Court File No. CV-12-9667-00CL

ONTARIO

SUPERIOR COURT OF JUSTICE

COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

BRIEF OF AUTHORITIES OF THE APPLICANT, SINO-FOREST CORPORATION
(Motion for Plan Filing and Meeting Order Returnable August 28, 2012)

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Tab 1

Indexed as:

Elan Corp. v. Comiskey

Elan Corp. and Nova Metal Products Inc.
v. Michael Comiskey, trustee of a debenture issued
to Joseph Comiskey and all secured creditors of Elan Corp.
and Nova Metal Products Inc.

[1990] O.J. No. 2180

1 O.R. (3d) 289

41 O.A.C. 282

1 C.B.R. (3d) 101

23 A.C.W.S. (3d) 1192

Action Nos. 684/90 and 685/90

Court of Appeal for Ontario

Finlayson, Krever and Doherty JJ.A.

November 2, 1990*
*Released November 23, 1990

Counsel:

F.J.C. Newbould, Q.C., and G.B. Morawetz, for Bank of Nova Scotia.

John Little, for Elan Corp. and Nova Metal Products Inc.

Michael B. Rotsztain, for RoyNat Inc.

Kim Twohig and M. Olanow, for Ontario Development Corp.

K.P. McElcheran, for monitor Ernst & Young.

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1 **FINLAYSON J.A.** (KREVER J.A. concurring) (orally):-- This is an appeal by the Bank of Nova Scotia (the Bank) from orders made by Mr. Justice Hoolihan as hereinafter described. The Bank of Nova Scotia was the lender to two related companies, namely, Elan Corporation (Elan) and Nova Metal Products Inc. (Nova), which commenced proceedings under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (the CCAA) for the purposes of having a plan of arrangement put to a meeting of secured creditors of those companies.

2 The orders appealed from are:

(i) An order of September 11, 1990 which directed a meeting of the secured creditors of Elan and Nova to consider the plan of arrangement filed, or other suitable plan. The order further provided that for three days until September 14, 1990, the Bank be prevented from acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova and that Elan and Nova could spend the accounts receivable assigned to the Bank that would be received.

(ii) an order dated September 14, 1990 extending the terms of the order of September 11, 1990 to remain in effect until the plan of arrangement was presented to the court no later than October 24, 1990. This order continued the stay against the Bank and the power of Elan and Nova to spend the accounts receivable assigned to the Bank. Further orders dated September 27, 1990 and October 18, 1990 have extended the stay and the power of Elan and Nova to spend the accounts receivable that have been assigned to the Bank. The date of the meetings of creditors has been extended to November 9, 1990. The application to sanction the plan of arrangement must be heard by November 14, 1990.

(iii) An order dated October 18, 1990 directing that there be two classes of secured creditors for the purposes of voting at the meeting of secured creditors. The first class is to be comprised of the Bank, RoyNat Inc. (RoyNat), the Ontario Development Corporation (O.D.C.), the City of Chatham and the Village of Glencoe. The second class is to be comprised of persons related to Elan and Nova that acquired debentures to enable the companies to apply under the CCAA.

3 There is very little dispute about the facts in this matter, but the chronology of events is important and I am setting it out in some detail.

4 The Bank has been the banker to Elan and Nova. At the time of the application in August 1990 it was owed approximately $1,900,000. With interest and costs, including receivers' fees, it is now owed in excess of $2,300,000. It has a first registered charge on the accounts receivable and inventory of Elan and Nova and a second registered charge on the land, buildings and equipment. It also has security under s. 178 [am. R.S.C. 1985, c. 25 (3rd Supp.), s. 26] of the Bank Act, R.S.C. 1985, c. B-1. The terms of credit between the Bank and Elan as set out in a commitment agreement provide that Elan and Nova may not encumber their assets without the consent of the Bank.

5 RoyNat is also a secured creditor of Elan and Nova and it is owed approximately $12,000,000. It holds a second registered charge on the accounts receivable and inventory of Elan and Nova and a first registered charge on the land, buildings and equipment. The Bank and RoyNat entered into a priority agreement to define with certainty the priority which each holds over the assets of Elan and Nova.

6 The O.D.C. guaranteed payment of $500,000 to RoyNat for that amount lent by RoyNat to Elan. The O.D.C. holds debenture security from Elan to secure the guarantee which it gave to RoyNat. That security ranks third to the Bank and RoyNat. The O.D.C. has not been called upon by RoyNat to pay under its guarantee. O.D.C. has not lent any money directly to Elan or Nova.

7 Elan owes approximately $77,000 to the City of Chatham for unpaid municipal taxes. Nova owes approximately $18,000 to the Village of Glencoe for unpaid municipal taxes. Both municipalities have a lien on the real property of the respective companies in priority to every claim except the Crown under s. 369 of the Municipal Act, R.S.O. 1980, c. 302.

8 On May 8, 1990 the Bank demanded payment of all outstanding loans owing by Elan and Nova to be made by June 1, 1990. Extensions of time were granted and negotiations directed to the settlement of the debt took place thereafter. On August 27, 1990, the Bank appointed Coopers & Lybrand Ltd. as receiver and manager of the assets of Elan and Nova and as agent under the Bank's security to realize upon the security. Elan and Nova refused to allow the receiver and manager to have access to their premises on the basis that insufficient notice had been provided by the Bank before demanding payment.

9 Later on August 27, 1990 the Bank brought a motion in an action against Elan and Nova (Doc. No. 54033/90) for an order granting possession of the premises of Elan and Nova to Coopers & Lybrand. On the evening of August 27, 1990 at approximately 9:00 p.m., Mr. Justice Saunders made an order adjourning the motion on certain conditions. The order authorized Coopers & Lybrand access to the premises to monitor Elan's business and permitted Elan to remain in possession and carry on its business in the ordinary course. The Bank was restrained in the order, until the motion could be heard, from selling inventory, land, equipment or buildings or from notifying account debtors to collect receivables, but was not restrained from applying accounts receivables that were collected against outstanding bank loans.

10 On Wednesday, August 29, 1990 Elan and Nova each issued a debenture for $10,000 to a friend of the principals of the companies, Joseph Comiskey, through his brother Michael Comiskey as trustee, pursuant to a trust deed executed the same day. The terms were not commercial and it does not appear that repayment was expected. It is conceded by counsel for Elan that the sole purpose of issuing the debentures was to qualify as a "debtor company" within the meaning of s. 3 of the CCAA. Section 3 reads as follows:

> 3. This Act does not apply in respect of a debtor company unless
>
> (a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and
>
> (b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

11 The debentures conveyed the personal property of Elan and Nova as security to Michael Comiskey as trustee. No consent was obtained from the Bank as required by the loan agreements,

nor was any consent obtained from the receiver. Cheques for $10,000 each, representing the loans secured in the debentures were given to Elan and Nova on Wednesday, August 29, 1990 but not deposited until six days later on September 4, 1990 after an interim order had been made by Mr. Justice Farley in favour of Elan and Nova staying the Bank from taking proceedings.

12 On August 30, 1990 Elan and Nova applied under s. 5 of the CCAA for an order directing a meeting of secured creditors to vote on a plan of arrangement. Section 5 provides:

> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

13 The application was heard by Farley J. on Friday, August 31, 1990 at 8:00 a.m. Farley J. dismissed the application on the grounds that the CCAA required that there be more than one debenture issued by each company. Later on the same day, August 31, 1990, Elan and Nova each issued two debentures for $500 to the wife of the principal of Elan through her sister as trustee. The debentures provided for payment of interest to commence on August 31, 1992. Cheques for $500 were delivered that day to the companies but not deposited in the bank account until September 4, 1990. These debentures conveyed the personal property in the assets of Elan and Nova to the trustee as security. Once again it is conceded that the debentures were issued for the sole purpose of meeting the requirements of s. 3 of the CCAA. No consent was obtained from the Bank as required by the loan terms, nor was any consent obtained from the receiver.

14 On August 31, 1990, following the creation of the trust deeds and the issuance of the debentures, Elan and Nova commenced new applications under the CCAA which were heard late in the day by Farley J. He adjourned the applications to September 10, 1990 on certain terms, including a stay preventing the Bank from acting on its security and allowing Elan to spend up to $321,000 from accounts receivable collected by it.

15 The plan of arrangement filed with the application provided that Elan and Nova would carry on business for three months, that secured creditors would not be paid and could take no action on their security for three months and that the accounts receivable of Elan and Nova assigned to the Bank could be utilized by Elan and Nova for purposes of its day to day operations. No compromise of any sort was proposed.

16 On September 11, 1990, Hoolihan J. ordered that a meeting of the secured creditors of Elan and Nova be held no later than October 22, 1990 to consider the plan of arrangement that had been filed, or other suitable plan. He ordered that the plan of arrangement be presented to the secured creditors no later than September 27, 1990. He made further orders effective for three days until September 14, 1990, including orders:

(i) that the companies could spend the accounts receivable assigned to the Bank that would be collected in accordance with a cash flow forecast filed with the court providing for $1,387,000 to be spent by September 30, 1990; and

(ii) a stay of proceedings against the Bank acting on any of its security or paying down any of its loans from accounts receivable collected by Elan and Nova.

17 On September 14, 1990, Hoolihan J. extended the terms of his order of September 11, 1990 to remain in effect until the plan of arrangement was presented to the court no later than October 24, 1990 for final approval. This order continued the power of Elan and Nova to spend up to $1,387,000 of the accounts receivable assigned to the Bank in accordance with the projected cash flow to September 30, 1990, and to spend a further amount to October 24, 1990 in accordance with a cash flow to be approved by Hoolihan J. prior to October 1, 1990. Further orders dated September 27 and October 18 have extended the power to spend the accounts receivable to November 14, 1990.

18 On September 14, 1990 the Bank requested Hoolihan J. to restrict his order so that Elan and Nova could use the accounts receivable assigned to the Bank only so long as they continued to operate within the borrowing guidelines contained in the terms of the loan agreements with the Bank. These guidelines require a certain ratio to exist between Bank loans and the book value of the accounts receivable and inventory assigned to the Bank and are designed in normal circumstances to ensure that there is sufficient value in the security assigned to the Bank. Hoolihan J. refused to make the order.

19 On October 18, 1990 Hoolihan J. ordered that the composition of the classes of secured creditors for the purposes of voting at the meeting of secured creditors shall be as follows:

(a) The Bank, RoyNat, O.D.C., the City of Chatham and the Village of Glencoe shall comprise one class.

(b) The parties related to the principal of Elan that acquired their debentures to enable the companies to apply under the CCAA shall comprise a second class.

20 On October 18, 1990, at the request of counsel for Elan and Nova, Hoolihan J. further ordered that the date for the meeting of creditors of Elan and Nova be extended to November 9, 1990 in order to allow a new plan of arrangement to be sent to all creditors, including unsecured creditors of those companies. Elan and Nova now plan to offer a plan of compromise or arrangement to the unsecured creditors of Elan and Nova as well as to the secured creditors.

21 There are five issues in this appeal.

(1) Are the debentures issued by Elan and Nova for the purpose of permitting the companies to qualify as applicants under the CCAA, debentures within the meaning of s. 3 of the CCAA?

(2) Did the issue of the debentures contravene the provisions of the loan agreements between Elan and Nova and the Bank? If so, what are the consequences for CCAA purposes?

(3) Did Elan and Nova have the power to issue the debentures and make application under the CCAA after the Bank had appointed a receiver and after the order of Saunders J.?

(4) Did Hoolihan J. have the power under s. 11 of the CCAA to make the interim orders that he made with respect to the accounts receivable?

(5) Was Hoolihan J. correct in ordering that the Bank vote on the proposed plan of arrangement in a class with RoyNat and the other secured creditors?

22 It is well established that 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. Such a resolution can have significant benefits for the company, its shareholders and employees. For this reason the debtor companies, Elan and Nova, are entitled to a broad and liberal interpretation of the jurisdiction of the court under the CCAA. Having said that, it does not follow that, in exercising its discretion to order a meeting of creditors under s. 5 of the CCAA, the court should not consider the equities in this case as they relate to these companies and to one of its principal secured creditors, the Bank.

23 The issues before Hoolihan J. and this court were argued on a technical basis. Hoolihan J. did not give effect to the argument that the debentures described above were a "sham" and could not be used for the purposes of asserting jurisdiction. Unfortunately, he did not address any of the other arguments presented to him on the threshold issue of the availability of the CCAA. He appears to have acted on the premise that if the CCAA can be made available, it should be utilized.

24 If Hoolihan J. did exercise any discretion overall, it is not reflected in his reasons. I believe, therefore, that we are in a position to look at the uncontested chronology of these proceedings and exercise our own discretion. To me, the significant date is August 27, 1990 when the Bank appointed Coopers & Lybrand Ltd. as receiver and manager of the undertaking, property and assets mortgaged and charged under the demand debenture and of the collateral under the general security agreement, both dated June 20, 1979. On the same date it appointed the same company as receiver and manager for Nova under a general security agreement dated December 5, 1988. The effect of this appointment is to divest the companies and their boards of directors of their power to deal with the property comprised in the appointment (Kerr on Receivers, 16th ed. by Raymond Walton (London: Sweet & Maxwell, 1983), p. 292). Neither Elan nor Nova had the power to create further indebtedness and thus to interfere with the ability of the receiver to manage the two companies (Re Hat Development Ltd. (1988), 64 Alta. L.R. (2d) 17, 71 C.B.R. (N.S.) 264 (Q.B.), affd (1989), 65 Alta. L.R. (2d) 374 (C.A.)).

25 Counsel for the debtor companies submitted that the management powers of the receiver were stripped from the receiver by Saunders J. in his interim order when he allowed the receiver access to the companies' properties but would not permit it to realize on the security of the Bank until further order. He pointed out that the order also provided that the companies were entitled to remain in possession and "to carry on business in the ordinary course" until further order.

26 I do not agree with counsel's submission covering the effect of the order. It certainly restricted what the receiver could do on an interim basis, but it imposed restrictions on the companies as well. The issue of these disputed debentures in support of an application for relief as insolvent companies under the CCAA does not comply with the order of Saunders J. This is not carrying on business in the ordinary course. The residual power to take all of these initiatives for relief under the CCAA remained with the receiver, and if trust deeds were to be issued, an order of the court in Action 54033/90 was required permitting their issuance and registration.

27 There is another feature which, in my opinion, affects the exercise of discretion and that is the probability of the meeting achieving some measure of success. Hoolihan J. considered the calling of the meeting at one hearing, as he was asked to do, and determined the respective classes of creditors at another. This latter classification is necessary because of the provisions of s. 6(a) of the CCAA which reads as follows:

6. Where a majority in number representing three-fourths in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company ...

28 If both matters had been considered at the same time, as in my view they should have been, and if what I regard as a proper classification of the creditors had taken place, I think it is obvious that the meeting would not be a productive one. It was improper, in my opinion, to create one class of creditors made up of all the secured creditors save the so-called "sham" creditors. There is no true community of interest among them and the motivation of Elan and Nova in striving to create a single class is clearly designed to avoid the classification of the Bank as a separate class.

29 It is apparent that the only secured creditors with a significant interest in the proceeding under the CCAA are the Bank and RoyNat. The two municipalities have total claims for arrears of taxes of less than $100,000. They have first priority in the lands of the companies. They are in no jeopardy whatsoever. The O.D.C. has a potential liability in that it can be called upon by RoyNat under its guarantee to a maximum of $500,000 and this will trigger default under its debentures with the companies, but its interests lie with RoyNat.

30 As to RoyNat, it is the largest creditor with a debt of some $12,000,000. It will dominate any class it is in because under s. 6 of the CCAA the majority in a class must represent three- quarters in value of that class. It will always have a veto by reason of the size of its claim but requires at least one creditor to vote for it to give it a majority in number (I am ignoring the municipalities). It needs the O.D.C.

31 I do not base my opinion solely on commercial self-interest but also on the differences in legal interest. The Bank has first priority on the receivables referred to as the "quick assets", and RoyNat ranks second in priority. RoyNat has first priority on the buildings and realty, the "fixed assets", and the Bank has second priority.

32 It is in the commercial interests of the Bank with its smaller claim and more readily realizable assets to collect and retain the accounts receivable. It is in the commercial interests of RoyNat to preserve the cash flow of the business and sell the enterprise as a going concern. It can only do that by overriding the prior claim of the Bank to these receivables. If it can vote with the O.D.C. in the same class as the Bank it can achieve that goal and extinguish the prior claim of the Bank to realize on the receivables. This it can do despite having acknowledged its legal relationship to the Bank in the priority agreement signed by the two. I can think of no reason why the legal interest of the Bank as the holder of the first security on the receivables should be overridden by RoyNat as holder of the second security.

33 The classic statement on classes of creditors is that of Lord Esher M.R. in Sovereign Life Assurance Co. v. Dodd, [1892] 2 Q.B. 573, [1891-4] All E.R. Rep. 246, 41 W.R. 4 (C.A.), at pp. 579-80 Q.B.:

> The Act (Joint Stock Companies Arrangement Act, 1870) says that the persons to be summoned to the meeting (all of whom, be it said in passing, are creditors) are persons who can be divided into different classes -- classes which the Act of Parliament recognises, though it does not define them. This, therefore, must be done: they must be divided into different classes. What is the reason for such a course? It is because the creditors composing the different classes have different interests; and, therefore, if we find a different state of facts existing among different creditors which may differently affect their minds and their judgment, they must be divided into different classes.

34 The Sovereign Life case was quoted with approval by Kingstone J. in Re Wellington Building Corp. Ltd., [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626 (H.C.J.), at p. 659 O.R. He also quoted another English authority [Re Alabama, New Orleans, Texas & Pacific Junction Railway Co., [1891] 1 Ch. 213, [1886-90] All E.R. Rep. Ext. 1143, 60 L.J. Ch. 221 (C.A.)] at p. 658 O.R.:

> In In re Alabama, New Orleans, Texas and Pacific Junction Ry. Co., [1891] 1 Ch. 213, a scheme and arrangement under the Joint Stock Companies Arrangement Act (1870), was submitted to the Court for approval. Lord Justice Bowen, at p. 243, says: --
>
> Now, I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation. ... Its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.

35 Kingstone J. set aside a meeting where three classes of creditors were permitted to vote together. He said at p. 660 O.R.:

> It is clear that Parliament intended to give the three-fourths majority of any class power to bind that class, but I do not think the Statute should be construed so as to permit holders of subsequent mortgages power to vote and thereby destroy the priority rights and security of a first mortgagee.

36 We have been referred to more modern cases including two decisions of Trainor J. of the British Columbia Supreme Court, both entitled Re Northland Properties Ltd. One case is reported in (1988), 31 B.C.L.R. (2d) 35, 73 C.B.R. (N.S.) 166, and the other in the same volume [of C.B.R.] at p. 175. Trainor J. was upheld on appeal on both judgments. The first judgment of the British Columbia Court of Appeal is unreported (September 16, 1988) [now reported 32 B.C.L.R. (2d) 309].

The judgment in the second appeal is reported sub nom. Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada at (1989), 34 B.C.L.R. (2d) 122, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363.

37 In the first Northland case, Trainor J. held that the difference in the terms of parties to and priority of different bonds meant that they should be placed in separate classes. He relied upon Re Wellington Building Corp., supra. In the second Northland case he dealt with 15 mortgagees who were equal in priority but held different parcels of land as security. Trainor J. held that their relative security positions were the same notwithstanding that the mortgages were for the most part secured by charges against separate properties. The nature of the debt was the same, the nature of the security was the same, the remedies for default were the same, and in all cases they were corporate loans by sophisticated lenders. In specifically accepting the reasoning of Trainor J., the Court of Appeal held that the concern of the various mortgagees as to the quality of their individual securities was "a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both" (p. 203 C.B.R.).

38 In Re NsC Diesel Power Inc. (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (T.D.) the court stressed that a class should be made up of persons "whose rights are not so dissimilar as to make it impossible for them to consult together with a view to a common interest" (p. 8 C.B.R.).

39 My assessment of these secured creditors is that the Bank should be in its own class. This being so, it is obvious that no plan of arrangement can succeed without its approval. There is no useful purpose to be served in putting a plan of arrangement to a meeting of creditors if it is known in advance that it cannot succeed. This is another cogent reason for the court declining to exercise its discretion in favour of the debtor companies.

40 For all the reasons given above, the application under the CCAA should have been dismissed. I do not think that I have to give definitive answers to the individual issues numbered (1) and (2). They can be addressed in a later case where the answers could be dispositive of an application under the CCAA. The answer to (3) is that the combined effect of the receivership and the order of Saunders J. disentitled the companies to issue the debentures and bring the application under the CCAA. It is not necessary to answer issue (4) and the answer to (5) is no.

41 Accordingly, I would allow the appeal, set aside the three orders of Hoolihan J., and in their place, issue an order dismissing the application under the CCAA. The Bank should receive its costs of this appeal, the applications for leave to appeal, and the proceedings before Farley and Hoolihan JJ., to be paid by Elan, Nova and RoyNat.

42 Ernst & Young were appointed monitor in the order of Hoolihan J. dated September 14, 1990 to monitor the operations of Elan and Nova and give effect to and supervise the terms and conditions of the stay of proceedings in accordance with Appendix C appended to the order. The monitor should be entitled to be paid for all services performed to date including whatever is necessary to complete its reports for past work as called for in Appendix C.

DOHERTY J.A. (dissenting):--

I. BACKGROUND

43 On November 2, 1990, this court allowed the appeal brought by the Bank of Nova Scotia (the Bank) and vacated several orders made by Hoolihan J. Finlayson J.A. delivered oral reasons on behalf of the majority. At the same time, I delivered brief oral reasons dissenting in part from the conclusion reached by the majority and undertook to provide further written reasons. These are those reasons.

44 The events relevant to the disposition of this appeal are set out in some detail in the oral reasons of Finlayson J.A. I will not repeat that chronology but will refer to certain additional background facts before turning to the legal issues.

45 Elan Corporation (Elan) owns the shares of Nova Metal Products Inc. (Nova Inc.). Both companies have been actively involved in the manufacture of automobile parts for a number of years. As of March 1990, the companies had total annual sales of about $30,000,000 and employed some 220 people in plants located in Chatham and Glencoe, Ontario. The operation of these companies no doubt plays a significant role in the economy of these two small communities.

46 In the four years prior to 1989, the companies had operated at a profit ranging from $287,000 (1987) to $1,500,000 (1986). In 1989, several factors, including large capital expenditures and a downturn in the market, combined to produce an operational loss of about $1,333,000. It is anticipated that the loss for the year ending June 30, 1990, will be about $2.3 million. As of August 1, 1990, the companies continued in full operation and those in control anticipated that the financial picture would improve significantly later in 1990 when the companies would be busy filling several contracts which had been obtained earlier in 1990.

47 The Bank has provided credit to the companies for several years. In January of 1989 the Bank extended an operating line of credit to the companies. The line of credit was by way of a demand loan that was secured in the manner described by Finlayson J.A. Beginning in May 1989, and from time to time after that, the companies were in default under the terms of the loan advanced by the Bank. On each occasion the Bank and the companies managed to work out some agreement so that the Bank continued as lender and the companies continued to operate their plants.

48 Late in 1989, the companies arranged for a $500,000 operating loan from RoyNat Inc. It was hoped that this loan, combined with the operating line of $2.5 million from the Bank, would permit the company to weather its fiscal storm. In March 1990, the Bank took the position that the companies were in breach of certain requirements under their loan agreements and warned that if the difficulties were not rectified the Bank would not continue as the company's lender. Mr. Patrick Johnson, the president of both companies, attempted to respond to these concerns in a detailed letter to the Bank dated March 15, 1990. The response did not placate the Bank. In May 1990, the Bank called its loan and made a demand for immediate payment. Mr. Spencer, for the Bank, wrote: "We consider your financial condition continues to be critical and we are not prepared to delay further making formal demand". He went on to indicate that, subject to further deterioration in the companies' fiscal position, the Bank was prepared to delay acting on its security until June 1, 1990.

49 As of May 1990, Mr. Johnson, to the Bank's knowledge, was actively seeking alternative funding to replace the Bank. At the same time, he was trying to convince the union which represented the workers employed at both plants to assist in a co-operative effort to keep the plants operational during the hard times. The union had agreed to discuss amendment of the collective bargaining agreement to facilitate the continued operation of the companies.

50 The June 1, 1990, deadline set by the Bank passed without incident. Mr. Johnson continued to search for new financing. A potential lender was introduced to Mr. Spencer of the Bank on August 13, 1990, and it appeared that the Bank, through Mr. Spencer, was favourably impressed with this potential lender. However, on August 27, 1990, the Bank decided to take action to protect its position. Coopers & Lybrand Ltd. was appointed by the Bank as receiver-manager under the terms of the security agreements with the companies. The companies denied the receiver access to their plants. The Bank then moved before the Honourable Mr. Justice E. Saunders for an order giving the receiver possession of the premises occupied by the companies. On August 27, 1990, after hearing argument from counsel for the Bank and the companies, Mr. Justice Saunders refused to install the receivers and made the following interim order:

> 1. THIS COURT ORDERS that the receiver be allowed access to the property to monitor the operations of the defendants but shall not take steps to realize on the security of The Bank of Nova Scotia until further Order of the Court.
>
> 2. THIS COURT ORDERS that the defendants shall be entitled to remain in possession and to carry on business in the ordinary course until further Order of this Court.
>
> 3. THIS COURT ORDERS that until further order the Bank of Nova Scotia shall not take steps to notify account debtors of the defendants for the purpose of collecting outstanding accounts receivable. This Order does not restrict The Bank of Nova Scotia from dealing with accounts receivable of the defendants received by it.
>
> 4. THIS COURT ORDERS that the motion is otherwise adjourned to a date to be fixed.

51 The notice of motion placed before Saunders J. by the Bank referred to "an intended action" by the Bank. It does not appear that the Bank took any further steps in connection with this "intended action".

52 Having resisted the Bank's efforts to assume control of the affairs of the companies on August 27, 1990, and realizing that their operations could cease within a matter of days, the companies turned to the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (the Act) in an effort to hold the Bank at bay while attempting to reorganize their finances. Finlayson J.A. has described the companies' efforts to qualify under that Act, the two appearances before the Honourable Mr. Justice Farley on August 31, 1990, and the appearances before the Honourable Mr. Justice Hoolihan in September and October 1990, which resulted in the orders challenged on this appeal.

II. THE ISSUES

53 The dispute between the Bank and the companies when this application came before Hoolihan J. was a straightforward one. The Bank had determined that its best interests would be served by the immediate execution of the rights it had under its various agreements with the companies. The Bank's best interest was not met by the continued operation of the companies as going

concerns. The companies and their other two substantial secured creditors considered that their interests required that the companies continue to operate, at least for a period which would enable the companies to place a plan of reorganization before its creditors.

54 All parties were pursuing what they perceived to be their commercial interests. To the Bank these interests entailed the "death" of the companies as operating entities. To the companies these interests required "life support" for the companies through the provisions of the Act to permit a "last ditch" effort to save the companies and keep them in operation.

55 The issues raised on this appeal can be summarized as follows:

(i) Did Hoolihan J. err in holding that the companies were entitled to invoke the Act?
(ii) Did Hoolihan J. err in exercising his discretion in directing that a meeting of creditors should be held under the Act?
(iii) Did Hoolihan J. err in directing that the Bank and RoyNat Inc. should be placed in the same class of creditors for the purposes of the Act?
(iv) Did Hoolihan J. err in the terms of the interim orders he made pending the meeting of creditors and the submission to the court of a plan of reorganization?

III. THE PURPOSE AND SCHEME OF THE ACT

56 Before turning to these issues, it is necessary to understand the purpose of the Act and the scheme established by the Act for achieving that purpose. The Act first appeared in the midst of the Great Depression (Companies' Creditors Arrangement Act, 1933, S.C. 1932-33, c. 36). The Act was intended to provide a means whereby insolvent companies could avoid bankruptcy and continue as ongoing concerns through a reorganization of their financial obligations. The reorganization contemplated required the co-operation of the debtor companies' creditors and shareholders: Re Avery Construction Co. (1942), 24 C.B.R. 17, [1942] 4 D.L.R. 558 (Ont. H.C.J.), Stanley E. Edwards, "Reorganizations under the Companies' Creditors Arrangement Act" (1947), 25 Can. Bar Rev. 587, at pp. 592-93; David H. Goldman, "Reorganizations Under the Companies' Creditors Arrangement Act (Canada)" (1985), 55 C.B.R. (N.S.) 36, at pp. 37-39.

57 The legislation is remedial in the purest sense in that it provides a means whereby the devastating social and economic effects of bankruptcy or creditor-initiated termination of ongoing business operations can be avoided while a court-supervised attempt to reorganize the financial affairs of the debtor company is made.

58 The purpose of the Act was artfully put by Gibbs J.A., speaking for the British Columbia Court of Appeal (Carrothers, Cumming and Gibbs JJ.A.) in Chef Ready Foods Ltd. v. HongKong Bank of Canada, an unreported judgment released October 29, 1990 [summarized 23 A.C.W.S. (3d) Paragraph976], at pp. 11 and 6 of the reasons. In referring to the purpose for which the Act was initially proclaimed, he said:

> Almost inevitably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A. (the Act), to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to

> attempt a reorganization or compromise or arrangement under which the company could continue in business ...

In an earlier passage His Lordship had said:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business.

