TAB 7

CANADIAN BANKRUPTCY REPORTS

Fourth Series/Quatrième série

Recueil de jurisprudence canadienne
en droit de la faillite

[Indexed as: **Canadian Airlines Corp., Re**]

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

The Bank of Nova Scotia Trust Company of New York, As Trustee for the Holders of Senior Secured Notes and Montreal Trust Company of Canada, As Collateral Agent for the Holders of Senior Secured Notes, Plaintiffs and Canadian Airlines Corporation, Canadian Airlines International Ltd., Canadian Regional Airlines Ltd., Canadian Regional Airlines (1998) Ltd. and Canadian Airlines Fuel Corporation Inc., Defendants

Alberta Court of Queen's Bench

Paperny J.

Judgment: May 4, 2000

Docket: Calgary 0001-05071, 0001-05044

G. Morawetz, A.J. McConnell and *R.N. Billington*, for Bank of Nova Scotia Trust Co. of New York and Montreal Trust Co. of Canada.

A.L. Friend, Q.C., and *H.M. Kay, Q.C.*, for Canadian Airlines.

S. Dunphy, for Air Canada and 853350 Alberta Ltd.

R. Anderson, Q.C., for Loyalty Group.

H. Gorman, for ABN AMRO Bank N.V.

P. McCarthy, for Monitor - Price Waterhouse Cooper.

D. Haigh, Q.C., and *D. Nishimura*, for Unsecured noteholders - Resurgence Asset Management.

C.J. Shaw, for Airline Pilots Association International.

G. Wells, for NavCanada.

D. Hardy, for Royal Bank of Canada.

Corporations — Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Effect of arrangement — Stay of proceedings — Senior secured noteholders brought application for appointment of receiver over collateral on same day that airline was granted CCAA protection — Noteholders

constituted separate class that intended to vote against plan and had voted to realize on security — Noteholders brought application for order lifting stay of proceedings against them to allow for appointment of receiver and manager over assets and property charged in their favour, and for order appointing court officer with exclusive right to negotiate sale of assets or shares of airline's subsidiary — Application dismissed — In determining whether stay should be lifted, court had to balance interests of all parties who stood to be affected — This would include general public, which would be affected by collapse of airline — Evidence indicated that liquidation would be inevitable were noteholders to realize on collateral — Objective of stay was not to maintain literal status quo but to maintain situation that was not prejudicial to creditors while allowing airline "breathing room" — It was premature to conclude that plan would be rejected or that proposal acceptable to noteholders could not be reached — Evidence indicated that airline was moving to effect compromises swiftly and in good faith — Appointment of receiver to manage collateral would negate effect of stay and thwart purposes of Act — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Corporations — Arrangements and compromises — Under Companies' Creditors Arrangement Act — Miscellaneous issues — Senior secured noteholders brought application for appointment of receiver over collateral on same day that airline was granted CCAA protection — Noteholders constituted separate class that intended to vote against plan and voted to realize on security — Noteholders brought application for order lifting stay of proceedings against them to allow for appointment of receiver and manager over assets and property charged in their favour, and for order appointing court officer with exclusive right to negotiate sale of assets or shares of airline's subsidiary — Application dismissed — Proposal that airline make interim payments for use of security was not viable — Suggestion that other airline financially supporting plan should pay out airline's debts to noteholders was without legal foundation — Existence of solvent entity financially supporting plan with view to obtaining economic benefit for itself did not create obligation on that entity to pay airline's creditors — Noteholders could not require sale of assets or shares of airline's subsidiary — Subsidiary was not debtor company but was itself property of airline — Marketing of subsidiary's assets would constitute "proceeding in respect of petitioners' property" within meaning of s. 11 of Act — Even if marketing of subsidiary's assets did not so qualify, court has inherent jurisdiction to grant stays in relation to proceedings against third parties where exercise of jurisdiction is important to reorganization process — In deciding whether to exercise inherent jurisdiction, court weighs interests of insolvent corporation against interests of parties who would be affected by stay — Threshold of prejudice required to persuade court not to exercise inherent jurisdiction to grant stay is lower than threshold required to persuade court not to exercise discretion under s. 11 of Act — Noteholders failed to meet either threshold — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

Cases considered by *Paperny J.*:

Alberta-Pacific Terminals Ltd., Re (1991), 8 C.B.R. (3d) 99 (B.C. S.C.) — considered

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303, 14 C.P.C. (3d) 339 (Ont. Gen. Div.) — considered

Citibank Canada v. Chase Manhattan Bank of Canada (1991), 5 C.B.R. (3d) 165, 2 P.P.S.A.C. (2d) 21, 4 B.L.R. (2d) 147 (Ont. Gen. Div.) — referred to

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 51 B.C.L.R. (2d) 84, 4 C.B.R. (3d) 311, (sub nom. *Chef Ready Foods Ltd. v. Hongkong Bank of Canada)* [1991] 2 W.W.R. 136 (B.C. C.A.) — referred to

Meridian Development Inc. v. Toronto Dominion Bank, [1984] 5 W.W.R. 215, 52 C.B.R. (N.S.) 109, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Alta. Q.B.) — referred to

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20, 72 C.R. (N.S.) 20 (Alta. Q.B.) — referred to

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey)* 1 O.R. (3d) 289, (sub nom. *Elan Corp. v. Comiskey)* 41 O.A.C. 282 (Ont. C.A.) — referred to

Pacific National Lease Holding Corp., Re (1992), 72 B.C.L.R. (2d) 368, 19 B.C.A.C. 134, 34 W.A.C. 134, 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]) — considered

Philip's Manufacturing Ltd., Re (1992), 9 C.B.R. (3d) 25, 67 B.C.L.R. (2d) 84, 4 B.L.R. (2d) 142 (B.C. C.A.) — considered

Philip's Manufacturing Ltd., Re (1992), 15 C.B.R. (3d) 57 (note), 143 N.R. 286 (note), 70 B.C.L.R. (2d) xxxiii (note), 15 B.C.A.C. 240 (note), 27 W.A.C. 240 (note), 6 B.L.R. (2d) 149 (note) (S.C.C.) — referred to

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 80 C.B.R. (N.S.) 98 (B.C. S.C.) — considered

Woodward's Ltd., Re (1993), 17 C.B.R. (3d) 236, 79 B.C.L.R. (2d) 257 (B.C. S.C.) — considered

Statutes considered:

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

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — considered
s. 11 — considered
s. 11(4) — considered

APPLICATION by holders of senior secured notes in corporation for order lifting stay of proceedings against them in *Companies' Creditors Arrangement Act* proceeding to allow for appointment of receiver and manager over assets and property charged in their favour and for order appointing court officer with exclusive right to negotiate sale of assets or shares of corporation's subsidiary.

***Paperny J.* (orally):**

1 Montreal Trust Company of Canada, Collateral Agent for the holders of the Senior Secured Notes, and the Bank of Nova Scotia Trust Company of New York, Trustee for the holders of the Senior Secured Notes, apply for the following relief:

> 1. In the CCAA proceeding (Action No. 0001-05071) an order lifting the stay of proceedings against them contained in the orders of this court

dated March 24, 2000 and April 19, 2000 to allow for the court-ordered appointment of Ernst & Young Inc. as receiver and manager over the assets and property charged in favour of the Senior Secured Noteholders; and

2. In Action No. 0001-05044, an order appointing Ernst & Young Inc. as a court officer with the exclusive right to negotiate the sale of the assets or shares of Canadian Regional Airlines (1998) Ltd.

2 Canadian Airlines Corporation ("CAC") is a Canadian based holding company which, through its majority owned subsidiary Canadian Airlines International Ltd. ("CAIL") provides domestic, U.S.-Canada transborder and international jet air transportation services. CAC also provides regional transportation through its subsidiary Canadian Regional Airlines (1998) Ltd. ("Canadian Regional"). Canadian Regional is not an applicant under the CCAA proceedings.

3 The Senior Secured Notes were issued under an Indenture dated April 24, 1998 between CAC and the Trustee. The principal face amount is $175 million U.S. As well, there is interest outstanding. The Senior Secured Notes are directly and indirectly secured by a diverse package of assets and property of the CCAA applicants, including spare engines, rotables, repairables, hangar leases and ground equipment. The security comprises the key operational assets of CAC and CAIL. The security also includes the outstanding shares of Canadian Regional and the $56 million intercompany indebtedness owed by Canadian Regional to CAIL.

4 Under the terms of the Indenture, CAC is required to make an offer to purchase the Senior Secured Notes where there is a "change of control" of CAC. It is submitted by the Senior Secured Noteholders that Air Canada indirectly acquired control of CAC on January 4, 2000 resulting in a change of control. Under the Indenture, CAC is then required to purchase the notes at 101 percent of the outstanding principal, interest and costs. CAC did not do so. According to the Trustee, an Event of Default occurred, and on March 6, 2000 the Trustee delivered Notices of Intention to Enforce Security under the Bankruptcy and Insolvency Act.

5 On March 24, 2000, the Senior Secured Noteholders commenced Action No. 0001-05044 and brought an application for the appointment of a receiver over their collateral. On the same day, CAC and CAIL were granted CCAA protection and the Senior Secured Noteholders adjourned their application for a receiver. However, the Senior Secured Noteholders made further application that day for orders that Ernst & Young be appointed monitor over their security and for weekly payments from CAC and CAIL of $500,000 U.S. These applications were dismissed.

6 The CCAA Plan filed on April 25, 2000, proposes that the Senior Secured Noteholders constitute a separate class and offers them two alternatives:

1. To accept repayment of less than the outstanding amount; or

2. To be unaffected by the CCAA Plan and realize on their security.

7 On April 26th, 2000, the Senior Secured Noteholders met and unanimously rejected the first option. They passed a resolution to take steps to realize on the security.

8 The Senior Secured Noteholders argue that the time has come to permit them to realize on their security. They have already rejected the Plan and see no utility in waiting to vote in this regard on May 26th, 2000, the date set by this court.

9 The Senior Secured Noteholders submit that since the CCAA proceedings began five weeks ago, the following has occurred:

-interest has continued to accrue at approximately $2 million U.S. per month;

-the security has decreased in value by approximately $6 million Canadian;

-the Collateral Agent and the Trustee have incurred substantial costs;

-no amounts have been paid for the continued use of the collateral, which is key to the operations of CAIL;

-no outstanding accrued interest has been paid; and- they are the only secured creditor not getting paid.

10 The Senior Secured Noteholders emphasize that one of the end results of the Plan is a transfer of CAIL's assets to Air Canada. The Senior Secured Noteholders assert that the Plan is sponsored by this very solvent proponent, who is in a position to pay them in full. They are argue that Air Canada has made an economic decision not to do so and instead is using the CCAA to achieve its own objectives at their expense, an inappropriate use of the Act.

11 The Senior Secured Noteholders suggest that the Plan will not be impacted if they are permitted to realize on their security now instead of after a formal rejection of the Plan at the court-scheduled vote on May 26, 2000. The Senior Secured Noteholders argue that for all of the preceding reasons lifting the stay would be in accordance with the spirit and intent of the CCAA.

12 The CCAA is remedial legislation which should be given a large and liberal interpretation: See, for example, *Citibank Canada v. Chase Manhattan Bank of Canada* (1991), 5 C.B.R. (3d) 165 (Ont. Gen. Div.). It is intended to permit the court to make orders which will effectively maintain the status quo for a period while the struggling company attempts to develop a plan to compromise its debts and ultimately continue operations for the benefit of both the company and its creditors: See for example, *Meridian Development Inc. v. Toronto Dominion*

Bank (1984), 52 C.B.R. (N.S.) 109 (Alta. Q.B.), and *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C. C.A.).

13 This aim is facilitated by the power to stay proceedings provided by Section 11 of the Act. The stay power is the key element of the CCAA process.

14 The granting of a stay under Section 11 is discretionary. On the debtor's initial application, the court may order a stay at its discretion for a period not to exceed 30 days. The burden of proof to obtain a stay extension under Section 11(4) is on the debtor. The debtor must satisfy the court that circumstances exist that make the request for a stay extension appropriate and that the debtor has acted, and is acting, in good faith and with due diligence. CAC and CAIL discharged this burden on April 19, 2000. However, unlike under the Bankruptcy and Insolvency Act, there is no statutory test under the CCAA to guide the court in lifting a stay against a certain creditor.

15 In determining whether a stay should be lifted, the court must always have regard to the particular facts. However, in every order in a CCAA proceeding the court is required to balance a number of interests. McFarlane J.A. states in his closing remarks of his reasons in *Re Pacific National Lease Holding Corp.* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]):

> In supervising a proceeding under the C.C.A.A. orders are made, and orders are varied as changing circumstances require. Orders depend upon a careful and delicate balancing of a variety of interests and problems.

16 Also see Blair J.'s decision in *Campeau v. Olympia & York Developments Ltd.* (1992), 14 C.P.C. (3d) 339 (Ont. Gen. Div.), for another example of the balancing approach.

17 As noted above, the stay power is to be used to preserve the status quo among the creditors of the insolvent company. Huddart J., as she then was, commented on the status quo in *Re Alberta-Pacific Terminals Ltd.* (1991), 8 C.B.R. (3d) 99 (B.C. S.C.). She stated:

> The status quo is not always easy to find... Nor is it always easy to define. The preservation of the status quo cannot mean merely the preservation of the relative pre-stay debt status of each creditor. Other interests are served by the CCAA. Those of investors, employees, and landlords among them, and in the case of the Fraser Surrey terminal, the public too, not only of British Columbia, but also of the prairie provinces. The status quo is to be preserved in the sense that manoeuvres by creditors that would impair the financial position of the company while it attempts to reorganize are to be prevented, not in the sense that all creditors are to be treated equally or to be maintained at the same relative level. It is the company and all the interests its demise would affect that must be considered.

18 Further commentary on the status quo is contained in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 80 C.B.R. (N.S.) 98 (B.C. S.C.). Thackray J. comments that the maintenance of the status quo does not mean that every detail of

the status quo must survive. Rather, it means that the debtor will be able to stay in business and will have breathing space to develop a proposal to remain viable.

19 Finally, in making orders under the CCAA, the court must never lose sight of the objectives of the legislation. These were concisely summarized by the chambers judge and adopted by the British Columbia Court of Appeal in *Re Pacific National Lease Holding Corp.* (1992), 15 C.B.R. (3d) 265 (B.C. C.A. [In Chambers]):

> (1) The purpose of the CCAA is to allow an insolvent company a reasonable period of time to reorganize its affairs and prepare and file a plan for its continued operation subject to the requisite approval of the creditors and court.
>
> (2) The CCAA is intended to serve not only the company's creditors but also a broad constituency which includes the shareholders and employees.
>
> (3) During the stay period, the Act is intended to prevent manoeuvres for positioning amongst the creditors of the company.
>
> (4) The function of the court during the stay period is to play a supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure.
>
> (5) The status quo does not mean preservation of the relative pre-stay debt status of each creditor. Since the companies under CCAA orders continue to operate and having regard to the broad constituency of interests the Act is intended to serve, the preservation of the status quo is not intended to create a rigid freeze of relative pre-stay positions.
>
> (6) The court has a broad discretion to apply these principles to the facts of th particular case.

20 At pages 342 and 343 of this text, Canadian Commercial Reorganization: Preventing Bankruptcy (Aurora: Canada Law Book, looseleaf), R.H. McLaren describes situations in which the court will lift a stay:

> 1. When the plan is likely to fail;
>
> 2. The applicant shows hardship (the hardship must be caused by the stay itself and be independent of any pre-existing condition of the applicant creditor);
>
> 3. The applicant shows necessity for payment (where the creditors' financial problems are created by the order or where the failure to pay the creditor would cause it to close and thus jeopardize the debtor's company's existence);
>
> 4. The applicant would be severely prejudiced by refusal to lift the stay and there would be no resulting prejudice to the debtor company or the positions of creditors;
>
> 5. It is necessary to permit the applicant to take steps to protect a right which could be lost by the passage of time;

6. After the lapse of a significant time period, the insolvent is no closer to a proposal than at the commencement of the stay period.

21 I now turn to the particular circumstances of the applications before me.

22 I would firstly address the matter of the Senior Secured Noteholders' current rejection of the compromise put forward under the Plan. Although they are in a separate class under CAC's Plan and can control the vote as it affects their interest, they are not in a position to vote down the Plan in its entirety. However, the Senior Secured Noteholders submit that where a plan offers two options to a class of creditors and the class has selected which option it wants, there is no purpose to be served in delaying that class from proceeding with its chosen course of action. They rely on the *Nova Metal Products Inc. v. Comiskey (Trustee of)* (1990), 1 C.B.R. (3d) 101 (Ont. C.A.) at 115, as just one of several cases supporting this proposition. *Re Philip's Manufacturing Ltd.* (1992), 9 C.B.R. (3d) 25 (B.C. C.A.) at pp. 27-28, leave to appeal to S.C.C. refused (1992), 15 C.B.R. (3d) 57 (note) (S.C.C.), would suggest that the burden is on the Senior Secured Noteholders to establish that the Plan is "doomed to fail". To the extent that Nova Metal and Philip's Manufacturing articulate different tests to meet in this context, the application of either would not favour the Senior Secured Noteholders.

23 The evidence before me suggests that progress may still be made in the negotiations with the representatives of the Senior Secured Noteholders and that it would be premature to conclude that any further discussions would be unsuccessful. The parties are continuing to explore revisions and alternative proposals which would satisfy the Senior Secured Noteholders.

24 Mr. Carty's affidavit sworn May 1, 2000, in response to these applications states his belief that these efforts are being made in good faith and that, if allowed to continue, there is a real prospect for an acceptable proposal to be made at or before the creditors' meeting on May 26, 2000. Ms. Allen's affidavit does not contain any assertion that negotiations will cease. Despite the emphatic suggestion of the Senior Secured Noteholders' counsel that negotiations would be "one way", realistically I do not believe that there is no hope of the Senior Secured Noteholders coming to an acceptable compromise.

25 Further, there is no evidence before me that would indicate the Plan is "doomed to fail". The evidence does disclose that CAC and CAIL have already achieved significant compromises with creditors and continue to work swiftly and diligently to achieve further progress in this regard. This is reflected in the affidavits of Mr. Carty and the reports from the Monitor.

26 In any case, there is a fundamental problem in the application of the Senior Secured Noteholders to have a receiver appointed in respect of their security which the certainty of a "no" vote at this time does not vitiate: It disregards the interests of the other stakeholders involved in the process. These include other secured creditors, unsecured creditors, employees, shareholders and the flying

public. It is not insignificant that the debtor companies serve an important national need in the operation of a national and international airline which employs tens of thousands of employees. As previously noted, these are all constituents the court must consider in making orders under the CCAA proceeding.

27 Paragraph 11 of Mr. Carty's May 1, 2000 affidavit states as follows:

> In my opinion, the continuation of the stay of proceedings to allow the restructuring process to continue will be of benefit to all stakeholders including the holders of the Senior Secured Notes. A termination of the stay proceedings as regards the security of the holders of the Senior Secured Notes would immediately deprive CAIL of assets which are critical to its operational integrity and would result in grave disruption of CAIL's operations and could lead to the cessation of operations. This would result in the destruction of value for all stakeholders, including the holders of the Senior Secured Notes. Furthermore, if CAIL ceased to operate, it is doubtful that Canadian Regional Airlines (1998) Ltd. ("CRAL98"), whose shares form a significant part of the security package of the holders of the Senior Secured Notes, would be in a position to continue operating and there would be a very real possibility that the equity of CAIL and CRAL, valued at approximately $115 million for the purposes of the issuance of the Senior Secured Notes in 1998, would be largely lost. Further, if such seizure caused CAIL to cease operations, the market for the assets and equipment which are subject to the security of the holders of the Senior Secured Notes could well be adversely affected, in that it could either lengthen the time necessary to realize on these assets or reduce realization values.

