 30.

[30] The language used by the parties in the Purchase Agreement supports this interpretation.

[31] Viewed contextually, ss. 4.4(1), 4.4(2), 4.4(3) and 4.4(8) form part of a section of the Purchase Agreement that deals with the general covenant of Sunrise not to shop for other offers pending unitholder consideration of the Ventas bid. Viewed in light of the factual matrix in which the Agreement was negotiated, the provisions provide deal protection for Ventas, as the successful bidder in the auction, subject to Sunrise REIT's fiduciary out obligations.

[32] As I read s. 4.4 of the Agreement, it has four major components. First, it contains the overriding obligation of Sunrise not to solicit other bids, buttressed by the commitment of Sunrise to enforce existing standstill agreements that may be in place with bidders who have already engaged in the auction process (s. 4.4(1)). Secondly, it contains the "fiduciary out" protection for the Sunrise Trustees (and unitholders), permitting the Trustees to consider *bona fide* unsolicited Acquisition Proposals from third parties (*that are not in breach of the provisions of section 4.4*) (ss. 4.4(2) and 4.4(3)). Thirdly, it contains a series of provisions dealing with how the parties are to address a situation

where a permitted Acquisition Proposal is received (ss. 4.4(3)-4.4(7)).[5] Lastly, s. 4.4(8)(v) returns to the general non-solicitation obligation, reinforcing it by ensuring that Sunrise will (i) ensure all of its officers, Trustees and agents are aware of the non-solicitation provisions, (ii) immediately stop negotiating with anyone previously involved in the bidding process, (iii) require those bidders to return any confidential documentation and information they may have received during the process, (iv) terminate access to the data room by anyone other than Ventas and its representatives, and finally (a reiteration of the requirement set out in s. 4.4(1)):

> (v) not amend, modify, waive or fail to enforce any of the standstill terms or other conditions included in any of the confidentiality agreements between Sunrise REIT and any third parties.

[33] Contrary to the appellants' submissions, however, it is not *any* Acquisition Proposal that the Trustees are free to consider as part of the fiduciary out scenario; it is only an Acquisition Proposal from a third party *that is not in breach of section 4.4 of the Agreement*.

[34] Properly understood in this fashion, then, a reading of s. 4.4 demonstrates that there is no *conflict* between the provisions of ss. 4.4(1)(ii), 4.4(2), 4.4(3) and 4.4(8)(v). The repeated standstill enforcement terms *complement* one another. As the application judge pointed out, the opening phrases of ss. 4.4(2) and 4.4(3) — "notwithstanding anything contained in Section 4.4(1)" — do not have the words "or Section 4.4(8)(v)" added to them. This reinforces the interpretation that s. 4.4(8)(v) is there to clarify that Sunrise's obligation to enforce its Standstill Agreements with third parties is not negated by the fiduciary out clause. An unsolicited proposal by a prior bidder bound by a Standstill Agreement is a proposal that is otherwise in breach of s. 4.4, because it violates s. 4.4(8)(v), and therefore is not immunized by the fiduciary out provisions.

[35] In that sense, contrary to the appellants' submissions, the application judge's reading of the Purchase Agreement does not reduce s. 4.4(8)(v) to simply the functional equivalent of s. 4.4(1)(ii). Nor is it a case of s. 4.4(8)(v) continuing to require the enforcement of a Standstill Agreement even when the fiduciary out clause is otherwise applicable. The fiduciary out clause

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5 The Proposal has to be a Superior Proposal; Sunrise has to notify Ventas of the Proposal and provide it with all relevant documentation; Ventas had the right to match the Proposal within five days (as defined) and, if it chooses not to, to terminate the Agreement and receive the break fee (see also, s. 5.3 and Schedule "B" (definition of "Termination Payment")).

does not apply where the unsolicited proposal is tendered in breach of the non-solicitation provisions of the Purchase Agreement, *i.e.*, in breach of a Standstill Agreement that Sunrise is obliged to enforce. The fiduciary out formula is an important feature of the non-solicitation format, but it does not allow Sunrise to resile from the terms of its Standstill Agreements with earlier bidders, in my opinion.