59 Gibbs J.A. also observed (at p. 13 of the reasons) that the Act was designed to serve a "broad constituency of investors, creditors and employees". Because of that "broad constituency" the court must, when considering applications brought under the Act, have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest. That interest is generally, but not always, served by permitting an attempt at reorganization: see Edwards, "Reorganizations under the Companies' Creditors Arrangement Act", supra, at p. 593.

60 The Act must be given a wide and liberal construction so as to enable it to effectively serve this remedial purpose: Interpretation Act, R.S.C. 1985, c. I-21, s. 12; Chef Ready Foods Ltd. v. HongKong Bank of Canada, supra, at p. 14 of the reasons.

61 The Act is available to all insolvent companies, provided the requirements of s. 3 of the Act are met. That section provides:

> 3. This Act does not apply in respect of a debtor company unless
>
> (a) the debtor company has outstanding an issue of secured or unsecured bonds of the debtor company or of a predecessor in title of the debtor company issued under a trust deed or other instrument running in favour of a trustee; and
>
> (b) the compromise or arrangement that is proposed under section 4 or 5 in respect of the debtor company includes a compromise or an arrangement between the debtor company and the holders of an issue referred to in paragraph (a).

62 A debtor company, or a creditor of that company, invokes the Act by way of summary application to the court under s. 4 or s. 5 of the Act. For present purposes, s. 5 is the relevant section:

> 5. Where a compromise or an arrangement is proposed between a debtor company and its secured creditors or any class of them, the court may, on the application in a summary way of the company or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

63 Section 5 does not require that the court direct a meeting of creditors to consider a proposed plan. The court's power to do so is discretionary. There will no doubt be cases where no order will be made, even though the debtor company qualifies under s. 3 of the Act.

64 If the court determines that a meeting should be called, the creditors must be placed into classes for the purpose of that meeting. The significance of this classification process is made apparent by s. 6 of the Act.

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

65 If the plan of reorganization is approved by the creditors as required by s. 6, it must then be presented to the court. Once again, the court must exercise a discretion and determine whether it will approve the plan of reorganization. In exercising that discretion, the court is concerned not only with whether the appropriate majority has approved the plan at a meeting held in accordance with the Act and the order of the court, but also with whether the plan is a fair and reasonable one: Re Northland Properties Ltd. (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) [affd sub nom Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada (1989), 34 B.C.L.R. (2d) 122, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363 (C.A.)], at pp. 182-85 C.B.R.

66 If the court chooses to exercise its discretion in favour of calling a meeting of creditors for the purpose of considering a plan of reorganization, the Act provides that the rights and remedies available to creditors, the debtor company, and others during the period between the making of the initial order and the consideration of the proposed plan may be suspended or otherwise controlled by the court.

67 Section 11 gives a court wide powers to make any interim orders:

> 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.

68 Viewed in its totality, the Act gives the court control over the initial decision to put the reorganization plan before the creditors, the classification of creditors for the purpose of considering the plan, conduct affecting the debtor company pending consideration of that plan, and the ultimate acceptability of any plan agreed upon by the creditors. The Act envisions that the rights and remedies of individual creditors, the debtor company, and others may be sacrificed, at least temporarily, in an effort to serve the greater good by arriving at some acceptable reorganization which allows the debtor company to continue in operation: Icor Oil & Gas Co. v. Canadian Imperial Bank of Commerce (No. 1) (1989), 102 A.R. 161 (Q.B.), at p. 165.

IV. DID HOOLIHAN J. ERR IN HOLDING THAT THE DEBTOR COMPANIES WERE ENTITLED TO INVOKE THE ACT?

69 The appellant advances three arguments in support of its contention that Elan and Nova Inc. were not entitled to seek relief under the Act. It argues first that the debentures issued by the companies after August 27, 1990, were "shams" and did not fulfil the requirements of s. 3 of the Act. The appellant next contends that the issuing of the debentures by the companies contravened their agreements with the Bank in which they undertook not to further encumber the assets of the companies without the consent of the Bank. Lastly, the appellant maintains that once the Bank had appointed a receiver-manager over the affairs of the companies on August 27, 1990, the companies had no power to create further indebtedness by way of debentures or to bring an application on behalf of the companies under the Act.

(i) Section 3 and "instant" trust deeds

70 The debentures issued in August 1990, after the Bank had moved to install a receiver-manager, were issued solely and expressly for the purpose of meeting the requirements of s. 3 of the Act. Indeed, it took the companies two attempts to meet those requirements. The debentures had no commercial purpose. The transactions did, however, involve true loans in the sense that monies were advanced and debt was created. Appropriate and valid trust deeds were also issued.

71 In my view, it is inappropriate to refer to these transactions as "shams". They are neither false nor counterfeit, but rather are exactly what they appear to be, transactions made to meet jurisdictional requirements of the Act so as to permit an application for reorganization under the Act. Such transactions are apparently well known to the commercial bar: B. O'Leary, "A Review of the Companies' Creditors Arrangement Act" (1987), 4 National Insolvency Review 38, at p. 39; C.

Keith Ham, " 'Instant' Trust Deeds Under the CCAA" (1988), 2 Comm. Insol. R. 25; G. Morawetz, "Emerging Trends in the Use of the Companies' Creditors Arrangement Act" (1990), Proceedings of the First Annual General Meeting and Conference of the Insolvency Institute of Canada.

> Mr. Ham, supra, writes at p. 25, continued on p. 30:
>
> Consequently, some companies have recently sought to bring themselves within the ambit of the CCAA by creating "instant" trust deeds, i.e., trust deeds which are created solely for the purpose of enabling them to take advantage of the CCAA.

72 Applications under the Act involving the use of "instant" trust deeds have been before the courts on a number of occasions. In no case has any court held that a company cannot gain access to the Act by creating a debt which meets the requirements of s. 3 for the express purpose of qualifying under the Act. In most cases, the use of these "instant" trust deeds has been acknowledged without comment.

73 The decision of Chief Justice Richard in Re United Maritime Fishermen Co-op (1988), 67 C.B.R. (N.S.) 44, 84 N.B.R. (2d) 415, 214 A.P.R. 415 (Q.B.), at pp. 55-56 C.B.R., speaks directly to the use of "instant" trust deeds. The Chief Justice refused to read any words into s. 3 of the Act which would limit the availability of the Act depending on the point at which, or the purpose for which, the debenture or bond and accompanying trust deed were created. He accepted [p. 56 C.B.R.] the debtor company's argument that the Act:

> ... does not impose any time restraints on the creation of the conditions as set out in s. 3 of the Act, nor does it contain any prohibition against the creation of the conditions set out in s. 3 for the purpose of obtaining jurisdiction.

74 It should, however, be noted that in Re United Maritime Fishermen Co-op, supra, the debt itself was not created for the purpose of qualifying under the Act. The bond and the trust deed, however, were created for that purpose. The case is therefore factually distinguishable from the case at bar.

75 The Court of Appeal reversed the ruling of the Chief Justice ((1988), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618 sub nom. Canadian Co-operative Leasing Services v. United Maritime Fishermen Co-op, 88 N.B.R. (2d) 253, 224 A.P.R. 253) on the basis that the bonds required by s. 3 of the Act had not been issued when the application was made, so that on a precise reading of the words of s. 3 the company did not qualify. The court did not go on to consider whether, had the bonds been properly issued, the company would have been entitled to invoke the Act. Hoyt J.A., for the majority, did, however, observe without comment that the trust deeds had been created specifically for the purpose of bringing an application under the Act.

76 The judgment of MacKinnon J. in Re Stephanie's Fashions Ltd. and Children's Corner Fashions Ltd., released January 24, 1990 (B.C. S.C.), is factually on all fours with the present case. In that case, as in this one, it was acknowledged that the sole purpose for creating the debt was to effect compliance with s. 3 of the Act. After considering the judgment of Chief Justice Richard in Re United Maritime Fishermen Co-op, supra, MacKinnon J. held, at p. 4 of the reasons:

> The reason for creating the trust deed is not for the usual purposes of securing a debt but when one reads it, on its face, it does that. I find that it is a genuine trust deed and not a fraud and that the petitioners have complied with s. 3 of the statute.

77 Re Metals & Alloys Co. is a recent example of a case in this jurisdiction in which "instant" trust deeds were successfully used to bring a company within the Act. The company issued debentures for the purpose of permitting the company to qualify under the Act so as to provide it with an opportunity to prepare and submit a reorganization plan. The company then applied for an order, seeking inter alia a declaration that the debtor company was a corporation within the meaning of the Act. Houlden J.A., hearing the matter at first instance, granted the declaration requested in an order dated February 16, 1990. No reasons were given. It does not appear that the company's qualifications were challenged before Houlden J.A.; however, the nature of the debentures issued and the purpose for their issue was fully disclosed in the material before him. The requirements of s. 3 of the Act are jurisdictional in nature and the consent of the parties cannot vest a court with jurisdiction it does not have. One must conclude that Houlden J.A. was satisfied that "instant" trust deeds suffice for the purposes of s. 3 of the Act.

78 A similar conclusion is implicit in the reasons of the British Columbia Court of Appeal in Chef Ready Foods Ltd. and HongKong Bank of Canada, supra. In that case, a debt of $50, with an accompanying debenture and trust deed, was created specifically to enable the company to make application under the Act. The court noted that the debt was created solely for that purpose in an effort to forestall an attempt by the bank to liquidate the assets of the debtor company. The court went on to deal with the merits and to dismiss an appeal from an order granting a stay pending a reorganization meeting. The court could not have reached the merits without first concluding that the $50 debt created by the company met the requirements of s. 3 of the Act.

79 The weight of authority is against the appellant. Counsel for the appellant attempts to counter that authority by reference to the remarks of the Minister of Justice when s. 3 was introduced as an amendment to the Act in the 1952-53 sittings of Parliament (House of Commons Debates, 1952-53 (1-2 Eliz. 2), vol. II, pp. 1268-69). The interpretation of words found in a statute by reference to speeches made in Parliament at the time legislation is introduced has never found favour in our courts: Re Residential Tenancies Act, 1979, [1981] 1 S.C.R. 714, 123 D.L.R. (3d) 554, 37 N.R. 158, at p. 721 S.C.R., p. 561 D.L.R. Nor, with respect to Mr. Newbould's able argument, do I find the words of the Minister of Justice at the time the present s. 3 was introduced to be particularly illuminating. He indicated that the amendment to the Act left companies with complex financial structures free to resort to the Act, but that it excluded companies which had only unsecured mercantile creditors. The Minister does not comment on the intended effect of the amendment on the myriad situations between those two extremes. This case is one such situation. These debtor companies had complex secured debt structures but those debts were not, prior to the issuing of the debentures in August 1990, in the form contemplated by s. 3 of the Act. Like Richard C.J.Q.B. in Re United Maritime Fishermen Co-op, supra, at pp. 52-53 C.B.R., I am not persuaded that the comments of the Minister of Justice assist in interpreting s. 3 of the Act in this situation.

80 The words of s. 3 are straightforward. They require that the debtor company have, at the time an application is made, an outstanding debenture or bond issued under a trust deed. No more is needed. Attempts to qualify those words are not only contrary to the wide reading the Act deserves but can raise intractable problems as to what qualifications or modifications should be read into the

Act. Where there is a legitimate debt which fits the criteria set out in s. 3, I see no purpose in denying a debtor company resort to the Act because the debt and the accompanying documentation was created for the specific purpose of bringing the application. It must be remembered that qualification under s. 3 entitles the debtor company to nothing more than consideration under the Act. Qualification under s. 3 does not mean that relief under the Act will be granted. The circumstances surrounding the creation of the debt needed to meet the s. 3 requirement may well have a bearing on how a court exercises its discretion at various stages of the application, but they do not alone interdict resort to the Act.

81 In holding that "instant" trust deeds can satisfy the requirements of s. 3 of the Act, I should not be taken as concluding that debentures or bonds which are truly shams, in that they do not reflect a transaction which actually occurred and do not create a real debt owed by the company, will suffice. Clearly, they will not. I do not, however, equate the two. One is a tactical device used to gain the potential advantages of the Act. The other is a fraud.

82 Nor does my conclusion that "instant" trust deeds can bring a debtor company within the Act exclude considerations of the good faith of the debtor company in seeking the protection of the Act. A debtor company should not be allowed to use the Act for any purpose other than to attempt a legitimate reorganization. If the purpose of the application is to advantage one creditor over another, to defeat the legitimate interests of creditors, to delay the inevitable failure of the debtor company, or for some other improper purpose, the court has the means available to it, apart entirely from s. 3 of the Act, to prevent misuse of the Act. In cases where the debtor company acts in bad faith, the court may refuse to order a meeting of creditors, it may deny interim protection, it may vary interim protection initially given when the bad faith is shown, or it may refuse to sanction any plan which emanates from the meeting of the creditors: see L. Crozier "Good Faith and the Companies' Creditors Arrangement Act" (1989), 15 Can. Bus. L.J. 89.

(ii) Section 3 and the prior agreement with the Bank limiting creation of new debt

83 The appellant also argues that the debentures did not meet the requirements of s. 3 of the Act because they were issued in contravention of a security agreement made between the companies and the Bank. Assuming that the debentures were issued in contravention of that agreement, I do not understand how that contravention affects the status of the debentures for the purposes of s. 3 of the Act. The Bank may well have an action against the debtor company for issuing the debentures, and it may have remedies against the holders of the debentures if they attempted to collect on their debt or enforce their security. Neither possibility, however, negates the existence of the debentures and the related trust deeds. Section 3 does not contemplate an inquiry into the effectiveness or enforceability of the s. 3 debentures, as against other creditors, as a condition precedent to qualification under the Act. Such inquiries may play a role in a judge's determination as to what orders, if any, should be made under the Act.

(iii) Section 3 and the appointment of a receiver-manager

84 The third argument made by the Bank relies on its installation of a receiver-manager in both companies prior to the issue of the debentures. I agree with Finlayson J.A. that the placement of a receiver, either by operation of the terms of an agreement or by court order, effectively removes those formerly in control of the company from that position and vests that control in the receiver-manager: Re Hat Development Ltd. (1988), 64 Alta. L.R. (2d) 17, 71 C.B.R. (N.S.) 264 (Q.B.),

affirmed without deciding this point (1989), 65 Alta. L.R. (2d) 374 (C.A.). I cannot, however, agree with his interpretation of the order of Saunders J. I read that order as effectively turning the receiver into a monitor with rights of access, but with no authority beyond that. The operation of the business is specifically returned to the companies. The situation created by the order of Saunders J. can usefully be compared to that which existed when the application was made in Re Hat Development Ltd., supra. Forsyth J., at p. 268 C.B.R., states:

> The receiver-manager in this case and indeed in almost all cases is charged by the court with the responsibility of managing the affairs of a corporation. It is true that is appointed pursuant, in this case, to the existence of secured indebtedness and at the behest of a secured creditor to realize on its security and retire the indebtedness. Nonetheless, this receiver-manager was court-appointed and not by virtue of an instrument. As a court-appointed receiver it owed the obligation and the duty to the court to account from time to time and to come before the court for the purposes of having some of its decisions ratified or for receiving advice and direction. It is empowered by the court to manage the affairs of the company and it is completely inconsistent with that function to suggest that some residual power lies in the hands of the directors of the company to create further indebtedness of the company and thus interfere however slightly, with the receiver-manager's ability to manage.

(Emphasis added)

85 After the order of Saunders J., the receiver-manager in this case was not obligated to manage the companies. Indeed, it was forbidden from doing so. The creation of the "instant" trust deeds and the application under the Act did not interfere in any way with any power or authority the receiver-manager had after the order of Saunders J. was made.

86 I also find it somewhat artificial to suggest that the presence of a receiver-manager served to vitiate the orders of Hoolihan J. Unlike many applications under s. 5 of the Act, the proceedings before Hoolihan J. were not ex parte and he was fully aware of the existence of the receiver-manager, the order of Saunders J., and the arguments based on the presence of the receiver-manager. Clearly, Hoolihan J. considered it appropriate to proceed with a plan of reorganization despite the presence of the receiver-manager and the order of Saunders J. Indeed, in his initial order he provided that the order of Saunders J. "remains extant". Hoolihan J. did not, as I do not, see that order as an impediment to the application for the granting of relief under the Act. Had he considered that the receiver-manager was in control of the affairs of the company he could have varied the order of Saunders J. to permit the applications under the Act to be made by the companies: Re Hat Development Ltd., supra, at pp. 268-69 C.B.R. It is clear to me that he would have done so had he felt it necessary. If the installation of the receiver-manager is to be viewed as a bar to an application under this Act, and if the orders of Hoolihan J. were otherwise appropriate, I would order that the order of Saunders J. should be varied to permit the creation of the debentures and the trust deeds and the bringing of this application by the companies. I take this power to exist by the combined effect of s. 14(2) of the Act and s. 144(1) of the Courts of Justice Act, 1984, S.O. 1984, c. 11.

87 In my opinion, the debentures and "instant" trust deeds created in August of 1990 sufficed to bring the company within the requirements of s. 3 of the Act, even if in issuing those debentures the companies breached a prior agreement with the Bank. I am also satisfied that given the terms of the

order of Saunders J., the existence of a receiver-manager installed by the Bank did not preclude the application under s. 3 of the Act.

V. DID HOOLIHAN J. ERR IN EXERCISING HIS DISCRETION IN FAVOUR OF DIRECTING THAT A CREDITORS MEETING BE HELD TO CONSIDER THE PROPOSED PLAN OF REORGANIZATION?

88 As indicated earlier, the Act provides a number of points at which the court must exercise its discretion. I am concerned with the initial exercise of discretion contemplated by s. 5 of the Act by which the court may order a meeting of creditors for purposes of considering a plan of reorganization. Hoolihan J. exercised that discretion in favour of the debtor companies. The factors relevant to the exercise of that discretion are as variable as the fact situations which may give rise to the application. Finlayson J.A. has concentrated on one such factor, the chance that the plan, if put before a properly constituted meeting of the creditors, could gain the required approval. I agree that the feasibility of the plan is a relevant and significant factor to be considered in determining whether to order a meeting of creditors: Edwards, "Reorganizations Under the Companies' Creditors Arrangement Act", supra, at pp. 594-95. I would not, however, impose a heavy burden on the debtor company to establish the likelihood of ultimate success from the outset. As the Act will often be the last refuge for failing companies, it is to be expected that many of the proposed plans of reorganization will involve variables and contingencies which will make the plan's ultimate acceptability to the creditors and the court very uncertain at the time the initial application is made.

89 On the facts before Hoolihan J. there were several factors which supported the exercise of his discretion in favour of directing a meeting of the creditors. These included the apparent support of two of the three substantial secured creditors, the companies' continued operation, and the prospect (disputed by the Bank) that the companies' fortunes would take a turn for the better in the near future, the companies' ongoing efforts, that eventually met with some success, to find alternate financing, and the number of people depending on the operation of the company for their livelihood. There were also a number of factors pointing in the other direction, the most significant of which was the likelihood that a plan of reorganization acceptable to the Bank could not be developed.

90 I see the situation which presented itself to Hoolihan J. as capable of a relatively straightforward risk-benefit analysis. If the s. 5 order had been refused by Hoolihan J., it was virtually certain that the operation of the companies would have ceased immediately. There would have been immediate economic and social damage to those who worked at the plants and those who depended on those who worked at the plants for their well-being. This kind of damage cannot be ignored, especially when it occurs in small communities like those in which these plants are located. A refusal to grant the application would also have put the investments of the various creditors, with the exception of the Bank, at substantial risk. Finally, there would have been obvious financial damage to the owner of the companies. Balanced against these costs inherent in refusing the order would be the benefit to the Bank, which would then have been in a position to realize on its security in accordance with its agreements with the companies.

91 The granting of the s. 5 order was not without its costs. It has denied the Bank the rights it had bargained for as part of its agreement to lend substantial amounts of money to the companies. Further, according to the Bank, the order has put the Bank at risk of having its loans become under-secured because of the diminishing value of the accounts receivable and inventory which it holds as security and because of the ever increasing size of the companies' debt to the Bank. These

costs must be measured against the potential benefit to all concerned if a successful plan of reorganization could be developed and implemented.

92 As I see it, the key to this analysis rests in the measurement of the risk to the Bank inherent in the granting of the s. 5 order. If there was a real risk that the loan made by the Bank would become undersecured during the operative period of the s. 5 order, I would be inclined to hold that the Bank should not have that risk forced on it by the court. However, I am unable to see that the Bank is in any real jeopardy. The value of the security held by the Bank appears to be well in excess of the size of its loan on the initial application. In his affidavit, Mr. Gibbons of Coopers & Lybrand asserted that the companies had over-stated their cash flow projections, that the value of the inventory could diminish if customers of the companies looked to alternate sources for their product, and that the value of the accounts receivable could decrease if customers began to claim set-offs against those receivables. On the record before me, these appear to be no more than speculative possibilities. The Bank has had access to all of the companies' financial data on an ongoing basis since the order of Hoolihan J. was made almost two months ago. Nothing was placed before this court to suggest that any of the possibilities described above had come to pass.

93 Even allowing for some over-estimation by the companies of the value of the security held by the Bank, it would appear that the Bank holds security valued at approximately $4 million for a loan that was, as of the hearing of this appeal, about $2.3 million. The order of Hoolihan J. was to terminate no later than November 14, 1990. I am not satisfied that the Bank ran any real risk of having the amount of the loan exceed the value of the security by that date. It is also worth noting that the order under appeal provided that any party could apply to terminate the order at any point prior to November 14. This provision provided further protection for the Bank in the event that it wished to make the case that its loan was at risk because of the deteriorating value of its security.

94 Even though the chances of a successful reorganization were not good, I am satisfied that the benefits flowing from the making of the s. 5 order exceeded the risk inherent in that order. In my view, Hoolihan J. properly exercised his discretion in directing that a meeting of creditors should be held pursuant to s. 5 of the Act.

95 VI. DID HOOLIHAN J. ERR IN DIRECTING THAT THE BANK AND ROYNAT INC. SHOULD BE PLACED IN THE SAME CLASS FOR THE PURPOSES OF THE ACT?

96 I agree with Finlayson J.A. that the Bank and RoyNat Inc., the two principal creditors, should not have been placed in the same class of secured creditors for the purposes of ss. 5 and 6 of the Act. Their interests are not only different, they are opposed. The classification scheme created by Hoolihan J. effectively denied the Bank any control over any plan of reorganization.

97 To accord with the principles found in the cases cited by Finlayson J.A., the secured creditors should have been grouped as follows:

Class 1	--	The City of Chatham and the Village of Glencoe
Class 2	--	The Bank of Nova Scotia

Class 3 -- RoyNat Inc., Ontario Development Corporation, and those holding debentures issued by the company on August 29 and 31, 1990.

VII. DID HOOLIHAN J. ERR IN MAKING VII. THE INTERIM ORDERS HE MADE?

98 Hoolihan J. made a number of orders designed to control the conduct of all of the parties pending the creditors' meeting and the placing of a plan of reorganization before the court. The first order was made on September 11, 1990, and was to expire on or before October 24, 1990. Subsequent orders varied the terms of the initial order somewhat and extended its effective date until November 14, 1990.

99 These orders imposed the following conditions pending the meeting:

(a) all proceedings with respect to the debtor companies should be stayed, including any action by the Bank to realize on its security;
(b) the Bank could not reduce its loan by applying incoming receipts to those debts;
(c) the Bank was to be the sole banker for the companies;
(d) the companies could carry on business in the normal course, subject to certain very specific restrictions;
(e) a licensed trustee was to be appointed to monitor the business operations of the companies and to report to the creditors on a regular basis; and
(f) any party could apply to terminate the interim orders, and the orders would be terminated automatically if the companies defaulted on any of the obligations imposed on them by the interim orders.

100 The orders placed significant restrictions on the Bank for a two-month period but balanced those restrictions with provisions limiting the debtor companies' activities and giving the Bank ongoing access to up-to-date financial information concerning the companies. The Bank was also at liberty to return to the court to request any variation in the interim orders which changes in financial circumstances might merit.

101 These orders were made under the wide authority granted to the court by s. 11 of the Act. L.W. Houlden and C.H. Morawetz in Bankruptcy Law in Canada, 3rd ed. (Toronto: Carswell, looseleaf), at p. 2-103, describe the purpose of the section:

> The legislation is intended to have wide scope and allows a judge to make orders which will effectively maintain the status quo for a period while the insolvent company attempts to gain the approval of its creditors for a proposed arrangement which will enable the company to remain in operation for what is, hopefully, the future benefit of both the company and its creditors. This aim is facilitated by s. 11 of the Act which enables the court to restrain further proceedings in any action, suit or proceeding against the company upon such terms as the court sees fit.

102 A similar sentiment appears in Chef Ready Foods Ltd. v. HongKong Bank of Canada, supra. Gibbs J.A., in discussing the scope of s. 11, said at p. 7 of the reasons:

> When a company has recourse to the C.C.A.A. 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. Obviously 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.

103 Similar views of the scope of the power to make interim orders covering the period when reorganization is being attempted are found in Meridian Developments Inc. v. Toronto-Dominion Bank (1984), 32 Alta. L.R. (2d) 150, 53 A.R. 39, 52 C.B.R. (N.S.) 109, 11 D.L.R. (4th) 576, [1984] 5 W.W.R. 215 (Q.B.), at pp. 42-45 A.R., pp. 114-18 C.B.R.; Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 63 Alta. L.R. (2d) 361, 72 C.B.R. (N.S.) 1 (Q.B.), at pp. 12-15 C.B.R.; Quintette Coal Ltd. v. Nippon Steel Corp. B.C. S.C., Thackray J., released June 18, 1990, at pp. 5-9 of the reasons [now reported 47 B.C.L.R. (2d) 193; and O'Leary, B., "A Review of the Companies' Creditors Arrangement Act", supra, at p. 41.

104 The interim orders made by Hoolihan J. are all within the wide authority created by s. 11 of the Act. The orders were crafted to give the company the opportunity to continue in operation pending its attempt to reorganize while at the same time providing safeguards to the creditors, including the Bank, during that same period. I find no error in the interim relief granted by Hoolihan J.

VIII. CONCLUSION

105 In the result, I would allow the appeal in part, vacate the order of Hoolihan J. of October 18, 1990, insofar as it purports to settle the class of creditors for the purpose of the Act, and I would substitute an order establishing the three classes referred to in Part VI of these reasons. I would not disturb any of the other orders made by Hoolihan J.

Appeal allowed.

Tab 2

Case Name:

ScoZinc Ltd. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of ScoZinc Limited

[2009] N.S.J. No. 227

2009 NSSC 163

55 C.B.R. (5th) 205

2009 CarswellNS 283

177 A.C.W.S. (3d) 294

Docket: Hfx No. 305549

Registry: Halifax

Nova Scotia Supreme Court
Halifax, Nova Scotia

D.R. Beveridge J.

Heard: May 1, 2009.
Oral judgment: May 1, 2009.
Released: May 20, 2009.

(13 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Proposals -- Meetings of creditors -- Sanction by court -- Motion by ScoZinc for a meeting of creditors under the Companies' Creditors Arrangement Act, for extension of a stay of proceedings, and for approval that notice of the motion be given only to defined creditors allowed -- Court approval of the proposal was not necessary before it was presented to creditors; accordingly, the meeting was ordered -- The extension of the stay was granted -- Given the

volume of material involved, only creditors with claims over $100,000 need be given notice of the motion.

Bankruptcy and insolvency law -- Proceedings -- Practice and procedure -- Notice -- Stays -- Motion by ScoZinc for a meeting of creditors under the Companies' Creditors Arrangement Act, for extension of a stay of proceedings, and for approval that notice of the motion be given only to defined creditors allowed -- Court approval of the proposal was not necessary before it was presented to creditors; accordingly, the meeting was ordered -- The extension of the stay was granted -- Given the volume of material involved, only creditors with claims over $100,000 need be given notice of the motion.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 4, s. 5, s. 11, s. 11(4), s. 11(6)

Counsel:

John D. Stringer, Q.C. and Ben Durnford, for the applicant.

Robbie MacKeigan, Q.C., for Daniel Rozon.

John McFarlane, Q.C. for Kamatsu.

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1 **D.R. BEVERIDGE J.** (orally):-- ScoZinc brings a motion seeking an order to accomplish three things. The first is for a meeting of the creditors pursuant to ss. 4 and 5 of the *Companies' Creditors Arrangement Act*. The second is a further extension of the stay of proceedings initially ordered by this Court on December 22, 2008 and extended from time to time. The third is approval of notice of this motion being given only to certain defined creditors.

2 The company has filed an affidavit of William Felderhof referred to as his seventh affidavit, sworn April 28, 2009 and the Monitor has filed its sixth report dated April 30, 2009.

3 As part of its submissions the company notes that there is nothing in the *CCAA* which requires the Court to give prior preliminary approval of ScoZinc's proposed plan before it is presented to the creditors. It notes that the jurisprudence establishes that this approval is generally desirable prior to calling a meeting of the creditors. Some, but not all of this jurisprudence was reviewed by MacAdam J. in *Re Federal Gypsum* 2007 NSSC 384.

4 Justice MacAdam in *Re Federal Gypsum* did refer to the two different standards that have been proposed or referred to in cases from Ontario and British Columbia. Some of these cases have expressed the view that the debtor company should establish that the plan has "a reasonable chance" that it would be accepted by the creditors. Other cases have referred to the appropriate test as simply a determination as to whether or not the proposed plan is one that would be "doomed to failure".

5 In a different context, Glube C.J.T.D. (as she then was) in *Fairview Industries* (1991), 11 C.B.R. (3d) 43 cautioned that it would be impractical and extremely costly to continue to prepare a plan when "there is no hope that it would be approved".