28 The alternative to this Plan proceeding is addressed in the Monitor's reports to the court. For example, in Paragraph 8 of the Monitor's third report to the court states:

> The Monitor believes the if the Plan is not approved and implemented, CAIL will not be able to continue as a going concern. In that case, the only foreseeable alternative would be a liquidation of CAIL's assets by a receiver and manager and/or by a trustee. Under the Plan, CAIL's obligations to parties it considers to be essential in order to continue operations, including employees, customers, travel agents, fuel, maintenance, catering and equipment suppliers, and airport authorities, are in most cases to be treated as unaffected and paid in full. In the event of a liquidation, those parties would not, in most cases, be paid in full and, except for specific lien rights, statutory priorities or other legal protection, would rank as ordinary unsecured creditors. The Monitor estimates that the additional unsecured claims which would arise if CAIL were to cease operation as a going concern and be forced into liquidation would be in excess of $1.1 billion.

29 This evidence is uncontradicted and flies in the face of the Senior Secured Noteholders' assertion that realizing on their collateral at this point in time will not affect the Plan. Although, as the Senior Secured Noteholders heavily empha-

sized the Plan does contemplate a "no" vote by the Senior Secured Noteholders, the removal of their security will follow that vote. 9.8(c) of the Plan states that:

> If the Required Majority of Affected Secured Noteholders fails to approve the Plan, arrangements in form and substance satisfactory to the Applicants will have been made with the Affected Secured Noteholders or with a receiver appointed over the assets comprising the Senior Notes Security, which arrangements provide for the transitional use by [CAIL], and subsequent sale, of the assets comprising the Senior Notes Security.

30 On the other side of the scale, the evidence of the Senior Secured Noteholders is that the value of their security is well in excess of what they are owed. Paragraph 15(a) of the Monitor's third report to the court values the collateral at $445 million. The evidence suggests that they are not the only secured creditor going unpaid. CAIL is asking that they be permitted to continue the restructuring process and their good faith efforts to attempt to reach an acceptable proposal with the Senior Secured Noteholders until the date of the creditors meeting, which is in three weeks. The Senior Secured Noteholders have not established that they will suffer any material prejudice in the intervening period.

31 The appointment of a receiver at this time would negate the effect of the order staying proceedings and thwart the purposes of the CCAA.

32 Accordingly, I am dismissing the application, with leave to reapply in the event that the Senior Secured Noteholders vote to reject the Plan on May 26, 2000.

33 An alternative to receivership raised by the Senior Secured Noteholders was interim payment for use of the security. The Monitor's third report makes it clear that the debtor's cash flow forecasts would not permit such payments.

34 The Senior Secured Noteholders suggested Air Canada could make the payments and, indeed, that Air Canada should pay out the debt owed to them by CAC. It is my view that, in the absence of abuse of the CCAA process, simply having a solvent entity financially supporting a plan with a view to ultimately obtaining an economic benefit for itself does not dictate that that entity should be required to pay creditors in full as requested. In my view, the evidence before me at this time does not suggest that the CCAA process is being improperly used. Rather, the evidence demonstrates these proceedings to be in furtherance of the objectives of the CCAA.

35 With respect to the application to sell shares or assets of Canadian Regional, this application raises a distinct issue in that Canadian Regional is not one of the debtor companies. In my view, Paragraph 5(a) of Chief Justice Moore's March 24, 2000 order encompasses marketing the shares or assets of Canadian Regional. That paragraph stays, inter alia:

> ...any and all proceedings ... against or in respect of ... any of the Petitioners' property ... whether held by the Petitioners directly or indirectly, as principal or nominee, beneficially or otherwise...

36 As noted above, Canadian Regional is CAC's subsidiary, and its shares and assets are the "property" of CAC and marketing of these would constitute a "proceeding ... in respect of ... the Petitioners' property" within the meaning of Paragraph 5(a) and Section 11 of the CCAA.

37 If I am incorrect in my interpretation of Paragraph 5(a), I rely on the inherent jurisdiction of the court in these proceedings.

38 As noted above, the CCAA is to be afforded a large and liberal interpretation. Two of the landmark decisions in this regard hail from Alberta: *Meridian Development Inc. v. Toronto Dominion Bank*, supra, and *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.). At least one court has also recognized an inherent jurisdiction in relation to the CCAA in order to grant stays in relation to proceedings against third parties: *Re Woodward's Ltd.* (1993), 17 C.B.R. (3d) 236 (B.C. S.C.). Tysoe J. urged that although this power should be used cautiously, a prerequisite to its use should not be an inability to otherwise complete the reorganization. Rather, what must be shown is that the exercise of the inherent jurisdiction is important to the reorganization process. The test described by Tysoe J. is consistent with the critical balancing that must occur in CCAA proceedings. He states:

> In deciding whether to exercise its inherent jurisdiction, the court should weigh the interests of the insolvent company against the interests of parties who will be affected by the exercise of the inherent jurisdiction. If, in relative terms, the prejudice to the affected party is greater than the benefit that will be achieved by the insolvent company, the court should decline to its inherent jurisdiction. The threshold of prejudice will be much lower than the threshold required to persuade the court that it should not exercise its discretion under Section 11 of the CCAA to grant or continue a stay that is prejudicial to a creditor of the insolvent company (or other party affected by the stay).

39 The balancing that I have described above in the context of the receivership application equally applies to this application. While the threshold of prejudice is lower, the Senior Secured Noteholders still fail to meet it. I cannot see that it is important to the CCAA proceedings that the Senior Secured Noteholders get started on marketing Canadian Regional. Instead, it would be disruptive and endanger the CCAA proceedings which, on the evidence before me, have progressed swiftly and in good faith.

40 The application in Action No. 0001-05044 is dismissed, also with leave to reapply after the vote on May 26, 2000.

41 I appreciate that the Senior Secured Noteholders will be disappointed and likely frustrated with the outcome of these applications. I would emphasize that on the evidence before me their rights are being postponed and not eradicated. Any hardship they experience at this time must yield to the greater hardship that the debtor companies and the other constituents would suffer were the stay to be lifted at this time.

Application dismissed.

TAB 8

[Indexed as: **Lehndorff General Partner Ltd., Re**]

Re Companies' Creditors Arrangement Act,
R.S.C. 1985, c. C-36;
Re Courts of Justice Act, R.S.O. 1990, c. C-43;
Re plan of compromise in respect of LEHNDORFF GENERAL PARTNER LTD. (in its own capacity and in its capacity as general partner of LEHNDORFF UNITED PROPERTIES (CANADA), LEHNDORFF PROPERTIES (CANADA) and LEHNDORFF PROPERTIES (CANADA) II) and in respect of certain of their nominees LEHNDORFF UNITED PROPERTIES (CANADA) LTD., LEHNDORFF CANADIAN HOLDINGS LTD., LEHNDORFF CANADIAN HOLDINGS II LTD., BAYTEMP PROPERTIES LIMITED and 102 BLOOR STREET WEST LIMITED and in respect of THG LEHNDORFF VERMÖGENSVERWALTUNG GMBH (in its capacity as limited partner of LEHNDORFF UNITED PROPERTIES (CANADA))

Ontario Court of Justice (General Division – Commercial List)
Farley J.

Heard – December 24, 1992.
Judgment – January 6, 1993.

Corporations – Arrangements and compromises – Companies' Creditors Arrangement Act – Stay of proceedings – Stay being granted even where it would affect non-applicants that were not companies within meaning of Act – Business operations of applicants and non-applicants being so intertwined as to make stay appropriate.

The applicant companies were involved in property development and management and sought the protection of the *Companies' Creditors Arrangement Act* ("CCAA") in order that they could present a plan of compromise. They also sought a stay of all proceedings against the individual company applicants either in their own capacities or because of their interest in a larger group of companies. Each of the applicant companies was insolvent and had outstanding debentures issued under trust deeds. They proposed a plan of compromise among themselves and the holders of the debentures as well as those others of their secured and unsecured creditors deemed appropriate in the circumstances.

A question arose as to whether the court had the power to grant a stay of proceedings against non-applicants that were not companies and, therefore, not within the express provisions of the CCAA.

Held – The application was allowed.

It was appropriate, given the significant financial intertwining of the applicant companies, that a consolidated plan be approved. Further, each of the applicant

companies had a realistic possibility of being able to continue operating even though each was currently unable to meet all of its expenses. This was precisely the sort of situation in which all of the creditors would likely benefit from the application of the CCAA and in which it was appropriate to grant an order staying proceedings.

The inherent power of the court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Clearly, the court had the jurisdiction to grant a stay in respect of any of the applicants that were companies fitting the criteria in the CCAA. However, the stay requested also involved limited partnerships where (1) the applicant companies acted on behalf of the limited partnerships, or (2) the stay would be effective against any proceedings taken by any party against the property assets and undertakings of the limited partnerships in which they held a direct interest. The business operations of the applicant companies were so intertwined with the limited partnerships that it would be impossible for a stay to be granted to the applicant companies that would affect their business without affecting the undivided interest of the limited partnerships in the business. As a result, it was just and reasonable to supplement s. 11 and grant the stay.

While the provisions of the CCAA allow for a cramdown of a creditor's claim, as well as the interest of any other person, anyone wishing to start or continue proceedings against the applicant companies could use the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain the stay. In such a motion, the onus would be on the applicant companies to show that it was appropriate in the circumstances to continue the stay.

Cases considered

Amirault Fish Co., Re, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) – referred to.

Associated Investors of Canada Ltd., Re, 67 C.B.R. (N.S.) 237, 56 Alta. L.R. (2d) 259, [1988] 2 W.W.R. 211, 38 B.L.R. 148, (sub nom. *Re First Investors Corp.*) 46 D.L.R. (4th) 669 (Q.B.), reversed (1988), 71 C.B.R. 71, 60 Alta. L.R. (2d) 242, 89 A.R. 344 (C.A.) – referred to.

Campeau v. Olympia & York Developments Ltd. (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) – referred to.

Canada Systems Group (EST) v. Allen-Dale Mutual Insurance Co. (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.) [affirmed (1983), 41 O.R. (2d) 135, 33 C.P.C. 210, 145 D.L.R. (3d) 266 (C.A.)] – referred to.

Empire-Universal Films Ltd. v. Rank, [1947] O.R. 775 (H.C.) – referred to.

Feifer v. Frame Manufacturing Corp., Re, 28 C.B.R. 124, [1947] Que. K.B. 348 (C.A.) – referred to.

Fine's Flowers Ltd. v. Fine's Flowers (Creditors of) (1992), 10 C.B.R. (3d) 87, 4 B.L.R. (2d) 293, 87 D.L.R. (4th) 391, 7 O.R. (3d) 193 (Gen. Div.) – referred to.

Gaz Métropolitain v. Wynden Canada Inc. (1982), 44 C.B.R. (N.S.) 285 (Que. S.C.) [affirmed (1982), 45 C.B.R. (N.S.) 11 (Que. C.A.)] – referred to.

Hongkong Bank of Canada v. Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84, [1991] 2 W.W.R. 136 (C.A.) – referred to.

Inducon Development Corp. Re (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) – referred to.

International Donut Corp. v. 050863 N.B. Ltd. (1992), 127 N.B.R. (2d) 290, 319 A.P.R. 290 (Q.B.) – considered.

Keppoch Development Ltd., Re (1991), 8 C.B.R. (3d) 95 (N.S. T.D.) – referred to.

Langley's Ltd., Re, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.) – referred to.

McCordic v. Bosanquet (1974), 5 O.R. (2d) 53 (H.C.) – referred to.

Meridian Developments Inc. v. Toronto Dominion Bank, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Q.B.) – referred to.

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 1 (Q.B.) – referred to.

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) – referred to.

Nova Metal Products Inc. v. Comiskey (Trustee of) (1990), 1 C.B.R. (3d) 101, (sub nom. *Elan Corp. v. Comiskey*) 41 O.A.C. 282, 1 O.R. (3d) 289 (C.A.) – referred to.

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.), affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.), leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 B.C.L.R. (2d) xxxiii (note), 135 N.R. 317 (note) – referred to.

Reference re Companies' Creditors Arrangement Act (Canada), [1934] S.C.R. 659, 16 C.B.R. 1, [1934] 4 D.L.R. 75 – referred to.

Seven Mile Dam Contractors v. R. (1979), 13 B.C.L.R. 137, 104 D.L.R. (3d) 274 (S.C.), affirmed (1980), 25 B.C.L.R. 183 (C.A.) – referred to.

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.) – referred to.

Slavik, Re (1992), 12 C.B.R. (3d) 157 (B.C. S.C.) – considered.

Stephanie's Fashions Ltd., Re (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) – referred to.

Ultracare Management Inc. v. Zevenberger (Trustee of) (1990), 3 C.B.R. (3d) 151, (sub nom. *Ultracare Management Inc. v. Gammon*) 1 O.R. (3d) 321 (Gen. Div.) – referred to.

United Maritime Fishermen Co-operative, Re (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.), varied on reconsideration (1988), 68 C.B.R. (N.S.) 170, 87 N.B.R. (2d) 333, 221 A.P.R. 333 (Q.B.), reversed (1988), 69 C.B.R. (N.S.) 161, 88 N.B.R. (2d) 253, 224 A.P.R. 253, (sub nom. *Cdn. Co-op. Leasing Services v. United Maritime Fishermen Co-op.*) 51 D.L.R. (4th) 618 (C.A.) – referred to.

Statutes considered

Bankruptcy Act, R.S.C. 1985, c. B-3 –
- s. 85
- s. 142

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 –
- preamble
- s. 2
- s. 3
- s. 4
- s. 5
- s. 6
- s. 7
- s. 8
- s. 11

Courts of Justice Act, R.S.O. 1990, c. C.43.

Judicature Act, The, R.S.O. 1937, c. 100.

Limited Partnerships Act, R.S.O. 1990, c. L.16 –
- s. 2(2)
- s. 3(1)
- s. 8
- s. 9

s. 11
s. 12(1)
s. 13
s. 15(2)
s. 24
Partnership Act, R.S.A. 1980, c. P-2 –
Pt. 2
s. 75

Rules considered
Ontario, Rules of Civil Procedure –
r. 8.01
r. 8.02

APPLICATION under *Companies' Creditors Arrangement Act* to file consolidated plan of compromise and for stay of proceedings.

Alfred Apps, Robert Harrison and *Melissa J. Kennedy*, for applicants.

L. Crozier, for Royal Bank of Canada.

R.C. Heintzman, for Bank of Montreal.

J. Hodgson, Susan Lundy and *James Hilton*, for Canada Trustco Mortgage Corporation.

Jay Schwartz, for Citibank Canada.

Stephen Golick, for Peat Marwick Thorne* Inc., proposed monitor.

John Teolis, for Fuji Bank Canada.

Robert Thorton, for certain of the advisory boards.

(Doc. B366/92)

1 January 6, 1993. FARLEY J.: – These are my written reasons relating to the relief granted the applicants on December 24, 1992 pursuant to their application under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("CCAA") and the *Courts of Justice Act*, R.S.O. 1990, c. C.43 ("CJA"). The relief sought was as follows:

(a) short service of the notice of application;

(b) a declaration that the applicants were companies to which the CCAA applies;

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*As amended by the court.

(c) authorization for the applicants to file a consolidated plan of compromise;

(d) authorization for the applicants to call meetings of their secured and unsecured creditors to approve the consolidated plan of compromise;

(e) a stay of all proceedings taken or that might be taken either in respect of the applicants in their own capacity or on account of their interest in Lehndorff United Properties (Canada) ("LUPC"), Lehndorff Properties (Canada) ("LPC") and Lehndorff Properties (Canada) II ("LPC II") and collectively (the "Limited Partnerships") whether as limited partner, as general partner or as registered titleholder to certain of their assets as bare trustee and nominee; and

(f) certain other ancillary relief.

2 The applicants are a number of companies within the larger Lehndorff group ("Group") which operates in Canada and elsewhere. The group appears to have suffered in the same way that a number of other property developers and managers which have also sought protection under the CCAA in recent years. The applicants are insolvent; they each have outstanding debentures issues under trust deeds; and they propose a plan of compromise among themselves and the holders of these debentures as well as those others of their secured and unsecured creditors as they deemed appropriate in the circumstances. Each applicant except THG Lehndorff Vermögensverwaltung GmbH ("GmbH") is an Ontario corporation. GmbH is a company incorporated under the laws of Germany. Each of the applicants has assets or does business in Canada. Therefore each is a "company" within the definition of s. 2 of the CCAA. The applicant Lehndorff General Partner Ltd. ("General Partner Company") is the sole general partner of the Limited Partnerships. The General Partner Company has sole control over the property and businesses of the Limited Partnerships. All major decisions concerning the applicants (and the Limited Partnerships) are made by management operating out of the Lehndorff Toronto Office. The applicants aside from the General Partner Company have as their sole purpose the holding of title to properties as bare trustee or nominee on behalf of the Limited Partnerships. LUPC is a limited partnership registered under the *Limited Partnership Act*, R.S.O. 1990, c. L.16 ("Ontario LPA"). LPC and LPC II are limited partnerships registered under Part 2 of the *Partnership Act*, R.S.A. 1980, c. P-2 ("Alberta PA") and each is registered in Ontario as an extra provincial limited partnership. LUPC has

over 2,000 beneficial limited partners, LPC over 500 and LPC II over 250, most of whom are residents of Germany. As at March 31, 1992 LUPC had outstanding indebtedness of approximately $370 million, LPC $45 million and LPC II $7 million. Not all of the members of the Group are making an application under the CCAA. Taken together the Group's indebtedness as to Canadian matters (including that of the applicants) was approximately $543 million. In the summer of 1992 various creditors (Canada Trustco Mortgage Company, Bank of Montreal, Royal Bank of Canada, Canadian Imperial Bank of Commerce and the Bank of Tokyo Canada) made demands for repayment of their loans. On November 6, 1992 Funtanua Investments Limited, a minor secured lendor also made a demand. An interim standstill agreement was worked out following a meeting of July 7, 1992. In conjunction with Peat Marwick Thorne Inc. which has been acting as an informal monitor to date and Fasken Campbell Godfrey the applicants have held multiple meetings with their senior secured creditors over the past half year and worked on a restructuring plan. The business affairs of the applicants (and the Limited Partnerships) are significantly intertwined as there are multiple instances of inter-corporate debt, cross-default provisions and guarantees and they operated a centralized cash management system.

3 This process has now evolved to a point where management has developed a consolidated restructuring plan which plan addresses the following issues:

(a) The compromise of existing conventional, term and operating indebtedness, both secured and unsecured.

(b) The restructuring of existing project financing commitments.

(c) New financing, by way of equity or subordinated debt.

(d) Elimination or reduction of certain overhead.

(e) Viability of existing businesses of entities in the Lehndorff Group.

(f) Restructuring of income flows from the limited partnerships.

(g) Disposition of further real property assets aside from those disposed of earlier in the process.

(h) Consolidation of entities in the Group; and

(i) Rationalization of the existing debt and security structure in the continuing entities in the Group.

Formal meetings of the beneficial limited partners of the Limited Partnerships are scheduled for January 20 and 21, 1993 in Germany and an information circular has been prepared and at the time of hearing was being translated into German. This application was brought on for hearing at this time for two general reasons: (a) it had now ripened to the stage of proceeding with what had been distilled out of the strategic and consultative meetings; and (b) there were creditors other than senior secured lenders who were in a position to enforce their rights against assets of some of the applicants (and Limited Partnerships) which if such enforcement did take place would result in an undermining of the overall plan. Notice of this hearing was given to various creditors: Barclays Bank of Canada, Barclays Bank PLC, Bank of Montreal, Citibank Canada, Canada Trustco Mortgage Corporation, Royal Trust Corporation of Canada, Royal Bank of Canada, the Bank of Tokyo Canada, Funtauna Investments Limited, Canadian Imperial Bank of Commerce, Fuji Bank Canada and First City Trust Company. In this respect the applicants have recognized that although the initial application under the CCAA may be made on an ex parte basis (s. 11 of the CCAA; *Re Langley's Ltd.*, [1938] O.R. 123, [1938] 3 D.L.R. 230 (C.A.); *Re Keppoch Development Ltd.* (1991), 8 C.B.R. (3d) 95 (N.S. T.D.). The court will be concerned when major creditors have not been alerted even in the most minimal fashion (*Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.) at p. 310). The application was either supported or not opposed.