The difference in wording between sections 4.4(1)(ii) and 4.4(8)(v)

[36] Mr. Howard emphasized what he argued was a difference in wording between those two provisions. He points out that s. 4.4(1)(ii) expressly refers to situations involving "an actual or potential Acquisition Proposal" whereas s. 4.4(8)(v) contains no such reference, and further, that other subsections of s. 4.4(8) — namely, ss. 4.4(8)(ii) and (iii) — refer to Acquisition Proposals as well, although not in the context of standstill agreements (4.4(8)(ii) and 4.4(8)(iii)). Because s. 4.4(8)(v) does not refer to "Acquisition Proposals", Mr. Howard submits it does not apply in the context of such a proposal and therefore does not apply in the context of the HCPI Acquisition Proposal.

[37] There are several problems with this argument. First, it misapprehends the fact that *any* proposal to acquire more than 20 per cent of the assets of Sunrise — whether made before or after the close of the auction — constitutes an "Acquisition Proposal" as defined in the Agreement. Consequently, s. 4.4(8)(v) can only apply in the context of an Acquisition Proposal of some sort, regardless of its wording.

[38] Secondly, the argument appears to be founded on the unarticulated premise that an Acquisition Proposal, as referenced in ss. 4.4(1)(ii), 4.4(2) and 4.4(3), is the equivalent of a Superior Proposal. The appellants' theory of the Agreement is that the Trustees are entitled to consider any Acquisition Proposal received after the close of the auction, and that the commitment in s. 4.4(8)(v) to enforce standstill agreements only applies in the event that a subsequent Acquisition Proposal received by the Trustees does not make the grade as a Superior Proposal. The function of s. 4.4(8)(v), they say, is to permit the Trustees in such circumstances to prevent a bidder in such a case — whether a prior bidder or not — from continuing to participate in the bidding process.

[39] It is not the case, however, that an Acquisition Proposal and a Superior Proposal are the same thing. The latter is a narrower concept than the former. While an Acquisition Proposal is essentially an offer by anyone to acquire more than 20 per cent of

the assets of Sunrise, a Superior Proposal is an Acquisition Proposal[6] that is more favourable to the unitholders from a financial point of view than the Ventas bid. Sunrise submits, at para. 43 of its factum, that s. 4.4(8)(v) "is part of the filtering protection for both Ventas and Sunrise REIT that allows and obliges Sunrise REIT to deal summarily with offers that do not meet the Acquisition Proposal threshold". Sunrise does not mean the "Acquisition Proposal threshold" in this statement, however; it means the "Superior Proposal threshold". To support the appellants' argument, the reference to "Acquisition Proposal" in s. 4.4(1)(ii) would have to be read as "Superior Proposal". That is not what it says.

[40] Moreover, and in any event, a careful reading of s. 4.4(1)(ii) does not bear out the nexus between the reference to "Acquisition Proposal" and the commitment to enforce the standstill agreements. For ease of reference I repeat the wording of s. 4.4(1)(ii) here:

> 4.4(1) Following the date hereof, Sunrise REIT shall not . . .
>
> (ii) participate in any discussions or negotiations in furtherance of such inquiries or proposals or regarding an actual or potential Acquisition Proposal or release any Person from, or fail to enforce, any confidentiality or standstill agreement or similar obligations to Sunrise REIT or any of its Subsidiaries.

[41] Section 4.4(1)(ii) in reality contains two prohibitions, not one. The language does not work otherwise. Sunrise agrees not to participate in discussions or negotiations regarding actual or potential Acquisition Proposals. It also agrees not to release anyone from, or fail to enforce, existing Standstill Agreements. The drafters could well have divided s. 4.4(1) into six general prohibitions rather than five. The commitment to enforce the Standstill Agreements is not, therefore, tied to "Acquisition Proposals" in a way that s. 4.4(8)(v) is not.

[42] Accordingly, I agree with the application judge's observation that while the appellants' interpretation arguments are creative, they are strained. As she said [at para. 39], "They disregard the parties' intention and the true meaning of the subject sections and the Purchase Agreement as a whole."

An interpretation that reflects the "factual matrix", is "commercially sensible", and accords with the fiduciary obligations of the Sunrise trustees

[43] Nor do I accept the submission that the application judge failed to consider the factual matrix underlying the negotiation of

6 That meets the s. 4.4(2) requirements of being *bona fide* and unsolicited.

the Purchase Agreement, or that she failed to give effect to the "commercial sense" component of contract interpretation.