6 I think it fair to say that MacAdam J., although not expressly but by necessary implication, preferred the lower standard facing a debtor company in submitting its plan to the Court for a preliminary approval. At para. 12 he wrote:

> [12] In view of the relatively low threshold on the Company in seeking Court approval to have a plan of arrangement submitted to the creditors for a vote, I am satisfied the plan should proceed and the creditors should determine whether they do, or do not accept the plan as finally filed.

7 In my opinion it should not be up to the Court to second guess the probability of success of a proposed plan of arrangement. Businessmen are free to make their own views known before and ultimately at the creditors' meeting. It seems to me that the Court should only decline to give preliminary approval and refuse to order a meeting if it was of the view that there was no hope that the plan would be approved by the creditors or, if it was approved by the creditors, it would not, for some other reason, be approved by the Court.

8 The Monitor in its sixth report says that the proposed plan is reasonable under the circumstances. This opinion appears to flow from its conclusion that if the plan is rejected and the company forced into receivership or bankruptcy, unsecured creditors will not recover the amount offered in the plan and it is highly unlikely that the secured creditors will recover the amount offered to them. I see no reason to disagree with the opinion offered by the Monitor.

9 Given that opinion and in light of the terms that are set out in the proposed plan I am certainly satisfied that the plan is far from one that is doomed to failure. It is one that should be put to the creditors for their consideration. It is therefore appropriate that I exercise the discretion that is set out in ss. 4 and 5 of the *CCAA* and order a meeting of the creditors on the terms set out in the proposed meeting order.

10 With respect to the extension of the stay of proceedings, as I noted at the outset there had been an initial order of this Court under s. 11 of the *CCAA*. This order was granted on December 22, 2008. It was, as required by the statute, limited to a period of 30 days. It has been extended on two previous occasions. It is now due to expire May 22nd, 2009. The meeting of the creditors is scheduled for May 21, 2009. There is a tentative return date scheduled for May 28, 2009 for the Court to consider sanctioning the plan, should it be approved by the creditors.

11 The test with respect to extending the stay of proceedings has been set out in a number of cases that have considered ss. 11(4) and (6) of the *CCAA*. These were reviewed by me in *Re ScoZinc Ltd.* 2009 NSSC 108. In these circumstances there is no need to review the test and the evidence in support of that test.

12 In light of my conclusion that the company had met the threshold for ordering a meeting of the creditors under ss. 4 and 5 of the *CCAA* the appropriateness of a further extension permitting the company to return to the Court within a very short period of time following that meeting of the creditors is patently obvious. The extension is therefore granted.

13 The last issue is the approval of notice of this motion being given only to certain defined creditors. Given the number of creditors that appeared early on in the proceedings it was somewhat impractical to give notice to each of them with the volumes of materials that would be required to be produced and served. With respect to the prior motions it was required that notice be given to all creditors asserting claims against the debtor company in excess of $100,000.00 and all creditors as-

serting builders liens. In addition all creditors were apprised of these proceedings by way of the mail out to each and every creditor as required by the *CCAA* leading to filing of proofs of claim. The status of the proceedings, including this motion, have been posted on the Monitor's website. I see no reason to depart from the previous practice and this aspect of the motion is also granted.

D.R. BEVERIDGE J.

cp/e/qlrxg/qlpwb/qlaxw/qlced

Tab 3

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

And in the Matter of a Proposed Plan of Compromise or Arrangement with Respect to Stelco Inc. and the Other Applicants Listed Under Schedule "A"
Application Under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
[Indexed as: Stelco Inc. (Re) (No.2)]

78 O.R. (3d) 254

[2005] O.J. No. 4733

Docket: M33099 (C44332)

Court of Appeal for Ontario,

Laskin, Rosenberg and LaForme JJ.A.

November 4, 2005

Debtor and creditor -- Companies' Creditors Arrangement Act -- Jurisdiction -- Jurisdiction of supervising judge not limited to preserving status quo -- Supervising judge having power to vary stay and allow company to enter into agreements to facilitate restructuring, provided that creditors have final decision whether or not to approve Plan -- Supervising judge entitled to use his own judgment and conclude that plan was not doomed to fail despite creditors' opposition -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11.

The debtor company negotiated agreements with two of its stakeholders and a finance provider which were intrinsic to the success of the Plan of Arrangement that the company proposed. While the stakeholders did not have a right to vote to approve any plan of arrangement and reorganization, they had a functional veto in the sense that no restructuring could be completed without their support. The company sought court authorization to enter into the agreements. Authorization was granted by the supervising judge. Creditors of the company appealed the orders, arguing that the supervising judge did not have jurisdiction generally to make the orders and that he did not have jurisdiction to approve orders that would facilitate a Plan that was doomed to fail, considering the creditors' opposition to the Plan.

Held, the appeal should be dismissed.

The motions judge had jurisdiction to make the orders authorizing the company to enter into the agreements. Section 11 of the Companies' Creditors Arrangement Act provides a broad jurisdiction to impose terms and conditions on the granting of the stay. Section 11(4) includes the power to vary the stay and allow the company to enter into agreements to facilitate the restructuring, provided that the creditors have the final decision under s. 6 whether or not to approve the Plan. The court's jurisdiction is not limited to preserving the status quo. The orders in this case did not usurp the s. 6 rights of the creditors and did not unduly interfere with the business judgment of the creditors. The orders moved the process along to the point where the creditors were free to exercise their rights at the creditors' meeting. It must be a matter of judgment for the supervising judge to determine whether a Plan is doomed to fail. It was apparent in this case that the motions judge brought his judgme nt to bear and decided that the Plan was not doomed to fail. There was no basis for second guessing him on that issue.

Cases referred to

Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 7 O.R. (3d) 362, [1992] O.J. No. 374, 4 B.L.R. (2d) 306, 10 C.B.R. (3d) 23 (Gen. Div.); [page255] 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.) (sub nom. Hongkong Bank of Canada v. Chef Ready Foods); Inducon Development Corp. (Re), [1992] O.J. No. 8, 8 C.B.R. (3d) 306, 31 A.C.W.S. (3d) 94 (Gen. Div.)

Statutes referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 6 [as am.], 11 [as am.], 13 [as am.]

APPEAL from the orders of Farley J., [2005] O.J. No. 4309 (S.C.J.) authorizing the company to enter into agreements.

Robert W. Staley and Alan P. Gardner, for Informal Committee of Senior Debentureholders, appellants.

Michael E. Barrack and Geoff R. Hall, for Stelco Inc., respondent.

Robert I. Thornton and Kyla E.M. Mahar, for Monitor, respondent.

John R. Varley, for Salaried Active Employees, respondents.

Michael C.P. McCreary and David P. Jacobs, for USW Locals 8782 and 5328, respondents.

George Karayannides, for EDS Canada Inc., respondent.

Aubrey E. Kauffman, for Tricap Management Ltd., respondents.

Ben Zarnett and Gale Rubenstein, for the Province of Ontario, respondents.

Murray Gold, for Salaried Retirees, respondents.

Kenneth T. Rosenberg, for USW International, respondents.

Robert A. Centa, for USWA, respondents.

George Glezos, for AGF Management Ltd., respondents.

The judgment of the court was delivered by

[1] **ROSENBERG J.A.**:-- This appeal is another chapter in the continuing attempt by Stelco Inc. and four of its wholly-owned subsidiaries to emerge from protection from their creditors under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ["CCAA"]. The appellant, an Informal Committee of Senior Debenture Holders who are Stelco's largest creditor, applies for leave to appeal under s. 13 of the CCAA and if leave be granted appeals three orders made by Farley J. on October 4, 2005 in the CCAA proceedings. These orders authorize Stelco to enter into agreements with two of its stakeholders and a finance provider. The appellant submits that the motions judge had no jurisdiction to make these orders and that the effect of these orders is to distort or skew the CCAA process. A group of Stelco's equity holders support the submissions of the appellant. The various other players with a stake in the restructuring and the court-appointed Monitor support the orders made by the motions judge. [page256]

[2] Given the urgency of the matter it is only possible to give relatively brief reasons for my conclusion that while leave to appeal should be granted, the appeal should be dismissed.

The Facts

[3] Stelco Inc. and the four wholly-owned subsidiaries obtained protection from their creditors under the CCAA on January 29, 1994. Thus, the CCAA process has been going on for over 20 months, longer than anyone expected. Farley J. has been managing the process throughout. The initial order made under s. 11 of the CCAA gives Stelco sole and exclusive authority to propose and file a plan of arrangement with its creditors. To date, attempts to restructure have been unsuccessful. In particular, a plan put forward by the Senior Debt Holders failed.

[4] While there have no doubt been many obstacles to a successful restructuring, the paramount problem appears to be that stakeholders, the Ontario government and Stelco's unions, who do not have a formal veto (i.e., they do not have a right to vote to approve any plan of arrangement and reorganization) have what the parties have referred to as a functional veto. It is unnecessary to set out the reasons for these functional vetoes. Suffice it to say, as did the Monitor in its Thirty-Eighth Report, that each of these stakeholders is "capable of exercising sufficient leverage against Stelco and other stakeholders such that no restructuring could be completed without that stakeholder's support".

[5] In an attempt to successfully emerge from CCAA protection with a plan of arrangement, the Stelco board of directors has negotiated with two of these stakeholders and with a finance provider and has reached three agreements: an agreement with the provincial government (the "Ontario Agreement"), an agreement with The United Steelworkers International and Local 8782 (the "USW Agreement"), and an agreement with Tricap Management Limited (the "Tricap Agreement"). Those agreements are intrinsic to the success of the Plan of Arrangement that Stelco proposes. However, the debt holders including this appellant have the ultimate veto. They alone will vote on whether to approve Stelco's Plan. The vote of the affected debt holders is scheduled for November 15, 2005.

[6] The three agreements have terms to which the appellant objects. For example, the Tricap Agreement contemplates a break fee of up to $10.75 million depending on the circumstances.

Tricap will be entitled to a break fee if the Plan fails to obtain the requisite approvals or if Tricap terminates its obligations to provide financing as a result of the Plan being amended without Tricap's approval. Half of the break fee becomes payable if the Plan [page257] is voted down by the creditors. Another example is found in the Ontario Agreement, which provides that the order sanctioning the Final Plan shall name the members of Stelco's board of directors and such members must be acceptable to the province. Consistent with the Order of March 30, 2005 and as required by the terms of the agreements themselves, Stelco sought court authorization to enter into the three agreements. We were told that, in any event, it is common practice to seek court approval of agreements of this importance. The appellant submits that t he motions judge had no jurisdiction to make these orders.

[7] There are a number of other facts that form part of the context for understanding the issues raised by this appeal. First, on July 18, 2005, the motions judge extended the stay of proceedings until September 9, 2005 and warned the stakeholders that this was a "real and functional deadline". While that date has been extended because Stelco was making progress in its talks with the stakeholders, the urgency of the situation cannot be underestimated. Something will have to happen to either break the impasse or terminate the CCAA process.

[8] Second, on October 4, 2005, the motions judge made several orders, not just the orders to authorize Stelco to enter into the three agreements to which the appellant objects. In particular, the motions judge extended the stay to December and made an order convening the creditors' meeting on November 15 to approve the Stelco Plan. The appellant does not object to the orders extending the stay or convening the meeting to vote on the Plan.

[9] Third, the appellant has not sought permission to prepare and file its own plan of arrangement. At present, the Stelco Board's Plan is the only plan on the table and as the motions judge observed, "one must also realistically appreciate that a rival financing arrangement at this stage, starting from essentially a standing start, would take considerable time for due diligence and there is no assurance that the conditions will be any less onerous than those extracted by Tricap" [at para. 5].

[10] Fourth, in his orders authorizing Stelco to enter into these agreements, the motions judge made it clear that these authorizations, "are not a sanction of the terms of the plan ... and do not prohibit Stelco from continuing discussions in respect of the Plan with the Affected Creditors".

[11] Fifth, the independent Monitor has reviewed the Agreements and the Plan and supports Stelco's position.

[12] Finally, and importantly, the Senior Debenture Holders that make up the appellant have said unequivocally that they will not approve the Plan. The motions judge recognized this in his reasons [at para. 7]: [page258]

> The Bondholder group has indicated that it is firmly opposed to the plan as presently constituted. That group also notes that more than half of the creditors by $ value have advised the Monitor that they are opposed to the plan as presently constituted. ... The present plan may be adjusted (with the blessing of others concerned) to the extent that it, in a revised form, is palatable to the creditors (assuming that they do not have a massive change of heart as to the presently proposed plan).

Leave to Appeal

[13] The parties agree on the test for granting leave to appeal under s. 13 of the CCAA. The moving party must show the following:

(a) the point on appeal is of significance to the practice;
(b) the point is of significance to the action;
(c) the appeal is prima facie meritorious; and
(d) the appeal will not unduly hinder the progress of the action.

[14] In my view, the appellant has met this test. The point raised is a novel and important one. It concerns the jurisdiction of the supervising judge to make orders that do not merely preserve the status quo but authorize key elements of the proposed plan of arrangement. The point is of obvious significance in this action. If the motions judge's approvals were to be set aside, it is doubtful that the Plan could proceed. On the other hand, the appellant submits that the orders have created a coercive and unfair environment and that the Plan is doomed to fail. It was therefore wrong to authorize Stelco to enter into agreements, especially the Tricap Agreement, that could further deplete the estate. The appeal is prima facie meritorious. The matter appears to be one of first impression. It certainly cannot be said that the appeal is frivolous. Finally, the appeal will not unduly hinder the progress of the action. Because of the speed with which this court is able to deal with the case, t he appeal will not unduly interfere with the continuing negotiations prior to the November 15th meeting.

[15] For these reasons, I would grant leave to appeal.

Analysis

Jurisdiction generally

[16] The thrust of the appellant's submissions is that while the judge supervising a CCAA process has jurisdiction to make orders that preserve the status quo, the judge has no jurisdiction to make an order that, in effect, entrenches elements of the proposed Plan. Rather, the approval of the Plan is a matter solely for [page259] the business judgment of the creditors. The appellant submits that the orders made by the motions judge are not authorized by the statute or under the court's inherent jurisdiction and are in fact inconsistent with the scheme and objects of the CCAA. They submit that the orders made in this case have the effect of substituting the court's judgment for that of the debt holders who, under s. 6, have exclusive jurisdiction to approve the plan. Under s. 6, it is only after a majority in number representing two-thirds in value of the creditors vote to approve the plan that the court has a role in deciding whether to sanction the plan.

[17] Underlying this argument is a concern on the part of the creditors that the orders are coercive, designed to force the creditors to approve a plan, a plan in which they have had no input and of which they disapprove.

[18] In my view, the motions judge had jurisdiction to make the orders he did authorizing Stelco to enter into the agreements. Section 11 of the CCAA provides a broad jurisdiction to impose terms and conditions on the granting of the stay. In my view, s. 11(4) includes the power to vary the stay and allow the company to enter into agreements to facilitate the restructuring, provided that the creditors have the final decision under s. 6 whether or not to approve the Plan. The court's jurisdiction is not limited to preserving the status quo. The point of the CCAA process is not simply to preserve the status quo but to facilitate restructuring so that the company can successfully emerge from

the process. This point was made by Gibbs J.A. in Chef Ready Foods Ltd. v. Hongkong Bank of Canada, [1990] B.C.J. No. 2384, 4 C.B.R. (3d) 311 (C.A.), at para. 10:

> The purpose of the C.C.A.A. is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors to the end that the company is able to continue in business. It is available to any company incorporated in Canada with assets or business activities in Canada that is not a bank, a railway company, a telegraph company, an insurance company, a trust company, or a loan company. When a company has recourse to the C.C.A.A. 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. Obviously 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.

(Emphasis added)

[19] In my view, provided the orders do not usurp the right of the creditors to decide whether to approve the Plan the motions judge had the necessary jurisdiction to make them. The orders made in this case do not usurp the s. 6 rights of the creditors and [page260] do not unduly interfere with the business judgment of the creditors. The orders move the process along to the point where the creditors are free to exercise their rights at the creditors' meeting.

[20] The argument that the orders are coercive and therefore unreasonably interfere with the rights of the creditors turns largely on the potential $10.75 million break fee that may become payable to Tricap. However, the motions judge has found as a fact that the break fee is reasonable. As counsel for Ontario points out, this necessarily entails a finding that the break fee is not coercive even if it could to some extent deplete Stelco's assets.

[21] Further, the motions judge [at para. 9] both in his reasons and in his orders made it clear that he was not purporting to sanction the Plan. As he said in his reasons, "I wish to be absolutely clear that I am not ruling on or considering in any way the fairness of the plan as presented". The creditors will have the ultimate say on November 15 whether this plan will be approved.

Doomed to fail

[22] The appellant submits that the motions judge had no jurisdiction to approve orders that would facilitate a Plan that is doomed to fail. The authorities indicate that a court should not approve a process that will lead to a plan that is doomed to fail. The appellant says that it has made it as clear as possible that it does not accept the proposed Plan and will vote against it. In Inducon Development Corp. (Re), [1992] O.J. No. 8, 8 C.B.R. (3d) 306 (Gen. Div.), at p. 310 C.B.R., Farley J. said that, "It is of course, ... fruitless to proceed with a plan that is doomed to failure at a further stage."

[23] However, it is important to take into account the dynamics of the situation. In fact, it is the appellant's position that nothing will happen until a vote on a Plan is imminent or a proposal from Stelco is voted down; only then will Stelco enter into realistic negotiations with its creditors. It is apparent that the motions judge is of the view that the Plan is not doomed to fail; he would not have approved steps to continue the process if he thought it was. As Austin J. said in Bargain Harold's

Discount Ltd. v. Paribas Bank of Canada (1992), 7 O.R. (3d) 362, [1992] O.J. No. 374 (Gen. Div.), at p. 369 O.R.:

> The jurisprudence is clear that if it is obvious that no plan will be found acceptable to the required percentages of creditors, then the application should be refused. The fact that Paribas, the Royal Bank and K Mart now say there is no plan that they would approve, does not put an end to the inquiry. All affected constituencies must be considered, including secured, preferred and unsecured creditors, employees, landlords, shareholders, and the public generally ...

(Emphasis added) [page261]

[24] It must be a matter of judgment for the supervising judge to determine whether the Plan is doomed to fail. This Plan is supported by the other stakeholders and the independent Monitor. It is a product of the business judgment of the Stelco board as a way out of the CCAA process. It was open to the motions judge to conclude that the plan was not doomed to fail and that the process should continue. Despite its opposition to the Plan, the appellant's position inherently concedes the possibility of success, otherwise these creditors would have opposed the extension of the stay, opposed the order setting a date for approval of the plan and sought to terminate the CCAA proceedings.

[25] The motions judge said this in his reasons [at para. 2]:

> It seems to me that Stelco as an ongoing enterprise is getting a little shop worn/shopped worn. It would not be helpful to once again start a new general process to find the ideal situation [sic solution?]; rather the urgency of the situation requires that a reasonable solution be found.

He went on to state [at para. 7] that in the month before the vote there "will be considerable discussion and negotiation as to the plan which will in fact be put to the vote" and that the present Plan may be adjusted. He urged the stakeholders and Stelco to "deal with this question in a positive way" and that "it is better to move forward than backwards, especially where progress is required". It is obvious that the motions judge has brought his judgment to bear and decided that the Plan or some version of it is not doomed to fail. I can see no basis for second-guessing the motions judge on that issue.

[26] I should comment on a submission made by the appellant that no deference should be paid to the business judgment of the Stelco board. The appellant submits that the board is entitled to deference for most of the decisions made in the day-to-day operations during the CCAA process except whether a restructuring should proceed or a plan of arrangement should proceed. The appellant submits that those latter decisions are solely the prerogative of the creditors by reason of s. 6. While there is no question that the ultimate decision is for the creditors, the board of directors plays an important role in the restructuring process. Blair J.A. made this clear in an earlier appeal to this court concerning Stelco reported at (2005), 75 O.R. (3d) 5, [2005] O.J. No. 1171 (C.A.), at para. 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 credi-

> tors 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 [page262] 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 schem e 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.

(Emphasis added)

[27] The approvals given by the motions judge in this case are consistent with these principles. Those orders allow the company's restructuring efforts to move forward.

[28] The position of the appellant also fails to give any weight to the broad range of interests in play in a CCAA process. Again to quote Blair J.A. in the earlier Stelco case at para. 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.

(Emphasis added)

[29] For these reasons, I would not give effect to the submissions of the appellant.

Submissions of the equity holders

[30] The equity holders support the position of the appellant. They point out that the Stelco CCAA situation is somewhat unique. While Stelco entered the process in dire straits, since then almost unprecedented worldwide prices for steel have boosted Stelco's fortunes. In an endorsement of February 28, 2005, [2005] O.J. No. 730, 7 C.B.R. (5th) 310 (S.C.J.), the motions judge recognized this unusual state of affairs [at para. 5]:

> In most restructurings, on emergence the original shareholder equity, if it has not been legally "evaporated" because the insolvent corporation was so far under water, is very substantially diminished. For example, the old shares may be converted into new emergent shares at a rate of 100 to 1; 1,000 to 1; or even 12,000 to 1. ... Stelco is one of those rare situations in which a change of external circumstances ... may result in the original equity having a more substantial "recovery" on emergence than outline above.

[31] The equity holders point out that while an earlier plan would have allowed the shareholders to benefit from the continued [page263] and anticipated growth in the Stelco equity, the present

plan does not include any provision for the existing shareholders. I agree with counsel for Stelco that these arguments are premature. They raise issues for the supervising judge if and when he is called upon to exercise his discretion under s. 6 to sanction the Plan of arrangement.

Disposition

[32] Accordingly, I would dismiss the appeal. On behalf of the court, I wish to thank all counsel for their very helpful written and oral submissions that made it possible to deal with this appeal expeditiously.

Appeal dismissed.

Tab 4

Case Name:

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.

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 and Arrangement Involving Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits Listed In Schedule "A" Hereto
Between
The Investors represented on the Pan-Canadian Investors Committee for Third-Party Structured Asset-backed Commercial Paper listed in Schedule "B" hereto, Applicants, and
Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits listed in Schedule "A" hereto, Respondents

[2008] O.J. No. 1818

42 C.B.R. (5th) 90

2008 CarswellOnt 2652

45 B.L.R. (4th) 201

168 A.C.W.S. (3d) 245

Court File No. 08-CL-7440

Ontario Superior Court of Justice
Commercial List

C.L. Campbell J.

Heard: March 17, 2008.
Judgment: April 8, 2008.

(56 paras.)

Insolvency law -- Proposals -- Court approval -- Application for initial order under the Companies' Creditors Arrangement Act allowed -- The applicants were investors holding more than $21 billion of the $32 billion of asset-backed commercial paper (ABCP) issued by the respondents -- They sought an initial order as essential to the resolution of an ABCP liquidity crisis -- The court found that the application was consistent with the remedial purposes of the Act -- It was appropriate to treat holders of ABCP as a single class of creditors, as fragmentation of classes would render it excessively difficult to obtain approval of a plan under the Act -- Companies' Creditors Arrangement Act, s. 2.

Corporations, partnerships and associations law -- Corporations -- Borrowing -- Trust indenture -- Enforcement -- Application for initial order under the Companies' Creditors Arrangement Act allowed -- The applicants were investors holding more than $21 billion of the $32 billion of asset-backed commercial paper (ABCP) issued by the respondents -- They sought an initial order as essential to the resolution of an ABCP liquidity crisis -- The court found that the application was consistent with the remedial purposes of the Act -- It was appropriate to treat holders of ABCP as a single class of creditors, as fragmentation of classes would render it excessively difficult to obtain approval of a plan under the Act -- Companies' Creditors Arrangement Act, s. 2.

Application by the Investors represented on the Pan-Canadian Investors Committee for Third-Party Structure Asset-backed Commercial Paper (ABCP), for an initial order under the Companies' Creditors Arrangement Act. The applicants were comprised of investors holding more than $21 billion of the $32 billion of ABCP issued by at least one of the respondents. Each series of ABCP was issued pursuant to a trust indenture. In order to facilitate the within application, the respondents replaced the trust companies under the indentures. Each respondent assumed legal ownership of assets held for each series in the conduit of which it was trustee, and became the debtor with respect to the ABCP issued thereunder. Each ABCP note provided that recourse was limited to the assets of the trust. Since August 2007, the trustees of each conduit had insufficient liquidity to make payments on the ABCP to the applicants and other noteholders. Accordingly, each of the respondents was insolvent. The applicants sought an initial order under the Act as consistent with the underlying statutory policy, and as essential to the resolution of an ABCP liquidity crisis. Nobody challenged the entitlement of the applicants to the initial order sought. At issue was whether the application complied with the Act's requirements, whether the relief sought was consistent with its purpose, and whether the classification of creditors was appropriate for voting and distribution purposes.

HELD: Application allowed. The respondents were debtor companies within the meaning of the Act. As trustees, the respondents were the obligors under the trusts' covenants to pay. The respondents were insolvent for the purposes of the Act. That insolvency was not negated by provisions in the notes and trust indentures that limited noteholders' recourse to the trust assets. Practical restructuring of the ABCP claims could only be implemented on a global basis. The claims for relief by the applicants involved common questions of law and fact. Joining of the claims promoted the convenient administration of justice. The application was consistent with the remedial purposes of the Act. It was appropriate to treat holders of ABCP as a single class of creditors, as fragmentation of classes would render it excessively difficult to obtain approval of a plan under the Act.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2, s. 2, s. 3(1), s. 4, s. 5, s. 8, s. 11

Ontario Rules of Civil Procedure, Rule 5.01, Rule 5.02

Counsel:

B. Zarnett, F. Myers, and B. Empey, for the Applicants.

R.S. Harrison, for Metcalfe & Mansfield Alternative Investments Corps.

Scott Bomhof and John Laskin, for National Bank of Canada.

Peter Howard and William Scott, for Asset Providers/Liquidity Providers.

Jeff Carhart, Joe Marin and Jay Hoffman, for Ad Hoc Committee of ABCP Holders.

T. Sutton, for Securitus.

Jay Swartz and Natasha MacParland, for New Shore Conduits.

Aubrey Kauffman, for 4446372 Canada Inc.

Stuart Brotman, for 6932819 Canada Inc.

Robin B. Schwill and James Rumball, for Coventree Capital Inc., Coventree Administration Corp. and Nereus Financial Inc.

Ian D. Collins, for Desjardins Group.

Harvey Chaiton, for CIBC.

Kevin McEicheran and Geoff R. Hall, for Bank of Montreal, Bank of Nova Scotia, CIBC, Royal Bank of Canada and Toronto Dominion Bank.

Marc S. Wasserman, for Blackrock Financial.

S. Richard Orzy, for CIBC Mellon, Computershare and Bank of New York as Indenture Trustee.

Dan Macdonald and Andrew Kent, for Bank of Nova Scotia.

Virginie Gauthier and Mario Forte, for Caisse de Dépôt.

Junior Sirivar, for Navcan.

REASONS FOR DECISION

1 **C.L. CAMPBELL J.**:-- These are the reasons for this Court having granted on March 17, 2008 an Initial Order under the *Companies Creditors Arrangement Act* ("CCAA") in respect of various corporate trustees in respect of what is known as Asset Backed Commercial Paper ("ABCP.")

2 This highly unusual and hopefully not to be repeated procedure (given its magnitude and implications) represents the culmination of a great deal of work and effort on the part of the Applicants known informally as the Investors' Committee under the leadership of a leading Canadian lawyer and businessman, Purdy Crawford.

3 Assuming approval of the proposed Plan under the CCAA, the process will result in the successful restructuring of the ABCP market in Canada and avoid a liquidity crisis that would result in certain loss to many of the various participants in the ABCP market.

4 It is neither necessary nor appropriate in these Reasons to describe in detail just what is involved in the products and operation of the ABCP market.

5 The Information Circular that is part of the Application and will be sent to each of the affected Noteholders (and is also found on the website of the Monitor, Ernst & Young), contains a complete description of the nature of the products, the various market participants, the problem giving rise to the liquidity crisis and the proposed Plan that, if approved, will allow for recovery by most Noteholders of at least their capital over time in return for releases of other market participant parties.

6 An equally informative but less detailed description of the market for ABCP and its problems can be found in the affidavit of Mr. Crawford in the sites referred to above.

7 The Applicants include Crown corporations, business corporations, pension funds and financial institutions. Together, they hold more than $21 billion of the approximately $32 billion of ABCP at issue in this proceeding. Each Applicant holds ABCP for which at least one of the Respondents is the debtor. Each Applicant has a significant ABCP claim.

8 Each series of ABCP was issued pursuant to a trust indenture or supplemental trust indenture. Each trust indenture appointed an "Indenture Trustee" to serve as trustee for the investors, and gave that trustee certain rights, on behalf of investors, to enforce obligations under ABCP. However, the Indenture Trustee has no economic interest in the underlying debt and, under the circumstances, it is neither practical nor realistic to expect the Indenture Trustees to put forward a restructuring plan.

9 In this proceeding, the Applicants seek to put forward and obtain approval of the restructuring plan they have developed in their own right as holders of ABCP and as the real creditors of the Respondents.

10 Each Respondent is a corporation which is the trustee of one or more Conduits. Each Respondent is the legal owner of the assets held for each series in the Conduit of which it is the trustee, and is the debtor with respect to the ABCP issued by the trustee of that Conduit. The ABCP debt for which each Respondent is liable exceeds $5 million.

11 Each ABCP note provides that recourse under it is limited to the assets of the trust. The trust indentures pursuant to which each series of notes were issued provide that each note is to be repaid from the assets held for that series.