4 "Instant" debentures are now well recognized and respected by the courts: see *Re United Maritime Fishermen Co-operative* (1988), 67 C.B.R. (N.S.) 44 (N.B. Q.B.), at pp. 55-56, varied on reconsideration (1988), 68 C.B.R. (N.S.) 170 (N.B. Q.B.), reversed on different grounds (1988), 69 C.B.R. (N.S.) 161 (N.B. C.A.), at pp. 165-166; *Re Stephanie's Fashions Ltd.* (1990), 1 C.B.R. (3d) 248 (B.C. S.C.) at pp. 250-251; *Nova Metal Products Inc. v. Comiskey (Trustee of)* (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 (C.A.) per Doherty J.A., dissenting on another point, at pp. 306-310 (O.R.); *Ultracare Management Inc. v. Zevenberger (Trustee of)* (sub nom. *Ultracare Management Inc. v. Gammon*) (1990), 1 O.R. (3d) 321 (Gen. Div.) at p. 327. The applicants would appear to me to have met the technical hurdle of s. 3 and as defined s. 2) of the CCAA in that they are debtor companies since they are insolvent, they have outstanding an issue of debentures under a trust deed and the compromise or arrangement that is proposed includes that compromise between the applicants and the holders of those trust

deed debentures. I am also satisfied that because of the significant intertwining of the applicants it would be appropriate to have a consolidated plan. I would also understand that this court (Ontario Court of Justice (General Division)) is the appropriate court to hear this application since all the applicants except GmbH have their head office or their chief place of business in Ontario and GmbH, although it does not have a place of business within Canada, does have assets located within Ontario.

5 The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors and the court. In the interim, a judge has great discretion under the CCAA to make order 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. See the preamble to and sections 4, 5, 6, 7, 8 and 11 of the CCAA; *Reference re Companies' Creditors Arrangement Act*, [1934] S.C.R. 659 at p. 661, 16 C.B.R. 1, [1934] 4 D.L.R. 75; *Meridian Developments Inc. v. Toronto Dominion Bank*, [1984] 5 W.W.R. 215 (Alta. Q.B.) at pp. 219-220; *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361 (Q.B.), at pp. 12-13 (C.B.R.); *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 2 C.B.R. (3d) 303 (B.C. C.A.), at pp. 310-311, affirming (1990), 2 C.B.R. (3d) 291, 47 B.C.L.R. (2d) 193 (S.C.), leave to appeal to S.C.C. dismissed (1991), 7 C.B.R. (3d) 164 (S.C.C.).; *Nova Metal Products Inc. v. Comiskey (Trustee of)*, supra, at p. 307 (O.R.); *Fine's Flowers v. Fine's Flowers (Creditors of)* (1992), 7 O.R. (3d) 193 (Gen. Div.), at p. 199 and "Reorganizations Under The Companies' Creditors Arrangement Act", Stanley E. Edwards (1947) 25 Can. Bar Rev. 587 at p. 592.

6 The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. see *Nova Metal Products Inc. v. Comiskey (Trustee of)*, supra at pp. 297 and 316; *Re Stephanie's Fashions Ltd.*, supra, at pp. 251-252 and *Ultracare Management Inc. v. Zevenberger (Trustee of)*, supra, at p. 328 and

p. 330. It has been held that the intention of the CCAA is to prevent any manoeuvres for positioning among the creditors during the period required to develop a plan and obtain approval of creditors. Such manoeuvres could give an aggressive creditor an advantage to the prejudice of others who are less aggressive and would undermine the company's financial position making it even less likely that the plan will succeed: see *Meridian Developments Inc. v. Toronto Dominion Bank*, supra, at p. 220 (W.W.R.). The possibility that one or more creditors may be prejudiced should not affect the court's exercise of its authority to grant a stay of proceedings under the CCAA because this affect is offset by the benefit to all creditors and to the company of facilitating a reorganization. The court's primary concerns under the CCAA must be for the debtor and *all* of the creditors: see *Quintette Coal Ltd. v. Nippon Steel Corp.*, supra, at pp. 108-110; *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (C.A.), at pp. 315-318 (C.B.R.) and *Re Stephanie's Fashions Ltd.*, supra, at pp. 251-252.

7 One of the purposes of the CCAA is to facilitate ongoing operations of a business where its assets have a greater value as part of an integrated system than individually. The CCAA facilitates reorganization of a company where the alternative, sale of the property piecemeal, is likely to yield far less satisfaction to the creditors. Unlike the *Bankruptcy Act*, R.S.C. 1985, c. B-3, before the amendments effective November 30, 1992 to transform it into the *Bankruptcy and Insolvency Act* ("BIA"), it is possible under the CCAA to bind secured creditors it has been generally speculated that the CCAA will be resorted to by companies that are generally larger and have a more complicated capital structure and that those companies which make an application under the BIA will be generally smaller and have a less complicated structure. Reorganization may include partial liquidation where it is intended as part of the process of a return to long term viability and profitability. See *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, supra, at p. 318 and *Re Associated Investors of Canada Ltd.* (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) at pp. 245, reversed on other grounds at (1988), 71 C.B.R. (N.S.) 71 (Alta. C.A.). It appears to me that the purpose of the CCAA is also to protect the interests of creditors and to enable an orderly distribution of the debtor company's affairs. This may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally. See *Re Associated Investors of Canada Ltd.*, supra, at p. 318; *Re Amirault Fish Co.*, 32 C.B.R. 186, [1951] 4 D.L.R. 203 (N.S. T.D.) at pp. 187-188 (C.B.R.).

8 It strikes me that each of the applicants in this case has a realistic possibility of being able to continue operating, although each is

currently unable to meet all of its expenses albeit on a reduced scale. This is precisely the sort of circumstance in which all of the creditors are likely to benefit from the application of the CCAA and in which it is appropriate to grant an order staying proceedings so as to allow the applicant to finalize preparation of and file a plan of compromise and arrangement.

9 Let me now review the aspect of the stay of proceedings. Section 11 of the CCAA provides as follows:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act*, whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (*c*) make an order that no suit, action or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

10 The power to grant a stay of proceeding should be construed broadly in order to permit the CCAA to accomplish its legislative purpose and in particular to enable continuance of the company seeking CCAA protection. The power to grant a stay therefore extends to a stay which affected the position not only of the company's secured and unsecured creditors, but also all non-creditors and other parties who could potentially jeopardize the success of the plan and thereby the continuance of the company. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.*, supra, at pp. 12-17 (C.B.R.) and *Quintette Coal Ltd. v. Nippon Steel Corp.*, supra, at pp. 296-298 (B.C. S.C.) and pp. 312-314 (B.C. C.A.) and *Meridian Developments Inc. v. Toronto Dominion Bank*, supra, at pp. 219 ff. Further the court has the power to order a stay that is effective in respect of the rights arising in favour of secured creditors under all forms of commercial security: see *Hongkong Bank of Canada v. Chef Ready Foods Ltd.*, supra, at p. 320 where Gibbs J.A. for the court stated:

> The trend which emerges from this sampling will be given effect here by holding that where the word "security" occurs in the C.C.A.A., it includes s. 178 security and, where the word creditor occurs, it includes a bank holding s. 178 security. To the extent that there may be conflict between the two statutes, therefore, the broad

scope of the C.C.A.A. prevails.

11 The power to grant a stay may also extend to preventing persons seeking to terminate or cancel executory contracts, including, without limitation agreements with the applying companies for the supply of goods or services, from doing so: see *Gaz Métropolitain v. Wynden Canada Inc.* (1982), 44 C.B.R. (N.S.) 285 (Que. S.C.) at pp. 290-291 and *Quintette Coal Ltd. v. Nippon Steel Corp.*, supra, at pp. 311-312 (B.C. C.A.). The stay may also extend to prevent a mortgagee from proceeding with foreclosure proceedings (see *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 141 (B.C. S.C.) or to prevent landlords from terminating leases, or otherwise enforcing their rights thereunder (see *Feifer v. Frame Manufacturing Corp.* (1947), 28 C.B.R. 124 (Que. C.A.)). Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318. The jurisdiction of the court to make orders under the CCAA in the interest of protecting the debtor company so as to enable it to prepare and file a plan is effective notwithstanding the terms of any contract or instrument to which the debtor company is a party. Section 8 of the CCAA provides:

> 8. This Act extends and does not limit the provisions of any instrument now or hereafter existing that governs the rights of creditors or any class of them and has full force and effect notwithstanding anything to the contrary contained in that instrument.

The power to grant a stay may also extend to prevent persons from exercising any right of set off in respect of the amounts owed by such a person to the debtor company, irrespective of whether the debtor company has commenced any action in respect of which the defense of set off might be formally asserted: see *Quintette Coal Ltd. v. Nippon Steel Corp.*, supra, at pp. 312-314 (B.C.C.A.).

12 It was submitted by the applicants that the power to grant a stay of proceedings may also extend to a stay of proceedings against non-applicants who are not companies and accordingly do not come within the express provisions of the CCAA. In support thereof they cited a CCAA order which was granted staying proceedings against individuals who guaranteed the obligations of a debtor-applicant which was a qualifying company under the terms of the CCAA: see *Re Slavik*, unreported, [1992] B.C.J. No. 341 [now reported at 12 C.B.R. (3d) 157 (B.C. S.C.)]. However in the *Slavik* situation the individual guarantors were officers and shareholders of two companies which had sought and obtained CCAA protection. Vickers J. in that case indicated that the facts of that case included the following unexplained and unamplified fact [at p. 159]:

> 5. The order provided further that all creditors of Norvik Timber Inc. be enjoined from making demand for payment upon that firm or upon any guarantor of an obligation of the firm until further order of the court.

The CCAA reorganization plan involved an assignment of the claims of the creditors to "Newco" in exchange for cash and shares. However the basis of the stay order originally granted was not set forth in this decision.

13 It appears to me that Dickson J. in *International Donut Corp. v. 050863 N.D. Ltd.*, unreported, [1992] N.B.J. No. 339 (N.B. Q.B.) [now reported at 127 N.B.R. (2d) 290, 319 A.P.R. 290] was focusing only on the stay arrangements of the CCAA when concerning a limited partnership situation he indicated [at p. 295 N.B.R.]:

> In August 1991 the limited partnership, through its general partner the plaintiff, applied to the Court under the *Companies' Creditors Arrangement Act*, R.S.C., c. C-36 for an order delaying the assertion of claims by creditors until an opportunity could be gained to work out with the numerous and sizable creditors a compromise of their claims. An order was obtained but it in due course expired without success having been achieved in arranging with creditors a compromise. *That effort may have been wasted, because it seems questionable that the federal Act could have any application to a limited partnership in circumstances such as these.* (Emphasis added.)

14 I am not persuaded that the words of s. 11 which are quite specific as relating as to a *company* can be enlarged to encompass something other than that. However it appears to me that Blair J. was clearly in the right channel in his analysis in *Campeau v. Olympia & York Developments Ltd.* unreported, [1992] O.J. No. 1946 [now reported at 14 C.B.R. (3d) 303 (Ont. Gen. Div.)] at pp. 4-7 [at pp. 308-310 C.B.R.].

> *The Power to Stay*
>
> The court has always had an inherent jurisdiction to grant a stay of proceedings whenever it is just and convenient to do so, in order to control its process or prevent an abuse of that process: see *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance Co.* (1982), 29 C.P.C. 60, 137 D.L.R. (3d) 287 (Ont. H.C.), and cases referred to therein. In the civil context, this general power is also embodied in the very broad terms of s. 106 of the *Courts of Justice Act*, R.S.O. 1990, c. C.43, which provides as follows:
>
> "106. A court, on its own initiative or on motion by any person, whether or not a party, may stay any proceeding in the court on such terms as are considered just."
>
> Recently, Mr. Justice O'Connell has observed that this discre-

tionary power is "highly dependent on the facts of each particular case": *Arab Monetary Fund v. Hashim* (unreported) [(June 25, 1992), Doc. 24127/88 (Ont. Gen. Div.)], [1992] O.J. No. 1330.

Apart from this inherent and general jurisdiction to stay proceedings, there are many instances where the court is specifically granted the power to stay in a particular context, by virtue of statute or under the *Rules of Civil Procedure*. The authority to prevent multiplicity of proceedings in the same court, under r. 6.01(1), is an example of the latter. The power to stay judicial and extra-judicial proceedings under s. 11 of the C.C.A.A., is an example of the former. Section 11 of the C.C.A.A. provides as follows.

The Power to Stay in the Context of C.C.A.A. Proceedings

By its formal title the C.C.A.A. is known as "An Act to facilitate compromises and arrangements between companies and their creditors". To ensure the effective nature of such a "facilitative" process it is essential that the debtor company be afforded a respite from the litigious and other rights being exercised by creditors, while it attempts to carry on as a going concern and to negotiate an acceptable corporate restructuring arrangement with such creditors.

In this respect it has been observed that the C.C.A.A. is "to be used as a practical and effective way of restructuring corporate indebtedness.": see the case comment following the report of *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.), and the approval of that remark as "a perceptive observation about the attitude of the courts" by Gibbs J.A. in *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A.) at p. 113 [B.C.L.R.].

Gibbs J.A. continued with this comment:

"To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is *a discretionary power to restrain judicial or extra-judicial conduct* against the debtor company *the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period.*" (emphasis added)

I agree with those sentiments and would simply add that, in my view, the restraining power extends as well to conduct which could seriously impair the debtor's ability to focus and concentrate its efforts on the business purpose of negotiating the compromise or arrangement. [In this respect, see also *Sairex GmbH v. Prudential Steel Ltd.* (1991), 8 C.B.R. (3d) 62 (Ont. Gen. Div.) at p. 77.]

I must have regard to these foregoing factors while I consider, as well, the general principles which have historically governed the court's exercise of its power to stay proceedings. These principles

> were reviewed by Mr. Justice Montgomery in *Canada Systems Group (EST) Ltd. v. Allendale Mutual Insurance*, supra (a "Mississauga Derailment" case), at pp. 65-66 [C.P.C.]. The balance of convenience must weigh significantly in favour of granting the stay, as a party's right to have access to the courts must not be lightly interfered with. The court must be satisfied that a continuance of the proceeding would serve as an injustice to the party seeking the stay, in the sense that it would be oppressive or vexatious or an abuse of the process of the court in some other way. The stay must not cause an injustice to the plaintiff.

It is quite clear from *Empire-Universal Films Limited v. Rank*, [1947] O.R. 775 (H.C.) that McRuer C.J.H.C. considered that *The Judicature Act* [R.S.O. 1937, c. 100] then [and now the CJA] merely confirmed a statutory right that previously had been considered inherent in the jurisdiction of the court with respect to its authority to grant a stay of proceedings. See also *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 (H.C.) and *Canada Systems Group (EST) Ltd. v. Allen-Dale Mutual Insurance Co.* (1982), 29 C.P.C. 60 (H.C.) at pp. 65-66.

15 Montgomery J. in *Canada Systems*, supra, at pp. 65-66 indicated:

> Goodman J. (as he then was) in *McCordic v. Bosanquet* (1974), 5 O.R. (2d) 53 in granting a stay reviewed the authorities and concluded that the inherent jurisdiction of the Court to grant a stay of proceedings may be made whenever it is just and reasonable to do so. "This court has ample jurisdiction to grant a stay whenever it is just and reasonable to do so." (Per Lord Denning M.R. in *Edmeades v. Thames Board Mills Ltd.*, [1969] 2 Q.B. 67 at 71, [1969] 2 All E.R. 127 (C.A.)). Lord Denning's decision in *Edmeades* was approved by Lord Justice Davies in *Lane v. Willis; Lane v. Beach (Executor of Estate of George William Willis)*, [1972] 1 All E.R. 430, [1972] 1 W.L.R. 326 (*sub nom. Lane v. Willis; Lane v. Beach*) (C.A.).
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> . . .
>
> In *Weight Watchers Int. Inc. v. Weight Watchers of Ont. Ltd.* (1972), 25 D.L.R. (3d) 419, 5 C.P.R. (2d) 122, appeal allowed by consent without costs (*sub nom. Weight Watchers of Ont. Ltd. v. Weight Watchers Inc. Inc.*) 42 D.L.R. (3d) 320n, 10 C.P.R. (2d) 96n (Fed. C.A.), Mr. Justice Heald on an application for stay said at p. 426 [25 D.L.R.]:
>
> "The principles which must govern in these matters are clearly stated in the case of *Empire Universal Films Ltd. et al. v. Rank et al.*, [1947] O.R. 775 at p. 779, as follows [quoting *St. Pierre et al. v. South American Stores (Gath & Chaves), Ltd. et al.*, [1936] 1 K.B. 382 at p. 398]:
>
> '(1.) A mere balance of convenience is not a sufficient ground for depriving a plaintiff of the advantages of prosecuting his action in an English Court if it is otherwise properly brought. The right of access

> to the King's Court must not be lightly refused. (2.) In order to justify a stay two conditions must be satisfied, one positive and the other negative: (a) the defendant must satisfy the Court that the continuance of the action would work an injustice because it would be oppressive or vexatious to him or would be an abuse of the process of the Court in some other way; and (b) the stay must not cause an injustice to the plaintiff. On both the burden of proof is on the defendant.' "

16 Thus it appears to me that the inherent power of this court to grant stays can be used to supplement s. 11 of the CCAA when it is just and reasonable to do so. Is it appropriate to do so in the circumstances? Clearly there is jurisdiction under s. 11 of the CCAA to grant a stay in respect of any of the applicants which are all companies which fit the criteria of the CCAA. However the stay requested also involved the limited partnerships to some degree either (i) with respect to the applicants acting on behalf of the Limited Partnerships or (ii) the stays being effective vis-à-vis any proceedings taken by any party against the property assets and undertaking of the Limited Partnerships in respect of which they hold a direct interest (collectively the "Property") as set out in the terms of the stay provisions of the order paragraphs 4 through 18 inclusive attached as an appendix to these reasons. [Appendix omitted.] I believe that an analysis of the operations of a limited partnership in this context would be beneficial to an understanding of how there is a close inter-relationship to the applicants involved in this CCAA proceedings and how the Limited Partnerships and their Property are an integral part of the operations previously conducted and the proposed restructuring.

17 A limited partnership is a creation of statute, consisting of one or more general partners and one or more limited partners. The limited partnership is an investment vehicle for passive investment by limited partners. It in essence combines the flow through concept of tax depreciation or credits available to "ordinary" partners under general partnership law with limited liability available to shareholders under corporate law. See Ontario LPA sections 2(2) and 3(1) and Lyle R. Hepburn, *Limited Partnerships*, (Toronto: De Boo, 1991), at p. 1-2 and p. 1-12. I would note here that the limited partnership provisions of the Alberta PA are roughly equivalent to those found in the Ontario LPA with the interesting side aspect that the Alberta legislation in s. 75 does allow for judgment against a limited partner to be charged against the limited partner's interest in the limited partnership. A general partner has all the rights and powers and is subject to all the restrictions and liabilities of a partner in a partnership. In particular a general partner is fully liable to each creditor of the business of the limited partnership. The general partner has sole control over the property and business of the limited partnership: see Ontario LPA

ss. 8 and 13. Limited partners have no liability to the creditors of the limited partnership's business; the limited partners' financial exposure is limited to their contribution. The limited partners do not have any "independent" ownership rights in the property of the limited partnership. The entitlement of the limited partners is limited to their contribution plus any profits thereon, after satisfaction of claims of the creditors. See Ontario LPA sections 9, 11, 12(1), 13, 15(2) and 24. The process of debtor and creditor relationships associated with the limited partnership's business are between the general partner and the creditors of the business. In the event of the creditors collecting on debt and enforcing security, the creditors can only look to the assets of the limited partnership together with the assets of the general partner including the general partner's interest in the limited partnership. This relationship is recognized under the *Bankruptcy Act* (now the BIA) sections 85 and 142.