[44] In a blended argument, the appellants submit that the application judge's interpretation of the Purchase Agreement ignores the factual matrix in which the Agreement was negotiated, defies commercial sense and reasonableness, and eviscerates the fiduciary out mechanism that was central to the parties' agreement. Respectfully, I do not read the application judge's reasons in this fashion.

The factual matrix

[45] Contracts are not made in a vacuum, and there is no dispute that the surrounding circumstances in which a contract is negotiated are relevant considerations in interpreting contracts. As this court noted in *Kentucky Fried Chicken*, *supra*, at para. 25, "[w]hile the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its 'factual matrix' will also provide the court with useful assistance."

[46] Sunrise points to a number of surrounding circumstances which it says the application judge ignored in arriving at her decision. These include that:

(a) the Purchase Agreement was entered into at the conclusion of the second stage of a private sale auction process where it was clear that the overall objective of Sunrise was to maximize value for [its] unitholders;

(b) the expectations of the bidders, objectively determined, could not have been that the "winner" of the auction was assured of acquiring the Sunrise assets, because everyone was aware that there would be a fiduciary out clause and that superior proposals could displace the winning bid;

(c) Ventas's own standstill terms ceased to apply in the event that Sunrise entered into a sales transaction with a third party, and Ventas could not know whether the other Standstill Agreements rested on the same footing (and did not know that HCPI's did not);

(d) Ventas never told Sunrise it believed the participants in the auction would be excluded from the operation of the fiduciary out provision; and

(e) Ventas had bargained for, and achieved, considerable deal protection, in the form of the "no shop" provision, the right

to match any Superior Proposal, and the right to receive a $39.8 million break fee if it chose not to match such an offer.

[47] Matters involving the factual matrix underlying a contract are matters of fact, or at least matters of mixed fact and law. A judge is owed considerable deference in her assessment of such matters. Here, the experienced Commercial List judge was exercising a function common to that role — the interpretation of a commercial contract — and, while she may not have dealt with the foregoing themes expressly as the appellants would like, her reasons, read as a whole, indicate that she was alive to most, if not all, of them. She was certainly aware of the facts contained in points (a), (b), (c) and (e) above, as she dealt with them at one time or another in the reasons. The factor mentioned in (d) is not dispositive of anything.

[48] At the conclusion of her consideration of the interpretation issue, as noted earlier, the application judge said (at paras. 38 and 39):

> It seems to me that the clear scheme of this Purchase Agreement was [to] ensure enforcement of standstill agreements that had been signed as part of the auction process. This strikes me as being objectively reasonable and was a form of protection afforded to the purchaser, Ventas. *This was part of the package negotiated between it and Sunrise REIT.*
>
> Such an interpretation derives from the words used by the parties to the Purchase Agreement and gives effect to the parties' intention. It is also consistent with *the context of the transaction including the auction process which was the genesis of the Purchase Agreement.* The Purchase Agreement does not preclude *bona fide* written unsolicited Acquisition Proposals nor does it preclude such a proposal from a party whose standstill agreement operated to permit such a proposal. It simply precludes a proposal from anyone else who is in breach of its standstill agreement.

(Emphasis added, footnote omitted)

[49] I can find no basis for concluding the applications judge was not attuned to the need to keep the factual matrix in mind when conducting her interpretative exercise.

[50] Nor do I accept that she either ignored the need to interpret the contract in a way that reflected sound commercial sense, or that she failed to give it such an interpretation. It is apparent from her recitation of the principles of contract interpretation that she was aware of the relevance of the "sound commercial sense" theme. She cited the following passage from this court's decision in *Kentucky Fried Chicken, supra*, at para. 27:

> Where, as here, the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity: [*Toronto (City) v. W.H. Hotel Ltd.*, [1966] S.C.R. 434, [1966] S.C.J. No. 23, 56 D.L.R. (2d) 539, at p. 548 D.L.R.]. Rather, the document should be construed in accordance with sound commercial principles

and good business sense: [*Scanlon v. Castlepoint Development Corporation* (1992), 11 O.R. (3d) 744, [1992] O.J. No. 2692 (C.A.), at p. 770 O.R.]. Care must be taken, however, to do this objectively rather than from the perspective of one contracting party or the other, since what might make good business sense to one party would not necessarily do so for the other.