12 Since mid-August, 2007, the trustees of each of the Conduits have, in respect of each series of ABCP, had insufficient liquidity to make payments that were due and payable on their maturing ABCP. Each remains unable to meet its liabilities to the Applicants and to the other holders of each series of ABCP as those obligations become due, from assets held for that series. Accordingly, each of the Respondents is insolvent.

13 Most of the Conduits originally had trustees that were trust companies. The original trustees that were trust companies were replaced by certain of the Respondents, in accordance with applicable law and the terms of the applicable declarations of trust, in order to facilitate the making of this Application. The Respondents that replaced the trust companies assumed legal ownership of the assets of each Conduit for which they serve as trustees and assumed all of the obligations of the original trustees whom they replaced.

14 The Applicants chose court proceedings under the CCAA because the issuer trustees of the Conduits, as currently structured, are insolvent because they cannot satisfy their liabilities as they become due. The CCAA process allows meaningful efficiencies by restructuring all of the affected ABCP simultaneously while also providing stakeholders, including Noteholders, with more certainty that the Plan will be implemented. In addition, the CCAA provides a process to obtain comprehensive releases, which releases bind Noteholders and other parties who are not directly affected by the Plan. The granting of these comprehensive releases is a condition of participation by certain key parties.

15 The CCAA expresses a public policy favouring compromise and consensual restructuring over piecemeal liquidation and the attendant loss of value. It is designed to encourage and facilitate consensual compromises and arrangements among businesspeople; indeed the essence of a CCAA proceeding is the determination of whether a sufficient consensus exists among them to justify the imposition of a statutory compromise. It is only after this determination is made that the Court will examine whether a plan is otherwise fair and reasonable.

16 On the first day of a CCAA proceeding, the Court should strive to maintain the *status quo* while the plan is developed. The Court will exercise its power under the statute and at common law in order to maintain a level playing field while allowing the debtor the breathing space it needs to develop the required consensus. At this stage, the goal is to seek consensus - to allow the business people and individual investors to make their judgments and to express those judgments by voting. The Court's primary concern on a first day application is to ensure that the business people have a chance to exercise their judgment and vote on the Plan.

17 The Applicants submitted that the Initial Order sought should be granted and the creditors given an opportunity to vote on the Plan, because (a) this application complies with all requirements of the CCAA and is properly brought as a single proceeding; (b) the relief sought is available under the CCAA. It is also consistent with the purpose and policy of the CCAA and essential to the resolution of the ABCP crisis; and (c) the classification of creditors set out in the Plan for voting and distribution purposes is appropriate.

18 ABCP programs have been used to fund the acquisition of long-term assets, such as mortgages and auto loans. Even when funding short-term assets such as trade receivables, ABCP issuers

still face the inherent timing mismatch between cash generated by the underlying assets and the cash needed to repay maturing ABCP. Maturing ABCP is typically repaid with the proceeds of newly issued ABCP, a process commonly referred to as "rolling." Because ABCP is a highly rated commercial obligation with a long history of market acceptance, market participants in Canada formed the view that, absent a "general market disruption," ABCP would readily be saleable without the need for extraordinary funding measures.

19 There are three questions that need to be answered before the Court makes an Order accepting an Initial Plan under the CCAA.

20 The first question is, does the Application comply with the requirements of the CCAA? The second question involves determining that the relief sought in the circumstances is available under the CCAA and is consistent with the purpose and policy of the statute. The third question asks whether the classification of creditors set out in the Plan for voting and distribution purposes is appropriate.

21 I am satisfied that all three questions can be answered in the affirmative.

22 The CCAA, despite its relative brevity and lack of specifics, has been accepted by the Courts across Canada as a vehicle to encourage and facilitate consensual compromise and arrangements among various creditor interests in circumstances of insolvent corporations.

23 At the stage of accepting a Plan for filing, the Court seeks to maintain a status quo and provide a "structured environment for the negotiation of compromises between a company and its creditors." The ultimate decision on the acceptance of a Plan will be made by those directly affected and vote in favour of it.[1]

24 Section 3(1) of the CCAA applies in respect of a "debtor company" or "affiliate debtor companies" with claims against them of $5 million.

25 The problem faced by the applicants in this proceeding is that the terms "company" and "debtor company" as defined in s. 2 of the CCAA do not include trust entities.

26 For the purpose of this Application and proposed Plan, those entities that did not qualify as "companies" for the purposes of the CCAA were replaced by Companies (the Respondents) that do meet the definition.

27 I am satisfied in the circumstances that these steps are an appropriate exercise of legally available rights to satisfy the threshold requirements of the CCAA. I am satisfied that the change in trustees was undertaken in good faith to facilitate the making of this application.

28 The use of what have been called "instant" trust deeds has been judicially accepted as legitimate devices that can satisfy the requirement of s. 3 of the CCAA as long as they reflect legitimate transactions that actually occurred and are not shams.[2]

29 I am satisfied that the Respondents are "debtor companies" within the meaning of the CCAA because they are companies that meet the s. 2 definition and they are insolvent. The Conduits (referred to above) are trusts and the Respondents are trustees of those trusts. The trustee is the obligor under the trusts covenant to pay. I am satisfied that the trustee corporations are "insolvent" within the judicially accepted meaning under the CCAA.

30 The decision in *Re Stelco*[3] sets out three disjunctive tests. A company will be an insolvent "debtor company" under the CCAA if: (a) it is for any reason unable to meet its obligations as they

generally become due; or (b) it has ceased paying its current obligations in the ordinary course of business as they generally become due; or (c) the aggregate of its property is not, at a fair valuation, sufficient or, if disposed of at a fairly conducted sale under legal process, would not be sufficient to enable payment of all its obligations, due and accruing due.

31 I am satisfied that on the material filed as of August 13, 2007 and the stoppage of payment by trustees of the Conduits (which continues), the Conduits and now the Respondents remain unable to meet their liabilities at the present time.

32 The Conduits and now trustees in my view meet the test accepted by the Court in *Re Stelco* of being "reasonably expected to run out of liquidity within a reasonable proximity of time as compared with the time reasonably required to implement a restructuring."[4] Indeed, it was that very circumstance that brought about the standstill agreement and the ensuing discussions and negotiations to formulate a Plan.

33 Finally on this point I am satisfied that the insolvency of the Respondents is not affected or negated by contractual provisions in the applicable notes and trust indentures that limit Noteholders' recourse to the trust assets held in the Conduits. This statement should not be taken as a determination of the rights or remedies of any creditor.

34 It was urged and I accept that the applicants are creditors under ss. 4 and 5 of the CCAA and as such are entitled to standing to propose a Plan for restructuring the ABCP.

35 On the return of the motion for the Initial Order, while the proceeding was technically "ex parte," a significant number of interested parties were represented. None of those parties opposed the making of the Initial Order and since then no one has come forward to challenge the entitlement of the Applicants to the Initial Order.

36 S. 8 of the CCAA renders ineffective any provisions in the trust indentures that otherwise purport to restrict, directly or indirectly, the rights of the Applicants to bring this application:

> 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.

37 See also the following for the proposition that a trust indenture cannot by its terms restrict recourse to the CCAA.[5]

38 Another feature of this Application is the joining within a single proceeding of claims by many parties against each of the Respondents. Rules 5.01 and 5.02 of the *Rules of Civil Procedure* allow for the joinder of claims by multiple applicants against multiple respondents. It is not necessary that all relief claimed by each applicant be claimed against each respondent. Here the Applicants assert claims for relief against the Respondents involving common questions of law and fact. Joining of the claims in one proceeding promotes the convenient administration of justice.

39 I am satisfied that in the unique circumstances that prevail here, the practical restructuring of the ABCP claims can only be implemented on a global basis; accordingly, if there were separate proceedings, each individual plan would of necessity have been conditional upon approval of all the other plans.

40 One further somewhat unusual aspect of this Application has been the filing of the proposed Plan along with the request for the Initial Order. This is not unusual in what have come to be known as "liquidating" CCAA applications where the creditors are in agreement when the matter first comes to Court. It is more unusual where there are a large number of creditors who are agreed but a significant number of investors who have yet to be consulted.

41 In general terms, besides complying with the technical requirements of the CCAA, this Application is consistent with the purpose and policy underlying the Act. It is well established that the CCAA is remedial legislation, intended to facilitate compromises and arrangements. The Court should give the statute a broad and liberal interpretation so as to encourage and facilitate successful restructurings whenever possible.

42 The CCAA is to be broadly interpreted as giving the Court a good deal of power and flexibility. The very brevity of the CCAA and the fact that it is silent on details permits a wide and liberal construction to enable it to serve its remedial purpose.

43 A restructuring under the CCAA may take any number of forms, limited only by the creativity of those proposing the restructuring. The courts have developed new and creative remedies to ensure that the objectives of the CCAA are met.

> [45] The CCAA is designed to be a flexible instrument, and it is that very flexibility which gives it its efficacy. ... It is not infrequently that judges are told, by those opposing a particular initiative at a particular time, that if they make a particular order that is requested it will be the first time in Canadian jurisprudence (sometimes in global jurisprudence, depending upon the level of the rhetoric) that such an order has been made! *Nonetheless, the orders are made, if the circumstances are appropriate and the orders can be made within the framework and in the spirit of the CCAA legislation.* [Emphasis added.][6]

44 Similarly, the courts have acknowledged the need to maintain flexibility in CCAA matters, discouraging importation of any statutory provisions, restrictions or requirements that might impede creative use of the CCAA without a demonstrated need or statutory direction.

45 I am satisfied that a failure of the Plan would cause far-reaching negative consequences to investors, including pension funds, governments, business corporations and individuals.

46 All those involved, particularly the individuals, may not yet appreciate the consequences involved with a Plan failure.

47 In order that those who are affected have an opportunity to consider all the consequences and decide whether or not they are prepared to vote in favour of the proposed or any other Plan, the stay of proceedings sought in favour of those parties integrally involved in the financial management of the Conduits or whose support is essential to the Plan is appropriate.

48 S. 11 of the CCAA provides for stays of proceedings against the debtor companies. It is silent as to the availability of stays in favour of non-parties. The granting of stays in favour of non-parties has been held to be an appropriate exercise of the Court's jurisdiction. A number of authorities have supported the concept of a stay to enable a "global resolution."[7]

49 More recently in *Re Calpine Canada Energy Limited*[8], Romaine J. of the Alberta Court of Queens Bench permitted not only an initial order, but also one that extended after exit from CCAA

without a plan so that the process of the CCAA would not be undermined against orders made during an unsuccessful plan.

50 Finally, I am satisfied at this stage of the approval of filing of the Initial Plan that all creditors be placed in a single class. The CCAA provides no statutory guidance to assist the Court in determining the proper classification of creditors. The tests for proper classification of creditors for the purpose of voting on a CCAA plan of arrangement have been developed in the case law.[9]

51 The Plan is, in essence, an offer to all investors that must be accepted by or made binding on all investors. In light of this reality, the Applicants propose that there be a single class of creditors consisting of all ABCP holders. It is urged that all holders of ABCP invested in the Canadian marketplace with its lack of transparency and other common problems. The Plan treats all ABCP holders equitably. While the risks differ as among traditional assets, ineligible assets and synthetic assets, I am advised that the calculation of the differing risks and corresponding interests has been taken into account consistently across all of the ABCP in the Plan.

52 I am satisfied that, at least at this stage, fragmentation of classes would render it excessively difficult to obtain approval of a CCAA plan and is therefore contrary to the purpose of the CCAA.

> Not every difference in the nature of a debt due to a creditor or a group of creditors warrants the creation of a separate class. What is required is some community of interest and rights which are not so dissimilar as to make it impossible for the creditors in the class to consult with a view toward a common interest.[10]

53 The Court of Appeal for Ontario in Re Stelco noted that a "commonality of interest" applied. Likely fact-driven circumstances were at the heart of classification.

> It is clear that classification is a fact-driven exercise, dependent upon the circumstances of each particular case. Moreover, given the nature of the CCAA process and the underlying flexibility of that process - a flexibility which is its genius - there can be no fixed rules that must apply in all cases.[11]

54 For the above reasons the Initial Order and Meeting Ordered will issue in the form filed and signed.

55 I note that the process includes sending to each investor a detailed and comprehensive description of the problems that developed in the ABCP market as well as its proposed solution. In a recognition that the understanding of the problem and its proposed solution might be difficult to understand, the Investor Committee is to be commended for arranging to hold information meetings across Canada.

56 I am of the view that resolution of this difficult and complex problem will be best achieved by those directly affected reaching agreement in a timely fashion for a lasting resolution.

C.L. CAMPBELL J.

* * * * *

SCHEDULE "A"

CONDUITS

Apollo Trust

Apsley Trust

Aria Trust

Aurora Trust

Comet Trust

Encore Trust

Gemini Trust

Ironstone Trust

MMAI-I Trust

Newshore Canadian Trust

Opus Trust

Planet Trust

Rocket Trust

Selkirk Funding Trust

Silverstone Trust

Slate Trust

Structured Asset Trust

Structured Investment Trust III

Symphony Trust

Whitehall Trust

SCHEDULE "B"

APPLICANTS

ATB Financial

Caisse de Dépôt et Placement du Québec

Canaccord Capital Corporation

Canada Post Corporation

Credit Union Central of Alberta Limited

Credit Union Central of British Columbia

Credit Union Central of Canada

Credit Union Central of Ontario

Credit Union Central of Saskatchewan

Desjardins Group

Magna International Inc.

National Bank Financial Inc./National Bank of Canada

NAV Canada

Northwater Capital Management Inc.

Public Sector Pension Investment Board

The Governors of the University of Alberta

cp/e/qlmxm/qlclg/qlltl/qltxp/qlaxw/qlbrl/qlcas/qlaxw

1 See *Lehndorff General Partner, Re* (1993), 17 C.B.R. (3d) 24 at 31 (Ont. Gen. Div.) contrasted with *Re Royal Oak Mines Inc.* (1999), 6 C.B.R. (4th) 314 at 316.

2 *Elan Corp. v. Comiskey* (1990), 1 O.R. (3d) 289 (Ont. C.A.) per Doherty J.A. (in dissent on result but not on this point); also cases referred to in *Re Cadillac Fairview Inc.* (1995), 30 C.B.R. (3d) 29 (Ont. Gen. Div.).

3 *Re Stelco Inc.* (2004), 48 C.B.R. (4th) 299 (Ont. S.C.J.) at paras. 21-22; leave to appeal to C.A. refused, [2004] O.J. No. 1903; leave to appeal to S.C.C. refused [2004] S.C.C.A. No. 336.

4 *Supra* at (2004) paragraphs 26 and 28.

5 Instruments such as trust deeds may give specified rights to creditors or any class of them in certain circumstances. Some instruments may purport to provide that a creditor may not circumvent any limitation in the rights contained in the instrument by proposing an arrangement under the CCAA and thereby obtaining wider or extended rights. ... Relief under the CCAA is available notwithstanding the terms of any instrument. [Footnote omitted.] (John D. Honsberger, *Debt Restructuring: Principles and Practice,* vol. 1 (Aurora: Canada Law Book, 1997+) at 9-18). See also *Citibank Canada v. Chase Manhattan Bank of Canada, [1991] O.J. No. 944, supra*, at paras. 25-26 (Ont. Gen. Div.); *Re United Used Auto & Truck Parts Ltd.* (1999), 12 C.B.R. (4th) 144 at para. 11 (B.C.S.C.).

6 *Re Canadian Red Cross Society* (1998), 5 C.B.R. (4th) 299 at para. 45.

7 *Campeau v. Olympia & York Developments Ltd.* (1992), 14 C.B.R. (3d) 303 (Ont. Gen. Div.) at paras. 23-25; *Re MuscleTech Research & Development* (2006), 19 C.B.R. (5th) 54 (Ont. S.C.J. - Commercial List) at para. 3.

8 *Re Calpine Canada Energy Limited* (2006), 19 C.B.R. (5th) 187 (Alta. Q.B.) at paras. 33-34; *Re Calpine Canada Energy Limited* (8 February 2008), Calgary 0501-17864 (Alta. Q.B.) at 5.

9 *Re Campeau Corp.* (1991), 10 C.B.R. (3d) 100 (Ont. Gen. Div.) at para. 18.

10 *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) at paras. 13-14.

11 *Re Stelco Inc.* (2005), 15 C.B.R. (5th) 307 (Ont. C.A.), at para. 22.

Tab 5

Indexed as:

Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Between
Sklar-Peppler Furniture Corporation, Applicant, and
The Bank of Nova Scotia, 949073 Ontario Inc., H & R Properties Limited, Shermic Inc., Joante Investments Ltd., Canadian Equipment Leasing (a division of Triathlon Leasing Inc.), Pitney Bowes Leasing (a division of Pitney Bowes of Canada Ltd.), Michael Weinig Ag and all other affected Creditors of the Applicant, Respondents

[1991] O.J. No. 2288

86 D.L.R. (4th) 621

8 C.B.R. (3d) 312

Action No. B301/91

Ontario Court of Justice - General Division
Toronto, Ontario

Borins J.

Heard: October 31, 1991
Judgment: November 18, 1991

(17 pp.)

Creditors and debtors -- Winding-up -- Plans of compromise -- Whether status quo to be preserved pending consideration -- Classification of creditors -- Whether lessors to be put in separate class.

Application for an order preventing creditors from bringing winding-up proceedings pending consideration of a plan of compromise. Two of the respondents were secured creditors, owing over $60,000. The applicant was indebted to trade and other secured creditors for over ten million dollars. Six of the respondents leased equipment and premises to the applicant. The applicant repudiated the leases due to financial circumstances. The applicant sought to maintain the status quo until

its proposed plan of compromise was considered. The plan provided for two classes of creditors, secured and others which included employees, lessors and debenture holders. The creditors were to be treated as they would be under bankruptcy. The lessors objected to the plan.

HELD: Application allowed. The plan presented a realistic proposal of compromise and reorganization with the probable chance of success. It was appropriate to maintain the status quo to avoid impairment of the continued ability of the applicant to continue business while the plan was considered. It was not appropriate for the court to consider specific provisions of the plan until approved by the creditors. The classification of creditors did not require that lessors be placed in a separate class.

STATUTES, REGULATIONS AND RULES CITED:

Bankruptcy Act, R.S.C. 1985, c. B-3.
Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, ss. 2, 3, 4, 5, 6, 11.

Cases considered:

Elan Corporation and Nova Metal Products Inc. v. Comiskey, (1990), 1. O.R. (3d) 289 (C.A.).
Meridian Developments Inc. v. Toronto Dominion Bank (1984), 52 C.B.R. (N.S.) 109 (Alta. Q.B.).
Re Northland Properties Limited et al. (1988), 73 C.B.R. (N.S.) 146 (B.C.S.C.).
Re Northland Properties Limited et al. (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.).
Quintette Coal Limited v. Nippon Steel Corporation et al. (1990), 51 B.C.L.R. (2d) 105 (C.A.).
In re Quintette Coal Limited (unreported) April 12, 1991 (B.C.S.C.).
Re Ultracare Management Inc. et al. v. Gammon (1990), 1 O.R. (3d) 321 (Ont. Ct. G.D.).
Perfection Foods Limited et al. v. Royal Bank of Canada et al. (unreported) January 22, 1991, (P.E.I.S.C.).
Re Stephanie's Fashion Ltd. (unreported) January 24, 1990, (B.C.S.C.).
G.T. Campbell & Associates Ltd. v. Hugh Carson Co. Ltd. (1979), 7 B.L.R. 84 (Ont. C.A.).
Quebec Steel Products (Industries) Ltd. v. James United Steel Ltd., (1969) 2 O.R. 349 (H.C.).
Manbro Holdings v. Bank of Montreal (unreported) Oct. 18, 1991 (Lane J. Ont. Ct. G.D.).
Re Chef Ready Foods Ltd. v. Hong Kong Bank of Canada (1990), 51 B.C.L.R. (2d) 84 (B.C.C.A.).
Norcen Energy Resources Limited and Prairie Oil Royalties Company Ltd. v. Oakwood Petroleums Ltd. (1988), 72 C.B.R. (N.S.) 1 (Alta. Q.B.).
Wynden Canada Inc. v. Gaz Metropolitan Inc. (1982), 44 C.B.R. (N.S.) 285 (Que. S.C.).
Re United Maritime Fishing Coop (1988), 67 C.B.R. 44 (N.B.Q.B.), rev'd on other grounds (1988), 69 C.B.R 161 (N.B.C.A.).
Icor Oil & Gas Co. Ltd. et al. v. Canadian Imperial Bank of Commerce et al. (No. 1) (1989), 102 A.R. 161 at 163 (Alta. Q.B.).
First Treasury Financial Inc. and Cango Petroleums, (1991), 3 C.B.R. (3d) 232.
Re Ursel Investments Ltd., unreported, March 20, 1990 (Sask. Q.B.).
Re 229531 B.C. Ltd., (1989) 72 C.B.R. (N.S.) 310 (B.C.S.C.).
Edwards, Reorganizations Under the Companies' Creditors Arrangement Act, (1947) Vol. XXV, The Canadian Bar Review, 587.
Highway Properties Ltd. v. Kelly, Douglas & Co. Ltd., 17 D.L.R. (3d) 710 (S.C.C.).

Barbara Grossman, for the Applicant and the Respondent 949073 Ontario Inc.
L. Crozier and Catherine Francis, for H & R Properties Limited.

Kent E. Thomson, for Bank of Nova Scotia.

BORINS J.:-- This is an application brought by Sklar-Peppler Furniture Corporation (subsequently referred to as "Sklar") pursuant to ss. 4, 5 and 11 of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (subsequently referred to as "C.C.A.A.") for the relief contained in the draft order annexed to the notice of application.

The essential nature of the relief requested is the maintenance of the status quo in regard to the business operations conducted by Sklar by preventing any of its creditors from taking proceedings against it under the Bankruptcy Act, R.S.C. 1985 c. B-3 and the Winding-Up Act, R.S.C. 1985 c. W-10, or commencing or continuing any lawsuit or related proceedings against Sklar until further order of the court, pending the consideration of a plan of compromise or arrangement between Sklar and the classes of its creditors affected by the proposed plan.

Before the court is the proposed plan. It is a most comprehensive document, thirty-nine pages in length, to which is appended an additional thirty-three pages containing information referred to in the plan, including the classification of creditors for the purpose of voting in respect to the approval of the plan as required by s. 6 of the Act. The urgent nature of this application, with the resulting need to provide an early decision in respect to it, as well as a limited time available to me since the conclusion of submissions late yesterday, do not permit me to review in detail the provisions of the plan. However, I am able to say that I have examined in detail the plan and the evidence before the court and, subject to what follows, I would have had no hesitation in granting the order as sought because the order and the plan, in my view, provide a compelling example of the very situation to which the C.C.A.A. is intended to address. The proposed plan exemplifies the policy and objectives of the Act as it proposes a regime for the court-supervised re-organization of the applicant company intended to avoid the devastating social and economic effects of a creditor-initiated termination of its ongoing business operations and enabling the company to carry on its business in a manner in which it is intended to cause the least possible harm to the company, its creditors, its employees and former employees and the communities in which it carries on and carried on its business operations.

Two of the named respondents, the Bank of Nova Scotia and 949073 Ontario Inc. are the major creditors of Sklar and their combined indebtedness is about $60,000,000. The bank is a secured creditor and 949073 Ontario Inc. is an unsecured creditor which is the guarantor of a debt of Sklar and which has given security to the bank. Counsel for the bank advised the court of the bank's strong support for the order sought by Sklar. The applicant is indebted to trade and other secured creditors in the aggregate amount of about $10,500,000. There are six other named respondents. Three of these respondents are the landlords of premises under lease to Sklar which Sklar, as part of its proposed reorganization, can no longer afford and which, therefore, it no longer requires for what it hopes will be its continuing business operations. Two of the other three respondents are lessors of equipment to Sklar, the continued use of which Sklar also considers to be uneconomical. The sixth respondent is a conditional sales vendor of certain equipment purchased by Sklar.

On October 24, 1991 Sklar delivered a notice to each of the three realty landlords advising them that due to its financial situation it was unable to continue to occupy the leased premises, that it has vacated the premises in question and that it would make delivery of the keys to the premises

and expressing the view that each landlord would take appropriate steps to protect its interest and secure the leased premises. Each of the landlords replied to the notice stating, inter alia, that Sklar's letter constituted a repudiation of its lease.

As for the respondents, Mr. Hess was in attendance as a representative of Michael Weinig AG and through counsel for the applicant advised the court that Michael Weinig AG neither opposed nor consented to the granting of the order. A similar position was taken by two realty lessors, Shermic Inc., and Joante Investments Ltd. who appeared respectively by counsel and a representative. Nothing was heard from the remaining two equipment lessors, Triathlon Leasing Inc. and Pitney Bowes of Canada Ltd. The only opposition to the granting of the order was that of the realty lessor H & R Properties Limited. As I wall explain, as I understand, the principle objections of H & R Properties Limited are not to the plan as such, but are in respect to the way in which certain provisions of the plan purport to interfere with its contractual rights as landlord and its remedies against Sklar consequent to its repudiation of the lease and in respect to the classification of creditors for the purposes of the vote required to consider the approval or rejection of the plan.

However, before I discuss the submissions made by counsel for H & R Properties, there are some observations which I wish to make by way of background. Sklar is a long established company which has carried on the business of manufacturing and marketing wooden furniture and upholstered furniture for many years in southern Ontario. A subsidiary carries on its business in the United States. Until its financial circumstances caused the company to reduce its operations, it formerly employed approximately 212 people in Hanover and 60 people in Toronto. It now employs about 400 people in Whitby, and about 200 people are employed by the American subsidiary, in Operations which it proposes to continue if the plan is approved.

Since late 1989 Sklar has experienced financial difficulties and is now insolvent. Among the reasons for its insolvency are the combined effects of economic recession, the introduction of free trade, the strong Canadian dollar, the high volume of bankruptcies among Canadian furniture manufacturers and the effects of the Goods and Services Tax on consumer spending. It has already introduced economic measures designed to deal with its financial problems. If the plan is not approved, the Bank of Nova Scotia will enforce its security. This will result in Sklar's bankruptcy, which in turn will result in its remaining employees losing their jobs and no funds being available to satisfy the claims of unsecured creditors, including terminated employees. The plan provides for a fund of $1.5 million to pay, on a pro rata basis, the amounts due to the over 1,000 unsecured creditors to whom the proposed plan will be mailed and who will be given the opportunity to vote, in person or by proxy, with respect to its approval or rejection. Sklar has issued the debentures necessary to qualify it as a debtor company within the meaning of ss. 2 and 3 of the C.C.A.A. Although an issue was raised as to whether H & R Properties Limited is an unsecured creditor within s. 2 of the Act, I am satisfied that under the broad definition of unsecured creditor contained in the Act in the cases in which I have considered the question, H & R Properties is an unsecured creditor both in respect to the outstanding rent which is now owed to it by Sklar, and any contingent claim for unliquidated damages to which it may become entitled as a result of Sklar's apparent repudiation of its lease.

This brings me to the objections raised by counsel for H & R Properties in their submissions. There are two main objections which are, in a sense, related. The first objection relates to paragraph 20 of the draft order which stipulates that H & R Properties is an "Affected Creditor" as defined in the order and the plan and provides that the claims of every such creditor includes claims for con-

tingent and unliquidated claims arising, inter alia, under any lease. The first objection relates as well to the provisions of paragraph 26 of the plan which states that if the plan is approved realty leases will be terminated as of the date the order is granted, and the lessors "will be treated insofar as the situation permits in a manner equivalent to treatment to which they would be entitled if the company had gone into bankruptcy" on the date the order is granted. The second objection relates to the classification of the creditors in the plan. The plan provides for two classes of creditors. The first class was comprised of the two secured creditors, Bank of Nova Scotia and 949073 Ontario Inc. The second class contains all other affected creditors, numbering over one thousand, and includes the holders of debentures issued by the company, all terminated employees of the company, the three realty lessors and the three equipment lessors.

In considering the objections raised by H & R Properties, I wish to emphasize that while I have read the authorities provided by counsel for all parties, time has not permitted me to discuss and analyze them in these reasons. I have, however, in an appendix [See cases considered in head-notes.] to my reasons, listed the authorities provided by counsel for all parties. I have also read the helpful article by Goldman, Baird and Weinczok, "Arrangements Under the Companies' Creditors' Arrangements Act", (1991) 1 C.B.R. (3d) 135 in which the authorities are reviewed.

With respect to the first objection, I am satisfied that on the broad interpretation which the authorities have placed on s. 11 of the C.C.A.A. and the discretionary powers which it provides to the court in considering an application under the C.C.A.A. and the purposes of the legislation, the provisions of paragraph 20 of the draft order are appropriate to avoid impairment to the ability of Sklar to continue its business operations during the period while the plan of compromise or arrangement is under consideration. To the extent that it is appropriate to comment on paragraph 26 of the plan, I see nothing inappropriate in its terms. However, the plan is yet to be approved by the creditors and it is only after it has been approved by them that it is, in my view, appropriate for the court, in considering whether or not court approval is to be given, to comment specifically on a proposed plan except, of course, in regard to the classification of creditors and its probability of success or failure in relation to the circumstances of the application.