18 A general partner is responsible to defend proceedings against the limited partnership in the firm name, so in procedural law and in practical effect, a proceeding against a limited partnership is a proceeding against the general partner. See Ontario *Rules of Civil Procedure*, O. Reg. 560/84, Rules 8.01 and 8.02.

19 It appears that the preponderance of case law supports the contention that contention that a partnership including a limited partnership is not a separate legal entity. See *Lindley on Partnership*, 15th ed. (London: Sweet & Maxwell, 1984), at pp. 33-35; *Seven Mile Dam Contractors v. R.* (1979), 13 B.C.L.R. 137 (S.C.), affirmed (1980), 25 B.C.L.R. 183 (C.A.) and "Extra-Provincial Liability of the Limited Partner", Brad A. Milne, (1985) 23 Alta. L. Rev. 345, at pp. 350-351. Milne in that article made the following observations:

> The preponderance of case law therefore supports the contention that a limited partnership is not a separate legal entity. It appears, nevertheless, that the distinction made in *Re Thorne* between partnerships and trade unions could not be applied to limited partnerships which, like trade unions, must rely on statute for their validity. The mere fact that limited partnerships owe their existence to the statutory provision is probably not sufficient to endow the limited partnership with the attribute of legal personality as suggested in *Ruzicks* unless it appeared that the Legislature clearly intended that the limited partnership should have a separate legal existence. A review of the various provincial statutes does not reveal any procedural advantages, rights or powers that are fundamentally different from those advantages enjoyed by ordinary partnerships. The legislation does not contain any provision resembling section 15 of the *Canada Business Corporation Act* [S.C. 1974-75, c. 33, as am.] which expressly states that a corporation has the capacity, both in and outside of Canada, of a natural person. It is therefore difficult to imagine that the Legislature intended to create a new category of legal entity.

20 It appears to me that the operations of a limited partnership in the ordinary course are that the limited partners take a completely passive role (they must or they will otherwise lose their limited liability protection which would have been their sole reason for choosing a limited partnership vehicle as opposed to an "ordinary" partnership vehicle). For a lively discussion of the question of "control" in a limited partnership as contrasted with shareholders in a corporation, see R. Flannigan, "The Control Test of Investor Liability in Limited Partnerships" (1983) 21 Alta. L. Rev. 303; E. Apps, "Limited Partnerships and the 'Control' Prohibition: Assessing the Liability of Limited Partners" (1991) 70 Can. Bar Rev. 611; R. Flannigan, "Limited Partner Liability: A Response" (1992) 71 Can. Bar Rev. 552. The limited partners leave the running of the business to the general partner and in that respect the care, custody and the maintenance of the property, assets and undertaking of the limited partnership in which the limited partners and the general partner hold an interest. The ownership of this limited partnership property, assets and undertaking is an undivided interest which cannot be segregated for the purpose of legal process. It seems to me that there must be afforded a protection of the whole since the applicants' individual interest therein cannot be segregated without in effect dissolving the partnership arrangement. The limited partners have two courses of action to take if they are dissatisfied with the general partner or the operation of the limited partnership as carried on by the general partner – the limited partners can vote to (a) remove the general partner and replace it with another or (b) dissolve the limited partnership. However Flannigan strongly argues that an unfettered right to remove the general partner would attach general liability for the limited partners (and especially as to the question of continued enjoyment of favourable tax deductions) so that it is prudent to provide this as a conditional right: *Control Test*, (1992), supra, at pp. 524-525. Since the applicants are being afforded the protection of a stay of proceedings in respect to allowing them time to advance a reorganization plan and complete it if the plan finds favour, there should be a stay of proceedings (vis-à-vis any action which the limited partners may wish to take as to replacement or dissolution) through the period of allowing the limited partners to vote on the reorganization plan itself.

21 It seems to me that using the inherent jurisdiction of this court to supplement the statutory stay provisions of s. 11 of the CCAA would be appropriate in the circumstances; it would be just and reasonable to do so. The business operations of the applicants are so intertwined with the limited partnerships that it would be impossible for relief as to a stay to be granted to the applicants which would affect their business without at the same time extending that stay to the

undivided interests of the limited partners in such. It also appears that the applicants are well on their way to presenting a reorganization plan for consideration and a vote; this is scheduled to happen within the month so there would not appear to be any significant time inconvenience to any person interested in pursuing proceedings. While it is true that the provisions of the CCAA allow for a cramdown of a creditor's claim (as well as an interest of any other person), those who wish to be able to initiate or continue proceedings against the applicants may utilize the comeback clause in the order to persuade the court that it would not be just and reasonable to maintain that particular stay. It seems to me that in such a comeback motion the onus would be upon the applicants to show that in the circumstances it was appropriate to continue the stay.

22 The order is therefore granted as to the relief requested including the proposed stay provisions.

Application allowed.

TAB 9

Case Name:

Smurfit-Stone Container Canada Inc. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
AND IN THE MATTER OF the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended
IN THE MATTER OF a plan of compromise or arrangement of Smurfit-Stone Container Canada Inc. and other applicants listed on Schedule "A"*

[2009] O.J. No. 4375

Court File No. CV-09-7966-00CL

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

October 20, 2009.

(29 paras.)

[Editor's note: Schedule "A" was not attached to the copy received by LexisNexis Canada and therefore is not included in the judgment.]

Bankruptcy and insolvency law -- Proceedings -- Parties -- Stays -- Pending concurrent proceedings -- Motion by fund managers for declaration of conflict of interest and direction to assign company into bankruptcy dismissed -- Company in question formed specifically for financing -- It and two operating companies, owned by same parent, obtained protection under CCAA -- Companies had overlapping directors and operators -- Company's only assets were debts owed and shares in other companies -- Moving parties alleged irreconcilable differences with other companies -- Motion premature since nature of claims not yet determined -- Granting motion and having company petitioned into bankruptcy would prejudice other companies and likely prevent them from emerging from CCAA proceedings.

Statutes, Regulations and Rules Cited:

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

Companies Act, s. 135

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 3(1)

US Bankruptcy Code,

Chapter 11 R

Counsel:

Kevin McElcheran and Heather Meredith for the Moving Parties.

Sean F. Dunphy and Alexander Rose for the Respondents/Applicants.

Robert J. Chadwick and Christopher G. Armstrong for the Monitor.

Kevin Zych for the Official Committee of Unsecured Creditors.

R. Thornton and S. Aggarwal for Manufacturers and Traders Trust Company as Indenture Trustee.

ENDORSEMENT

S.E. PEPALL J.:--

Relief Requested

1 Aurelius Capital Management, LP and Columbus Hill Capital Management, L.P. are Fund Managers for notes issued by Stone Container Finance Company of Canada II ("Finance II") in the amount of US$200 million. Amongst other things, they request an order declaring that the interests of Finance II and its creditors are adverse to those of Smurfit-Stone Container Enterprises Inc. ("Enterprises") and Smurfit-Stone Container Canada Inc. ("Smurfit Canada") and directing the officers and directors of Finance II to file an assignment in bankruptcy appointing a trustee in bankruptcy and discharging Deloitte & Touche Inc. as Monitor of Finance II. They are supported by the indenture trustee for the noteholders, Manufacturers and Traders Trust Company.

Facts

2 Finance II is an unlimited company formed under the laws of Nova Scotia and is a wholly owned subsidiary of Enterprises. Smurfit Canada, one of the two operating entities in Canada, is also a wholly owned subsidiary of Enterprises.

3 On January 26, 2009, Smurfit Canada, Finance II, Enterprises and others filed for relief pursuant to Chapter 11 of the U.S. Bankruptcy Code. Later that day, Smurfit Canada, Finance II and others (but not including Enterprises) (the "applicants") were granted CCAA protection.

4 Finance II is not an operating company and carries on no trade. It is a special purpose financing entity that is subject to a series of complementary agreements entered into in 2004 to facilitate tax efficient financing. That year, Finance II raised funds in the public debt market by issuing unsecured senior notes due in 2014 in the principal amount of US$200 million. The notes are guaranteed by Enterprises.

5 Finance II then lent the proceeds to Smurfit Canada pursuant to an intercompany loan agreement dated July 20, 2004. The loan is unsecured. The obligation to pay interest on the loan is satis-

fied by the issuance of class C shares of Smurfit Canada to Finance II. The loan agreement states that on an event of default such as the adjudication of insolvency by the borrower, Smurfit Canada, Finance II as the lender "may exercise any and all of its rights and recourses under this agreement, provided, however, that the Borrower shall perform its obligations in this regard hereunder by the issuance to the Lender of Class B shares having a value no less than the dividend or other amount that otherwise would be received by the Lender".

6 According to the affidavit filed by the moving parties, this intercompany loan was not publicly disclosed. The prospectus pursuant to which the notes were issued confirms that Finance II has no significant assets and will depend on the guarantor to make all payments under the notes. As the sole shareholder of Finance II, Enterprises may have an obligation pursuant to section 135 of the *Companies' Act* (Nova Scotia) to contribute amounts sufficient to satisfy all creditor claims against Finance II in the event of a winding up of Finance II.

7 The assets of Finance II are:

(a) a claim against Smurfit Canada for approximately US$200 million;
(b) a claim against Smurfit Canada relating to 68,413 Class C Shares of Smurfit Canada; and
(c) a claim against Enterprises for contribution pursuant to the provisions of the Companies' Act (Nova Scotia).

8 The only disclosed obligations of Finance II at the date of filing were:

(a) the US$200 million plus accrued interest owing under the notes to the holders of the notes;
(b) an intercompany note of approximately US$66.1 million owed to Enterprises for funds advanced to Finance II to enable it to pay interest on the notes; and
(c) unspecified income tax obligations.

9 Finance II is a guarantor of the DIP facility but is not a borrower under that facility nor did it receive any proceeds under it.

10 The creditors of Finance II are the noteholders and possibly the federal government for unspecified income tax obligations. The only other disclosed creditor of Finance II as of the filing date was the sole shareholder of Finance II, Enterprises. The moving parties hold approximately 61.3% of the principal amount due on the notes. The moving parties state that they are veto creditors with respect to Finance II, or put differently, Finance II cannot implement a plan of arrangement without their affirmative vote.

11 Finance II and Smurfit Canada have overlapping directors and officers and are represented by the same counsel. The moving parties' concerns have been raised with the respondents but only in the context of requesting cooperation and document production.

12 The CCAA and Chapter 11 proceedings are obviously ongoing. The applicants have worked diligently to stabilize their operations and have engaged in a number of restructuring efforts including negotiating the sale of non-core assets and engaging in ongoing discussions regarding their potential tax liabilities with taxation authorities at the federal and provincial government levels. At this stage, a claims procedure in the CCAA and Chapter 11 proceedings has been implemented. Both

court orders treat intercompany claims as excluded claims for claims bar date purposes. Therefore, Finance II was not required to file any claim prior to the claims bar date. The applicants have presented an operational plan and preliminary plan of reorganization term sheet to the Official Committee of Unsecured Creditors ("UCC"). The indenture trustee is an ex officio member of the UCC in the US bankruptcy proceedings which in turn has standing in the CCAA proceedings by virtue of the court ordered protocol.

13 A stay was imposed as part of the Initial Order dated January 26, 2009 and there have been subsequent extensions of the stay. When the applicants were seeking an extension of the stay to December 24, 2009 and the moving parties were scheduling this motion, it was agreed that any extension of the stay was without prejudice to the rights and interests of the moving parties on this motion.

Issues

14 There are two issues to consider. Is there a conflict of interest that merits relief being granted and should the stay be lifted to appoint a trustee in bankruptcy with respect to Finance II?

Positions of Parties

15 In brief, the moving parties take the position that the Monitor, the directors of Finance II and counsel for the applicants are in a position of irreconcilable conflict the result of which is that no one is in a position to advance the interests of Finance II in the CCAA or the Chapter 11 proceedings. The interests of Finance II and the noteholders are to ensure that Finance II obtains maximum recovery from Smurfit Canada and from Enterprises and as such, Finance II is adverse in interest to those entities. The recovery of the noteholders is entirely dependent on Finance II's recovery from Smurfit Canada and Enterprises in their plans of arrangement or reorganization. The problems are compounded because there are overlapping directors and officers amongst Finance II, Smurfit Canada and Enterprises; they are represented by the same counsel; and are under the oversight of the same court Monitor as Smurfit Canada. The moving parties submit that there are conflicting fiduciary duties and there is a need for someone to advance the interests of Finance II. They argue that causing the directors and officers to make an assignment into bankruptcy will eliminate the conflict issues because such a procedure requires a bankruptcy trustee to be installed. The trustee, being an independent court officer, could assert and negotiate the claims on behalf of Finance II. In addition, the contribution claim against Enterprises would be crystallized. The assignment in bankruptcy would not impair the restructuring proceedings because while a guarantor of the DIP facility, Finance II was not an operating company and its only assets were claims against the other applicants and the contribution claim against Enterprises.

16 The indenture trustee supports the moving parties on this motion.

17 The respondents are opposed to the motion. They take the position that there is no conflict of interest and the nature of Finance II's claim has not been determined. Furthermore, one should not presume that the plan is doomed to fail. They submit that appointment of a trustee in bankruptcy is premature and significantly there would be real prejudice to the applicants in that a bankruptcy of Finance II would constitute an event of default under the DIP facility. In contrast, the prejudice to the noteholders is speculative. Furthermore, Finance II's claims are preserved and those having an economic interest will have input either before or after the plan is tabled. In addition, the indenture trustee is an ex officio member of the UCC and the noteholders are represented by those entities.

18 The Official Committee of Unsecured Creditors is also opposed to the motion.

19 The Monitor supports the position of the respondents.

Discussion

20 It is not unusual for restructurings to involve consolidated plans that address intercompany claims. Indeed, section 3(1) of the CCAA contemplates group filings. By their nature, these often involve intercompany claims. In its seventh report, the Monitor notes: "It is common in large, integrated, cross-border reorganizations for CCAA and Chapter 11 proceedings to be dealt with on a consolidated basis with a single CCAA Monitor appointed by the Court to oversee all aspects of the reorganization of an integrated group for the benefit of all stakeholders of the Canadian debtors. These restructurings will invariably include certain intercompany claims and interests which are addressed in a consolidated plan or plans."

21 The moving parties acknowledge in their factum that intercompany debts are often found in CCAA proceedings. Consistent with that fact, in the various pieces of correspondence that predated this motion, the moving parties never asked counsel for the applicants to remove themselves from the record nor did they make such a suggestion to the Monitor. Conflicts are frequently found in CCAA proceedings particularly those involving corporate groups. If one were to insist on independent counsel and an independent court officer for every instance of perceived conflict of interest, restructuring proceedings of corporate groups would become completely unwieldy and unproductive. On the other hand, there may be instances of conflicts of interest that should be addressed. The court should adopt a case by case analysis to ascertain whether there is a conflict of interest that merits the granting of relief.

22 In this case before me, there is a real issue as to whether Finance II's claims constitute debt or equity and it is unclear that Finance II has a claim entitling it to vote on any plan. This issue could be addressed in the plan itself or beforehand by way of a motion. No determination of the nature of Finance II's claims has been made yet. As such, the declaratory relief requested is premature. In the meantime, Finance II's assets consist of its intercompany claims and its ability to assert those claims has been preserved. There is no evidence that the applicants are not working on a plan in good faith for the benefit of all stakeholders including Finance II and the noteholders or that the interests of Finance II and the noteholders are not being taken into account. Indeed, there is no evidence of any breach of any duty by any of the impugned parties.

23 Even if I am wrong in this regard, I would not lift the stay of proceedings imposed in the Initial Order so that Finance II may be assigned into bankruptcy. In exercising discretion to lift the stay, the court should balance the interests of the creditors and debtors and consider the prejudice that may be suffered by each: *Re Canadian Airlines Corp.* The court should also be mindful of the purposes underlying the CCAA and their application to the facts of the case. The former are described by Gibbs J.A. in *Hongkong Bank v. Chef Ready Foods, [1990] B.C.J. No. 2384:*

> "The purpose of the CCAA is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to remain in business ... When a company has recourse to the CCAA the court is called upon to play a kind of supervisory role to preserve the status quo and to move the process along to the point where a compromise or arrangement is approved or it is evident that the attempt is doomed to failure. Ob-

> viously, time is critical. Equally obviously, if the attempt at compromise or arrangement is to have any prospect of success there must be a means of holding the creditors at bay, hence the powers vested in the court under s. 11."

24 The goals of the CCAA apply not only to individual companies but to interdependent corporate groups operating as a single enterprise, particularly when the treatment of the corporate group as an integrated system will result in greater value. The court may consider the implications of the corporate group's reorganization efforts as a whole: *Re SemCanada Crude Co.* and *Re Calpine Canada Energy Ltd.*

25 In my view and keeping these principles in mind, the stay should not be lifted at this time. There is real prejudice to the applicants in that a bankruptcy of Finance II would constitute an event of default under the DIP facility and could upset the applicants' ability to emerge successfully from CCAA protection. An event of default allows for termination of the commitments under the DIP facility and a declaration that outstanding amounts are due and payable. The applicants rely on the DIP facility and forecast draws of $29.4 million during the next three months.

26 Counsel for the moving parties advance seven reasons in support of their position that a bankruptcy is unlikely to cause any prejudice and they are outlined in their factum. They complain that Finance II should never have been a guarantor of the DIP loan; there is no reason to assume the DIP lenders will accelerate the loan or enforce the security; the guarantee of Finance II adds no incremental value; supervision of the restructuring should not be delegated to the DIP lenders; the applicants should seek a default waiver from the DIP lenders or refinance or repay the DIP loan. In argument counsel for the moving parties also noted the absence of counsel for the DIP lender and asked that I infer from such absence that the default under the DIP facility would be of no consequence.

27 While one may argue that Finance II should not have been a party to the DIP loan agreement, it is and certain remedies flow in the event of a default. There is no certainty that the DIP lenders would enforce the agreement but there is some risk and the absence of their counsel at the motion does not serve to eliminate that risk. While I agree that a DIP loan agreement should not be the only driver in CCAA proceedings, it is a factor to consider. Even if one were to disregard its significance, as stated by the Monitor, assigning Finance II into bankruptcy would disrupt the consolidated, cross-border restructuring efforts being undertaken. I agree with the Monitor that such a disruption is not warranted at this stage of the proceedings. In addition, the bankruptcy could upset the applicants' tax structure. There would also be the administrative burden and expense associated with the appointment of a trustee in bankruptcy and likely delay.

28 In my view the potential prejudice to the applicants outweighs that to the moving parties. Accordingly, I am dismissing the request to have Finance II assigned into bankruptcy.

29 I have no doubt that the Monitor will attend not just to the interests of the group of stakeholders but to the needs of individual creditors as well. That said, even though I am dismissing the remedy requested by the moving parties, I do accept that there is some basis to their complaint of a need for "a seat at the table". During argument, counsel for the applicants and the indenture trustee raised different means of addressing this problem. Both the applicants and the moving parties indicated that the characterization of Finance II's claims is a threshold issue. Stakeholders should with some dispatch turn their minds to an appropriate process to address that issue. If counsel require any

assistance or further direction from the court in this regard, they may arrange for a 9:30 appointment before me.

S.E. PEPALL J.

cp/e/qllqs/qljxr/qlaxr/qlaxw

TAB 10

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

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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

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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);

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[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 subparas. 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.

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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

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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 11

[Indexed as: **San Francisco Gifts Ltd., Re**]

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OFSAN FRANCISCO GIFTS LTD. ("SAN FRANCISCO"), SAN FRANCISCO RETAIL GIFTS INCORPORATED (PREVIOUSLY CALLED SAN FRANCISCO GIFTS INCORPORATED), SAN FRANCISCO GIFT STORES LIMITED, SAN FRANCISCO GIFTS (ATLANTIC) LIMITED, SAN FRANCISCO STORES LTD., SAN FRANCISCO GIFTS & NOVELTIES INC., SAN FRANCISCO GIFTS & NOVELTY MERCHANDISING CORPORATION (PREVIOUSLY CALLED SAN FRANCISCO GIFTS AND NOVELTY CORPORATION), SAN FRANCISCO (THE ROCK) LTD. (PREVIOUSLY CALLED SAN FRANCISCO NEWFOUNDLAND LTD.) and SAN FRANCISCO RETAIL GIFTS & NOVELTIES LIMITED (PREVIOUSLY CALLED SAN FRANCISCO GIFTS & NOVELTIES LIMITED) (COLLECTIVELY "THE COMPANIES")

Alberta Court of Queen's Bench

Topolniski J.