[51] The appellants' argument that the application judge failed to interpret the Purchase Agreement in a fashion that accords with sound commercial sense is grounded in the belief that she overlooked the importance of the "maximizing value" principle and the centrality of the Trustees' fiduciary obligations in that regard, in cases of this nature. She did neither, in my view.

[52] As noted above, the application judge was sensitive to the fiduciary out provisions that permitted other *bona fide* written unsolicited Acquisition Proposals. In her view, however, this was balanced, objectively and reasonably, by the requirement that Sunrise ensure enforcement of Standstill Agreements that had been signed as part of the auction process in order to protect the successful bidder. This interpretation makes commercial sense, in my view.

[53] On behalf of HCPI, Mr. Leon placed great emphasis on the sanctity of the fiduciary out mechanism in acquisition agreements of this nature. There is no doubt that the directors of a corporation that is the target of a takeover bid — or, in this case, the Trustees — have a fiduciary obligation to take steps to maximize shareholder (or unitholder) value in the process: see *CW Shareholdings Inc. v. WIC Western International Communications Ltd.* (1998), 39 O.R. (3d) 755, [1998] O.J. No. 1886 (Gen. Div.), at pp. 768 and 774 O.R. That is the genesis of the "fiduciary out" clauses in situations such as the case at hand. They enable directors or trustees to comply with their fiduciary obligations by ensuring that they are not precluded from considering other *bona fide* offers that are more favourable financially to the shareholders or unitholders than the bid in hand.

[54] It is not necessary — nor would it be wise, in my view — to go as far as HCPI suggests this court might go, and adopt the principle gleaned from some American authorities, that the target vendor can place no limits on the directors' right to consider superior offers and that any provision to the contrary is invalid and unenforceable: see *Paramount Communications, Inc. v. QVC Network Inc.*, 637 A. 2d 34 (Del. 1994), and *ACE Ltd. v. Capital Re Corp.*, 747 A. 2d 95 (Del. Ch. 1999), at p. 105. That is not what happened in this case.

[55] The Trustees did not contract away their fiduciary obligations. Rather, they complied with them by setting up an auction process, in consultation with their professional advisers, that was designed to maximize the unit price obtained for Sunrise's

assets, in a fashion resembling a "shotgun" clause, by requiring bidders to come up with their best price in the second round, subject to a fiduciary out clause that allowed them to consider superior offers from anyone save only those who had bound themselves by a Standstill Agreement in the auction process not to make such a bid. In this case, that turned out to be only HCPI.

[56] An auction process is well-accepted as being one — although only one — "appropriate mechanism to ensure that the board of a target company acts in a neutral manner to achieve the best value reasonably available to shareholders in the circumstances": *Maple Leaf Foods Inc. v. Schneider Corp.* (1999), 42 O.R. (3d) 177, [1999] O.J. No. 4142 (C.A.), at p. 200 O.R. Here, the trustees, acting reasonably and on professional advice, formed the view that an auction process was the best way to maximize value, and conducted such an auction to the point where they attracted a successful bidder. This is not a case where the Trustees were unable to judge the adequacy of the bid (*Schneider*, at p. 200 O.R.). They had dealt with seven prospective purchasers in the course of the two auction rounds, and had received preliminary proposals. Ventas's $15-per-unit price represented a 35.8 per cent increase over the market price of the Units on the date the auction closed. I do not think the Trustees can be said to have failed in the exercise of their fiduciary obligations to their unitholders in these circumstances simply by agreeing in the Purchase Agreement to preclude earlier bidders, who had bound themselves under Standstill Agreements not to do so, from coming in after the auction was concluded and the "successful" bidder had showed its cards and attempting to "top up" that bid.

[57] It is well accepted that "where an agreement admits of two possible constructions, one of which renders the agreement lawful and the other of which renders it unlawful, courts will give preference to the former interpretation": John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at p. 729. Advancing this principle, the appellants argue that we should be loath to adopt an interpretation of the Purchase Agreement that is inconsistent with overarching fiduciary obligations. While I accept the principle put forward, however, I do not think it applies in the context of this case for the reasons outlined above. The interpretation given to the Purchase Agreement by the application judge is not inconsistent with the Trustee's fiduciary obligation to maximize unitholder value. Indeed, it is consistent with that obligation.