The second objection concerns the classification of creditors. This objection emanates from the fact that H & R Properties is displeased with the impact of the plan and in particular paragraph 26 on any claims which it might have for future rent subsequent to the date its lease with Sklar is terminated. It fears that because it is in a class with over 1,000 creditors the negative vote which one presumes it proposes to cast against the plan will be meaningless and the plan will be approved. It, therefore, submits that a third class of creditors should be established consisting of the three realty lessors and the other three respondents. It submits that because there is no community of interest between itself and the other creditors, the applicant is attempting to Isolate it by placing it in a class in which it does not belong and to thereby force upon it conditions which it feels are unacceptable.

The subject of the appropriate classification of creditors has attracted considerable attention over the past decade. The earlier cases and the recent cases are discussed at pages 157 to 169 of the article to which I have referred. In my view, an important principle to consider in approaching ss. 4 and 5 of the C.C.A.A. is that followed in Re Wellington Building Corporation, (1934) O.R. 653 in which it was emphasized that the object of ss. 4 and 5 is not confiscation but is to enable compromises to be made for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such. To this I would add that recognition must be given to the legislative intent to facilitate corporate re-organization and that in the modern world of large and complex

business enterprises the excessive fragmentation of classes could be counter-productive to the fulfilment of this intent. In this regard, to approach the classification of creditors on the basis of identity of interest, as suggested by counsel for H & R Properties, would in some instances result in the multiplicity of classes which would make any re-organization difficult, if not impossible, to achieve. In my view, in placing a broad and purposive interpretation upon the provisions of the C.C.A.A. the court should take care to resist approaches which would potentially fragment creditors and thereby jeopardize potentially viable plans of arrangement, such as the plan advanced in this application.

In Elan Corporation v. Comiskey, (1991) 1 O.R. (3d) 289, Finlayson, J.A. discussed the factors to be considered in the classification of shareholders. Based upon the factors considered by him, and agreed with by Doherty, J.A. in his dissenting reasons, and the factors discussed in the various cases reviewed in the article, I am not persuaded that a separate class should be created consisting of the realty lessors, the equipment lessors and the conditional sales vendor. Not every difference in the nature of a debt due to a creditor or a group of creditors warrants the creation of a separate class. What is required is some community of interest and rights which are not so dissimilar as to make it impossible for the creditors in the class to consult with a view toward a common interest. I do not see any reason for lessors, simply because they are lessors, to constitute a separate class of creditors. In reaching this conclusion I have also considered that paragraph 26 of the plan does take into account the rights given to landlords under the Bankruptcy Act and incorporates these rights into the plan. By the same token it would be improper to create a special class simply for the benefit of the opposing creditor which would give that creditor the potential to exercise an unwarranted degree of power. The proposed plan is not for the exclusive benefit of H & R Properties but is intended to be for the benefit of all of the creditors. In my view, it presents a realistic proposal of compromise and reorganization which has a probable chance of success if presented to the creditors for their consideration.

Accordingly, the order will go as asked.

Tab 6

Indexed as:

Keddy Motor Inns Ltd. (Re)

Between
RoyNat Inc. and Royal Trust Corporation of Canada,
Appellants, and
Keddy Motor Inns Limited, Respondent

[1992] N.S.J. No. 98

90 D.L.R. (4th) 175

110 N.S.R. (2d) 246

6 B.L.R. (2d) 116

13 C.B.R. (3d) 245

32 A.C.W.S. (3d) 1085

299 A.P.R. 246

Action S.C.A. Nos. 02595 and 02598

Nova Scotia Supreme Court - Appeal Division
Halifax, Nova Scotia

Clarke C.J.N.S., Matthews and Freeman JJ.A.

Heard: February 7, 1992
Judgment: March 2, 1992

(32 pp.)

Company law -- Companies' Creditors Arrangement Act -- Validity -- Voting irregularities -- Late proxy vote -- Classification -- Fairness.

Faced with debts totalling $42,000,000 that threatened insolvency, the respondent brought proceedings under the Companies' Creditors Arrangement Act. The plan involved a division of the respondent's creditors into classes according to interest and a vote was passed approving the plan. The

plan was sanctioned by the Supreme Court. The appellants comprised the minority that opposed the plan. In this appeal they urged that the plan was invalid for irregularities. They argued that the trial judge should not have allowed the inclusion of a proxy vote that arrived late; that creditors were permitted to negotiate preferential treatment within their classes as an inducement to vote for the plan; and that the classification of the creditors was unfair.

HELD: The appeal was dismissed. While late proxy votes are to be discouraged, there is nothing in the Act that precludes the approval of late-arriving proxy votes. The evidence showed that there could have been a better classification than that adopted in the plan. However, the present classification did not give rise to any substantial injustice. Classification order was made prior to the order sanctioning the plan. In the absence of appeal from the classification order, the debtor and its creditors were entitled to rely upon it as a foundation for the plan. The Act contemplates negotiations between the debtor company and creditors based on the best terms they can get. The appellants failed to participate in negotiating favourable terms for themselves in the hope that the plan would fail for non-approval. The emerging plan accorded some creditors preferential treatment at the expense of the appellants but this was done within the fair and equitable process laid down in the Act.

STATUTES, REGULATIONS AND RULES CITED:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 6.

Daniel M. Campbell, Q.C., for Appellant RoyNat Inc.
Peter G. MacKeigan and Gregory Cooper, for Royal Trust Corporation of Canada.
John D. Stringer, Richard Freeman and Roy F. Redgrave, for Keddy Motor Inns Limited.
Gerald R.P. Moir, for Central Guaranty Trust Company.

THE COURT: Appeal dismissed from order sanctioning plan of arrangement under Companies' Creditors Arrangement Act between hotel chain and creditors per reasons for judgment of Freeman J.A.; Clarke C.J.N.S. and Matthews J.A., concurring.

FREEMAN J.A.:-- Two secured creditors are seeking to overturn the Supreme Court order sanctioning a hotel chain's plan of arrangement under the Companies' Creditors Arrangement Act R.S.C. 1985, c. C-36, on grounds of voting irregularity and unfair practices.

Faced with debts totalling $42,000,000 that threatened to overwhelm it, the respondent, Keddy's Motor Inns Limited, brought proceedings under the Act. Under a series of court orders creditors' actions were stayed, creditors divided into classes according to interest, and a schedule established requiring a plan to be voted on by November 2, 1991.

Following the vote approving the plan as amended at the meetings, it was sanctioned on application to Mr. Justice Nathanson of the Trial Division.

The issues on the appeal from his decision are that he should not have allowed the inclusion of a proxy vote that arrived late, resulting in approval of the plan by the class of capital lease creditors; that creditors were permitted to negotiate preferential treatment within their classes as an in-

ducement to vote for a plan confiscatory of secured creditors' rights; and that the creditors had been unfairly classified.

The appellants must overcome obstacles including strong creditor approval of the plan, a well reasoned decision by Mr. Justice Nathanson and able submissions on behalf of both respondents.

The scheme of the Act is contained in s. 6:

> 6. Where a majority in number representing three-fourths in value of the creditors or class of creditors, as the case may be, present and voting, either in person or by proxy, at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding
>
> (a) on all the creditors or class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company;

Important features are that the majority as defined in the Act can bind the minority, that the final plan is defined by the vote of the creditors at the meetings, and that modifications can be negotiated up to the time of voting.

The right of majority creditors of a class to bind the minority is an extraordinary one, reflecting a willingness on the part of Parliament to deprive some creditors of their contractual rights in the interest of the survival of the economic unit comprised of the ailing corporation and its creditors. Fairness is preserved by the requirement for court sanction. But fairness must be understood within the spirit of the statute.

The Act itself, apart from the jurisprudence which has developed around it, is little encumbered by detail or nicety and provides minimal direct guidance as to procedures to be followed. It is intended to provide distressed businessmen and their creditors with a means of reaching an accommodation of benefit to both, and to the public generally. Writing for the British Columbia Court of Appeal, Mr. Justice Gibbs described the Act in Chef Ready Foods Ltd. v. Hongkong Bank of Canada, [1991] 2 W.W.R. 136 at p. 142:

> "The CCAA was enacted by Parliament in 1933 when the nation and the world were in the grip of an economic depression. When a company became insolvent liquidation followed because that was the only consequence of the only insolvency legislation which then existed--the Bankruptcy Act and the Winding-up Act. Almost invariably liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the CCAA, to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a

> reorganization or compromise or arrangement under which the company could continue in business."

The Act was considered by the Supreme Court of Canada soon after its enactment in Re Companies' Creditors Arrangement Act; A.G. Can. v. A.G. Que., [1934] S.C.R. 659 in which Cannon, J. described it as follows:

> "Therefore, if the proceedings under this new Act of 1933 are not, strictly speaking 'bankruptcy' proceedings, because they had not for object the sale and division of the assets of the debtor, they may, however, be considered as 'insolvency' proceedings with the object of preventing a declaration of bankruptcy and the sale of these assets. If the creditors directly interested for the time being reach the conclusion that an opportune arrangement to avoid such sale would better protect their interest, as a whole or in part, provisions for the settlement of the liabilities of the insolvent are an essential element of any insolvency legislation ..."

The Act fell into disuse until recent years but now appears to be enjoying a resurgence. McEachern, C.J.B.C., discussed its purpose in the influential case of Northland Properties Limited et al. v. Excelsior Life Insurance Company of Canada et al. (1989), 73 C.B.R. 195 (B.C.C.A.):

> " ... there can be no doubt about the purpose of the C.C.A.A. It is to enable compromises to be made for the common benefit of the creditors and of the company, particularly to keep a company in financial difficulties alive and out of the hands of liquidators. To make the Act workable, it is often necessary to permit a requisite majority of each class to bind the minority to the terms of the plan, but the plan must be fair and reasonable."

Nathanson, J. recognized that court sanction for the plan required that the court be satisfied as to three criteria which have evolved through the case law and which were stated in the Northland Properties case.

1. There must be strict compliance with all statutory requirements.
2. All material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the Companies' Creditors Arrangement Act.
3. The plan must be fair and reasonable.

Each of the six classes of creditors voted in favour of the plan by the majority required under the Act. The creditors did not vote as a whole. The votes cast at the class meetings--including the proxy vote at issue in this appeal--showed 92 per cent of the creditors representing 86.6 per cent of the value of the claims favored the plan.

After three days of hearings in November, 1991, Mr. Justice Nathanson sanctioned the plan. It provides for three unprofitable hotel or motel properties to be sold or transferred to mortgagees, and the eight profitable "core" properties to be retained. Interest rates on the core properties were standardized at eleven per cent and amortization periods at 25 years. Numerous variations were arrived at through negotiations, as contemplated by the Act, to make the plan acceptable to the major-

ity of creditors. Many creditors received concessions of particular interest or benefit to themselves, that were not made to their class of creditors as a whole.

Central Guarantee, the largest creditor, was added as respondent in this appeal. It was owed $16,600,000 secured by mortgages on hotels in Halifax, Moncton and Fredericton. Relying on provisions of its security contracts, it negotiated for monthly payments of $66,000 to cover municipal taxes and for payment of its legal fees of $25,000 as a protective disbursement out of a trust fund held for renovation expenses. The appellants did not receive equivalent benefits. It does not appear that they engaged in negotiations with the respondents to improve their positions, although they would have been free to do so. They did not expect the plan to be approved.

The appellants, in voting against the plan, were in the minority in the secured creditor class. They were among the few secured creditors who were fully secure. Royal Trust held a first mortgage for $985,000 on a hotel at Shediac Road, Moncton, and RoyNat, Inc., held a first mortgage for $3,750,000 on Keddy's Saint John hotel. Both properties are valued in excess of the first mortgages. The appellants claim their position has worsened because their interest rates were reduced from 13 per cent, the amortization periods were increased, and they are precluded from realizing on their security during the five-year currency of the plan. They also object that some creditors negotiated benefits for themselves which the appellants did not receive. They say that they should not be bound by a majority of creditors voting out of self-interest in hope of realizing the benefits they had negotiated for themselves.

Moreover, they say the class of secured creditors is too broad, and that they are unfairly grouped with creditors secured by non-core properties, and by mechanics' lienholders. They should not, they say, be bound by the votes of secured creditors with whom they have no community of interest.

I will dispose of the classification of creditors issue first. Similar arguments were considered by Forsyth, J. of the Alberta Queens' Bench in Norcen Energy Resources Limited and Prairie Oil Royalties Company Ltd. v. Oakwood Petroleums Ltd., (1988), 72 C.B.R. 20. He discussed the "commonality of interests test" described in Sovereign Life Assur. Co. v. Dodd, [1892] 2 Q.B. 573 (C.A) in which Lord Esher stated:

> "... If we find a different state of facts among different creditors which may differently affect their minds and their judgments, they must be divided into different classes."
>
> Bowen, L.J. stated that a class:
>
> "... 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."

Forsyth, J. also referred to the "bona fide lack of oppression test" considered in the widely cited case of Alabama, New Orleans, Texas & Pac. Junction Co., Co., [1891] 1 Ch. 2123 (C.A.). Lindley, L.J. stated at pl. 239:

> "The Court must look at the scheme, and see whether the Act has been complied with, whether the majority are acting bona fide, and whether they are coercing the minority border to promote interests adverse to those of the class whom they purport to represent.

Forsyth, J. considered an article by Ronald N. Robertson, Q.C., in a publication entitled "Legal Problems on Reorganizing of Major Financial and Commercial Debtors," Canadian Bar Association -- Ontario Continuing Legal Education, 5th April 1983, at pl. 15 and summarized it as follows:

> "These comments may be reduced to two cogent points. First, it is clear that the C.C.A.A. grants a court the authority to alter the legal rights of parties other than the debtor company without their consent. Second, the primary purpose of the Act is to facilitate reorganizations and this factor must be given due consideration at every stage of the process, including the classification of creditors made under a proposed plan. To accept the 'identity of interest' proposition as a starting point in the classification of creditors necessarily results in a 'multiplicity of discrete classes' which would make any reorganization difficult, if not impossible, to achieve.
>
> In the result, given that this planned reorganization arises under the C.C.A.A., I must reject the arguments put forth by the Hongkong Bank and the Bank of America, that since they hold separate security over different assets, they must therefore be classified as a separate class of creditors."

There is undoubtedly merit in the arguments of the appellants in the present case. Better classifications could no doubt be arranged with the benefit of hindsight. It might have been beneficial if secured creditors of core properties were in a separate class from secured creditors of non-core properties and holders of mechanics' liens. However the Act does not require more than a single class of secured creditors, and I am satisfied the present classification of creditors does not give rise to any substantial injustice. Classification was by a court order following a hearing at which the creditors were entitled to be heard. That order was made earlier than and distinct from the order sanctioning the plan. The classification order was never appealed, and the 21-day appeal period expired before the class meetings. The creditors and the debtor company were entitled to rely upon it as a foundation for the plan. It is not specifically included in the present appeal because it was not subject to collateral attack in the proceedings before Nathanson, J. who was bound by it. The proper procedure for attacking the classification order was by way of appeal from that order, not the sanctioning order. Nevertheless, because of the overall supervisory duty of the court to ensure fairness of the plan, it is my view that we could intervene with respect to the classification order if necessary to avert substantial injustice. I am not satisfied the present circumstances warrant this court's intervention. I would reject the grounds of appeal based on classification.

The ground of appeal first stated by the appellants is their assertion that a late-arriving proxy vote should not have been counted in the voting for the plan for the class of capital lease creditors. Without that vote that plan would have been defeated. The assumption of the appellants appears to be that rejection of a class plan would defeat the entire plan, or at least render it unfeasible, but that

is contrary to the intention of the Act and to s. 7.03 of the plan as sanctioned. They assert a right to appeal from the result of voting for a plan approved by another class of creditors because approval of that plan was essential to the overall plan which is binding on them. Without endorsing that reasoning, the duty of this court, once again, is to consider whether the trial judge erred in assessing the fairness of the plan. This includes jurisdiction over the votes of all classes of creditors; if the impugned vote is a nullity it must be rejected.

Meetings of the six classes of creditors took place November 1 and 2, 1991. The meeting of the capital leasing creditors was held the first day. The original draft of the entire plan, including the plan for that class, and written statements of amendments were before the creditors. Disclosures of results of the most recent negotiations were made orally at the meeting, having the effect of amending the plan to include them.

Marcus Wide of Coopers & Lybrand, the court appointed monitor, acted as chairman of all the meetings. He called for a motion of "closure" of the meeting following the vote. That is, he sought a motion prior to the vote to take effect after the vote. The minutes disclose that such a motion was made and seconded but do not show that it was voted on. After this motion the creditors and their proxies cast their votes and dispersed. There was no motion for adjournment. The ballot box was sealed. The votes were not to be counted until after the last class meeting the next day. The Bruncor proxy in favour of Martin MacKinnon, Keddy's representative, was received by Mr. Wide at 5:08 p.m. on November 1. Mr. Justice Nathanson said that Mr. Wide

> "... declined to include and count the vote in the final tabulation of votes. However, reluctant to deny a legitimate - creditor an opportunity to express its view concerning the plan, he brought the matter to the attention of the court in the monitor's final report".

The Monitor's report on the result of the vote by the capital lease creditors, and the controversial proxy, is as follows:

> 2. Capital Lease Creditors -- failed to approve the plan
>
> | | For | Against |
> |---|---|---|
> | Value of creditors voting | $679,148 | $261,509 |
> | Percentage | 72 | 28 |
>
> | | | |
> |---|---|---|
> | Number of creditors voting | 8 | 1 |
> | Percentage | 89 | 11 |
>
> The Monitor wishes to advise the Court that a proxy, instructing Mr. Martin MacKinnon to vote in favour of the plan, was received from Bruncor Leasing Inc., a capital lease creditor in the amount of $212,959, on the afternoon of November 1, 1991, subsequent to the meeting for that class, but not before the final meeting of creditors and while the ballots

were still in sealed boxes. The instruction regarding proxies circulated with the notice of Meeting provides as follows:

> A proxy may be deposited with, faxed or mailed to and received by the monitor at any time up to the respective creditor meeting, or any adjournment thereof, or may be deposited with the chairman of the meeting immediately prior to the creditors meeting, or any adjournment thereof.
>
> This vote has therefore not been tabulated.

Had the vote been tabulated the Capital Lease Class of Creditors would have approved the plan with 77.3 of the value of the votes cast in that class and 90 per cent of the number.

Mr. Justice Nathanson cited In re Alabama, New Orleans, Texas and Pacific Junction Railway Company, [1891] 1 Ch. 213 at p. 245 as authority for the statement that the vote required for approval of a plan is "a condition precedent to the jurisdiction of the court." He stated that "if the vote is not in accord with the statutory requirement, the court cannot exercise its jurisdiction under the statute to sanction the plan. Strict compliance with the statutory requirement is mandatory."

The Act provides statutory requirements as to the majorities necessary to approve a plan by a class of creditors, but no guidance as to the manner of voting. The words "present and voting either in person or by proxy at the meeting or meetings" of the creditors or a class of creditors have been referred to by counsel as a voting directive. In context, however, they merely define the creditors to be considered in determining whether the requisite majorities for approval of the plan have been met.

The somewhat unusual procedure of "closing" the meeting by motion prior to the vote presumably fixed the plan in the form it had attained up to the moment of closure and cut off further discussion while the creditors turned their attentions to the actual process of voting. Voting is as much a function of the meeting as discussion of the plan; while the voting was in progress the meeting necessarily continued in existence. Counting the ballots is as much a function of the vote as casting them. Apart from the security measure of sealing the ballot box, no step was taken, no motion moved nor voted on, to end the meeting or to close the voting, between the casting of the votes and the counting of them.

The meeting must still have been an existing, though fictitious, entity at the time the votes were counted; the count necessarily occurred within the context of the meeting. The continuation of the meeting and the acceptance of the late proxy vote finds support in the case law. See Shaw v. Tati Concessions Limited, [1913] 1 Ch. 292, Washington State Labour Council v. Federate American Insurance Company, Wash. 474 P. 2d 98 (S.C. En Banc).

Counsel for the appellants complain that the proxy was obviously solicited from Bruncor by representatives of Keddy's. However they specifically acknowledged that they do not allege it was induced by improper side deals or secret benefits.

While it was obviously intended that proxies should be produced prior to the meetings, there appears to be nothing in the Act, nor in the orders, nor in the voting instructions of the monitor, to preclude the tabulation of a proxy vote submitted prior to the counting of ballots. The common law applies. That is stated in Company Meetings by J.M. Wainberg, Q.C. 2nd ed., 1969 at p. 72 in his discussion of Rules of Order:

> When a poll is demanded, it shall be taken forthwith. If the poll is on the election of a chairman or on a motion to adjourn, the votes shall be counted forthwith, and the result declared before any further business is conducted. On any other question the count may be made at such time as the chairman directs, and other business may be proceeded with pending the results of the poll. Up to the time the poll is declared closed and the chairman (or the scrutineers) begin examining ballots, any qualified voter may vote.

The vote was carefully conducted, with due attention to fairness and security. I am not satisfied that prejudice was suffered by creditors of any other class as a result of the counting of the vote of a creditor qualified to vote in every respect save for tardiness. It is important that creditors not be disenfranchised for technical reasons; approval of a plan is an expression of the collective will of the creditors, and it is important that be as broadly based as possible. It must be borne in mind that this was a vote by creditors under the Companies' Creditors Arrangement Act, not a meeting of municipal councillors or a company board of directors. Clear evidence of illegality within the spirit and purpose of the Act, not mere irregularity, is necessary to invalidate the ballot. If the ballot was not invalid, it must be counted.

As McEachern, C.J.B.C. said in Northland,

> "As the authorities say, we should not be astute in finding technical arguments to overcome the decision of such a majority."

Nevertheless, late proxies are not desirable. They create uncertainty, and there exists a perceived possibility for abuse. The reason for holding the counting of the votes until all creditors had voted was to ensure that classes with the latest meetings would not have the negotiating advantage of knowing how other classes had voted. Chairmen of creditors' meetings would be well advised to have the ballots counted promptly after they are cast and then to have the meeting properly adjourned. There would be no need to announce the results until after the last meeting.

I am not satisfied the appellants have demonstrated that Mr. Justice Nathanson erred at law in approving the Bruncor ballot. I would dismiss this ground of appeal.

The remaining grounds of appeal include the allegation that the plan for secured creditors was actually a number of plans tailored to individual creditors. This ground is closely related to the classification issue. The commonality of interests test is no longer strictly applied because of its unwieldiness. It necessarily follows that plans for broad classes of secured creditors must contain variations tailored to the situations of the various creditors within the class. Equality of treatment--as opposed to equitable treatment--is not a necessary, nor even a desirable goal. Variations are not in and of themselves unfair, provided there is proper disclosure. They must, however, be determined to be fair and reasonable within the context of the plan as a whole.

The other grounds to be considered within the general heading of unfairness include allegations that votes of secured creditors obtained by inducements should have been excluded, that the plan was not fair and reasonable among secured creditors and that the process employed by the respondent was inherently unfair.

The instances complained of are set forth in Mr. Justice Nathanson's decision and need not be repeated here. In dealing with them generally, he remarked that what the appellants overlooked was "that their objections must be examined in the light of what is in the best interests of the class of secured creditors to which they belong and of the creditors as a whole."

He summarized his conclusions about the complaints as follows:

> "... some of the complaints are relatively inconsequential, others have another context which is not stated. What appears on the surface to be the whole truth is, in reality, of less moment ..."

He stated that he applied the following principles, which he derived from the case law:

1. Negotiations between the debtor company and creditors are salutary and ought to be encouraged.
2. Secret or side deals or arrangements are improper. Their impropriety can be ameliorated by making full disclosure in a timely manner.
3. There is no authoritative definition of what constitutes full disclosure or timely manner; therefore, these may be questions of fact to be determined in each individual case.
4. Members of a class of creditors must be treated fairly and equitably. Where different members are treated differently, all members of the class must have knowledge of the plan overall and for the particular class.

Mr. Justice Nathanson made the following findings:

> "I find that the debtor company made full disclosure in a timely manner by setting out the essential characteristics of the proposed plan, that is, all material information needed by a creditor in order to make a fair and informed judgment, in the draft plan as filed, in the two addenda circulated to the members of the class, and in the oral communications made during the meeting which could not have been made in writing at an earlier time because of the continuance of negotiations with various creditors. I also find that the members of the secured creditors class had full knowledge of the plan in its application to all members of that class and generally in its application to all creditors of all classes.
>
> I find that the members of the secured creditors class are treated fairly and equitably in the plan as amended. Some sacrifices will be made, but the evidence discloses that at least some of those sacrifices are of

> windfalls which might accrue if the plan is not approved and the sacrificing creditors are able to realize on the security which they hold.
>
> I hold that the proposed plan is fair and reasonable. It is a bona fide and creditable attempt to achieve a result which is generally fair to the creditors ..."

The burden on the appellants to show otherwise is a very heavy one. In considering fairness Mr. Justice Nathanson was in the last analysis exercising his discretion in addition to identifying and applying rules of law and making findings of fact. This court has ruled repeatedly, on sound authority, that it should only interfere with discretionary findings by a trial judge if serious or substantial injustice, material injury or very great prejudice would otherwise result. See, for example, McCarthy v. Acadia University (1977), 18 N.S.R. (2d) 364-; Exco Corporation v. Nova Scotia Savings and Loan et al. 59 N.S.R. (2d) 331; Coughlan et al. v. Westminer Canada Holdings Ltd. et al. (1989), 91 N.S.R. (2d) 214; Minkoff v. Poole and Lambert (1991), 101 N.S.R. (2d) 143; and the authorities cited therein.

When the judicial discretion is exercised in favour of sanctioning a plan proposed by a debtor company but in a very real way created by a resounding majority vote of its creditors, the burden on the appellants becomes even heavier.

Nevertheless, there remain some matters of serious concern which the appellants have raised, including the fact that the respondent Central Trust Guaranty did not support the plan until arrangements had been made for paying its legal costs and for monthly instalments of municipal taxes. If these could be characterized as inducements to procure its vote, unfairness would be apparent.

A creditor which withholds its support from a plan because it has failed to address legitimate concerns arising from its contractual relationship with the debtor company is perfectly within its right to insist on improvements. The Act encourages just this kind of negotiation. It is not material whether agreement occurs soon after the first draft of the plan is circulated, so the resulting amendments can also be circulated to creditors, or whether a last-minute compromise is reached moments before the vote. The disclosure to be made in the latter instance will be necessarily sketchier than the one made in the former.

On the other hand a creditor whose legitimate concerns have been met on a basis similar to that of other creditors in its class, but which continues to insist on a benefit to which it is not entitled as the price of its vote, is attempting to commit the debtor to an unfair practice which could invalidate the whole plan. The distinction between the two situations must be drawn by the trial judge, and there will be occasions when it is a very difficult and murky one.

The benefit derived by the Relax Company in the Northlands case is an example of the first instance. So are the benefits negotiated by the Central Guaranty Trust in the present case. It seems clear that when other complaints of instances of unfairness were found by Mr. Justice Nathanson to involve matters of substance, he was able to consign them to the first category. I am not satisfied that he was wrong in doing so.

The Act clearly contemplates rough-and-tumble negotiations between debtor companies desperately seeking a chance to survive and creditors willing to keep them afloat, but on the best terms they can get. What the creditors and the company must live with is a plan of their own design, not

the creation of a court. The court's role is to ensure that creditors who are bound unwillingly under the Act are not made victims of the majority and forced to accept terms that are unconscionable. No amount of disclosure could compensate for such deliberately unfair treatment. Neither disclosure, nor the votes of the majority, can be used to victimize a minority creditor. On the other hand negotiated inequalities of treatment which might be characterized as unfair in another context may well be ameliorated when made part of the plan by disclosure and voted upon by a majority. Lack of disclosure, however, can transform an intrinsically fair alteration in the terms of a plan into an unfair secret deal which invalidates a plan. As a general rule the plan must include all of the arrangements made between the debtor company and the creditors; in principle, undisclosed arrangements cannot be part of the plan because they are not what the creditors voted for. Nathanson, J. found there is no authoritative definition of full or timely disclosure -- these were questions of fact. Consequences of inadvertent and innocent non disclosure and imperfect or inadequate disclosure must be assessed. This involves a fine sifting of all factors to tax the skill of a trial judge; I am not satisfied Nathanson, J. committed reversible error in his analysis nor in his conclusion that all material information had been disclosed.

Another concern of the appellants, and of this court, is that regardless of any benefits they did not receive but which were negotiated by other secured creditors in their own interests, they are left worse off under the plan than they were under the provisions of their own security contracts. The appellants had taken pains to protect their own interests when they made the loans, and they would be repaid if they were left the freedom to realize on their security.

In his decision on a classification order in Re NsC Diesel Power Inc. (1990), 97 N.S.R. (2d) 295 Mr. Justice Davison cites with approval an article by Stanley E. Edwards in the Canadian Bar Review (1947) Vol. 25 at p. 587. He quotes Mr. Edwards at p. 595 as follows:

> "There can hardly be a dispute as to the right of each of the parties to receive under the proposal at least as much as he would have received if there had been no reorganization. Since the company is insolvent this is the amount he would have received upon liquidation.
>
> At p. 594 Mr. Edwards said
>
> "A further element of feasibility is that the plan should embrace all parties if possible, but particularly secured creditors, so that they will not be left in a position to foreclose and dismember the assets after the arrangement is sanctioned as they did in one case."

The one major disadvantage the appellants suffer is the loss of the present right to realize on their security. They may well consider that right has been confiscated from them. It is essential to the purpose of the Act to bring about such a result, but it must be done fairly.