Heard: September 1, 2004

Judgment: September 28, 2004*

Docket: Edmonton 0403-00170, 2004 ABQB 705

Richard T.G. Reeson, Q.C., Howard J. Sniderman for Companies

Jeremy H. Hockin for Oxford Properties Group Inc., Ivanhoe Cambridge 1 Inc., 20 Vic Management Ltd., Morguard Investments Ltd. Morguard Investments Ltd, Morguard Real Estate Investments Trust, RioCan Property Services, 1113443 Ontario Inc. (the "Objecting Landlords")

Michael J. McCabe, Q.C. for Monitor

Bankruptcy and insolvency —— Proposal — Companies' Creditors Arrangement Act — Miscellaneous issues —— SF group of companies (SF group) obtained protection under Companies' Creditors Arrangement Act under consolidated initial order — SF group was comprised of operating company and number of nominee companies — Operating company held all of SF group's assets while nominee companies were shells with sole purpose of leasing retail premises from landlords — Operating company was owned

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*Leave to appeal refused *San Francisco Gifts Ltd., Re* (2004), 2004 ABCA 386, 2004 CarswellAlta 1607 (Alta. C.A.).

100 percent by L Corp. which was owned by S — S was president and sole director of virtually all companies in SF group — L Corp. and S were only secured creditors of SF group — Landlords' leases had been either abandoned by SF group before proceedings under Act began or later terminated with court approval — SF group's plan of arrangement proposed various classes of creditors for voting purposes — Plan placed all non-governmental unsecured creditors, including landlords, into one class for purposes of voting on plan — Plan provided that S and L Corp.'s claims would survive reorganization — Landlords brought application for reclassification of creditors for purposes of voting on plan — Creditors were not reclassified but plan was amended — Landlords were not entitled to separate class of creditors simply due to fact that they were landlords — Sufficient evidence that landlords' claims were materially different from claims of other creditors in class was required to warrant separate class for landlords — Landlords' rights to distraint and cause of action against third parties for aiding in clandestine removal of goods from leased premises were unique — Uniqueness of rights was not, in and of itself, sufficient to justify separate class for landlords — Loss of right to follow and seize removed goods cannot support order for separate class for landlords since landlords did not pursue this time-limited remedy — Landlords established arguable case that landlords had claim for damages from clandestine removal of goods from leased premises — Despite that landlords' right to claim damages against third parties for aiding in clandestine removal was not adequately addressed in plan, creation of separate class for landlords was not viable option — Plan was to be amended to preserve cause of action rather than creation of separate class — Contractual right of landlords to terminate leases in event of tenant's insolvency was neither unique nor of any practical effect since leases were already terminated — Landlords' right to terminate was not sufficient ground for creation of separate voting class for landlords — Mechanism to value landlords' claims in claims procedure order negated landlords' arguments that separate class was needed since their claims were difficult to value — Preferential treatment of S and L Corp. under plan did not justify segregation of landlords since S and L Corp. required separate class due to lack of commonality of interest with other unsecured creditors.

Cases considered by *Topolniski J.*:

Alternative Fuel Systems Inc., Re (2004), 2004 ABCA 31, 2004 CarswellAlta 64, (sub nom. *Remington Development Corp. v. Alternative Fuel Systems Inc.)* 346 A.R. 28, (sub nom. *Remington Development Corp. v. Alternative Fuel Systems Inc.)* 320 W.A.C. 28, 24 Alta. L.R. (4th) 1, [2004] 5 W.W.R. 475, 47 C.B.R. (4th) 1, 236 D.L.R. (4th) 155 (Alta. C.A.) — considered

Armbro Enterprises Inc., Re (1993), 22 C.B.R. (3d) 80, 1993 CarswellOnt 241 (Ont. Bktcy.) — considered

Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd. (1982), 37 Nfld. & P.E.I.R. 259, 104 A.P.R. 259, 137 D.L.R. (3d) 320, 1982 CarswellNfld 90 (Nfld. T.D.) — referred to

Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd. (1983), 43 Nfld. & P.E.I.R. 158, 127 A.P.R. 158, 3 D.L.R. (4th) 704, 1983 CarswellNfld 68 (Nfld. C.A.) — referred to

Canadian Airlines Corp., Re (2000), 2000 CarswellAlta 623, 19 C.B.R. (4th) 12 (Alta. Q.B.) — distinguished

Canadian Airlines Corp., Re (2000), 2000 ABCA 149, 2000 CarswellAlta 503, 80 Alta. L.R. (3d) 213, 19 C.B.R. (4th) 33, 261 A.R. 120, 225 W.A.C. 120, [2000] A.J. No. 610 (Alta. C.A. [In Chambers]) — referred to

Dairy Corp. of Canada, Re (1934), [1934] O.R. 436, [1934] 3 D.L.R. 347, 1934 CarswellOnt 33 (Ont. C.A.) — referred to

Fairview Industries Ltd., Re (1991), 11 C.B.R. (3d) 71, (sub nom. *Fairview Industries Ltd., Re (No. 3))* 109 N.S.R. (2d) 32, (sub nom. *Fairview Industries Ltd., Re (No. 3))* 297 A.P.R. 32, 1991 CarswellNS 36 (N.S. T.D.) — referred to

Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce (1992), 11 C.B.R. (3d) 161, 90 D.L.R. (4th) 285, 1992 CarswellOnt 164 (Ont. Gen. Div.) — not followed

Highway Properties Ltd. v. Kelly, Douglas & Co. (1971), [1971] S.C.R. 562, [1972] 2 W.W.R. 28, 17 D.L.R. (3d) 710, 1971 CarswellBC 239, 1971 CarswellBC 274 (S.C.C.) — referred to

Jackpine Forest Products Ltd., Re (2004), 2004 BCSC 20, 2004 CarswellBC 87, 27 B.C.L.R. (4th) 332, 47 C.P.C. (5th) 313, 49 C.B.R. (4th) 110 (B.C. S.C.) — referred to

Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566, 72 C.B.R. (N.S.) 20, 1988 CarswellAlta 319 (Alta. Q.B.) — considered

Northland Properties Ltd., Re (1988), 31 B.C.L.R. (2d) 35, 73 C.B.R. (N.S.) 166, 1988 CarswellBC 556 (B.C. S.C.) — considered

Olympia & York Developments Ltd., Re (March 14, 1994), Doc. B125/92, [1994] O.J. No. 1335 (Ont. Gen. Div. [Commercial List]) — referred to

Playdium Entertainment Corp., Re (2001), 2001 CarswellOnt 4109, 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]) — considered

Sammi Atlas Inc., Re (1998), 1998 CarswellOnt 1145, 3 C.B.R. (4th) 171, [1998] O.J. No. 1089 (Ont. Gen. Div. [Commercial List]) — referred to

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia (1991), 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621, 1991 CarswellOnt 220 (Ont. Gen. Div.) — considered

Smoky River Coal Ltd., Re (1999), 1999 CarswellAlta 491, 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94, 1999 ABCA 179, (sub nom. *Luscar Ltd. v. Smoky River Coal Ltd.)* [1999] A.J. No. 676 (Alta. C.A.) — referred to

Sovereign Life Assurance Co. v. Dodd (1892), [1891-94] All E.R. Rep. 246, [1892] 2 Q.B. 573 (Eng. C.A.) — considered

Wellington Building Corp., Re (1934), 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626, 1934 CarswellOnt 103 (Ont. S.C.) — referred to

Woodward's Ltd., Re (1993), 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206, 1993 CarswellBC 555 (B.C. S.C.) — considered

Statutes considered:

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

Generally — referred to

s. 4 — referred to

s. 4(3)(c) — referred to

s. 54(3) — referred to

Commercial Tenancies Act, R.S.O. 1990, c. L.7
Generally — referred to
ss. 48-50 — referred to
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to
s. 2 — referred to
s. 6 — referred to
Distress for Rent Act, 1737, (U.K.), 11 Geo. 2, c. 19
Generally — referred to
s. 1 — referred to
Landlord and Tenant Act, R.S.N.B. 1973, c. L-1
Generally — referred to
s. 27 — referred to
s. 29 — referred to
Tenancies and Distress for Rent Act, R.S.N.S. 1989, c. 464
Generally — referred to
s. 13 — referred to
s. 14 — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 390/68
Generally — referred to

Tariffs considered:

Alberta Rules of Court, Alta. Reg. 390/68
Sched. C, Tariff of Costs, column 1 — referred to

APPLICATION by landlords for order reclassifying creditors for purposes of voting on plan of arrangement under *Companies' Creditors Arrangement Act*.

***Topolniski J.*:**

Introduction

1 The San Francisco group of companies (San Francisco) obtained *Companies' Creditors Arrangement Act*[1] (*CCAA*) protection on January 7, 2004 under a consolidated Initial Order. The Initial Order has been extended and the companies continue in business. They now propose a compromise of their debt that is spelled out in a plan of arrangement ("Plan") that has been circulated to their creditors. Like all *CCAA* plans of arrangement, this Plan proposes classes of creditors for voting purposes. Two-thirds in value and a majority in number of the creditors in each class must cast a positive vote for the Plan in order for it to pass muster. If approved, the Plan will then be presented to the Court for sanc-

[1] R.S.A. 1985, c. C-36, as am.

tioning at what is commonly referred to as a "fairness hearing".[2] These steps have been delayed by the present application.

2 The six applicants are landlords (the "objecting landlords") of retail premises in Ontario, New Brunswick, Nova Scotia and Newfoundland that were leased to San Francisco. The leases were either abandoned by San Francisco before the *CCAA* proceedings began or were later terminated with court approval. The objecting landlords seek to reclassify the creditors of San Francisco for purposes of voting on the Plan. They rely on three grounds for their application. First, they argue that they should be placed in a separate class because they have distinct legal rights, their claims are difficult to value and they are preferred over other creditors in the class. Second, they believe that their reclassification is warranted as a result of inequitable treatment of certain creditors under the Plan. Third, they seek to ban closely related creditors, or "related persons", as that phrase is defined in s. 4 of the *Bankruptcy and Insolvency Act*[3] (*BIA*), from voting on the Plan at all. They submit that, at the very least, related persons should be placed in a separate class to prevent them from controlling the creditor vote.

Background

3 San Francisco operates a national chain of novelty goods stores. It currently has 450 employees working from 84 locations. The head office is in Edmonton, Alberta.

4 The group of companies is comprised of the operating company San Francisco Gifts Ltd., and a number of nominee companies. The operating company, which is 100 percent owned by Laurier Investments Corp. ("Laurier"), holds all of the group's assets. In turn, Laurier is 100 percent owned by Barry Slawsky ("Slawsky"), the driving force behind the companies. He is the president and sole director of virtually all of the companies, and is one of the companies' two secured creditors, the other being Laurier. The nominee companies are hollow shells incorporated for the sole purpose of leasing premises.

5 The Monitor reports that the reviews by its counsel of Slawsky and Laurier's security documents "do not indicate any deficiencies in the security position" and that the combined book value of their loans to the companies is $9,767,000.00. San Francisco's debt at the date of the Initial Order was $5,300,000.00, not including any unsecured deficiency claims by the secured creditors. There are 1183 creditors in total.

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[2]The considerations at this hearing are typically whether there has been strict compliance with statutory requirements, whether any unauthorized acts have occurred, and whether the plan is fair and reasonable: see *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]).

[3]R.S.C. 1985, c. B-3, as am.

6 Like many consolidated *CCAA* plans of arrangement, this Plan contemplates the compromise of all of the participant companies' debts from one pool of assets. The Plan places all non-governmental unsecured creditors into one class and proposes a compromise payment of roughly $.10 on the dollar by dividing $500,000 between all unsecured creditors in this class on a *pro rata* basis, after payment of the first $200.00 of each proven claim. The Plan also provides that Slawsky and Laurier's claims will survive the reorganization. They are defined in the Plan as "unaffected creditors" who will not share in the payment to creditors. They may, however, value their security and vote as unsecured creditors for their deficiency claims.

7 There is little common ground between the parties on this application, except for their ready recognition that a separate landlords' class will secure its members the power to veto the creditor vote.

Analysis

Classification of Creditors Generally

8 The *CCAA* does not direct how creditors should be classified for voting purposes. It does nothing more than define what a secured versus an unsecured creditor is[4] and specify that a plan of arrangement must be approved by the various classes of creditors affected by it.[5] However, a "commonality of interest" test and well-defined guidelines for classification have been set out in the case law.

9 In *Sovereign Life Assurance Co. v. Dodd*,[6] Lord Esher M.R. articulated the rationale for the commonality of interest test:

> ...It seems plain that we must give such a meaning to the term "class" that will prevent the section being so worked as to prevent a confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

10 The objecting landlords focus their argument on the two themes in this passage: the need for meaningful consultation between class members, something the objecting landlords say will not occur because their rights are different from other creditors in the proposed class; and avoidance of injustice by "confiscation of rights", something the objecting landlords say is preordained if there is no reclassification.

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[4] *CCAA*, s. 2.

[5] *CCAA*, s. 6.

[6] *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (Eng. C.A.), at 583.

11 The commonality of interest test has evolved over time and now involves application of the following guidelines that were neatly summarized by Paperny J. (as she then was) in *Canadian Airlines Corp., Re* ("*Canadian Airlines*")[7]:

1. Commonality of interest should be viewed based on the non-fragmentation test,[8] not on an identity of interest test.
2. The interests to be considered are the legal interests that a creditor holds *qua* creditor in relationship to the debtor prior to and under the Plan as well as on liquidation.
3. The commonality of interests should be viewed purposively, bearing in mind that the object of the *CCAA*, namely to facilitate reorganizations if possible.
4. In placing a broad and purposive interpretation on the *CCAA*, the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans.
5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.
6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the Plan in a similar manner.

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[7] *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), leave to appeal denied (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]), cited in the Court of Appeal's subsequent decision in *Canadian Airlines Corp., Re* (2000), 261 A.R. 120, 2000 ABCA 149 (Alta. C.A. [In Chambers]) at para. 27: see also *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Gen. Div.)).

[8] "Non-fragmentation" means that a multiplicity of classes should be avoided if possible. The notion was first expressed in the Canadian context in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.), but does not appear to have gained wide acceptance until 1993 when *Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74 (B.C. S.C.), at 81 was decided. There were five creditor groups in *Woodward's Ltd., Re*, including one group of landlords of abandoned premises and another of creditors holding cross-corporate guarantees or joint covenants, which sought separate classes. The court ruled that, given there was sufficient commonality of interest among the general body of creditors and the applicant landlords, a separate class was unwarranted. Tysoe J. rejected the landlords' proposition that their legal interests differed from that of the other creditors in that repudiation of an anchor tenant's lease would cause the landlord to be in breach of other tenant obligations. He did, however, order a separate class for the holders of cross-corporate guarantees, observing that their unique rights were "confiscated without compensation" under the plan. Interestingly, Tysoe J. rejected the suggestion that the issue be dealt with at the fairness hearing because he was convinced that the scheme was so unfair that he would refuse to sanction a successful outcome, rendering the creditors' vote pointless.

12 To this pithy list, I would add the following considerations:

(i) Since the *CCAA* is to be given a liberal and flexible interpretation, classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application.[9]

(ii) In determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of the plan.[10]

Landlord Classifications Generally

13 The objecting landlords rely on the affidavit of Walter R. Stevenson, a Toronto lawyer who acts for them. I find it odd that counsel for a party would swear an affidavit in support of his client's motion. It is a risky proposition that is strongly discouraged in this Court. In any event, Mr. Stevenson deposes that he has thirteen years of experience representing clients in insolvency matters. He says that he has been involved in nine cases where national tenants abandoned leased premises and their landlords were placed in a separate class. Presumably, all of this information was intended to persuade me that a separate landlord class is now or should be the norm. It does not.

14 Mr. Stevenson's list is not, nor does it purport to be, an exhaustive review of classifications in multi-location *CCAA* restructurings across Canada. Further, he provides no insight as to whether it was the debtor company or the court which decided that a separate class was appropriate in each of the cases to which he referred. Nor does not provide any information as to why a particular classification decision was made in the first place. There may be valid reasons for a debtor to segregate landlords. For example, in *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce*,[11] the court refused to disturb a separate class proposed by the debtor company for 130 landlords. A landlord in that case was funding the Plan.

15 *Grafton-Fraser Inc.* is cited as authority for the general proposition that landlords should be entitled to a separate class. In his brief reasons, Houlden J. indicated that he was allowing the separate class to remain on the basis that, as compared to other creditors, landlords would have difficulty valuing their claims and would be enjoined from exercising the contractual and statutory claims that they would ordinarily enjoy on a tenant's insolvency. *Grafton-Fraser Inc.*, like all *CCAA* cases, was doubtless decided on its facts. It was considered, but not

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[9] *Fairview Industries Ltd., Re* (1991), 109 N.S.R. (2d) 32, 11 C.B.R. (3d) 71 (N.S. T.D.).

[10] *Woodward's Ltd., Re* at p. 81.

[11] *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285, 11 C.B.R. (3d) 161 (Ont. Gen. Div.).

applied, in *Woodward's Ltd., Re*, a case that brought widespread attention to the non-fragmentation and contextual approach in classification.[12]

16 Landlords are not entitled to a separate class simply because of who they are. There must be sufficient evidence that their claims are materially different from the claims of other creditors in the class to warrant that. To find otherwise would require that I ignore the contextual and non-fragmentation approach (which I observe does not appear to have firmly take hold until after *Grafton-Fraser Inc.* was decided), and give excessive power to one creditor group in relation to a plan of arrangement designed for the benefit of all of the creditors. This concern was expressed by Borins J. in *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*[13] in dismissing a landlord's plea for a separate class so that it's intended negative vote would not be fruitless. A similar caution was voiced by Blair J. in *Armbro Enterprises Inc., Re*[14]. He too found that a separate class for landlords was unwarranted in that case.

Distinct Legal Rights and Valuation Issues

17 Depending on their particular circumstances, the objecting landlords assert that they have one or more of three distinct legal rights that will be eroded or confiscated if they are unsuccessful in their application: (1) the right to follow and seize assets removed from abandoned premises; (2) the right to claim damages against any person who aided the tenant in clandestinely removing goods from their reach; and (3) the right to terminate a lease for default under what is commonly called an "insolvency clause" in their leases. At the risk of stating the obvious, objecting landlords who had leases terminated with court approval after the Initial Order cannot advance these arguments.

1. — Rights Arising from Clandestine Removal of Goods

18 Before applying for *CCAA* protection, San Francisco removed assets and abandoned 14 of the 16 premises leased from the objecting landlords.

19 Ontario and New Brunswick's legislation allows a landlord the right to follow and seize goods that were fraudulently and clandestinely removed to prevent the landlord from distraining for rental arrears. There is a thirty day time limit on this right to seize. The landlord is also granted a right of action against

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[12]Peter B. Birkness, "Re Woodward's Limited — The Contextual Commonality of Interest Approach to Classification of Creditors" (1993), 20 C.B.R. (3d) 91 at 92.

[13]*Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Gen. Div.).

[14]*Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.).

any person who knowingly aided in the removal or concealment of the goods.[15] These remedies are akin to those provided in the 1737 *Distress for Rent Act* of England,[16] commonly called *The Statute of George*, 11 Geo. II, c. 19. Nova Scotia's legislation differs from that in Ontario and New Brunswick in that it does not provide for the third party right of action and the time period for following the goods and seizing is twenty-one rather than thirty days.[17] Newfoundland lacks any specific legislation granting these remedies, and it is questionable if *The Statute of George*, although incorporated into the laws of Newfoundland before December 31, 1831, remains in effect there.[18]

20 To succeed in an action under these statutory schemes (and perhaps under the common law in Newfoundland), there must be sufficient evidence to establish that: (1) rent payments are in arrears; (2) goods owned by the tenant were removed from the premises; (3) this conduct was clandestine or fraudulent; and (4) the goods were removed for the purpose of preventing the landlord from seizing them for arrears of rent.