[58] Finally, Mr. Leon emphasizes the importance of the word "nothing" in the opening language of ss. 4.4(2) and 4.4(3) of the Purchase Agreement. Both provisions open with the words

"Notwithstanding anything contained in Section 4.4(1), until the Unitholder Approval, *nothing* shall prevent the Board from . . ." (emphasis added). Mr. Leon submits that "nothing" means what it says, and must be given the full scope of that meaning, in order to ensure that "nothing" in the Purchase Agreement or otherwise is permitted to stand in the way of the Trustees performing their duty to maximize shareholder value. This point involves parsing the Purchase Agreement in a microscopic fashion that is a little too fine, in my view. The use of the word "nothing" in ss. 4.4(2) and 4.4(3) is nothing more than a different way of saying "Notwithstanding anything contained in Section 4.4(1) . . . *the Board is not prevented from* . . .". I would not ascribe to it the expanded role that HCPI proposes.

The meaning of "bona fide"

[59] The appellants also attack the conclusion of the application judge that the HCPI Acquisition Proposal was not a "*bona fide*" offer. She accepted the Ventas submission that "a proposal made in breach of a contractual obligation not to make such a proposal cannot be considered to be *bona fide*", noting that ss. 4.4(2) and 4.4(3) of the Purchase Agreement contemplate an Acquisition Proposal from a third party "that did not result from a breach of . . . Section 4.4".

[60] There was much debate about the meaning of "*bona fide*". The application judge viewed it as meaning acting "in good faith; sincere, genuine", relying upon *The Oxford English Dictionary*.[7] She found that the HCPI Acquisition Proposal was not *bona fide* because it was made in breach of the HCPI Standstill Agreement, which Sunrise was obliged by s. 4.4 to enforce. The appellants agree that *bona fide* means "genuine" or "made in good faith", but submit that a *bona fide* Acquisition Proposal, as contemplated by the Purchase Agreement, is one that is "genuine" or "authentic" in the sense that it is not a sham and is reasonably capable of becoming a Superior Proposal, and that this decision must be made in the context of the entire situation.

[61] In the end, there is not much difference between the parties as to the meaning of the term "*bona fide*". As with the principles of contract interpretation, they differ on the application of the term in the circumstances of this case. Given the language of the Purchase Agreement, and the context in which it was negotiated — particularly the language "that did not result from a breach of this Section 4.4" in ss. 4.4(2) and 4.4(3) — I do not think

7 2d ed., *s.v.* "bona fide".

the application judge erred in her assessment and use of the term "*bona fide*" here.

Miscellaneous

[62] Two additional points were made by the appellants, but need not be dealt with at length.

[63] First, HCPI argued that Sunrise had given its prior consent to HCPI to make its subsequent Acquisition Proposal following completion of the auction process and the execution of the Purchase Agreement. This consent is said to derive from the waiver Sunrise gave to both HCPI and Ventas as part of the invitation to bid in the second round. The application judge made a specific finding against this position, however, concluding that the December 29, 2006 letter "cannot possibly be construed as constituting Sunrise REIT's prior written consent as that term is used in the Standstill Agreement". There is no basis for interfering with this finding.

[64] Secondly, HCPI submitted that the position of Ventas on these applications was tantamount to saying that the benefit of the HCPI Standstill Agreement had been assigned to it. The application judge correctly found that there was no merit in this argument. I agree with her that neither the Standstill Agreement nor its benefits had been assigned to anyone, and no one was taking the position that they had.

The HCPI Cross-Appeal

[65] HCPI applied for a declaration that communications between it and SSL regarding Sunrise were permitted. The application judge declined to deal with this request, given her ruling which effectively precluded the HCPI Acquisition Proposal from being pursued. She concluded the application was moot.

[66] I agree and for the same reason find it unnecessary to deal with the cross-appeal for the same relief.

Conclusion

[67] For the foregoing reasons, then, I would dismiss both the appeal and the cross-appeal.

[68] If the parties are unable to agree as to costs, they may make brief written submissions in that regard, not to exceed five pages in length.

[69] In closing, I would like to thank all counsel for their able presentations and assistance.

Appeal dismissed.

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST GLOBAL COMMUNICATIONS CORP. AND THE OTHER APPLICANTS LISTED ON SCHEDULE "A"

Court File No. M38600

COURT OF APPEAL FOR ONTARIO

Proceeding commenced at Toronto

BOOK OF AUTHORITIES OF THE RESPONDING PARTY, THE CATALYST CAPITAL GROUP INC.
(Motion for Leave to Appeal)

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