With an exception involving a government agency which had not been receiving a commercial rate of interest, all the secured creditors have their interest rates reduced to the current market level of eleven per cent, amortization periods increased, and in one case, principal and interest blended. However the appellants' security is unimpaired, and apart from the reduced interest, they stand to recover as much as they would have if the reorganization had not taken place. Their worst

disadvantage is that they are delayed in recovering under their security, which appears to be a necessity if the plan is to succeed. There is nothing to suggest that Keddy's, or the other creditors, sought to take advantage of them. Rather, they were asked to accept what appears to be the minimum disadvantage consistent with a plan which might permit the company's survival. And, had they chosen to negotiate, they might have improved the terms.

In the long term creditors in the position of the appellants should be required to suffer no loss, and when such appears likely courts must be vigilant to protect them in keeping with the spirit of the Act.

At first blush the reduction of their interest rates from approximately 13 per cent to 11 per cent appears to represent a greater loss than can fairly be imposed upon them. However what they are entitled to is not what they would recover if the contract were to be continue to its fulfilment as originally contemplated. What they are entitled to, as Mr. Edwards points out, is what they would recover from an insolvent company upon liquidation.

That is, they would be entitled to recover the outstanding balance they are owed plus interest to date. The reduced interest rate relates to future interest. On liquidation they may be presumed to reinvest their recovered capital at present market rates. The eleven per cent rate fairly represents the present market rate they would likely obtain on reinvestment of the funds. The other disadvantages of which they complain are merely delays in recovery for which they will be compensated by interest. They have suffered inconvenience but no injustice. They have not been treated unfairly within the spirit of the Act.

The plan originally proposed by Keddy's was unacceptable to many of the creditors, although it would appear to have been offered in good faith. Keddy's had to try to offer an acceptable plan, without any certain knowledge of the matters of chief concern to the individual creditors. If there had been no room for movement the plan would predictably have failed. What appears to be controversial is that a process of negotiations took place within a compressed time frame between Keddy's and the creditors, in which the concerns of the creditors were considered. It does not appear that advantages negotiated by any creditor were offset by substantial disadvantages to another, nor does it appear that the advantages were so great as to constitute substantial unfairness even viewed in their worst light. In keeping with the purposes of the Act, substance must prevail over merely theoretical or technical considerations. The process took place in the open, and the other creditors were reasonably well advised of all amendments that were agreed to, with the possible exception of some last minute changes of a relatively minor nature that escaped detailed disclosure. There appears to have been no deliberate intention to conceal or mislead.

The appellants were aware of the process but, in the belief that the plan would fail, did not fully participate. They were under no duty to negotiate for better terms. However, their choice not to do so does not entitle them on these facts to destroy a plan so strongly supported by the other creditors. The plan does not treat the creditors equally, but it treats them equitably. In my view both the plan and the process by which it was achieved were not perfect, nor beyond criticism, but they were roughly fair and within the objectives of the Act, as Nathanson, J. determined.

Considered as a whole, the concerns of the appellants are understandable. But when they are examined within the framework of the purposes and objectives of the Companies' Creditors Arrangement Act they lack sufficient substance to justify interference by this court with the plan sanctioned by Mr. Justice Nathanson.

I would dismiss the appeal. As the issues involved in this appeal were not previously considered by this court, the parties should bear their own costs.

FREEMAN J.A.
Concurred in:
CLARKE C.J.N.S.
MATTHEWS J.A.

Tab 7

Indexed as:

Royal Oak Mines 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 Courts of Justice Act, R.S.O. 1990, c. C-43, as amended
AND IN THE MATTER OF the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, as amended
AND IN THE MATTER OF a Plan of Compromise or Arrangement of Royal Oak Mines Inc., and the applicants listed on schedule "A"
APPLICATION UNDER The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended and the Business Corporations Act, R.S.O. 1990, c. B.16, as amended

[1999] O.J. No. 4848

14 C.B.R. (4th) 279

93 A.C.W.S. (3d) 607

Court File No. 99-CL-3278

Ontario Superior Court of Justice
Commercial List

Farley J.

Heard: November 22, 1999.
Judgment: November 22, 1999.

(6 paras.)

Counsel:

No counsel mentioned.

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1 **FARLEY J.** (endorsement):-- PricewaterhouseCoopers Inc., the Interim Receiver of Royal Oak Mines Inc., moved for an order to authorize the Interim Receiver, on behalf of and in the name of Royal Oak, to make a proposal pursuant to the Bankruptcy and Insolvency Act. While Royal Oak originally sought protection under the Companies' Creditors Arrangement Act, it never proposed a plan of arrangement or compromise to its creditors under CCAA. Ipso facto there has never been a rejection of a CCAA plan by the Royal Oak creditors. Thus Royal Oak (as an insolvent debtor) has the ability to commence proceedings under Part III of the BIA by filing a proposal. The Interim Receiver now wishes to do so in order that the deal now struck (and approved) for Northgate can be improved for the benefit of the unsecured creditors and shareholders of Royal Oak by allowing a structured transaction with Royal Oak shares so that the tax losses may be accessed. I see no impediment to the Interim Receiver making such a BIA proposal on behalf of Royal Oak.

2 There are substantial tax losses in Royal Oak which might be utilized by Northgate indirectly as a share purchaser. It is not proposed that the Royal Oak shareholders actually vote on the transaction set out in the Northgate term sheet - whereby the unsecured creditors and the shareholders would participate in the ongoing but restructured fortunes of Royal Oak but to a relatively quite limited small degree. Of course, if the transaction were to remain an approved asset sale, then neither the unsecured creditors nor the shareholders would receive anything. One might also observe that the shareholders would have to appreciate that, when viewed as to the hierarchy of interests to receive value in a liquidation or liquidated related transaction, they are at the bottom. Further in these particular circumstances there are, in relation to the available tax losses (which is in itself a conditional asset), very substantial amounts of unsecured debt standing on the shareholders' shoulders. That is, the shareholders, even assuming an ongoing operation achieving a turnaround to profitability without restructuring, would have to wait a long while before their interests saw the light of day.

3 I see no reason then why the proposal would not utilize the provisions of s. 186 of the OBCA since this "reorganization" provision contemplates inter alia "an order made under the Bankruptcy Act (Canada) [now BIA] approving a proposal". It is curious to note that s. 186(1) OBCA does not incorporate as does s. 191 CBCA that the Court order could also include "(c) any other Act of Parliament that affects the rights among the corporation, its shareholders and creditors" - which language would appear to encompass the CCAA. The CBCA language was introduced by S.C. 1974-75. While this was subsequent to the introduction, of the OBCA in 1970, it was not until the overhaul of the OBCA by S.O. 1982 that what is now s. 186 (then s. 185) was introduced.

4 In any event it is also desirable to keep in mind the question of whether the shareholders have a true interest to be protected (and voting) - i.e. an interest which given the existing financial fortunes of the corporation could be said to have some reasonable prospect of economic value. In that regard see my views in Re Proposed Arrangement Involving Cadillac Fairview and its Shareholders, [1995] O.J. No. 707, released March 7, 1995 at pp. 11-16 and the cases cited therein, especially In re Tea Corporation, Limited, Sorsbie v. Same Company, [1904] 1 Ch. D.12 (C.A.). In any event the shareholders will be notified by notice to their last known address that they may participate, if they wish, at the sanction hearing (assuming the structural plan is approved by the requisite majority of the creditors).

5 I am therefore of the view that the order requested is appropriate to grant.

6 Order to issue.

FARLEY J.

cp/s/qlrme

Tab 8

Indexed as:

Canadian Airlines Corp. (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 Business Corporations Act (Alberta) S.A. 1981, c. B-15, as amended, Section 185
AND IN THE MATTER OF Canadian Airlines Corporation and Canadian Airlines International Ltd.

[2000] A.J. No. 771

2000 ABQB 442

[2000] 10 W.W.R. 269

84 Alta. L.R. (3d) 9

265 A.R. 201

9 B.L.R. (3d) 41

20 C.B.R. (4th) 1

98 A.C.W.S. (3d) 334

Action No. 0001-05071

Alberta Court of Queen's Bench
Judicial District of Calgary

Paperny J.

Heard: June 5 - 19, 2000.
Judgment: filed June 27, 2000.

(185 paras.)

Counsel:

A.L. Friend, Q.C., H.M. Kay, Q.C., R.B. Low. Q.C. and L. Goldbach, for the petitioners.

S.F. Dunphy, P. O'Kelly and E. Kolers, for Air Canada and 853350 Alberta Ltd.
D.R. Haigh, Q.C., D.N. Nishimura, A.Z.A. Campbell and D. Tay, for Resurgence Asset Management LLC.
L.R. Duncan, Q.C. and G. McCue, for Neil Baker, Michael Salter, Hal Metheral and Roger Midiaty.
F.R. Foran, Q.C. and P.T. McCarthy, Q.C., for the Monitor, PwC.
G.B. Morawetz, R.J. Chadwick and A. McConnell, for the Senior Secured Noteholders and the Bank of Nova Scotia Trust Company.
C.J. Shaw, Q.C., for the unionized employees.
T. Mallett and C. Feasby, for Amex Bank of Canada.
E.W. Halt, for J. Stephens Allan, Claims Officer.
M. Hollins, for Pacific Costal Airlines.
P. Pastewka, for JHHD Aircraft Leasing No. 1 and No. 2.
J. Thom, for the Royal Bank of Canada.
J. Medhurst-Tivadar, for Canada Customs and Revenue Agency.
R. Wilkins, Q.C., for the Calgary and Edmonton Airport Authority.

REASONS FOR DECISION

PAPERNY J.:--

I. INTRODUCTION

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

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

3 Canadian has asked this court to sanction its plan under s. 6 of the CCAA. The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all the stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan repre-

sent a fair and reasonable compromise that will permit a viable commercial entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.

II. BACKGROUND

Canadian Airlines and its Subsidiaries

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

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

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

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

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

Events Leading up to the CCAA Proceedings

9 Canadian's financial difficulties significantly predate these proceedings.

10 In the early 1990s, Canadian experienced significant losses from operations and deteriorating liquidity. It completed a financial restructuring in 1994 (the "1994 Restructuring") which involved employees contributing $200,000,000 in new equity in return for receipt of entitlements to

common shares. In addition, Aurora Airline Investments, Inc. ("Aurora"), a subsidiary of AMR Corporation ("AMR"), subscribed for $246,000,000 in preferred shares of CAIL. Other AMR subsidiaries entered into comprehensive services and marketing arrangements with CAIL. The governments of Canada, British Columbia and Alberta provided an aggregate of $120,000,000 in loan guarantees. Senior creditors, junior creditors and shareholders of CAC and CAIL and its subsidiaries converted approximately $712,000,000 of obligations into common shares of CAC or convertible notes issued jointly by CAC and CAIL and/or received warrants entitling the holder to purchase common shares.

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

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

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

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

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

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

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

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

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

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

Initial Discussions with Air Canada

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

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

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

Offer by Onex

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

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

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

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

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

Offer by 853350

29 On November 11, 1999, 853350 (a corporation financed by Air Canada and owned as to 10% by Air Canada) made a formal offer for all of the common and non-voting shares of CAC. Air Canada indicated that the involvement of 853350 in the take-over bid was necessary in order to protect Air Canada from the potential adverse effects of a restructuring of Canadian's debt and that Air Canada would only complete a merger with Canadian after the completion of a debt restructuring transaction. The offer by 853350 was conditional upon, among other things, a satisfactory resolution of AMR's claims in respect of Canadian and a satisfactory resolution of certain regulatory issues arising from the announcement made on October 26, 1999 by the Government of Canada regarding its intentions to alter the regime governing the airline industry.

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

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

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

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

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

a) the doubts which were publicly raised as to Canadian's ability to survive made Canadian's efforts to secure additional financing through various sale-leaseback transactions more difficult;
b) sales for future air travel were down by approximately 10% compared to 1998;
c) CAIL's liquidity position, which stood at approximately $84 million (consolidated cash and available credit) as at September 30, 1999, reached a critical point in late December, 1999 when it was about to go negative.

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

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

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

38 Despite the $45 million provided by Air Canada, Canadian's liquidity position remained poor. With January being a traditionally slow month in the airline industry, further bridge financing was required in order to ensure that Canadian would be able to operate while a debt restructuring transaction was being negotiated with creditors. Air Canada negotiated an arrangement with the Royal Bank of Canada ("Royal Bank") to purchase a participation interest in the operating credit facility made available to Canadian. As a result of this agreement, Royal Bank agreed to extend Canadian's operating credit facility from $70 million to $120 million in January, 2000 and then to $145 million in March, 2000. Canadian agreed to supplement the assignment of accounts receivable security originally securing Royal's $70 million facility with a further Security Agreement securing certain unencumbered assets of Canadian in consideration for this increased credit availability. Without the support of Air Canada or another financially sound entity, this increase in credit would not have been possible.

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

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

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

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

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

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

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

46 Since that time, due to the assistance of Air Canada, Canadian has been able to complete the restructuring of the remaining financial obligations governing all aircraft to be retained by Canadian for future operations. These arrangements were approved by this Honourable Court in its Orders dated April 14, 2000 and May 10, 2000, as described in further detail below under the heading "The Restructuring Plan".

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

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

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

The Restructuring Plan

50 The Plan has three principal aims described by Canadian:

(a) provide near term liquidity so that Canadian can sustain operations;
(b) allow for the return of aircraft not required by Canadian; and
(c) permanently adjust Canadian's debt structure and lease facilities to reflect the current market for asset values and carrying costs in return for Air Canada providing a guarantee of the restructured obligations.

51 The proposed treatment of stakeholders is as follows:

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

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

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

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

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

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

   > The Offeror intends to conduct the Debt Restructuring in such a manner as to seek to ensure that the unionized employees of Canadian, the suppliers of new credit (including trade credit) and the members of the flying public are left unaffected.

The Offeror is of the view that the pursuit of these three principles is essential in order to ensure that the long term value of Canadian is preserved.

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

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

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

   The Affected Unsecured Creditors fall into the following categories:

a. Claims of holders of or related to the Unsecured Notes (the "Unsecured Noteholders");
b. Claims in respect of certain outstanding or threatened litigation involving Canadian;
c. Claims arising from the termination, breach or repudiation of certain contracts, leases or agreements to which Canadian is a party other than aircraft financing or lease arrangements;
d. Claims in respect of deficiencies arising from the termination or re-negotiation of aircraft financing or lease arrangements;
e. Claims of tax authorities against Canadian; and
f. Claims in respect of the under-secured or unsecured portion of amounts due to the Senior Secured Noteholders.

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

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

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

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

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

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

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

III. ANALYSIS

59 Section 6 of the CCAA provides that:

> 6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either

as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(a) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(b) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the Bankruptcy and Insolvency Act or is in the course of being wound up under the Winding-up and Restructuring Act, on the trustee in bankruptcy or liquidator and contributories of the company.

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

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

(2) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and

(3) the plan must be fair and reasonable.

61 A leading articulation of this three-part test appears in Re Northland Properties Ltd. (1988), 73 C.B.R. (N.S.) 175 (B.C.S.C.) at 182-3, aff'd (1989), 73 C.B.R. (N.S.) 195 (B.C.C.A.) and has been regularly followed, see for example Re Sammi Atlas Inc. (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div.) at 172 and Re T. Eaton Co., [1999] O.J. No. 5322 (Ont. Sup. Ct.) at paragraph 7. Each of these criteria are reviewed in turn below.

1. Statutory Requirements

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

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

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

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

(d) the creditors were properly classified;

(e) the meetings of creditors were properly constituted;

(f) the voting was properly carried out; and

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

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

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

(b) CAC and CAIL have total claims that would be claims provable in bankruptcy within the meaning of section 12 of the CCAA in excess of $5,000,000.
(c) In accordance with the April 7, 2000 Order of this court, a Notice of Meeting and a disclosure statement (which included copies of the Plan and the March 24th and April 7th Orders of this court) were sent to the Affected Creditors, the directors and officers of the Petitioners, the Monitor and persons who had served a Notice of Appearance, on April 25, 2000.
(d) As confirmed by the May 12, 2000 ruling of this court (leave to appeal denied May 29, 2000), the creditors have been properly classified.
(e) Further, as detailed in the Monitor's Fifth Report to the Court and confirmed by the June 14, 2000 decision of this court in respect of a challenge by Resurgence Asset Management LLC ("Resurgence"), the meetings of creditors were properly constituted, the voting was properly carried out and the Plan was approved by the requisite double majorities in each class. The composition of the majority of the unsecured creditor class is addressed below under the heading "Fair and Reasonable".

2. Matters Unauthorized

64 This criterion has not been widely discussed in the reported cases. As recognized by Blair J. in Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 17 C.B.R. (3d) 1 (Ont. Gen. Div.) and Farley J. in Cadillac Fairview (Re), [1995] O.J. No. 274, 53 A.C.W.S. (3d) 305 (Ont. Gen. Div.), within the CCAA process the court must rely on the reports of the Monitor as well as the parties in ensuring nothing contrary to the CCAA has occurred or is contemplated by the plan.

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

a. Legality of proposed share capital reorganization

66 Subsection 185(2) of the ABCA provides:

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

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

a. All CAIL common shares held by CAC will be converted into a single retractable share, which will then be retracted by CAIL for $1.00; and
b. All CAIL preferred shares held by 853350 will be converted into CAIL common shares.

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

(a) consolidating all of the issued and outstanding common shares into one common share;
(b) redesignating the existing common shares as "Retractable Shares" and changing the rights, privileges, restrictions and conditions attaching to the Retractable Shares so that the Retractable Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital;
(c) cancelling the Non-Voting Shares in the capital of the corporation, none of which are currently issued and outstanding, so that the corporation is no longer authorized to issue Non-Voting Shares;
(d) changing all of the issued and outstanding Class B Preferred Shares of the corporation into Class A Preferred Shares, on the basis of one (1) Class A Preferred Share for each one (1) Class B Preferred Share presently issued and outstanding;
(e) redesignating the existing Class A Preferred Shares as "Common Shares" and changing the rights, privileges, restrictions and conditions attaching to the Common Shares so that the Common Shares shall have attached thereto the rights, privileges, restrictions and conditions as set out in the Schedule of Share Capital; and
(f) cancelling the Class B Preferred Shares in the capital of the corporation, none of which are issued and outstanding after the change in paragraph (d) above, so that the corporation is no longer authorized to issue Class B Preferred Shares;

Section 167 of the ABCA

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

a. The corporation must be "subject to an order for re-organization"; and
b. The proposed amendments must otherwise be permitted under section 167 of the ABCA.

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

71 The relevant portions of section 167 provide as follows:

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

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

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

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

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

75 The architects of the business corporation act model which the ABCA follows, expressly contemplated reorganizations in which the insolvent corporation would eliminate the interest of common shareholders. The example given in the Dickerson Report of a reorganization is very similar to that proposed in the Plan:

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

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

77 The Petitioners were unable to provide any case law addressing the use of section 185 as proposed under the Plan. They relied upon the decisions of Royal Oak Mines Inc., [1999] O.J. No. 4848 and Re T Eaton Co., supra in which Farley J.of the Ontario Superior Court of Justice emphasized that shareholders are at the bottom of the hierarchy of interests in liquidation or liquidation related scenarios.

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

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

Section 183 of the ABCA

80 The Minority Shareholders argued in the alternative that if the proposed share reorganization of CAIL were not a cancellation of their shares in CAC and therefore allowed under section 167 of the ABCA, it constituted a "sale, lease, or exchange of substantially all the property" of CAC and thus required the approval of CAC shareholders pursuant to section 183 of the ABCA. The Minority Shareholders suggested that the common shares in CAIL were substantially all of the assets of CAC and that all of those shares were being "exchanged" for $1.00.

81 I disagree with this creative characterization. The proposed transaction is a reorganization as contemplated by section 185 of the ABCA. As recognized in Savage v. Amoco Acquisition Company Ltd, [1988] A.J. No. 68 (Q.B.), aff'd, 68 C.B.R. (3d) 154 (Alta. C.A.), the fact that the same end might be achieved under another section does not exclude the section to be relied on. A statute may well offer several alternatives to achieve a similar end.

Ontario Securities Commission Policy 9.1

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

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

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

b. Release

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

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

> As of the Effective Date, each of the Affected Creditors will be deemed to forever release, waive and discharge all claims, obligations, suits, judgments, damages, demands, debts, rights, causes of action and liabilities...that are based in whole or in part on any act, omission, transaction, event or other occurrence taking place on or prior to the Effective Date in any way relating to the Applicants and Subsidiaries, the CCAA Proceedings, or the Plan against:(i) The Applicants and Subsidiaries; (ii) The Directors, Officers and employees of the Applicants or Subsidiaries in each case as of the date of filing (and in addition, those who became Officers and/or Directors thereafter but prior to the Effective Date); (iii) The former Directors, Officers and employees of the Applicants or Subsidiaries, or (iv) the respective current and former professionals of the entities in subclauses (1) to (3) of this s. 6.2(2) (including, for greater certainty, the Monitor, its counsel and its current Officers and Directors, and current and former Officers, Directors, employees, shareholders and professionals of the released parties) acting in such capacity.

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

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

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

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

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

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

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

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

3. Fair and Reasonable

94 In determining whether to sanction a plan of arrangement under the CCAA, the court is guided by two fundamental concepts: "fairness" and "reasonableness". While these concepts are always at the heart of the court's exercise of its discretion, their meanings are necessarily shaped by the unique circumstances of each case, within the context of the Act and accordingly can be difficult to distill and challenging to apply. Blair J. described these concepts in Olympia and York Dev. Ltd. v. Royal Trust Co., supra, at page 9:

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

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

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

a. The composition of the unsecured vote;
b. What creditors would receive on liquidation or bankruptcy as compared to the Plan;
c. Alternatives available to the Plan and bankruptcy;
d. Oppression;
e. Unfairness to Shareholders of CAC; and
f. The public interest.

a. Composition of the unsecured vote

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

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

98 However, given the manner of voting under the CCAA, the court must be cognizant of the treatment of minorities within a class: see for example Quintette Coal Ltd., (1992) 13 C.B.R. (3d) 146 (B.C.S.C) and Re Alabama, New Orleans, Texas and Pacific Junction Railway Co. (1890) 60

L.J. Ch. 221 (C.A.). The court can address this by ensuring creditors' claims are properly classified. As well, it is sometimes appropriate to tabulate the vote of a particular class so the results can be assessed from a fairness perspective. In this case, the classification was challenged by Resurgence and I dismissed that application. The vote was also tabulated in this case and the results demonstrate that the votes of Air Canada and the Senior Secured Noteholders, who voted their deficiency in the unsecured class, were decisive.

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

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

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

101 The members of each class that vote in favour of a plan must do so in good faith and the majority within a class must act without coercion in their conduct toward the minority. When asked to assess fairness of an approved plan, the court will not countenance secret agreements to vote in favour of a plan secured by advantages to the creditor: see for example, Hochberger v. Rittenberg (1916), 36 D.L.R. 450 (S.C.C.)

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

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

103 Resurgence submitted that Air Canada manipulated the indebtedness of CAIL to assure itself of an affirmative vote. I disagree. I previously ruled on the validity of the deficiency when approving the LOIs and found the deficiency to be valid. I found there was consideration for the assignment of the deficiency claims of the various aircraft financiers to Air Canada, namely the provision of an Air Canada guarantee which would otherwise not have been available until plan sanction. The Monitor reviewed the calculations of the deficiencies and determined they were calculated in a reasonable manner. As such, the court approved those transactions. If the deficiency had instead remained with the aircraft financiers, it is reasonable to assume those claims would have been voted in favour of the plan. Further, it would have been entirely appropriate under the circumstances for the aircraft financiers to have retained the deficiency and agreed to vote in favour of the Plan, with the same result to Resurgence. That the financiers did not choose this method was explained by the testimony of Mr. Carty and Robert Peterson, Chief Financial Officer for Air Canada; quite simply it amounted to a desire on behalf of these creditors to shift the "deal risk" associated with the Plan to Air Canada. The agreement reached with the Senior Secured Noteholders was also disclosed and the challenge by Resurgence regarding their vote in the unsecured class was dismissed. There is nothing inappropriate in the voting of the deficiency claims of Air Canada or the Senior Secured Noteholders in the unsecured class. There is no evidence of secret vote buying such as discussed in Northland Properties Ltd. (Re).

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

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

106 The authorities which address minority creditors' complaints speak of "substantial injustice" (Keddy Motor Inns Ltd. (Re) (1992) 13 C.B.R. (3d) 245 (N.S.C.A.), "confiscation" of rights (Campeau Corp. (Re) (1992), 10 C.B.R. (3d) 104 (Ont. Ct. (Gen.Div.); Skydome Corp. (Re), [1999] O.J. No. 1261, 87 A.C.W.S (3d) 421 (Ont. Ct. Gen. Div.)) and majorities "feasting upon" the rights of the minority (Quintette Coal Ltd. (Re), (1992), 13 C.B.R.(3d) 146 (B.C.S.C.). Although it cannot be disputed that the group of Unsecured Noteholders represented by Resurgence are being asked to accept a significant reduction of their claims, as are all of the affected unsecured creditors, I do not see a "substantial injustice", nor view their rights as having been "confiscated" or "feasted upon" by being required to succumb to the wishes of the majority in their class. No bad faith has been demonstrated in this case. Rather, the treatment of Resurgence, along with all other affected unsecured creditors, represents a reasonable balancing of interests. While the court is directed to consid-

er whether there is an injustice being worked within a class, it must also determine whether there is an injustice with respect the stakeholders as a whole. Even if a plan might at first blush appear to have that effect, when viewed in relation to all other parties, it may nonetheless be considered appropriate and be approved: Algoma Steel Corp. v. Royal Bank (1992), 11 C.B.R. (3d) 1 (Ont. Gen. Div.)and Northland Properties (Re), supra at 9.

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

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

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

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

b. Receipts on liquidation or bankruptcy

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

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

113 Prior to and during the application for sanction, the Monitor responded to various requests for information by parties involved. In particular, the Monitor provided a copy of the Liquidation Analysis to those who requested it. Certain of the parties involved requested the opportunity to question the Monitor further, particularly in respect to the Liquidation Analysis and this court directed a process for the posing of those questions.

114 While there were numerous questions to which the Monitor was asked to respond, there were several areas in which Resurgence and the Minority Shareholders took particular issue: pension plan surplus, CRAL, international routes and tax pools. The dissenting groups asserted that

these assets represented overlooked value to the company on a liquidation basis or on a going concern basis.

Pension Plan Surplus

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

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

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

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

118 It is acknowledged that surplus prior to termination can be accessed through employer contribution holidays, which Canadian has taken to the full extent permitted. However, there is no basis that has been established for any surplus being available to be withdrawn from an ongoing pension plan. On a pension plan termination, the amount available as a solvency surplus would first have to be further reduced by various amounts to determine whether there was in fact any true surplus available for distribution. Such reductions include contingent benefits payable in accordance with the provisions of each respective pension plan, any extraordinary plan wind up cost, the amounts of any contribution holidays taken which have not been reflected, and any litigation costs.

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

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

CRAL

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

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

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

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

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

International Routes

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

127 Evidence was led that on June 23, 1999 Air Canada made an offer to purchase CAIL's international routes for $400 million cash plus $125 million for aircraft spares and inventory, along with the assumption of certain debt and lease obligations for the aircraft required for the interna-

tional routes. CAIL evaluated the Air Canada offer and concluded that the proposed purchase price was insufficient to permit it to continue carrying on business in the absence of its international routes. Mr. Carty testified that something in the range of $2 billion would be required.

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

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

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

Tax Pools

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

Capital Loss Pools

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

Undepreciated capital cost ("UCC")

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

pool, however, could be considered to be a source of benefit. There is no evidence that this amount is any greater than fair market value.

Operating Losses

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

Fuel tax rebates

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

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

c. Alternatives to the Plan

137 When presented with a plan, affected stakeholders must weigh their options in the light of commercial reality. Those options are typically liquidation measured against the plan proposed. If not put forward, a hope for a different or more favourable plan is not an option and no basis upon which to assess fairness. On a purposive approach to the CCAA, what is fair and reasonable must be assessed against the effect of the Plan on the creditors and their various claims, in the context of their response to the plan. Stakeholders are expected to decide their fate based on realistic, commercially viable alternatives (generally seen as the prime motivating factor in any business decision) and not on speculative desires or hope for the future. As Farley J. stated in Re T. Eaton Co., [1999] O.J. No. 4216 (Ont. Sup. Ct.) at paragraph 6:

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

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

d. Oppression

Oppression and the CCAA

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

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

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

> In deciding what is unfair, the history and nature of the corporation, the essential nature of the relationship between the corporation and the creditor, the type of rights affected in general commercial practice should all be material. More concretely, the test of unfair prejudice or unfair disregard should encompass the following considerations: The protection of the underlying expectation of a creditor in the arrangement with the corporation, the extent to which the acts complained of were unforeseeable where the creditor could not reasonably have protected itself from such acts and the detriment to the interests of the creditor.

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

143 Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: Re Royal Oak Mines Ltd., supra, para. 4., Re Cadillac Fairview, [1995] O.J. 707 (Ont. Sup. Ct), and Re T. Eaton Company, supra.

144 To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to

whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.

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

Oppression allegations by Resurgence

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

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

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

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

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

151 Next, Air Canada made it clear beginning in the fall of 1999 that Canadian would have to complete a financial restructuring so as to permit Air Canada to acquire CAIL on a financially sound basis and as a wholly owned subsidiary. Following the implementation of the moratorium, absent which Canadian could not have continued to operate, Canadian and Air Canada commenced efforts to restructure significant obligations by consent. They perceived that further damage to pub-

lic confidence that a CCAA filing could produce, required Canadian to secure a substantial measure of creditor support in advance of any public filing for court protection. Before the Petitioners started the CCAA proceedings on March 24, 2000, Air Canada, CAIL and lessors of 59 aircraft in its fleet had reached agreement in principle on the restructuring plan.