21 The issue arises whether the objecting landlords must prove their claims for classification purposes or simply show that they have an arguable case. Clearly, the court is not interested in ruling on hypothetical matters, but it would be unreasonable at this stage to require an applicant in a reclassification hearing to actually prove their claim. Proof will be required at a later date to establish entitlement to membership in a new class, if one is ordered. What must be presented at this point is sufficient evidence to show that there is an arguable case that would justify a separate class.

22 The objecting landlords rely on two leases, which they say are typical of the leases entered into between them and San Francisco (or its nominee corporations), to demonstrate that there were arrears owing at the date of abandonment. The alleged arrears are comprised of accelerated rent which, under the terms of

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[15] *Commercial Tenancies Act*, R.S.O.1990, c. L-7, ss. 48-50 and *Landlord and Tenant Act*, R.S.N.B. 1973, c. L-1, ss. 27, 29.

[16] *Distress for Rent Act 1737*, 11 Geo. 2, c. 19, s. 1, which provides: "In case of any tenant or tenants, lessee or lessees ... upon the demise or withholding whereof, any rent is or shall be reserved due or payable, shall fraudulently or clandestinely, convey away, or carry off or from such premises, his or her or their goods or chattels, to prevent the landlord or lessor ... from distraining the same for arrears of rent, it shall or may be lawful for every landlord or lessee ... to take or seize such goods and chattels wherever the same shall be found as distress for the said arrears of rent. "

[17] *An Act Respecting Tenancies and Distress for Rent*, R.S.N.S. 1989, c. 464, ss. 13 and 14.

[18] *Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd.* (1982), 137 D.L.R. (3d) 320 (Nfld. T.D.), affirmed (1983), 3 D.L.R. (4th) 704 (Nfld. C.A.).

the leases, became due on termination and are contractually deemed arrears. Without deciding on the correctness of the objecting landlords' assertion, I find that there is sufficient evidence to establish at least an arguable case that there are arrears of rent.

23 Insofar as evidence of clandestine removal is concerned, two landlords depose that, without their knowledge and without notice to them, San Francisco vacated and removed all of its assets from their premises. Although it would have been preferable to have more detail of the circumstances of the alleged removal of assets, this evidence again is sufficient to establish an arguable case. The merits of the objecting landlords' position will be fully aired and determined in quantifying their claims.

24 I have concluded that the objecting landlords have an arguable case. Their rights to pursue distraint and sue a person for aiding in clandestine removal of goods are unique ones. However, the uniqueness of a right is, in and of itself, insufficient to warrant a separate class. The right must be adjudged worthy of a separate class after considering the various factors outlined above. In essence, it must preclude consultation between the creditors.

25 The Initial Order specifically preserved all creditors' rights to take or continue an action against San Francisco if their claims were subject to statutory time limitations.[19] The objecting landlords elected not to pursue their statutorily time limited remedy of following and seizing goods within the time permitted. As a result, it is unreasonable to allow them to now assert that entitlement as the justification for a separate class. Moreover, in the context of a bankruptcy, the remedy is generally academic since there are no goods available for distraint. For these reasons, the inability to follow and seize goods cannot support the ordering of a separate class.

26 The Plan requires that all creditors give up claims against the company, its officers, employees, agents, affiliates, associates and directors. This requirement is subject to the qualification that an action based on allegations of misrepresentations made by a director to creditors or of *wrongful or oppressive conduct by a director* is preserved (emphasis added).[20] While candidly acknowledging that

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[19]The amendment on January 12, 2004 does not affect the issues at bar.

[20]Article 6.1 of the Plan provides as follows: "On the Effective Date, and except as provided below, each of the Companies, the Monitor, and the past and present directors, officers, employees, agents, affiliates and associates of each of the foregoing parties (the "Released Parties") shall be released and discharged by all Creditors, including holders of Unsecured Creditor Claims, and Goods and Services Tax Claims from any and all demands, claims, including claims of any past and present officers, directors or employees for contribution and indemnity, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, charges

their best chance of financial recovery on a successful action would be against Slawsky, the objecting landlords contend that preserving their right of action only against him would be insufficient protection given that they do not know at the moment whether he alone was the person who orchestrated or aided in the removal of San Francisco's goods. In view of Slawsky's apparent level of control over the companies, it might be reasonable to conclude that he was involved in the decision to abandon the premises. However, that is speculative at this point and others may well have been involved.

27 Although the Initial Order did not stay actions against San Francisco's employees or agents, the landlords' failure as yet to pursue the employees or agents does not end the matter. This aspect of a removal action is quite different from the statutorily time limited ability of a landlord to follow and seize their tenant's goods, which the objecting landlords chose not to exercise. Only general limitations legislation and the practical effects of the Releases contained in the Plan affect this aspect of the claim.

28 I find that the Plan does not adequately address the objecting landlords' unique legal entitlement to claim damages against persons who aided their tenant in clandestinely removing goods from the premises. In making this finding, I considered the following to be significant factors:

1. Unlike the ability to follow and seize goods, which has been rendered academic, this right of action is potentially meaningful.
2. The Plan does not offer compensation for deprivation of this right of action, resulting in a "confiscation" of the objecting landlords' right as described in *Sovereign Life*.
3. Unlike claims that would be extinguished on a bankruptcy of the companies, this right of action would survive since it is against third parties.

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and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any person may be entitled to assert, including, without limitation, any and all claims in respect of any environmental condition or damage affecting any of the property or assets of the Companies, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Effective Date relating to, arising out of or in connection with any Claims, the business and affairs of the Companies, whenever and however conducted, this Plan and the *CCAA* Proceedings, and any Claim that has been barred or extinguished by the Claims Procedure Order shall be irrevocably released and discharged, provided that this release shall not affect the rights of any Person to pursue any recoveries for a Claim against a director or the Companies that: (a) relates to contractual rights of one or more creditors against a director; or (b) are based on allegations of misrepresentations made by a director to creditors or of wrongful or oppressive conduct by a director."

29 The *CCAA* is designed to be fluid and flexible, and the Court is given wide discretion to facilitate that flexibility. Alternatives to establishing a separate voting class should be explored. I can envision at least three other options: (1) direct an amendment to the Plan to compensate the objecting landlords for the loss of their potential rights of action against persons other than Slawsky; (2) direct an amendment to the Plan to expand the survival of actions provision (clause 6.1 (b)) to include potential defendants other than Slawsky; or (3) deal with the matter at the fairness hearing.

30 Ordering a separate class would clearly recognize and protect the objecting landlords' potential causes of action against third parties other than Slawsky. Further, it would overcome potential hurdles in consultation among the unsecured creditors. However, a separate class would give the objecting landlords a veto power over the Plan. This flags the principle that courts should be careful to resist classification approaches that might jeopardize viable plans of arrangement.

31 Directing that the Plan be amended to compensate the objecting landlords for the loss of their potential rights of action is not a viable option. It would require that the Court blindly enter into San Francisco's strategic arena. Such a direction would interfere with the right of the companies to make their own Plan and would purport to cloak the Court with knowledge of the companies' resources, strategies and plans, knowledge which it simply does not posses. Interference of this sort should be avoided.

32 Directing an amendment to the Plan to expand the survival of actions provision to include potential defendants other than Slawsky certainly would be less intrusive than compensating the objecting landlords for the loss of their potential right of action. It would preserve their right to pursue the removal action against persons other than Slawsky and would enhance consultation with other creditors in the class. On the other hand, it would impose an obligation on the companies that they may not have contemplated or may have been unwilling to voluntarily assume.

33 As to dealing with the matter at a fairness hearing, I note that the *CCAA* does not require that debtors present a 'guaranteed winner' of a plan to their creditors. Debtors can make any proposal to their creditors and take whatever chances they might consider appropriate. However, to succeed, they must act in good faith and present a plan of arrangement at the end of the day which is fair and reasonable. If they fail to do so, the process is a waste of time and valuable resources. It accomplishes nothing but an erosion of assets that otherwise would be available to creditors on liquidation. This is precisely what Tysoe J. sought to avoid

when he ordered a separate class for guarantee holders in *Woodward's Ltd., Re*, on being convinced that the plan in that case was unfair to them.[21]

34 The opposite result occurred in *Canadian Airlines*, where Madam Justice Paperny deferred the classification issue to the fairness hearing. *Canadian Airlines* presented quite a different scenario to that in *Woodward's Ltd., Re* or the one before me. The concern in *Canadian Airlines* was with Air Canada voting in the same class as other unsecured creditors when it had appointed the board which directed the *CCAA* proceedings, was funding the Plan, and fears existed about its acquisition of deficiency claims to secure a positive vote. The court was not concerned about a confiscation of legal rights but was attempting to safeguard against "ballot stuffing".[22]

35 In the particular circumstances of the present case, I find it preferable to protect the objecting landlords' remedy by directing that there be an amendment to the Plan to preserve any cause of action they might have against any party who aided San Francisco in clandestinely removing its assets from their premises. This measure balances the need to avoid giving unwarranted power to one creditor group and the need to protect a unique legal entitlement. It avoids the potential of valuable resources being expended on creditors' meetings when the potential exists that at the end of the day I would find the Plan to be unfair on the basis of this aspect of the objecting landlords' argument. Finally, it avoids significant interference with the debtor's financial strategy in formulating its Plan.

2. — Loss of Default/Insolvency Clause Remedy

36 Some, if not all, of the leases allow the landlord to terminate the lease in the event of the tenant's insolvency. The objecting landlords argue that this is another unique right which is not compensated for in the Plan.

37 The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to the proceedings in the first place.[23] The objecting landlords complain that their rights are permanently lost because of the Release contained in the Plan. They do not acknowledge that the stay is essential to the longer-term feasibility of the *CCAA* restruc-

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[21] At para. 11.

[22] *Olympia & York Developments Ltd., Re*, [1994] O.J. No. 1335 (Ont. Gen. Div. [Commercial List]) at para. 24.

[23] See for example: *Norcen Energy Resources Ltd.*, where one of the debtor's joint venture partners was enjoined from relying on an insolvency clause to replace the operator under a petroleum operating agreement.

turing and something which courts have granted with increasing regularity to give effect to the remedial nature of the *CCAA*.[24] Even ignoring this pragmatic consideration, the objecting landlords' argument fails. The contractual right that is affected is neither unique, nor of any practical use. Thirteen other creditors, mainly equipment lessors and utility providers, have similar contractual default provisions. Further, all of the leases have already been terminated.

3. — Difficulty in Valuing Claim

38 The objecting landlords rely on *Grafton-Fraser Inc.* for the proposition that landlords' claims are difficult to value and therefore a separate class is warranted. Unfortunately, the brief reasons given by Houlden J. do not provide any insight as to how the company in that case proposed to value the landlords' claims. No doubt, Houlden J. had the specific facts before him clearly in focus as he made his decision. I reject the contention that *Grafton-Fraser Inc.* is a decision of sweeping application, being mindful that rigid rules of general application are to be avoided in *CCAA* matters.

39 The Claims Procedure Order, issued on June 22, 2004 in this matter, establishes a mechanism for valuing landlords' abandoned premises claims that reflects the methodology established by the Supreme Court of Canada in *Highway Properties Ltd. v. Kelly, Douglas & Co.*[25] The valuation mechanism, set out in para. 12 of the Order,[26] is straightforward. A claimant simply follows the

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[24]As noted by Spence J. in *Playdium Entertainment Corp., Re* (2001), 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]) at para. 32: "If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the *CCAA* order could not be asserted by the Famous Players after the stay period. If such an order could not be made the *CCAA* regime would prospectively be of no value even though a compromise of creditor claims might be worked out in the stay period." See also *Smoky River Coal Ltd., Re* (1999), 237 A.R. 326 (Alta. C.A.).

[25]*Highway Properties Ltd. v. Kelly, Douglas & Co.*, [1971] S.C.R. 562 (S.C.C.).

[26]12(a) With respect to Proofs of Claim to be filed with the Monitor by a Landlord of retail premises currently or formerly occupied by the Companies ("Landlord"), a Landlord is to value and calculate its claim ("Landlord's Claim") as being the aggregate of:

(i) Arrears of rent, if any, owing under a lease as at January 7, 2004;

(ii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7, 2004), the value of rent payable under the lease from the date of repudiation to the date of the Proof of Claim (if any) less any revenue received from any reletting of the premises (in whole or in part) as at the date of the Proof of Claim;

(iii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7,

formula. There is a clear cut-off date for mitigation efforts and a readily calculable present value. The landlords' claims will not be difficult to value.

Inequitable Treatment of Creditors

1. — Preferential Treatment of Some Landlords

40 The objecting landlords make the curious complaint that the Plan prefers them to other unsecured creditors in that it contemplates the duty to mitigate, for valuation purposes, ending at the claims bar date.

41 Presumably, the objecting landlords could re-let the premises the following day and still base their claim on the value of unpaid rent for the unexpired portion of the term of their lease. While they might receive a benefit, it is trite that there must always be a cut-off date for mitigation when future losses are the subject of a *CCAA* creditor claim. San Francisco chose the claims bar date for ease of analyzing claims for voting purposes. Its choice makes practical sense and is not facially offensive. As noted in *Alternative Fuel Systems Inc., Re*,[27] courts have approved a variety of solutions to quantifying landlords' claims. That approach is in keeping with the distinct purpose of the *CCAA*. Further, the treatment of landlords' claims under a plan of arrangement is an issue for negotiation and, ultimately, court approval.

42 The objecting landlords also say that they are preferred in that the Plan is a consolidated one that proposes a compromise regardless of whether a landlord's claim against a hollow nominee company would have been worthless outside of the *CCAA*. This issue will be of interest to other creditors as they consider their vote and position on the fairness hearing. However, it does not warrant creation of a separate class. If anything, it might warrant San Francisco revisiting the Plan, which some of the beneficiaries appear to think is too generous in the circumstances.

2004), the present value (using an interest factor of 3.65%) of rents payable under the lease as at the date of the Proof of Claim through to the end of the unexpired term of the lease (if any) less any revenue to be received during that time period from any reletting of the premises (in whole or in part) which has occurred prior to the date of the Proof of Claim.

(b) For the purposes of a Landlord's Claim, where a lease contains an option in favour of the Companies authorizing the Companies to treat that lease as terminated and at an end prior to the otherwise stated termination date of that lease, the Companies shall be deemed to have exercised that option and the Landlord's Claim with respect to that lease shall be calculated having regard to the early termination date.

[27] *Alternative Fuel Systems Inc., Re* (2004), 236 D.L.R. (4th) 155 at paras. 64-69, 2004 ABCA 31 (Alta. C.A.).

2. — Preferential Treatment of Slawsky and Laurier

43 The objecting landlords take issue with Slawsky and Laurier being classified as "unaffected creditors" whose claims survive the reorganization despite their ability to value their security for voting purposes and to vote as unsecured creditors for their deficiency claims. Slawsky and Laurier's view is that the Plan does not prefer them because they do not share in the payment available to the general pool of unsecured creditors under the Plan and they are, by deferring payment of their secured claims, effectively funding the Plan.

44 The Plan's treatment of Slawsky and Laurier does not serve as a reason to segregate the landlords. Whether it is a reason to place Slawsky and Laurier into a separate class is discussed under the next heading.

Related Parties

45 The objecting landlords take umbrage with Slawsky, his son Aaron, Laurier, and other corporate entities in which Slawsky has an interest, voting on the Plan. They want to import into the *CCAA* proceedings the *BIA* prohibition against "related persons" voting in favour of a proposal, urging that the same policy considerations apply against allowing an insider to control the vote.[28]

46 The Alberta Court of Appeal in *Alternative Fuel Systems Inc., Re* declined to import *BIA* landlord claim calculations into a *CCAA* proceeding. The court found that the section of the *CCAA* at issue did not mandate importation of *BIA* provisions and, more significantly, the court found that to do so would not pay sufficient attention to the distinct objectives of the *CCAA* (remedial) and *BIA* (largely liquidation). In conducting its contextual analysis, the court acknowledged the need to maintain flexibility in *CCAA* matters, discouraging importation of any statutory provision that might impede creative use of the *CCAA* without a demonstrated need or statutory direction. There is no such direction or need in this case.

47 The objecting landlords find support for their position in *Northland Properties Ltd., Re* [29] Trainor J. in that case refused to allow a subsidiary to vote on its parent's *CCAA* plan. While care should be exercised to avoid a corporation "stuffing the ballot boxes in its own favour",[30] a blanket ban on insider voting is not always necessary or desirable. Safeguards against potential abuses

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[28]The *BIA*, s. 4(3)(c) definition of "related person" includes a controlling shareholder of a corporation. Section 54(3) provides that a creditor related to the debtor may vote against but not for the acceptance of a proposal.

[29]*Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.), at 170. See also: *Wellington Building Corp., Re*, [1934] O.R. 653 (Ont. S.C.) and *Dairy Corp. of Canada, Re*, [1934] O.R. 436 (Ont. C.A.), referred to in *Northland Properties Ltd., Re.*

[30]*Olympia & York Developments Ltd., Re* at para.24, per Farley J.

can be built into a plan and the voting mechanism. For example, the Monitor could procure sworn declarations from insiders as to their direct and indirect shareholdings in order to help track voting. That information, together with proofs of claim, proxies, and ballots, which relate to the insiders' claims could then be presented at the fairness hearing. This type of safeguard was taken in *Canadian Airlines*. Paperny J. observed in that case that "absent bad faith, who creditors are is irrelevant".[31]

48 Safeguards such as this are applicable only if the court is satisfied that there is sufficient commonality of interest between the insiders and the other creditors to place them in the same class. That was the case in *Canadian Airlines*. There, all of the creditors in the class were unsecured creditors. They were treated in the same way under the plan, and would have been treated the same way on a bankruptcy. The plan called for the insider, Air Canada, to compromise its claim, just like all of the other creditors.

49 Here, there is no compromise by Slawsky or Laurier. Further, they would, but for a security position shortfall, be unaffected by a bankruptcy of the companies, whereas all of the other creditors in the class would receive nothing. Slawsky has created a Plan which gives him voting rights that he doubtless wants to employ if he senses the need to sway the vote. In return, he gives up nothing. It stretches the imagination to think that other creditors in the class could have meaningful consultations about the Plan with Slawsky and, through him, with Laurier. For that reason, Slawsky and Laurier must be placed in a separate class.

Conclusions

50 The right of the objecting landlords to pursue distraint is unique as is their right to sue a person for aiding in clandestine removal of goods from the leased premises. For the reasons stated, loss of the objecting landlords' right to follow and seize goods cannot support the ordering of a separate class. However, I find that the Plan does not adequately address their right to claim damages against persons who aided a tenant in clandestinely removing goods from the premises. Rather than create a separate voting class for the objecting landlords, I direct that the Plan be amended to preserve any cause of action the objecting landlords and others in their position might have against any party who aided San Francisco in clandestinely removing its assets from their premises.

51 The right or ability of the objecting landlords to terminate the leases in question in the event of their tenants' insolvency is neither unique nor of any practical effect at this point. It is not a sufficient ground for creation of a separate voting class. Nor have I accepted the argument of the objecting landlords that a separate class should be established because their claims will be difficult to

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[31] At para. 37.

value. The Claims Procedure Order provides a mechanism for valuing their claims.

52 I have determined that, to the extent there is preferential treatment of the landlords or of Slawsky and Laurier under the Plan, such preferential treatment does not justify segregating the objecting landlords. However, as Slawsky and Laurier do not share a commonality of interest with other unsecured creditors, they must constitute a separate class for voting purposes.

53 Although success on this application has been somewhat divided, the objecting landlords have enjoyed greater success. There are no provisions in the *CCAA* dealing with costs, however, the Court has the discretion to award costs under the *Rules of Court* and its inherent jurisdiction.[32] The nature of the relief granted to the objecting landlords is akin to declaratory relief and accordingly, costs under Column 1 of Schedule C to the *Rules of Court* are appropriate. The costs are payable forthwith.