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

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

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

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

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

157 Resurgence complained that other significant groups held negotiations with Canadian. The evidence indicates that a meeting was held with Mr. Symington, Managing Director of Resurgence, in Toronto in March 2000. It was made clear to Resurgence that the pool of unsecured creditors would be somewhere between $500 and $700 million and that Resurgence would be included within that class. To the extent that the versions of this meeting differ, I prefer and accept the evidence of Mr. Carty. Resurgence wished to play a significant role in the debt restructuring and indicated it was prepared to utilize the litigation process to achieve a satisfactory result for itself. It is therefore understandable that no further negotiations took place. Nevertheless, the original offer to affected unsecured creditors has been enhanced since the filing of the plan on April 25, 2000. The enhance-

ments to unsecured claims involved the removal of the cap on the unsecured pool and an increase from 12 to 14 cents on the dollar.

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

e. Unfairness to Shareholders

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

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

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

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

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

Minority Shareholders might have arising from the take over bid circular against Air Canada or 853350 , if any, is unaffected by the Plan and may be pursued after the stay is lifted.

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

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

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

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

168 The Minority Shareholders' submission attempts to compare and contrast the rights and expectations of the CAIL preferred shares as against the CAC common shares. This is not a meaningful exercise; the Petitioners are not submitting that the Preferred Shares have value and the evidence demonstrates unequivocally that they do not. The Preferred Shares are merely being utilized

as a corporate vehicle to allow CAIL to become a wholly owned subsidiary of Air Canada. For example, the same result could have been achieved by issuing new shares rather than changing the designation of 853350's Preferred Shares in CAIL.

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

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

e. The Public Interest

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

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

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

173 In Re Repap British Columbia Inc. (1998), 1 C.B.R. (4th) 49 (B.C.S.C.) the court noted that the fairness of the plan must be measured against the overall economic and business environment and against the interests of the citizens of British Columbia who are affected as "shareholders" of the company, and creditors, of suppliers, employees and competitors of the company. The court approved the plan even though it was unable to conclude that it was necessarily fair and reasonable. In Re Quintette Coal Ltd., supra, Thackray J. acknowledged the significance of the coal mine to the British Columbia economy, its importance to the people who lived and worked in the region and to the employees of the company and their families. Other cases in which the court considered the public interest in determining whether to sanction a plan under the CCAA include Canadian Red

Cross Society (Re), (1998),5 C.B.R. (4th) 299 (Ont. Gen. Div.) and Algoma Steel Corp. v. Royal Bank of Canada (Trustee of), [1992] O.J. No. 795 (Ont. Gen. Div.)

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

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

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

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

178 In summary, in assessing whether a plan is fair and reasonable, courts have emphasized that perfection is not required: see for example Wandlyn Inns Ltd. (Re) (1992), 15 C.B.R. (3d) 316 (N.BQ.B), Quintette Coal, supra and Repap, supra. Rather, various rights and remedies must be sacrificed to varying degrees to result in a reasonable, viable compromise for all concerned. The court

is required to view the "big picture" of the plan and assess its impact as a whole. I return to Algoma Steel v. Royal Bank of Canada., supra at 9 in which Farley J. endorsed this approach:

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

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

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

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

IV. CONCLUSION

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

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

183 This Plan represents a solid chance for the continued existence of Canadian. It preserves CAIL as a business entity. It maintains over 16,000 jobs. Suppliers and trade creditors are kept whole. It protects consumers and preserves the integrity of our national transportation system while we move towards a new regulatory framework. The extensive efforts by Canadian and Air Canada, the compromises made by stakeholders both within and without the proceedings and the commitment of the Government of Canada inspire confidence in a positive result.

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

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

PAPERNY J.

cp/i/qljpn/qlhcs

Tab 9

Indexed as:

Blue Range Resource Corp. (Re)

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, C. C-36, as amended AND IN THE MATTER OF Blue Range Resource Corporation

[2000] A.J. No. 14

2000 ABQB 4

[2000] 4 W.W.R. 738

76 Alta. L.R. (3d) 338

259 A.R. 30

15 C.B.R. (4th) 169

94 A.C.W.S. (3d) 223

Action No. 9901-04070

Alberta Court of Queen's Bench
Judicial District of Calgary

Romaine J.

Judgment: filed January 10, 2000.

(84 paras.)

Counsel:

R.J. (Bob) Wilkins and Gary Befus, for Big Bear Exploration Ltd.
A. Robert Anderson and Bryan Duguid, for Enron Trade & Capital Resources Canada Corp.
Glen H. Poelman, for the Creditors' Committee.
Virginia A. Engel, for MRF 1998 II Limited Partnership.

REASONS FOR JUDGMENT

ROMAINE J.:--

INTRODUCTION

1 This is an application for determination of three preliminary issues relating to a claim made by Big Bear Exploration Ltd. against Blue Range Resource Corporation, a company to which the Companies' Creditors Arrangement Act, R.S.C. 1985, c.C-36, as amended, applies. Big Bear is the sole shareholder of Blue Range, and submits that its claim should rank equally with claims of unsecured creditors. The preliminary issues relate to the ranking of Big Bear's claim, the scope of its entitlement to pursue its claim and whether Big Bear is the proper party to advance the major portion of the claim.

2 The Applicants are the Creditors' Committee of Blue Range and Enron Canada Corp., a major creditor. Big Bear is the Respondent, together with the MRF 1998 II Limited Partnership, whose partners are in a similar situation to Big Bear.

FACTS

3 Between October 27, 1998 and February 2, 1999, Big Bear took the following steps:

(a) it purchased shares of Blue Range for cash through The Toronto Stock Exchange on October 27 and 29, 1998;
(b) it undertook a hostile takeover bid on November 13, 1998, by which it sought to acquire all of the issued and outstanding Blue Range shares;
(c) it paid for the Blue Range shares sought through the takeover bid by way of a share exchange: Blue Range shareholders accepting Big Bear's offer received 11 Big Bear shares for each Blue Range share;
(d) it issued Big Bear shares from treasury to provide the shares used in the share exchange.

4 The takeover bid was accepted by Blue Range shareholders and on December 12, 1998, Big Bear acquired control of Blue Range. It is now the sole shareholder of Blue Range.

5 Big Bear says that its decision to undertake the takeover was made in reliance upon information publicly disclosed by Blue Range regarding its financial situation. It says that after the takeover, it discovered that the information disclosed by Blue Range was misleading, and in fact the Blue Range shares were essentially worthless.

6 Big Bear as the sole shareholder of Blue Range entered into a Unanimous Shareholders' Agreement pursuant to which Big Bear replaced and took on all the rights, duties and obligations of the Blue Range directors. Using its authority under the Unanimous Shareholders' Agreement, Big Bear caused Blue Range to apply for protection under the CCAA. An order stipulating that Blue Range is a company to which the CCAA applies was granted on March 2, 1999.

7 On April 6, 1999, LoVecchio, J. issued an order which provides, in part, that:

(a) all claims of any nature must be proved by filing with the Monitor a Notice of Claim with supporting documentation, and

(b) claims not received by the Monitor by May 7, 1999, or not proved in accordance with the prescribed procedures, are forever barred and extinguished.

8 Big Bear submitted a Notice of Claim to the Monitor dated May 5, 1999 in the amount of $151,317,298 as an unsecured claim. It also filed a Notice of Motion on May 5, 1999, seeking an order lifting the stay of proceedings granted by the March 2, 1999 order for the purpose of filing a statement of claim against Blue Range. Big Bear's application for leave to file its statement of claim was denied by LoVecchio, J. on May 11, 1999.

9 On May 21, 1999, the Monitor issued a Notice of Dispute disputing in full the Big Bear claim. Big Bear filed a Notice of Motion on May 31, 1999 for:

(a) a declaration that the unsecured claim of Big Bear is a meritorious claim against Blue Range; and
(b) an order directing the expeditious trial and determination of the issues raised by the unsecured claim of Big Bear.

10 On October 4, 1999, LoVecchio, J. directed that there be a determination of two issues in respect of the Big Bear unsecured claim by way of a preliminary application. On October 28, 1999, I defined the two issues and added a third one.

11 Big Bear's Notice of Claim sets out the nature and amount of its claim against Blue Range. The amount is particularized by the schedule attached to the Notice of Claim, which identifies the claim as being comprised of the following components:

(a) the price of shares acquired for cash on October 27 and 29, 1998 ($724,454.91);
(b) the value of shares acquired by means of the share exchange of Big Bear treasury shares for Blue Range shares held by Blue Range shareholders ($147,687,298); and
(c) "transaction costs," being costs incurred by Big Bear for consultants, professional advisers, filings, financial services, and like matters incidental to the share purchases generally, and the takeover bid in particular ($3,729,498).

ISSUE #1

12 With respect to the alleged share exchange loss, without considering the principle of equitable subordination, is Big Bear:

(a) an unsecured creditor of Blue Range that ranks equally with the unsecured creditors of Blue Range; or
(b) a shareholder of Blue Range that ranks after the unsecured creditors of Blue Range.

13 At the hearing, this question was expanded to include reference to the transaction costs and cash share purchase damage claims in addition to the alleged share exchange loss.

Summary of Decision

14 The nature of the Big Bear claim against Blue Range for an alleged share exchange loss, transaction costs and cash share purchase damages is in substance a claim by a shareholder for a return of what it invested qua shareholder. The claim therefore ranks after the claims of unsecured creditors of Blue Range.

Analysis

15 The position of the Applicants is that the share exchange itself was clearly an investment in capital, and that the claim for the share exchange loss derives solely from and is inextricably intertwined with Big Bear's interest as a shareholder of Blue Range. The Applicants submit that there are therefore good policy reasons why the claim should rank after the claims of unsecured creditors of Blue Range, and that basic corporate principles, fairness and American case law support these policy reasons. Big Bear submits that its claim is a tort claim, allowable under the CCAA, and that there is no good reason to rank the claim other than equally with unsecured creditors. Big Bear submits that the American cases cited are inappropriate to a Canadian CCAA proceeding, as they are inconsistent with Canadian law.

16 There is no Canadian law that deals directly with the issue of whether a shareholder allegedly induced by fraud to purchase shares of a debtor corporation is able to assert its claim in such a way as to achieve parity with other unsecured creditors in a CCAA proceeding. It is therefore necessary to start with basic principles governing priority disputes.

17 It is clear that in common law shareholders are not entitled to share in the assets of an insolvent corporation until after all the ordinary creditors have been paid in full: Re: Central Capital Corp. (1996), 132 D.L.R. (4th) 223 (Ont. C.A.) at page 245; Canada Deposit Insurance Corp. v. Canadian Commercial Bank (1992), 97 D.L.R. (4th) 385 (S.C.C.) at pages 402 and 408. In that sense, Big Bear acquired not only rights but restrictions under corporate law when it acquired the Blue Range shares.

18 There is no doubt that Big Bear has exercised its rights as a shareholder of Blue Range. Pursuant to the Unanimous Shareholders' Agreement, it authorized Blue Range to file an application under the CCAA "to attempt to preserve the equity value of [Blue Range] for the benefit of the sole shareholder of [Blue Range]" (Bourchier November 1, 1999 affidavit). It now attempts to recover its alleged share exchange loss through the claims approval process and rank with unsecured creditors on its claim. The issue is whether this is a collateral attempt to obtain a return on an investment in equity through equal status with ordinary creditors that could not be accomplished through its status as a shareholder.

19 In Canada Deposit Insurance (supra), the Supreme Court of Canada considered whether emergency financial assistance provided to the Canadian Commercial Bank by a group of lending institutions and government was properly categorized as a loan or as an equity investment for the purpose of determining whether the group was entitled to rank pari passu with unsecured creditors in an insolvency. The court found that, although the arrangement was hybrid in nature, combining elements of both debt and equity, it was in substance a loan and not a capital investment. It is noteworthy that the equity component of the arrangement was incidental, and in fact had never come into effect, and that the agreements between the parties clearly supported the characterization of the arrangement as a loan.

20 Central Capital (supra) deals with the issue of whether the holders of retractable preferred shares should be treated as creditors rather than shareholders under the CCAA because of the re-

traction feature of the shares. Weiler, J.A. commented at page 247 of the decision that it is necessary to characterize the true nature of a transaction in order to decide whether a claim is a claim provable in either bankruptcy or under the CCAA. She stated that a court must look to the surrounding circumstances to determine "whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability."

21 The court in Central Capital found that the true nature of the relationship between the preferred shareholders and the debtor company was that of shareholders. In doing so, it considered the statutory provision that prevents a corporation from redeeming its shares while insolvent, the articles of the corporation, and policy considerations. In relation to the latter factor, the court commented that in an insolvency where debts will exceed assets, the policy of federal insolvency legislation precludes shareholders from looking to the assets until the creditors have been paid (supra, page 257).

22 In this case, the true nature of Big Bear's claim is more difficult to characterize. There may well be scenarios where the fact that a party with a claim in tort or debt is a shareholder is coincidental and incidental, such as where a shareholder is also a regular trade creditor of a corporation, or slips and falls outside the corporate office and thus has a claim in negligence against the corporation. In the current situation, however, the very core of the claim is the acquisition of Blue Range shares by Big Bear and whether the consideration paid for such shares was based on misrepresentation. Big Bear had no cause of action until it acquired shares of Blue Range, which it did through share purchases for cash prior to becoming a majority shareholder, as it suffered no damage until it acquired such shares. This tort claim derives from Big Bear's status as a shareholder, and not from a tort unrelated to that status. The claim for misrepresentation therefore is hybrid in nature and combines elements of both a claim in tort and a claim as shareholder. It must be determined what character it has in substance.

23 It is true that Big Bear does not claim recission. Therefore, this is not a claim for return of capital in the direct sense. What is being claimed, however, is an award of damages measured as the difference between the "true" value of Blue Range shares and their "misrepresented" value - in other words, money back from what Big Bear "paid" by way of consideration. Although the matter is complicated by reason that the consideration paid for Blue Range shares by Big Bear was Big Bear treasury shares, the Notice of Claim filed by Big Bear quantifies the loss by assigning a value to the treasury shares. A tort award to Big Bear could only represent a return of what Big Bear invested in equity of Blue Range. It is that kind of return that is limited by the basic common law principal that shareholders rank after creditors in respect of any return on their equity investment. Whether payment of the tort liability by Blue Range would affect Blue Range's stated capital account is irrelevant, since the shares were not acquired from Blue Range but from its shareholders.

24 In considering the question of the characterization of this claim, it is noteworthy that Mr. Tonken in his March 2, 1999 affidavit in support of Blue Range's application to apply the CCAA did not include the Big Bear claim in his list of estimated outstanding debt, accounts payable and other liabilities. The affidavit does, however, set out details of the alleged mispresentations.

25 I find that the alleged share exchange loss derives from and is inextricably intertwined with Big Bear's shareholder interest in Blue Range. The nature of the claim is in substance a claim by a shareholder for a return of what it invested qua shareholder, rather than an ordinary tort claim.

26 Given the true nature of the claim, where should it rank relative to the claims of unsecured creditors?

27 The CCAA does not provide a statutory scheme for distribution, as it is based on the premise that a Plan of Arrangement will provide a classification of claims which will be presented to creditors for approval. The Plan of Arrangement presented by CNRL in the Blue Range situation has been approved by creditors and sanctioned by the Court. Section 3.1 of the Plan states that claims shall be grouped into two classes: one for Class A Claimants and one for Class B Claimants, which are described as claimants that are "unsecured creditors" within the meaning of the CCAA, but do not include "a Person with a Claim which, pursuant to Applicable Law, is subordinate to claims of trade creditors of any Blue Range Entities." The defined term "Claims" includes indebtedness, liability or obligation of any kind. Applicable Law includes orders of this Court.

28 Although there are no binding authorities directly on point on the issue of ranking, the Applicants submit that there are a number of policy reasons for finding that the Big Bear claim should rank subordinate to the claims of unsecured creditors.

29 The first policy reason is based on the fundamental corporate principle that claims of shareholders should rank below those of creditors on an insolvency. Even though this claim is a tort claim on its face, it is in substance a claim by a shareholder for a return of what it paid for shares by way of damages. The Articles of Blue Range state that a holder of Class A Voting Common Shares is entitled to receive the "remaining property of the corporation upon dissolution in equal rank with the holders of all other common shares of the Corporation". As pointed out by Laskin, J. in Central Capital (supra at page 274):

> Holding that the appellants do not have provable claims accords with sound corporate policy. On the insolvency of a company the claims of creditors have always ranked ahead of the claims of shareholders for the return of their capital. Case law and statute law protect creditors by preventing companies from using their funds to prejudice creditors' chances of repayment. Creditors rely on these protections in making loans to companies.

30 Although what is envisaged here is not that Blue Range will pay out funds to retract shares, the result is the same: Blue Range would be paying out funds to the benefit of its sole shareholder to the prejudice of third-party creditors.

31 It should be noted that this is not a case, as in the recent restructuring of Eatons under the CCAA, where a payment to the shareholders was clearly set out in the Plan of Arrangement and approved by the creditors and the court.

32 As counsel for Engage Energy, one of the trade creditors, stated on May 11, 1999 during Big Bear's application for an order lifting the stay order under the CCAA and allowing Big Bear to file a statement of claim:

> We've gone along in this process with a general understanding in our mind as to what the creditor pool is, and as recently as middle of April, long after the evidence will show that Big Bear was identifying in its own mind the existence of this claim, public statements were continuing to be made, setting out the creditor

> pool, which did not include this claim. And this makes a significant difference in how people react to supporting an ongoing plan...

33 Another policy reason which supports subordinating the Big Bear claim is a recognition that creditors conduct business with corporations on the assumption that they will be given priority over shareholders in the event of an insolvency. This assumption was referred to by Laskin, J. in Central Capital (supra), in legal textbooks (Hadden, Forbes and Simmonds, Canadian Business Organizations Law Toronto: Butterworths, 1984 at 310, 311), and has been explicitly recognized in American case law. The court in In the Matter of Stirling Homex Corporation, 579 F. 2d 206 (1978) U.S.C.A. 2nd Cir. at page 211 referred to this assumption as follows:

> Defrauded stockholder claimants in the purchase of stock are presumed to have been bargaining for equity type profits and assumed equity type risks. Conventional creditors are presumed to have dealt with the corporation with the reasonable expectation that they would have a senior position against its assets, to that of alleged stockholder claims based on fraud.

34 The identification of risk-taking assumed by shareholders and creditors is not only relevant in a general sense, but can be illustrated by the behaviour of Big Bear in this particular case. In the evidence put before me, Big Bear's president described how, in the course of Big Bear's hostile takeover of Blue Range, it sought access to Blue Range's books and records for information, but had its requests denied. Nevertheless, Big Bear decided to pursue the takeover in the absence of information it knew would have been prudent to obtain. Should the creditors be required to share the result of that type of risk-taking with Big Bear? The creditors are already suffering the results of misrepresentation, if it occurred, in the inability of Blue Range to make full payment on its trade obligations.

35 The Applicants submit that a decision to allow Big Bear to stand pari passu with ordinary creditors would create a fundamental change in the assumptions upon which business is carried on between corporations and creditors, requiring creditors to re-evaluate the need to obtain secured status. It was this concern, in part, that led the court in Stirling Homex to find that it was fair and equitable that conventional creditors should take precedence over defrauded shareholder claims (supra at page 208).

36 The Applicants also submit that the reasoning underlying the Central Capital case (where the court found that retraction rights in shares do not create a debt that can stand equally with the debt of shareholders) and the cases where shareholders have attempted to rescind their shareholdings after a corporation has been found insolvent is analogous to the Big Bear situation, and the same result should ensue.

37 It is clear that, both in Canada and in the United Kingdom, once a company is insolvent, shareholders are not allowed to rescind their shares on the basis of misrepresentation: McAskill v. The Northwestern Trust Company, [1926] S.C.R. 412 at 419; Milne v. Durham Hosiery Mills Ltd., [1925] 3 D.L.R. 725 (Ont. S.C.A.D.); Trusts and Guarantee Co. v. Smith (1923), 54 O.L.R. 144 (Ont. S.C.A.D.); Re: National Stadium Ltd. (1924), 55 O.L.R. 199 (Ont. S.C.); Oaks v. Turquend [1861-73] All E.R. Rep. 738 (H.L.) at page 743-744.

38 The court in McAskill (supra at page 419) in obiter dicta refers to a claim of recission for fraud, and comments that the right to rescind in such a case may be lost due to a change of circum-

stances making it unjust to exercise the right. Duff, J. then refers to the long settled principle that a shareholder who has the right to rescind his shares on the ground of misrepresentation will lose that right if he fails to exercise it before the commencement of winding-up proceedings, and comments:

> The basis of this is that the winding-up order creates an entirely new situation, by altering the relations, not only between the creditors and the shareholders, but also among the shareholders inter se.

39 This is an explicit recognition that in an insolvency, a corporation may not be able to satisfy the claims of all creditors, thus changing the entire complexion of the corporation, and rights that a shareholder may have been entitled to prior to an insolvency can be lost or limited.

40 In the Blue Range situation, Big Bear has actively embraced its shareholder status despite the allegations of misrepresentation, putting Blue Range under the CCAA in an attempt to preserve its equity value and, in the result, holding Blue Range's creditors at bay. Through the provision of management services, Big Bear has participated in adjudicating on the validity of creditor claims, and has then used that same CCAA claim approval process to attempt to prove its claim for misrepresentation. It may well be inequitable to allow Big Bear to exercise all of the rights it had arising from its status as shareholder before CCAA proceedings had commenced without recognition of Blue Range's profound change of status once the stay order was granted. Certainly, given the weight of authority, Big Bear would not likely have been entitled to rescind its purchase of shares on the basis of misrepresentation, had the Blue Range shares been issued from treasury.

41 Finally, the Applicants submit that it is appropriate to take guidance from certain American cases which are directly on point on this issue.

42 The question I was asked to address expressly excludes consideration of the principle of "equitable subordination". The Applicants submit that the principle of equitable subordination that is excluded for the purpose of this application is the statutory principle codified in the U.S. Bankruptcy Code in 1978 (Bankruptcy Code, Rules and Forms (1999 Ed.) West Group, Subchapter 1, Section 510 (b)). This statutory provision requires notice and a full hearing, and relates to the ability of a court to subordinate an allowed claim to another claim using the principles of equitable subordination set out and defined in case law. The Applicants submit, however, that I should look to three American cases that preceded this statutory codification and that dealt with subordination of claims by defrauded shareholders to the claims of ordinary unsecured creditors on an equitable basis.

43 The first of these cases is Stirling Homex (supra). The issue dealt with by the United States Court of Appeals, Second Circuit, is directly on point: whether claims filed by allegedly defrauded shareholders of a debtor corporation should be subordinated to claims filed by ordinary unsecured creditors for the purposes of formulating a reorganization plan. The court referred to the decision of Pepper v. Litton (308 U.S. 295 at page 305, 60 S.Ct. 238, 84 L. Ed. 281 (1939)) where the Supreme Court commented that the mere fact that a shareholder has a claim against the bankrupt company does not mean it must be accorded pari passu status with other creditors, and that the subordination of that claim may be necessitated by principles of equity. Elaborating on this, the court in Stirling Homex (supra at page 213) stated that where the debtor corporation is insolvent, the equities favour the general creditors rather than the allegedly defrauded shareholders, since in this case, the real party against which the shareholders are seeking relief is the general creditors whose percentage of realization will be reduced if relief is given to the shareholders. The court quotes a comment made by an earlier Court of Appeals (Newton National Bank v. Newbegin, 74 F. 135, 140 (8th Cir. 1896):

> When a corporation becomes bankrupt, the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of creditor, is very strong, and all attempts of that kind should be viewed with suspicion.

44 Although the court in Stirling Homex refers to its responsibility under US bankruptcy law to ensure that a plan of reorganization is "fair and equitable" and to the "absolute priority" rule of classification under US bankruptcy principles, it is clear that the basis for its decision is the general rule of equity, a "sense of simple fairness" (supra, page 215). Despite the differences that may exist between Canadian and American insolvency law in this area, this case is persuasive for its reasoning based on equitable principles.

45 If Big Bear's claim is allowed to rank equally with unsecured creditors, this will open the door in many insolvency scenarios for aggrieved shareholders to claim misrepresentation or fraud. There may be many situations where it could be argued that there should have been better disclosure of the corporation's declining fortunes, for who would deliberately have invested in a corporation that has become insolvent. Although the recognition that this may greatly complicate the process of adjudicating claims under the CCAA is not of itself sufficient to subordinate Big Bear's claim, it is a factor that may be taken into account.

46 The Applicants also cite the case of In re U.S. Financial Incorporated 648 F. 2d 515 (1980)(U.S.C.A. 9th Cir.). This case is less useful, as it was decided primarily on the basis of the absolute priority rule, but while the case was not decided on equitable grounds, the court commented that support for its decision was found in the recognition of the importance of recognizing differences in expectations between creditors and shareholders when classifying claims (supra at page 524). The court also stated that although both creditors and shareholders had been victimized by fraud, it was equitable to impose the risks of insolvency and illegality on the shareholders whose investment, by its very nature, was a risky one.

47 The final case cited to me on this issue is In re THC Financial 679 F. 2d 784 (1982) (U.S.C.A. 9th Cir.), where again the court concluded that claims of defrauded shareholders must be subordinated to the claims of the general creditors. The court commented that the claimant shareholders had bargained for equity-type profits and equity-type risks in purchasing their shares, and one such risk was the risk of fraud. As pointed out previously, Big Bear had an appreciation of the risks of proceeding with its takeover bid without access to the books and records of Blue Range and took the deliberate risk of proceeding in any event.

48 In THC Financial, the claimants argued that since they had a number of possible causes of action in addition to their claim of fraud, they should not subordinated merely because they were shareholders. The court found, however, that their claim was essentially that of defrauded shareholders and not as victims of an independent tort. All of the claimants' theories of recovery were based on the same operative facts - the fraudulent scheme.

49 Big Bear submits that ascribing some legal impediment to a shareholder pursuing a remedy in tort against a company in which it holds shares violates the principle set out in Salomon v. Salomon and Company, Limited [1897] A.C. 22 (H.L.) that corporations are separate and distinct entities from their shareholders. In my view, this is not in issue. What is being sought here is not to limit a tort action by a shareholder against a corporation but to subordinate claims made qua shareholder to claims made by creditors in an insolvency situation. That shareholder rights with respect

to claims against a corporation are not unlimited has already been established by the cases on rescission and recognized by statutory limitations on redemption and retraction. In this case, the issue is not the right to assert the claim, but the right to rank with creditors in the distribution of the proceeds of a pool of assets that will be insufficient to cover all claims. No piercing of the corporate veil is being suggested or would result.

50 Counsel for Big Bear cautions against the adoption of principles set out in the American cases on the basis that some decisions on equitable subordination require inequitable conduct by the claimant as a precondition to subordinating a claim, referring to a three-part test set out in a number of cases. This discussion of the inequitable conduct precondition takes place in the broader context of equitable subordination for any cause as it is codified under Section 510 of the US Bankruptcy Code. In any event, it appears that more recent American cases do not restrict the use of equitable subordination to cases of claimant misconduct, citing, specifically, that stock redemption claims have been subordinated in a number of cases even when there is no inequitable conduct by the shareholder. "Stock redemption" is the term used for cases involving fraud or misrepresentation: U.S. v. First Truck Lines, Inc. (1996) 517 U.S. 535; SPC Plastics Corporation et al v. Griffiths et al (1998) 6th Circuit Case No. 88-21236. Some of the American cases draw a distinction between cases where misconduct is generally required before subordination will be imposed and cases where "the claim itself is of a status susceptible to subordination, such as...a claim for damages arising from the purchase ... of a security of the debtor": U.S. v. First Truck Lines, Inc. (supra, at paragraph 542).

51 The issue of whether equitable subordination as codified in Section 510 of the U.S. Bankruptcy Code should form part of the law in Canada has been raised in several cases but left undecided. Big Bear submits that these cases establish that if equitable subordination is to be part of Canadian law, it should be on the basis of the U.S. three-part test which includes the condition of inequitable conduct. Again, I cannot accept this submission. It is true that Iacobucci, J. in Canada Deposit Insurance Corp., while he expressly refrains from deciding whether a comparable doctrine should exist in Canada, refers to the three-part test and states that he does not view the facts of the Canada Deposit Insurance Corp. case as giving rise to inequitable conduct. It should be noted, however, that that case did not involve a claim by a shareholder at all, since the lenders had never received the securities that were an option under the agreements, and that the relationship had at this point in the case been characterized as a debtor/creditor relationship.

52 At any rate, this case, together with Olympia and York Developments Ltd. v. Royal Trust Co. [1993] O.J. No. 181 (Ont. G.D.) and Unisource Canada Inc. v. HongKong Bank of Canada [1998] O.J. No. 5586 (Ont. H.C.) all refer to the doctrine of equitable subordination codified in the U.S. Bankruptcy Code which is not in issue here. The latter two cases appear to have accepted the erroneous proposition that inequitable misconduct is required in all cases under the American doctrine.