Order accordingly.

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[32] *Jackpine Forest Products Ltd., Re*, 2004 BCSC 20 (B.C. S.C.).

TAB 12

[Indexed as: **Woodward's Ltd., Re**]

Re Companies' Creditors Arrangement Act,
R.S.C. 1985, c. C-36;
Re Company Act, R.S.B.C. 1979, c. 59;
Re WOODWARD'S LIMITED, WOODWARD STORES LIMITED
and ABERCROMBIE & FITCH CO. (CANADA) LTD.

British Columbia Supreme Court
Tysoe J. [In Chambers]

Heard – January 8, 1993.
Judgment – January 11, 1993.

Corporations – Arrangements and compromises – Companies' Creditors Arrangement Act – Stay of proceedings – Company arranging provision of retiring allowances to former senior executives – Letters of credit securing payments – Prejudice to former senior executives outweighed by possible threat to reorganization plan – Inherent jurisdiction of court being exercised to grant stay preventing calling on letters of credit in entirety – Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

A company decided to provide retiring allowances to benefit its senior executives when they retired or were terminated without cause. Until 1991, the company entered into individual agreements with senior executives; after 1991, the company established a "Retiring Allowance Plan". Letters of credit issued by the company's bank securing the payment of both types of retiring allowance were lodged with two trust companies. The company entered into trust agreements with the trust companies in relation to the letters of credit.

When the company became insolvent and the monthly retirement allowances owing to the former senior executives became overdue, the company applied for and was granted an interim stay pursuant to s. 11 of the *Companies' Creditors Arrangement Act* ("CCAA"). An application was subsequently made to extend the stay and an issue arose as to whether the stay should apply to the former senior executives of the company and the trust companies acting as trustees of the letters of credit.

The company argued that the calling of the letters of credit could and should be stayed pursuant to the s. 11 stay. In the alternative, it argued that the court had the inherent jurisdiction to grant such a stay. The former senior executives argued that the court did not have the jurisdiction to grant a stay preventing the trust companies from calling on the letters of credit.

Held – The application was allowed in part.

Section 11 of the CCAA cannot be utilized to prevent the holder of a letter of credit from requiring the third party who issued the letter of credit to honour it because no steps are taken against the insolvent company when a call is made on the letter of credit. There are, however, circumstances where the holders of the letter of credit will not be entitled to call on it unless the holder takes some step that is a prerequisite to a drawing under the letter of credit. If such a step constitutes a "proceeding" against the insolvent company, it may be stayed under s. 11.

The trust agreement relating to the individual agreements provided that the prerequisite to drawing under the letters of credit was the insolvency of the company. As the company was in fact insolvent, the trust company could call on those letters of credit. No proceeding was required to do so, and, therefore, a s. 11 stay could not prevent the trustee from calling on these letters of credit.

The inherent jurisdiction of the court can be invoked for the purpose of imposing stays of proceedings against third parties. The exercise of that jurisdiction must be shown to be important to the reorganization process and involves a weighing of the interests of the insolvent company against the interests of the parties who will be affected. It was important to the reorganization process that the former senior executives not be paid the entire amounts of their retirement allowances right away. Such a full payment might cause recently terminated employees to vote against the company's reorganization plan. The relative benefit of staying the calling of the letters of credit in their entirety outweighed the prejudice to the former senior executives. The amounts owed were fully secured by the letters of credit and there would be no deterioration in the security if the right to draw on the full amounts was postponed pending the outcome of the reorganization effort. The stay was, therefore, continued to prevent the trust company from calling on the letters of credit except to the extent that it was necessary to obtain payment of the monthly retiring allowances that were overdue.

Under the trust agreement relating to the Retiring Allowance Plan, when the company became insolvent and failed to make a payment, a senior executive would certify the occurrence of the insolvency. The certificate would then be delivered by the trustee to the company. The trustee would then report to the company that a claim had been made. Both the delivery of the certificate to the company and the making of the report to the company constituted proceedings against the company. As such, they could be stayed under s. 11. A stay was granted restraining the trust company from delivering to the company a copy of any certificate.

A calling upon the letters of credit in their entirety by both trust companies was stayed. Monthly payments were, however, to be allowed to be made.

Cases considered

Alberta-Pacific Terminals Ltd., Re (1991), 8 C.B.R. (3d) 99 (B.C. S.C.) – considered.

Johns-Manville Corp., Re, 40 B.R. 219 (U.S., 1984) [reversed in part 41 B.R. 926] – referred to.

Meridian Developments Inc. v. Toronto Dominion Bank, 52 C.B.R. (N.S.) 109, [1984] 5 W.W.R. 215, 32 Alta. L.R. (2d) 150, 53 A.R. 39, 11 D.L.R. (4th) 576 (Q.B.) – distinguished.

Page v. First National Bank of Maryland, 18 B.R. 713 (1982) – referred to.

Philip's Manufacturing Ltd., Re (1991), 9 C.B.R. (3d) 1, 60 B.C.L.R. (2d) 311, [1992] 1 W.W.R. 651 (S.C.) – considered.

Quintette Coal Ltd. v. Nippon Steel Corp. (1990), 2 C.B.R. (3d) 303, 51 B.C.L.R. (2d) 105 (C.A.), leave to appeal to S.C.C. refused (1991), 7 C.B.R. (3d) 164 (note), 55 B.C.L.R. (2d) xxxiii (note), 135 N.R. 317 (note) – considered.

Westar Mining Ltd., Re, 14 C.B.R. (3d) 88, 70 B.C.L.R. (2d) 6, [1992] 6 W.W.R. 331 (S.C.) – considered.

Statutes considered
Bankruptcy Code, 11 U.S.C.
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 –
s. 11

APPLICATION for continuance of stay under s. 11 of *Companies' Creditors Arrangement Act.*

R.A. Millar, M.A. Fitch, and *J. Irving,* for Woodward's Limited, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd.

D.B. Kirkham, Q.C., and *G. Tucker,* for W.J. Woodward and others.

E.J. Adair, for H.J. Zayadi.

(Doc. Vancouver A924791)

1 January 11, 1993. TYSOE J.: – The aspect of these proceedings presently under consideration is whether the Court should grant a stay in respect of payments owing to retired or terminated senior executives of Woodward's Limited ("Woodward's") which are secured by letters of credit issued by Woodward's banker in favour of two trust companies acting as trustees pursuant to agreements or plans benefitting Woodward's senior executives.

2 On December 11, 1992 I granted an interim stay Order pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA") in favour of Woodward's, Woodward Stores Limited and Abercrombie & Fitch Co. (Canada) Ltd. The Order was granted on an *ex parte* basis and it was expressed to expire at 6 p.m. on January 8, 1993, the day on which the hearing of the Petition in this matter was intended to take place. On December 17 and 24, 1992 I made further interim Orders which, among other things, contained a stay in relation to the letters of credit held by the two trust companies.

3 The hearing of the Petition began on January 8, 1993 but there were also between 10 and 15 related applications scheduled to be heard on January 8 and the following days. On January 8, when it was clear that the hearing of the Petition and related applications would take several days, I extended the interim Orders until further Order with the intent that they would continue until I made my determinations on the various issues to be decided. There appears to be little doubt that there will be an extension of the stay Order generally and it is the terms of the continuing stay Order that are in dispute. These Reasons for Judgment relate to one of the issues that is in dispute. I will approach this matter on the basis that the CCAA stay is

going to be extended and the issue to be determined is whether the stay can or should apply in relation to the former senior executives and the trust companies acting as the trustees of the letters of credit.

4 Woodward's decided at some point in the past that it would make provision for retiring allowances to benefit its senior executives when they retired or when they were terminated without cause. Until 1991 Woodward's entered into individual agreements with certain senior executives in relation to the retiring allowances. In 1991 Woodward's established its Retiring Allowance Plan which applied to designated senior executives.

5 Mr. Kirkham's clients entered into the individual agreements prior to 1991. Letters of credit have been lodged with The Canada Trust Company ("Canada Trust") pursuant to these agreements as security for the payment of the retiring allowances. Ms. Adair's client was covered by the Retiring Allowance Plan which continues in effect and also applies to senior executives who are still employed by Woodward's. A letter of credit has been lodged with Montreal Trust Company of Canada ("Montreal Trust") pursuant to the Retiring Allowance Plan as security for the payment of the retiring allowances.

6 All of the letters of credit have been issued to the two trust companies by Woodward's banker, Canadian Imperial Bank of Commerce (the "Bank") which holds security against the assets of Woodward's for these contingent obligations. Counsel for Woodward's advised the Court that approximately $10.2 million has been paid by Woodward's to the Bank to "cash collateralize" the letters of credit. Counsel was unable to advise me when this payment was made but I believe that it was made recently and that it was not made at the time of the issuance of the letters of credit.

7 Woodward's entered into trust agreements with both of Canada Trust and Montreal Trust in relation to the letters of credit. It is useful to refer to the relevant portions of the trust agreements dealing with the calling of the letters of credit. Paragraphs 3, 4 and 5 of the trust agreement with Canada Trust (the "Canada Trust Agreement") read, in part, as follows:

> 3. The Trustee shall be entitled at any time and from time to time to draw on the Letter of Credit comprised in the Fund, either in whole or in part, to obtain money for the purpose of making any payment required to be made by it hereunder . . .
>
> 4. If from time to time the Company shall for any reason whatsoever fail to pay or cause to be paid to the Executive or to a Beneficiary, as the case may be, any amount owing to the Executive or a Beneficiary under the Retiring Allowance Agreement for a period of ten days after its due date, the Executive may deliver to the Trustee an executed or certified true copy of the Retiring Allowance Agreement and concurrently certify in writing to the Trustee that the amount has

> not been paid thereunder and that he or she is entitled to receive the payment. The Trustee shall within five days after receipt of the certificate report in writing to the Company the claim so submitted. If within seven days after delivery of the Trustee's report to the Company the Trustee has not been notified by the Company that the Company has made the payment and has not received the certificate of the Company hereinafter mentioned, the Trustee shall pay the claimed amount out of the Fund to the Executive or the Beneficiary, as the case may be, in full discharge of the Company's liability for the payment . . .
>
> 5. If the Company . . . becomes insolvent . . . and the Executive certifies to the Trustee that such an event has occurred, the Trustee shall draw the full amount of the Letter of Credit comprised in the Fund . . .

8 Paragraphs 8 and 9 of the trust agreement with Montreal Trust (the "Montreal Trust Agreement") read, in part, as follows:

> 8. If the Company . . . becomes bankrupt or insolvent . . . and any officer of the Company or any Senior Executive . . . certifies in writing . . . to the Trustee that such an event has occurred and giving particulars thereof, the Trustee shall within five days after receipt of the certificate deliver a copy to the Company. Subject to any order of a court of competent jurisdiction, the Trustee shall, after the expiration of 14 days from the date of delivery of the certificate to the Company, draw the full amount of all Letters of Credit comprised in the Trust Fund . . .
>
> 9. If the Company shall from time to time for any reason whatsoever fail to pay or cause to be paid to a Senior Executive or a Beneficiary, as the case may be, any amount owing to the Senior Executive or Beneficiary under the Retiring Allowance Plan for a period of ten days after its due date, the Senior Executive or Beneficiary . . . may certify in writing . . . to the Trustee that the amount has not been paid thereunder and that the Senior Executive or Beneficiary named in the certificate, as the case may be, is entitled to receive the payment. The Trustee shall within five days after receipt of the certificate report in writing to the Company the claim so submitted. If, within seven days after delivery of the Trustee's report to the Company, the Trustee has not been notified in writing by the Company that the Company has made the payment and has not received the certificate of the Company hereafter mentioned, the Trustee shall draw under the Letter of Credit . . .

9 It not disputed by Woodward's that monthly retirement allowances owing to the former senior executives are overdue or that it has become insolvent.

10 It is the position of Woodward's that the calling of the letters of credit can and should be stayed pursuant to s. 11 of the CCAA or, alternatively, that the Court has the inherent jurisdiction to grant such a

stay. Counsel for the former senior executives submit that the Court has no jurisdiction to grant a stay preventing the trust companies from calling on the letters of credit.

11 Section 11 of the CCAA reads as follows:

> 11. Notwithstanding anything in the *Bankruptcy Act* or the *Winding-up Act*, whenever an application has been made under this Act in respect of any company, the court, on the application of any person interested in the matter, may, on notice to any other person or without notice as it may see fit,
>
> (*a*) make an order staying, until such time as the court may prescribe or until any further order, all proceedings taken or that might be taken in respect of the company under the *Bankruptcy Act* and the *Winding-up Act* or either of them;
>
> (*b*) restrain further proceedings in any action, suit or proceeding against the company on such terms as the court sees fit; and
>
> (*c*) make an order that no suit, action, or other proceeding shall be proceeded with or commenced against the company except with the leave of the court and subject to such terms as the court imposes.

12 Section 11 of the CCAA has received a very broad interpretation. The main purpose of s. 11 is to preserve the status quo among the creditors of the company so that no creditor will have an advantage over other creditors while the company attempts to reorganize its affairs. The CCAA is intended to facilitate reorganizations involving compromises between an insolvent company and its creditors and s. 11 is an integral aspect of the reorganization process.

13 An example of the broad interpretation given to s. 11 is *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 51 B.C.L.R. (2d) 105 (C.A. – leave to appeal to S.C.C. dismissed [7 C.B.R. (3d) 164 (note)]). The B.C. Court of Appeal held that s. 11 was sufficiently broad to prevent a creditor from exercising a right of set-off against the insolvent company. The Court confirmed that the word "proceeding" in s. 11 encompassed extrajudicial conduct and it held that the exercise of a right of set-off was a "proceeding" within the meaning of s. 11. Gibbs J.A. commented on s. 11 in the following general terms at p. 113:

> To the extent that a general principle can be extracted from the few cases directly on point, and the others in which there is persuasive obiter, it would appear to be that the courts have concluded that under s. 11 there is a discretionary power to restrain judicial or extra-judicial conduct against the debtor company the effect of which is, or would be, seriously to impair the ability of the debtor company to continue in business during the compromise or arrangement negotiating period. The power is discretionary and therefore to be exercised judicially.

14 Coincidentally, the authority that is generally considered to be the landmark decision in respect of the broad interpretation to be given to s. 11 is a case involving a letter of credit issued by a bank at the request of the insolvent company in favour of a creditor, *Meridian Developments Inc. v. Toronto Dominion Bank* (1984), 11 D.L.R. (4th) 576, [1984] 5 W.W.R. 215 (Alta. Q.B.). Wachowich J. posed the issues before him in the following manner at pp. 579-580 of D.L.R. and p. 219 of W.W.R.:

> 1. Is payment of the letter of credit a "proceeding" within the meaning of clause 2 or 3 of the March 21 order?
>
> 2. If so, is it a proceeding "against the Petitioner" [Nu-West] so as to be restrained by clause 2 or 3 of that order.
>
> 3. If it is found to be a "proceeding" should the Court in any case give leave to Meridian in the circumstances to obtain payment of the letter of credit?

Cls. 2 and 3 of the Order referred to by Wachowich J. followed the wording of s. 11 of the CCAA.

15 Wachowich J. first decided that the payment of a letter of credit fell within the meaning of the word "proceeding" in s. 11 of the CCAA and it is this portion of his judgment that deals with the broad interpretation to be given to s. 11. However, Wachowich J. went on to conclude that the payment of the letter of credit could not be termed "a proceeding against the company" with the result that the stay Order did not prevent the calling of the letter of credit.

16 Counsel for Woodward's submitted that the present situation falls within an exception enunciated by Wachowich J. He first points to the following passage at p. 584 of D.L.R. and p. 224 of W.W.R.:

> It must be noted, however, that by the terms of the March 21, 1984 order it is only "further proceedings in any action, suit or proceeding against the petitioner" that are restrained. Unless the payment of the letter of credit is a "proceeding against the petitioner" (Nu-West) it was not restrained by this order. I agree with counsel for Meridian that the payment of the letter of credit cannot be termed a proceeding against Nu-West *unless the money to be paid is Nu-West's property.* (my italics)

Counsel next points to a passage on p. 588 of D.L.R. and p. 227 of W.W.R. where Wachowich J. is reviewing the American authority of *Page v. First National Bank of Maryland*, 18 B.R. 713 (1982):

> At p. 4 of the (unreported) decision the court stated:
>
> "In issuing the letter of credit the bank entered into an independent contractual obligation to pay W.C.C. out of its own assets. Although cashing the letter will immediately give rise to a claim by the bank

> against the debtors pursuant to the latter's indemnification obligations, that claim will not divest the debtors of any property since any attempt to enforce that claim would be subject to an automatic stay pursuant to 11 U.S.C., para. 362(4)."
>
> In my view, the Toronto-Dominion Bank is in the same position. It is obliged to honour its contract with Meridian even though the cashing of the letter of credit will increase Nu-West's debt to the bank and even though the bank has no method of enforcing its claim against Nu-West because of the March 21st order.

17 Counsel for Woodward's submits that the present situation falls within the exception recognized in the *Meridian* case in the sense that the money to be paid under the letter of credit is the property of Woodward's and that payment on the letters of credit will divest Woodward's of its property because the letters of credit are "cash collateralized" by $10.2 million of Woodward's money. I do not accept this submission.

18 The fact that Woodward's may have secured its obligations to the Bank in respect of the letters of credit does not mean that the letters of credit will be paid with Woodward's money. The letter of credit is an independent obligation of its issuer which is obliged to honour a call on the letter of credit with its own money. After being required to make a payment under a letter of credit, the issuer of the letter of credit is then entitled to look to its customer pursuant to the indemnification agreement that usually exists in relation to a letter of credit. If the issuer of the letter of credit holds a cash deposit from its customer as security for the obligations under the indemnification agreement, it may indemnify itself from the cash deposit. This involves the issuer of the letter of credit utilizing the money of its customer to indemnify itself but it is not the money on deposit that is to be used to make payment under the letter of credit.

19 After Wachowich J. made his statement that payment of the letter of credit cannot be termed to be a proceeding against Nu-West "unless the money to be paid is Nu-West's property", he proceeded to review the general nature of a letter of credit and he then reached his conclusion that payment of the letter of credit could not be termed a proceeding against Nu-West. It is my view that Wachowich J. was not creating an exception when he made the statement. Rather, he was stating the issue to be determined in deciding whether it could be termed a proceeding against Nu-West. After he review the general nature of a letter of credit and immediately before stating his conclusion, Wachowich J. said the following at p. 587 of D.L.R. and p. 226 of W.W.R.:

> The customer of the bank has, in my view, never had "ownership" of any funds represented by the letter of credit. He can lay claim only to

the debt that has been thereby created.

In addition, it should be noted that in the *Page v. First National Bank of Maryland* decision relied upon by Wachowich J., the bank held a certificate of deposit as security for the indemnification obligations of its customer and the U.S. District Court held that a claim on the letter of credit would not divest the debtor of any of its property.

20 Accordingly, I do not think that the letters of credit presently under consideration fall within any exception in *Meridian*. However, that does not end the s. 11 analysis in my view.

21 Section 11 cannot be utilized to prevent the holder of a letter of credit from requiring the third party who issued the letter of credit to honour it because no steps are taken against the insolvent company when a call is made on the letter of credit. But there will be circumstances where the holder of the letter of credit will not be entitled to call on it unless he or she first does take some step that is a prerequisite to a drawing under the letter of credit. If such a step constitutes a proceeding against the insolvent company, it may be stayed by the Court under s. 11. For example, the step taken against the insolvent company could be the making of demand on the company. Stay Orders under the CCAA frequently prevent creditors from making demand on the insolvent company.

22 The issue thus becomes whether any proceeding must be taken against Woodward's before the letters of credit may be called upon. The prerequisites under paragraph 4 of the Canada Trust Agreement are the following:

> (a) the Company has failed to make a payment;
>
> (b) the Executive has delivered to the Trustee a copy of the Retiring Allowance Agreement and a certificate to the effect that he or she has not been paid;
>
> (c) the Trustee has reported in writing to the Company that a claim has been submitted;
>
> (d) the Company has not notified the Trustee that the payment has been made.

The prerequisites under paragraph 5 of the Canada Trust Agreement are that the Company has become insolvent and that the Executive has certified the occurrence of that event to the Trustee.

23 The prerequisites under paragraph 8 of the Montreal Trust Agreement are as follows:

> (a) the Company has become insolvent;

(b) the Executive has certified the occurrence of the event to the Trustee;

(c) the Trustee has delivered a copy of the Executive's certificate to the Company;

(d) a court of competent jurisdiction has not made an order preventing the Trustee from drawing on the letters of credit.

The prerequisites under paragraph 9 of the Montreal Trust Agreement are the same as the prerequisites under paragraph 4 of the Canada Trust Agreement.

24 It is clear that paragraph 5 of the Canada Trust Agreement does not require that any proceeding be taken against the Company before the Trustee can draw on the letter of credit. Paragraph 4 of the Canada Trust Agreement becomes academic because Woodward's is insolvent and Canada Trust can call on the letter of credit pursuant to paragraph 5.

25 Both of paragraphs 8 and 9 of the Montreal Trust Agreement require a step to be taken vis-à-vis the Company before the Trustee can call on the letter of credit. Paragraph 8 requires that the Trustee deliver to the Company a copy of the certificate of the Senior Executive. Paragraph 9 requires that the Trustee must report to the Company that a claim has been made. It is my view that the delivery of a copy of the certificate to the Company and the making of a report to the Company are both proceedings against Woodward's that can be stayed pursuant to s. 11 of the CCAA.

26 If a step must be taken vis-à-vis the insolvent company before a creditor (or a trustee on behalf of a creditor) may enforce its rights, the form of the step should make no difference for the purposes of s. 11 of the CCAA. It should not matter whether the step is a demand for payment on the company, the delivery to the company of a notice of acceleration or the delivery to the company of some other type of document such as a copy of a certificate or a report. In the *Meridian* case, supra, Wachowich J. quoted the following portion of the definition of the word "proceeding" in *Black's Law Dictionary*, 5th ed. (St. Paul, Minn.: West, 1979) (at p. 582 of D.L.R. and p. 221 of W.W.R.):

> Term "proceeding" may refer not only to a complete remedy but also to a mere procedural step that is part of a larger action or special proceeding. Rooney v. Vermont Corp. (1973), 10 Cal.3d 351, 110 Cal.Rptr. 353, 365, 515 P.2d 297.

The delivery of a copy of a certificate or a report to Woodward's is no less a proceeding than the payment of a letter of credit (*Meridian*) or the exercise of a right of set-off (*Quintette*). It is a proceeding *against*

Woodward's because the copy of the certificate or the report must be delivered to Woodward's.

27 The result is that a stay under s. 11 of the CCAA can effectively prevent Montreal Trust from calling on the letters of credit held by it but Canada Trust cannot be restrained by such a stay from calling on the letters of credit held by it. It is therefore necessary to consider Woodward's alternative argument that the Court has the inherent jurisdiction to grant a stay that prevents a creditor (or a trustee on behalf of a creditor) from taking proceedings against third parties.

28 To my knowledge, the only example of the Court exercising its inherent jurisdiction in relation to the CCAA is *Re Westar Mining Ltd.* (Unreported, June 10, 1992 and June 16, 1992, B.C. Supreme Court Action No. A921164) [now reported at 14 C.B.R. (3d) 88]. In that case Macdonald J. exercised the inherent jurisdiction of the Court in order to create a charge against the assets of Westar for the benefit of suppliers which were continuing to provide goods and services to Westar after the commencement of the CCAA proceedings. Macdonald J. created the charge on June 10, 1992 without giving extensive reasons. His Order was made without prejudice to the claims of the Crown which did oppose the creation of the charge a few days later on the basis that it altered the priorities in the event that Westar went into bankruptcy. In his Reasons for Judgment dated June 16, 1992 Macdonald J. first explained how and why he created the charge (at p. 3) [p. 90, C.B.R.]:

> The charge has already been created. In doing so, I purported to exercise the inherent jurisdiction of this court. The company would have no chance of completing a successful reorganization without the ability to continue operations through the period of the stay. It must be able to arrange for further limited credit from its suppliers if it is to continue operations. Thus, security which is sufficient, in the eyes of its suppliers, to justify the extension of some further credit is a condition precedent to any acceptable plan of reorganization.

Macdonald J. rejected the argument of the Crown and he elaborated on the use of the Court's inherent jurisdiction at pp. 9 and 10 [p. 93, C.B.R.]:

> The issue is whether or not those suppliers who are prepared (or have been compelled, between May 14 and June 10) to extend the credit, which will hopefully keep the company operating during the period of the stay, should be secured. I have concluded that "justice dictates" they should, and that the circumstances call for the exercise of this court's inherent jurisdiction to achieve that end: see *Winnipeg Supply & Fuel Co. v. Genevieve Mortgage Corp.*, [1972] 1 W.W.R. 651, 23 D.L.R. (3d) 160 (Man. C.A.), at p. 657 [W.W.R.].
>
> The circumstances in which this court will exercise its inherent jurisdiction are not the subject of an exhaustive list. The power is

defined by *Halsbury's* (4th ed., vol. 37, para. 14) as:

> "... 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 ..."
>
> Proceedings under the CCAA are a prime example of the kind of situations where the court must draw upon such powers to "flesh out" the bare bones of an inadequate and incomplete statutory provision in order to give effect to its objects.

29 Mr. Kirkham submitted that *Westar* is distinguishable on the basis that the assets against which the Court created a charge were within the jurisdiction of the Court because they belonged to Westar and that in this case his clients and Canada Trust are not before the Court. I do not think that this is a valid distinction because the charge against Westar's assets affected the Crown which was not before the Court any more than Mr. Kirkham's clients and Canada Trust.

30 It may be argued that the Court should only exercise its inherent jurisdiction to "flesh out the bare bones" of the CCAA and that the Court should not utilize its inherent jurisdiction to grant stays because s. 11 of the CCAA already deals with the subject matter of stays and it contains Parliament's full intentions in that regard. This potential argument has not been given effect in analogous circumstances in the United States when proceedings under Chapter 11 of the U.S. *Bankruptcy Code* are pending. Under Chapter 11 there is an automatic stay of proceedings and, like s. 11 of the CCAA, it is a stay of proceedings against the debtor company only. The U.S. Courts have used an equivalent of inherent jurisdiction (i.e., a general provision in the U.S. *Bankruptcy Code* to make necessary or appropriate orders) to grant stays in relation to proceedings against third parties. The most common example is a proceeding against the principals of the insolvent company whose efforts are required to attempt to reorganize the company. One of the leading U.S. authorities is *Re Johns-Manville Corp.*, 40 B.R. 219 (U.S., 1984) which was referred to by Macdonald J. in the decision of *Re Philip's Manufacturing Ltd.* (1991), 60 B.C.L.R. 311 (S.C.) where he declined to continue a stay of all proceedings against the directors and officers of the insolvent company. In that case Macdonald J. expressed a reservation about whether the inherent jurisdiction of the Court could be utilized but this predated his decision in *Westar*, supra.

31 Hence, it is my view that the inherent jurisdiction of the Court can be invoked for the purpose of imposing stays of proceedings against third parties. However, it is a power that should be used cautiously. In *Westar* Macdonald J. relied upon the Court's inherent jurisdiction to create a charge against Westar's assets because he was

of the view that Westar would have no chance of completing a successful reorganization if he did not create the charge. I do not think that it is a prerequisite to the Court exercising its inherent jurisdiction that the insolvent company will not be able to complete a reorganization unless the inherent jurisdiction is exercised. But I do think that the exercise of the inherent jurisdiction must be shown to be important to the reorganization process.

32 In deciding whether to exercise its inherent jurisdiction the Court should weigh the interests of the insolvent company against the interests of the parties who will be affected by the exercise of the inherent jurisdiction. If, in relative terms, the prejudice to the affected party is greater than the benefit that will be achieved by the insolvent company, the Court should decline to exercise its inherent jurisdiction. The threshold of prejudice will be much lower than the threshold required to persuade the Court that it should not exercise its discretion under s. 11 of the CCAA to grant or continue a stay that is prejudicial to a creditor of the insolvent company (or other party affected by the stay).

33 In this case I am persuaded that it is important to the reorganization process that the former senior executives not be allowed to be paid the entire amounts of their retirement allowances at this time. On the day of the hearing of this matter Woodward's took the first step in implementing the reorganization of its business affairs (which involves a downsizing of its operations) by terminating approximately 1,200 of its 6,000 employees. These terminated employees will be entitled to severance pay which will be a significant obligation of Woodward's. They will be creditors of Woodward's who will be involved in the reorganization of its financial affairs and who will be entitled to vote on the reorganization plan. These former employees will undoubtedly be unhappy when they realize that their severance pay entitlement is an unsecured obligation of Woodward's that will be compromised as part of the reorganization while the former senior executives have security for the entire amounts of their retirement allowances (which are in reality severance payments in the cases of the senior executives who were terminated). If the former senior executives are paid the full amounts of their retirement allowances at this time, the recently terminated employees may not be understanding and it may cause them to vote against Woodward's reorganization plan even if it is in their economic interests to vote in favour of the plan. Negotiations under the CCAA require a delicate balance and payment of the full amounts of the retirement allowances at this time could well irreparably upset the balance.

34 The former senior executives will not be materially prejudiced if the full amounts of the letters of credit are not paid at this time. The amounts owed to them are fully secured by the letters of credit and

there will not be any deterioration in the security if the right to draw on the full amounts of the letters of credit is postponed pending the outcome of Woodward's reorganization effort. There was some evidence that there may be adverse income tax consequences if the full amounts of the letters of credit are drawn upon.

35 Another consideration is the dominant intention of the two trust agreements in allowing the full amounts of the letters of credit to be drawn upon. In quoting the relevant provisions of the two trust agreements, I only make reference to the triggering event of Woodward's becoming insolvent. The other triggering events are as follows:

> (a) if Woodward's ceases operations;
>
> (b) if Woodward's makes a general assignment for the benefit of creditors or files an assignment in bankruptcy or otherwise becomes bankrupt;
>
> (c) if Woodward's is wound up or dissolved;
>
> (d) if any receiver, trustee, liquidator of or for Woodward's or any substantial portion of its property is appointed and is not discharged within a period of 60 days.

The primary purpose of these triggering events in my view was to allow the former senior executives to cause the full amount of the letters of credit to be paid if Woodward's has effectively come to an end. The draftspersons of the trust agreements happened to chose insolvency as one of the triggering events because insolvency of a company frequently signifies its end. However, in this case, it will not be known whether Woodward's insolvency will result in its demise until it has made an attempt to reorganize pursuant to the CCAA. I am not saying that the Court should ignore the wording of the agreements but it is open to the Court to take into consideration the overall intent of the parties when deciding whether it is just and equitable to invoke its inherent jurisdiction.

36 The decision in *Meridian*, supra, is distinguishable from this case. In *Meridian* the Court was interpreting an Order that it had previously made and it was not considering whether a further Order could be made pursuant to its inherent jurisdiction.

37 Although I have concluded that the relative benefit of staying the calling of the letters of credit in their entirety outweighs the prejudice to the former senior executives and that I should exercise the Court's inherent jurisdiction to grant a stay to prevent the letters of credit from being fully drawn, it does not necessarily follow that the stay should prevent partial draws upon the letters of credit. In exercis-

ing its inherent jurisdiction in these circumstances the Court should endeavour to exercise the jurisdiction in a manner that balances the interests of the parties as much as possible.

The main prejudice to the former senior executives if they are not permitted to cause any call to be made on the letters of credit is the fact that the monthly payments of the retiring allowances will not be made. The monthly payments provide a source of income to the former senior executives and they will be prejudiced if the payments cease. Both of Mr. Kirkham and Ms. Adair indicated that if I did grant a stay of proceedings with respect to the letters of credit, one or more of their clients may make an application to have the stay discontinued on the basis that it creates a hardship to them.

On the other hand, the continuation of the monthly payments of the retiring allowances is much less likely to create a difficulty in the negotiations with the recently terminated employees than the payment of the retiring allowances in full. Although the former senior executives will be paid the monthly amounts of the retiring allowances without compromise pending the reorganization attempt, they will have to accept payment over a period of time. In addition, the recently terminated employees will hopefully appreciate that Woodward's would not be voluntarily making the monthly payments to the former senior executives and that it is the Court which is allowing the payments to be made.

It is my view that the interests of the parties can be largely balanced if the Court exercises its inherent jurisdiction to grant a stay that prevents payment on the letters of credit except to the extent of satisfying the obligation of Woodward's to make the monthly payments of the retiring allowances. In exercising the Court's discretion in this fashion I appreciate that a stay under s. 11 of the CCAA could effectively prevent the calling on the letters of credit for the purpose of paying the monthly amounts. In view of the fact that the Court is exercising its inherent jurisdiction to prevent the letters of credit being drawn in their entire amounts, I am exercising my discretion to decline to grant a stay under s. 11 which would prevent the calling on the letters of credit for the purpose of paying the monthly amounts.

It is necessary for the Court to exercise its inherent jurisdiction because a stay under s. 11 could not be utilized to prevent Canada Trust from drawing the full amounts of the letters of credit that are held by it. However, a stay under s. 11 could effectively prevent Montreal Trust from making any call on the letter of credit in its favour. I must now decide whether I should exercise my discretion under s. 11 to prevent Montreal Trust from making the partial draws on its letter of credit that I am permitting Canada Trust to make on each of its letters of credit.

As I have indicated above, the main purpose of s. 11 is to

preserve the status quo among the creditors of the insolvent company. Huddart J. commented on the status quo in *Re Alberta-Pacific Terminals Ltd.* (1991), 8 C.B.R. (3d) 99 (B.C.S.C.) at p. 105:

> The status quo is not always easy to find. It is difficult to freeze any ongoing business at a moment in time long enough to make an accurate picture of its financial condition. Such a picture is at best an artist's view, more so if the real value of the business, including goodwill, is to be taken into account. Nor is the status quo easy to define. The preservation of the status quo cannot mean merely the preservation of the relative pre-stay debt status of each creditor. Other interests are served by the CCAA. Those of investors, employees, and landlords among them, and in the case of the Fraser Surrey terminal, the public too, not only of British Columbia, but also of the prairie provinces. The status quo is to be preserved in the sense that manoeuvres by creditors that would impair the financial position of the company while it attempts to reorganize are to be prevented, not in the sense that all creditors are to be treated equally or to be maintained at the same relative level. It is the company and all the interests its demise would affect that must be considered.

43 In that case Huddart J. dismissed the application of the owner of the insolvent company's operating facilities for payment of ongoing amounts owing under the operating agreement between the two parties. In essence, the payments were the equivalent of rental payments under a lease. Huddart J. dismissed the application because there were insufficient funds to make the payments and the owner of the facilities had not shown hardship. The circumstances in that case were quite unusual because the insolvent company was continuing to pay interest to one of its lenders. In more normal cases under the CCAA one would expect during the reorganization period that rental payments for the ongoing use of facilities would be made and that interest on debt would not be paid. In any event, the case is an example of a situation where the status quo was maintained by way of different treatment of creditors.

44 In the present case I have decided to exercise my discretion under s. 11 of the CCAA so that Montreal Trust is treated in the same fashion as Canada Trust. It is my view that the status quo is best maintained in this case by giving equal treatment to creditors within the same class irrespective of the different wording in the two trust agreements. I add that Woodward's does have surplus cash at the present time and that other creditors will not be materially prejudiced by allowing partial payments to be made under the letter of credit held by Montreal Trust.

45 In the result, I continue the stay to prevent Canada Trust from calling on the letters of credit held by it except to the extent that it may be necessary to obtain payment of the monthly retiring allowances that are overdue. I grant a stay restraining Montreal Trust

from delivering to Woodward's a copy of any certificate provided to it under paragraph 8 of the Montreal Trust Agreement.

16 The Order dated December 11, 1992 stipulates that Woodward's is to retain its funds in its operating accounts with the Bank and that Woodward's may only use the funds for certain specified purposes. I anticipate that the continuing stay Order will have a similar provision. If it does contain a similar provision, the permitted purposes for use of funds may include the payment of the monthly retiring allowances to the former senior executives. I appreciate that Woodward's may prefer to require that the letters of credit be called upon so that there is no appearance to the recently terminated employees that Woodward's is voluntarily making payments to the former senior executives. On the other hand, Woodward's may not want to create an administrative nuisance for the Bank by having numerous calls being made on the letters of credit. Woodward's may exercise its discretion as to whether the monthly payments to the former senior executives are made voluntarily or involuntarily, recognizing of course that they will be made involuntarily if they are not made voluntarily.

Order accordingly.

TAB 13

BANKRUPTCY AND INSOLVENCY LAW OF CANADA

FOURTH EDITION

REVISED

VOLUME 4

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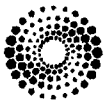

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Under a stay order, the court cannot compel a supplier to continue to extend credit to the debtor: s. 11.3(*b*). To protect creditors who choose to supply credit during this period, the court can give them a first charge on the assets of the debtor, which will rank ahead of certain Crown claims: *Re Westar Mining Ltd.*, 14 C.B.R. (3d) 88, 70 B.C.L.R. (2d) 6, [1992] 6 W.W.R. 331, 1992 CarswellBC 508 (S.C.). The persons who supplied goods pursuant to the order subsequently applied for interest. The court fixed a common date from which interest would commence, and once the money to pay the accounts had been received by the monitor, it allowed the suppliers interest at the average rate earned by the monitor during the period that it held the funds: *Re Westar Mining Ltd.* (1993), 30 C.B.R. (3d) 119, 1993 CarswellBC 585 (B.C. S.C.).

The court has power to stay the right of a bank to collect the accounts receivable of the debtor: *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 307, 1990 CarswellBC 393 (B.C. S.C.), affirmed at p. 311 (B.C. C.A.). In *Banque Royale c. Bâtisses d'Acier Novac Inc.* (1990), 5 C.B.R. (3d) 140, 1990 CarswellQue 38 (Que. S.C.), the court varied a stay order and directed that all payments of accounts receivable should be deposited into the debtor's bank account with the coordinator under the plan of arrangement being the sole signing authority. Even if a secured creditor has given notice of an assignment of rents and has started to collect rents prior to the debtor bringing an application under the *CCAA*, the court can make an order staying the creditor from collecting future rents, where the debtor required the income in order to carry on its business: *Timber Lodge Ltd. v. Timber Lodge Ltd. (Creditors of), supra.*

In *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 1, 63 Alta. L.R. (2d) 361, 92 A.R. 81 (Q.B.), it was held that s. 11 was wide enough to permit the court to restrain a party from exercising powers under an agreement with the debtor company that permitted termination of the agreement because of the debtor's insolvency. The court held that s. 11 is not limited to actions by a creditor, but encompasses all actions by parties that may threaten a compromise or arrangement in cluding contractual rights.

Pursuant to s. 11(4), the court held that it had jurisdiction to approve a proposed sale by the debtor of confidential intangible personal property in the nature of seismic data and information over the objection of the vendor of the information that retained title to the property pending full payment. The court held that it could interfere with contractual arrangements as long as it exercised its discretion sparingly and affected third party rights as minimally as possible in order to carry out the purposes of the *CCAA*. In exercising its discretion allowing the sale, the court noted that the intangible property constituted personal property within the meaning of the Alberta *PPSA*, the seller's interest was unsecured by way of a PMSI, the debtor had a proprietary interest in the property, and the main secured creditor had priority. The sale was to be conducted by a monitor and subject to court approval: *Re Gauntlett Energy Corp.* (2003), 2003 CarswellAlta 1209, 36 B.L.R. (3d) 250, 45 C.B.R. (4th) 47, 2003 ABQB 718 (Alta. Q.B.).

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

Court File No: CV-09-8396-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding commenced at Toronto

BOOK OF AUTHORITIES
(Motion returnable December 8, 2009)

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