53 Big Bear also submits that the equitable principles that exist in U.S. law which have led the courts to ignore separate corporate personality in the case of subsidiary corporations are related to equitable principles used to subordinate shareholder claims. The basis for this submission appears to be a reference by the British Columbia Court of Appeal in B.G. Preeco I (Pacific Coast) Ltd. v. Bon Street Holdings Ltd. et al (1989) 43 B.L.R. 68 (1989) to the Pepper v. Litton case (supra) and the so-called "Deep Rock doctrine" under American law. I do not see a link between the comments made in Pepper v. Litton and referred to in B.C. Preeco on an entirely different issue and comments

concerning the court's equitable jurisdiction in the case of claims by shareholders against insolvent corporations.

54 I acknowledge that caution must be used in following the approach taken in American cases to ensure that the principles underlying such approach do not arise from differences between U.S. and Canadian law. However, I find that the comments made by the American courts in these cases relating to the policy reasons for subordinating defrauded shareholder claims to those of ordinary creditors are persuasive, as they are rooted in principles of equity that are very similar to the equitable principles used by Canadian courts.

55 American cases are particularly useful in the areas of commercial and insolvency law given that the larger economy in the United States generates a wider variety of issues that are adjudicated by the courts. There is precedent for the use of such cases: Laskin, J. in Central Capital Corp. (supra) used the analysis set out in American case law on whether preferred shareholders can claim as creditors in an insolvency to help him reach his conclusion.

56 The three American cases decided on this direct issue before the 1978 statutory codification of the law of equitable subordination are not based on a doctrine of American law that is inconsistent with or foreign to Canadian common law. It is not necessary to adopt the U.S. absolute priority rule to follow the approach they espouse, which is based on equitable principles of fairness and policy. There is no principled reason to disregard the approach set out in these cases, which have application to Canadian business and economy, and I have found them useful in considering this issue.

57 Based on my characterization of the claim, the equitable principles and considerations set out in the American cases, the general expectations of creditors and shareholders with respect to priority and assumption of risk, and the basic equitable principle that claims of defrauded shareholders should rank after the claims of ordinary creditors in a situation where there are inadequate assets to satisfy all claims, I find that Big Bear must rank after the unsecured creditors of Blue Range in respect to the alleged share exchange loss, the claim for transaction costs and the claim for cash share purchase damages.

ISSUE #2

58 Assuming (without admitting) misrepresentation by Blue Range and reliance on it by Big Bear, is the alleged share exchange loss a loss or damage incurred by Big Bear and, accordingly, is Big Bear a proper party to advance the claim for such a loss?

Summary of Decision

59 As the alleged share exchange loss is not a loss incurred by Big Bear, Big Bear is not the proper party to advance this claim.

Analysis

60 The Applicants submit that negligence is only actionable if a plaintiff can prove that it suffered damages, as the purpose of awarding damages in tort is to compensate for actual loss. This is a significant difference between damages in tort and damages in contract. In order for a plaintiff to have a cause of action in negligent misrepresentation, it must satisfy the court as to the usual elements of duty of care and breach thereof, and it must establish that it has sustained damages from that breach.

61 The Applicants argue that Big Bear did not suffer any damages arising from the share exchange. The Big Bear shares used in the share exchange came from treasury: Big Bear did not use any corporate funds or corporate assets to purchase the Blue Range shares. As the shares used in the exchange did not exist prior to the transaction, Big Bear was essentially in the same financial position pre-issuance as it was post-issuance in terms of its assets and liabilities. The nature and composition of Big Bear's assets did not change as the treasury shares were created and issued for the sole purpose of the share exchange. Therefore, Big Bear did not sustain a loss in the amount of the value of the shares. The Applicants submit that the only potential loss is that of the pre-takeover shareholders of Big Bear, as the value of their shares may have been diluted as a result of the share exchange. However, even if there was such a loss, Big Bear is not the proper party to pursue such an action. Just as shareholders may not bring an action for a loss which properly belongs to the corporation, a corporation may not bring an action for a loss directly incurred by its shareholders.

62 Big Bear claims that it is entitled to recover the value of the Big Bear shares that were issued in furtherance of the share exchange. It says that it can prove all the elements of negligent misrepresentation: there was a special relationship; material misrepresentations were made to Big Bear; those representations were made negligently; Big Bear relied on those representations; and Big Bear suffered damage.

63 It submits that damages for negligent misrepresentation are calculated as the difference between the represented value of the shares less their sale value. Big Bear contends that it matters not that the consideration for the Blue Range shares was Big Bear shares issued from treasury. As long as the consideration is adequate consideration for legal purposes, its form does not affect the measure of damages awarded by the courts for negligent misrepresentation. Big Bear says that it bargained for a company with a certain value, and, in doing so, it gave up its own shares worth that value. Therefore, Big Bear submits that it clearly incurred a loss.

64 Big Bear submits that it is the proper party to pursue this head of damages. While the corporation has met the test for negligent misrepresentation, the shareholders likely could not, as the representations in questions were not made to them. In any event, Big Bear indicates that it does not claim for any damages caused by dilution of the shares. It also notes that a claim for dilution would not be the same as the face value of the shares issued in the share exchange, which is the amount claimed in the Notice of Claim.

65 Big Bear's claim is in tort, not contract. This is an important distinction, as the issue at hand concerns the measure of damages. The measure of damages is not necessarily the same in contract as it is in tort.

66 It is a first principle of tort law that a person is entitled to be put in the position, insofar as possible, that he or she was before the tort occurred. While the courts were historically loath to award damages for pure economic loss, this position was softened in Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.) where the court confirmed that damages could be recovered in this type of case. When assessing damages for negligent misrepresentation resulting in pure economic loss, the goal is to put the party who relied on the misrepresentation in the position which it would have been in had the misrepresentation not occurred. While the parties to this application appear to agree on this principle, it is the application thereof with which they disagree.

67 The proper measure of damages in cases of misrepresentation is discussed in S.M. Waddams, The Law of Damages (Toronto: Canada Law Book Inc., Looseleaf, Dec. 1998), where the author states:

> The English and Canadian cases have consistently held that the proper measure [with respect to fraudulent misrepresentation] is the tortious measure, that is the amount of money required to put the plaintiff in the position that would have been occupied not if the statement had been true but if the statement had not been made. The point was made clearly in McConnel v. Wright , [1903] 1 Ch. 546 (C.A.):
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> > It is not an action for breach of contract, and, therefore, no damages in respect of prospective gains which the person contracting was entitled by his contract to expect come in, but it is an action of tort - it is an action for a wrong done whereby the plaintiff was tricked out of certain money in his pocket; and therefore, prima facie, the highest limit of his damages is the whole extent of his loss, and that loss is measured by the money which was in his pocket and is now in the pocket of the company. That is the ultimate, final, highest standard of his loss. (at 5-19, 5-20)
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> ...
>
> Since the decision of the House of Lords in 1963 in Hedley Byrne Ltd. v. Heller & Partners Ltd., [1964] A.C. 465 (H.L.) it has been established that an action lies for negligent misrepresentation causing economic loss. It naturally follows from acceptance of out-of pocket loss rather than the contractual measure as the basic measure of damages for fraud, that the same basic measure applies to negligent misrepresentation. (at 5-28).

68 Big Bear claims to be entitled to the difference between the actual value and the exchange value of the shares. The flaw in this assertion is that it focuses on what Big Bear bargained for as opposed to what it actually received, which is akin to a contractual measure of damages. Big Bear clearly states that it is not maintaining an action in contract, only in tort. Damages in tort are limited to the losses which a plaintiff actually incurs as a result of the misrepresentation. Thus, Big Bear is not entitled to recover what it expected to receive as a result of the transaction; it is entitled to be compensated only for that which it actually lost. In other words, what did Big Bear have before the loss which it did not have afterwards? To determine what losses Big Bear actually sustained, its position after the share exchange must be compared with its position prior to the share exchange.

69 The situation at hand is unique. Due to a negligent misrepresentation, Big Bear was induced to give up something which, although it had value, was of substantially no cost to the corporation, and in fact did not even exist but for the misrepresentation. Big Bear created shares which had a value for the purpose of the share exchange, in that Blue Range shareholders were willing to accept them in exchange for Blue Range shares. However, outside of transaction costs, those shares had no actual cost to Big Bear, as compared to the obvious costs associated with a payment by way of cash or tangible assets. Big Bear cannot say that after the share exchange, it had lost approximately $150 million dollars, because the shares essentially did not exist prior to the transaction, and the cost of

creating those shares is not equivalent to their face value. Big Bear retains the ability to issue a limitless number of shares from treasury in the future; any loss in this regard would not be equivalent to the actual value of the shares. Therefore, all that is required to return Big Bear to its pre-misrepresentation position is compensation for the actual costs associated with issuing the shares.

70 That Big Bear has not incurred a loss in the face value of the exchanged shares is demonstrated by comparing the existing facts with hypothetical situations in which such a loss may be found. Had Big Bear been required to pay for the shares used in the exchange, for instance, by purchasing shares from existing Big Bear shareholders, there would have been a clear loss of funds evidenced in the Big Bear financial statements. Big Bear's financial position prior to the exchange would have been significantly better than its position afterwards. However, no such difference results from the mere exchange of newly-issued shares. If there had been evidence that Big Bear was or could be compelled to redeem or retract the new shares at the value assigned to them at the time of the share exchange, Big Bear may have a loss in the amount of the exchange value of the shares. However, there is no evidence of such a redemption or retraction feature attaching to these shares.

71 In sum, Big Bear's position prior to the share exchange is that the Big Bear shares issued as part of the exchange did not exist. As a result of the alleged misrepresentation, Big Bear issued shares from treasury. These shares would not have been issued but for the misrepresentation. All that is required to put Big Bear back into the position it was in prior to the negligent misrepresentation is compensation for the cost of issuing the shares, which is not the same as the exchange value of those shares. Although this is somewhat of an anomalous situation, it is consistent with the accepted tort principle that, except in cases warranting punitive damages, damages in tort are awarded to compensate for actual loss. A party may not recover in tort for a loss of something it never had. Indeed, if Big Bear was awarded damages for the share exchange equal to what it has claimed, it would be in a better position financially than it was prior to the exchange. To the extent that shareholders would indirectly benefit, they would not only be Big Bear's pre-exchange shareholders, who may have suffered a dilution loss, but a new group of shareholders, including former Blue Range shareholders who participated in the exchange.

72 Big Bear submits that it incurred other losses as a result of the misrepresentation. Transaction costs incurred in the share exchange may be properly characterized as damages in tort, as those costs would not have been incurred but for the negligent misrepresentation. The same is true for the Big Bear claim for cash expended to purchase Blue Range shares prior to the share exchange. However, as I have indicated in my decision on Issue #1, Big Bear's claim for transaction costs and for cash share purchase damages ranks after the claims of other unsecured creditors. There may also be losses such as loss of ability to raise equity. There was no evidence of this before me in this application, and I have addressed Big Bear's ability to advance a claim for this type of loss in the decision relating to Issue #3.

73 Finally, there may also be a loss in the form of dilution of the value of the Big Bear shares. However, as Big Bear admits in its submissions, no such claim is made by the corporation, and any loss relating to a diluted share value would not be the same amount as the exchange value of the shares.

74 In the result, I find that Big Bear is not the proper party to pursue a claim for the alleged share exchange loss.

ISSUE #3

74a Is Big Bear entitled to make or advance by way of argument in these proceedings the claims represented by the heads of damage specified in the draft Statement of Claim set out at Exhibit "F" to the affidavit of A. Jeffrey Tonken dated June 25, 1999?

[The Court did not paragraph number Issue #3. Quicklaw has assigned the number 74a.]

75 In addition to claims for damages for negligent misrepresentation, the claims that are set out in the draft Statement of Claim are claims for remedies for oppressive and unfairly prejudicial conduct and claims for loss of opportunity to pursue valuable investments and endeavours and loss of ability to raise equity.

Summary of Decision

76 Given the orders made by LoVecchio, J. on April 6, 1999 and May 11, 1999, Big Bear is not entitled to advance the claims represented by the heads of damage specified in the draft Statement of Claim other than as set out in its Notice of Claim.

Analysis

77 Big Bear submits that it is clear that, in an appropriate case, a complex liability issue that arises in the context of CCAA proceedings may be determined by a trial, including provision for production and discovery: Algoma Steel Corp. v. Royal Bank of Canada [1992] O.J. No. 889 (Ont. C.A.). Big Bear also submits that the court has the jurisdiction to overlook technical complaints about the contents of a Notice of Claim. The CCAA does not prescribe a claim form, nor set the rules for completion and contexts of a claim form, and it is common ground that in this case, the form used for the "Notice of Claim" was not approved by any order of the court. At any rate, Big Bear submits that it is not seeking to amend its claim to add new claims or to claim additional amounts.

78 It makes that assertion apparently on the basis that the major parties concerned with CCAA proceedings in the Blue Range matter were aware of the nature of Big Bear's additional claims by reason of the draft Statement of Claim attached to Mr. Tonken's May 5, 1999 affidavit, although that affidavit was filed in support of an application to lift the stay imposed under the CCAA, an application which was dismissed by LoVecchio, J. on May 11, 1999.

79 Big Bear characterizes the issue as whether it must prove the exact amount claimed in its Notice of Claim or otherwise have its claim barred forever. It submits that the bare contents of the Notice of Claim cannot be construed as a fixed election barring a determination and assessment of an unliquidated claim for tort damages, and that it would be inequitable to deny Big Bear a hearing on the substance of its claim based on a perceived technical deficiency in the contents of the Notice of Claim.

80 In summary, Big Bear asks that the court direct an expedited trial for the hearing of its claim as outlined in the draft Statement of Claim.

81 The Applicants submit that, by attempting now to make claims other than the claims set out in the Notice of Claim, Big Bear is attempting to indirectly and collaterally attack the orders of LoVecchio, J. dated April 6, 1999 and May 11, 1999, specifically:

a) by adding claims for alleged heads of damage other than those specified in the Notice of Claim contrary to the claims bar order of April 6, 1999; and

b) by attempting to include portions of the draft Statement of Claim relating to other alleged heads of damage in the Notice of Claim contrary to the May 11, 1999 order dismissing leave to file the draft Statement of Claim.

82 While it is true that a court has jurisdiction to overlook technical irregularities in a Notice of Claim, the issue is not whether the court should overlook technical non-compliance with, or ambiguity in, a form, but whether it is appropriate to do so in this case where previous orders have been made relating to these issues. Here, Big Bear chose to pursue its claims through two different routes. It filed a Notice of Claim alleging damages for a share exchange loss, transaction costs and the cost of shares purchased before the takeover bid, all damage claims that can reasonably be identified as being related to an action for negligent misrepresentation. At about the same time, it brought an application to lift the stay granted under the CCAA and file a Statement of Claim that alleged other causes of action. That application was dismissed, and the order dismissing it was never appealed. This is not a situation as in Re Cohen (1956) 19 W.W.R. 14 (Alta. C.A.) where a claim made on one basis was later sought to be made on a different basis, nor an issue of Big Bear lacking the necessary information to make its claim, although quantification of damage may have been difficult to determine. Given the previous application by Big Bear, this is a collateral or indirect attack on the effectiveness of LoVecchio, J.'s orders, and should not be allowed: Wilson v. The Queen (1983) 4 D.L.R. (4th) at 599). The effect of the two orders made by LoVecchio, J. is to prevent Big Bear from advancing its claim other than as identified in its Notice of Claim, which cannot reasonably be interpreted to extend beyond the claims for damages for negligent misrepresentation.

83 It is true that the Notice of Claim form is not designed for unliquidated tort claims. I do not accept, however, that it was not possible for Big Bear to include claims under other heads of damages in the claim process by, for example, attaching the draft Statement of Claim to the Notice of Claim, or by incorporating such claims by way of schedule or appendix, as was done with respect to the claims for damages for negligent misrepresentation.

84 I note that LoVecchio, J. issued a judgment after this application was heard relating to claims for relief from the impact of the claims procedure established by the court by a number of creditors who filed late or wished to amend their claims after the claims bar date of May 7, 1999 had passed. Although LoVecchio, J. allowed these claims, and found that it was appropriate in the circumstances to grant flexibility with respect to the applications before him, he noted that total amount of the applications made to him would be less than 1.4 million dollars, and the impact of allowing the applications was minimal to the remaining creditors. The applications before him do not appear to involve issues which had been the subject of previous court orders, as in the current situation, nor would they have the same implication to creditors as would Big Bear's claim. The decision of LoVecchio, J. in the circumstances of the applications before him is distinguishable from this issue.

ROMAINE J.

cp/i/qljpn

Tab 10

Case Name:

Stelco 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 a proposed plan of compromise or arrangement with respect to Stelco Inc. and the other applicants listed in Schedule "A"
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

[2006] O.J. No. 276

14 B.L.R. (4th) 260

17 C.B.R. (5th) 78

145 A.C.W.S. (3d) 194

2006 CarswellOnt 406

2006 CanLII 1773

Court File No. 04-CL-5306

Ontario Superior Court of Justice
Commercial List

J.M. Farley J.

Heard: January 17-18 and 20, 2006.
Judgment: January 20, 2006.

(41 paras.)

Creditors and debtors law -- Legislation -- Debtors' relief -- Companies Creditors Arrangement Act -- Motion by equity shareholders to extend the powers of a monitor dismissed -- Proposed plan of arrangement under Companies' Creditors Arrangement Act was approved.

Insolvency law -- Receivers, managers and monitors -- Property -- Sale of -- Motion by equity shareholders to extend the powers of a monitor dismissed -- Proposed plan of arrangement under Companies' Creditors Arrangement Act was approved.

Motion by certain shareholders of a company to extend the powers of a monitor to conduct a sale of the company's business as a going concern -- In the alternative, the shareholders sought suspension of a proposed plan of arrangement under the Companies' Creditors Arrangement Act -- The shareholders also requested that approval of the plan be adjourned for 60 days to have the monitor conduct an independent sale process -- HELD: Motion dismissed -- All statutory requirements and previous court orders had been complied with -- The plan was fair, reasonable and equitable in relation to the affected creditors -- The existing shareholders could not lay claim to there being any existing equity value -- The plan was implementable, therefore it was sanctioned and approved.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, s. 191

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

Counsel:

Michael Barrack, James D. Gage and Geoff R. Hall, for the Applicants

Robert Thornton and Kyla Mahar, for the Monitor

Peter Jervis, George Glezos and Karen Kiang, for the Equity Holders

John Varley, for the Salaried Employees

David Jacobs, for USW Locals 8782 and 5328

Aubrey Kauffman, for Tricap Management Ltd.

Kevin Zych and Rick Orzy, for the 8% and 10.4% Stelco Bondholders

Lawrence Thacker, for the Directors of Stelco

Sharon White, for USW Local 1005

Ken Rosenberg, for USW International

Kevin McElcheran, for GE

Gale Rubenstein and Fred Myers, for the Superintendent of Financial Services

Derrick Tay, for Mittal

David R. Byers and Sean Dunphy, for CIT Business Credit as DIP and ABL Lender

V. Gauthier, for BABC Global Finance

L. Edwards, for EDS Canada Inc.

Peter Jacobsen, for Globe & Mail

Paul Macdonald and Andy Kent, for Sunrise and Appalloosa

Murray Gold and Andrew Hatnay, for the Salaried Retirees

Flaviano Stanc, Self-Represented

ENDORSEMENT

(Motion by the Applicants for a Sanction Order and Cross-Motion of Certain Equity Holders)

1 J.M. FARLEY J. (endorsement):-- The Applicants (collectively "Stelco") moved for:

(a) a declaration that Stelco has complied with the provisions of the Companies' Creditors Arrangement Act ("CCAA") and the orders of this court made in this CCAA proceeding;

(b) a declaration that the Stelco plan of arrangement pursuant to the CCAA and the reorganization of Stelco Inc. ("S") under the Canada Business Corporations Act ("CBCA") (collectively the "Plan") as voted on by the affected creditors of Stelco is fair and reasonable;

(c) an order sanctioning and approving the Plan; and

(d) an order extending the Stay Period and Stay Date in the Initial Order until March 31, 2006.

2 This relief was unopposed by any of the stakeholders except for various existing shareholders of S (who may also be employees or retirees of Stelco). In particular there was organized objection to the Plan, especially as in essence the Plan would eliminate the existing shareholders, by a group of shareholders (AGF Management Ltd., Stephen Stow, Pollitt & Co., Levi Giesbrecht, Joe Falco and Phil Dawson) who have styled themselves as "The Equity Holders" ("EH"). On December 23, 2005 the EH brought in essence a cross motion seeking the following relief:

(a) An order extending the powers of the Monitor, Ernst & Young, in order to conduct a sale of the entire Stelco enterprise as a going concern through a sale of the common shares or assets of Stelco on such terms and conditions as are considered fair;

(b) An order authorizing and directing the Monitor to implement and to take all steps necessary to complete and fulfil all requirements, terms, conditions and steps of such a sale;

(c) An order authorizing and directing the Monitor to conduct the sale process in accordance with a plan for the sale process approved by the court;

(d) An order directing the Monitor to retain such fully independent financial advisors and other advisors as necessary to conduct this sale process;

(e) An order confirming that the powers granted herein to the Monitor supersede any provision of any prior Order of this Court made in the within proceedings to the extent that such provision of any prior order is inconsistent with or contradictory to this order, or would otherwise limit or hinder the power and authority granted to the Monitor;

(f) An order directing Stelco and its directors, officers, counsel, agents, professional advisors and employees, and its Chief Restructuring Officer, to cooperate fully with the Monitor with regard to this sale process, and to provide the Monitor with such assistance as may be requested by the Monitor or its independent advisors;

(g) In the alternative, an order suspending the sanctioning of the Proposed Plan of Arrangement, approved by the creditors on December 9, 2005, for a period of two months from the date of such order, so that the Monitor may conduct the independent sale process that may result in a more profitable outcome for all stakeholders, including the Equity Holders;

(h) In the further alternative, an order lifting the Companies' Creditors Arrangement Act stay of proceedings in respect of Stelco without approving the Plan of Arrangement, as approved by the creditors on December 9, 2005, pursuant to such terms as are just and are directed by court; and

(i) Such further and other relief as counsel may advise and this Honourable Court may permit.

3 In its factum, the EH requested that the court adjourn approval of the Plan for 60 days and direct the Monitor to conduct an independent sale process for the shares of S. In the attendances on January 17 and 18, 2006, the EH then asked that approval of the Plan be adjourned for 30 days in order to see if there were expressions of interest for the shares of S forthcoming in the interim.

4 I indicated that I would defer my consideration of the adjournment request until after I had had submissions on the motions before me as set out above. I also indicated that while there did not appear to be any concern by anyone including the EH as to the first two elements concerning CCAA plan sanctioning as discussed in Re Algoma Steel Inc. (2001), 30 C.B.R. (4th) 1 (Ont. S.C.J.) at p. 3:

> In a sanction hearing under the Companies' Creditors Arrangement Act ("CCAA") the general principles to be applied in the exercise of the court's discretion are:
>
> (a) There must be strict compliance with all statutory requirements and adherence to the previous orders of the court;
>
> (b) All materials filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and
>
> (c) The Plan must be fair and reasonable.
>
> See Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.), affirmed Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.) at p. 201; Campeau Corp., Re (1992), 10 C.B.R. (3d) 104 (Ont. Gen. Div.) at p. 109; Olympia & York Developments Ltd. v. Royal Trust Co. (1993), 12 O.R. (3d) 500 (Ont. Gen. Div.) at p. 506; Sammi Atlas Inc., Re (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]), at pp. 172-3; Canadian Airlines Corp., Re, [2000] 10 W.W.R. 269 (Alta.

Q.B.), leave to appeal dismissed, [2000] 10 W.W.R. 314 (Alta. C.A. [In Chambers]).

it would not be sufficient to only deal in this hearing with the third test of whether the Plan was fair and reasonable (including the aspect of "fair, reasonable and equitable" as discussed in Sammi). Rather the court also had to be concerned as to whether the Plan was implementable. In other words, it would be futile and useless for the court to approve a plan which stood no reasonable prospect of being implemented. That concern of the court had been raised by my having been alerted by the Monitor in its 46th Report at paragraphs 8-9:

> 8. The Monitor has had discussions with the proposed ABL lenders, Tricap, the Province and Stelco regarding the status of the ABL Loan and the Bridge Loan. The Monitor has been advised that the parties are continuing to work at resolving issues that are outstanding as at the date of this Forty-Sixth Report. However, all of the parties remain optimistic that acceptable solutions to the outstanding issues will be found and implemented.
>
> 9. In the Monitor's view, the principal issues to be resolved include:
>
> (a) the corporate structure of Stelco, which could involve the transfer of assets of some of the operations or divisions of the Applicants to new affiliates; and
>
> (b) satisfying the ABL lenders and Tricap as to the priority of the new financing.
>
> These issues need to be resolved primarily among the proposed ABL lenders, Tricap and Stelco and will also involve the Province insofar as they affect pension and related liabilities.

5 I was particularly disquieted by the lack of progress in dealing with these outstanding matters despite the passage of 39 days since the Plan was positively voted on December 9, 2005. I do appreciate that Christmas, Hanukkah and New Year's were celebrated in this interval and that there had been a certain "negotiation fatigue" leading up to the December 9th revisions to the Plan and that I have advocated that counsel, other professionals and litigation participants balance their lives and pay particular attention to family and health. However I find it unfortunate that there would appear to have been such a lengthy hiatus, especially when the workers at Stelco continued (as they have for the past two years while Stelco has been under CCAA protection) to produce steel in record amounts. I therefore demanded that evidence be produced forthwith to demonstrate to my satisfaction that progress was real and substantial so that I could be satisfied about implementability. As a side note I would observe that in the "normal" case, sanction orders are typically sought within two or three days of a positive creditor vote so that it is not unusual for documentation to be sorted out for a month before a plan is implemented with a closing.

6 The EH filed material to support its submission that the Plan is not fair, reasonable and equitable because it is alleged that there is currently sufficient value in Stelco to fully satisfy the claims of affected and unaffected creditors and to provide at least some value to current shareholders. The EH prefers to have a search for some entity to take out the current shareholders for "value". Fabrice Taylor, a chartered financial analyst with Pollit & Co. swore an affidavit on the eve of this hearing

which was sent electronically to the service list on January 16, 2006 at approximately 7:30 p.m. In that affidavit, he states:

> 2. The Dofasco bidding war has highlighted a crucial fact about steel asset valuations, notably that strategic buyers place a much higher value on them than public market investors. Attached as Exhibit "1" is an article entitled "Restructuring of steel industry revives investors' interest", published in the Financial Times on December 14, 2005.
>
> 3. I, along with Murray Pollitt and a number of Stelco shareholders, have spent the past three months attempting to attract strategic buyers and/or equity investors in Stelco. These strategic buyers and equity investors are mostly international. Some had already considered buying Stelco or had made bids for the company but had stopped following the story some months ago. Others were not very familiar with Stelco.
>
> 4. Three factors hindered our efforts. First, Stelco is under CCAA protection, a complicated situation involving multiple players and interests (unions, politics, pensions) that is difficult to understand, particularly for foreigners. Second, there has not been enough time for these strategic buyers or equity investors to deepen their understanding or to perform due diligence. Finally, the Dofasco bid process, while providing emphatic evidence that steel assets are increasingly valuable, hinders certain strategic buyers and financial institutions interested in participating in Stelco because they are distracted and/or conflicted by the Dofasco sale. I have been advised by some of the participants in the Dofasco negotiations that they would be willing to carefully consider a Stelco transaction once the Dofasco sale has been resolved.
>
> 5. The Forty Fifth Report of the Monitor confirmed that Stelco had not received any offers in the last several months. The report does not answer the question of whether the company or its financial advisors have in fact attempted to attract any offers. I believe that Stelco would have received expressions of interest had the company made efforts to attract offers, or had the Dofasco sale been resolved earlier. I believe that the Monitor should be authorized, for a period of at least 60 days, to canvas interest in a sale of Stelco before the approval of the proposed plan of restructuring.

7 No satisfactory explanation was forthcoming as to why this affidavit, if it needed to be filed at all, was not served and filed by December 23, 2005, in accordance with the timetable which the EH and the other stakeholders agreed to. Certainly there is nothing in the affidavit which is such late breaking news that this deadline could not have been met, let alone that it was served mere hours before the hearing commenced on January 17, 2006. Aside from the fact that the financing arrangements forming the basis of the Plan contained "no shop" covenants which would make it inappropriate and a breach to try to attract other offers, the foregoing excerpts from the Taylor affidavit clearly illustrate that despite apparently diligent efforts by the EH, no one has shown any real or realistic interest in Stelco. Reading between the lines and without undue speculation, it would appear that the efforts of the EH were merely politely rebuffed.

8 Certainly Stelco is not Dofasco, nor is it truly a comparable (as opposed to a contrastor). Stelco has been a wobbly company for a long time. Further as I indicated in my October 3, 2005 endorsement, in the preceding 20 months under the CCAA protection, Stelco has become "shopped worn". The unusual elevation of steel prices in the past two years has helped Stelco avoid the looming liquidity crisis which it anticipated in its CCAA filing on January 29, 2004. However even this financial transfusion has not allowed it to become a healthy company or truly given it a burgeoning war chest to weather bad times the way that other steel companies (including some in Canada) have so benefited. The redness of the visage of Stelco is not a true indication of health and well being; rather it seems that it is rouge to mask a deep pallor.

9 I am satisfied on the evidence of Hap Stephen, the Chief Restructuring Officer of Stelco and of the Monitor that there has been compliance with all statutory requirements and adherence to previous orders of the court and further that nothing has been done or purported to be done that is not authorized by the CCAA.

10 The next question to be dealt with is whether the Plan is fair, reasonable and equitable. I was advised that creditors of the affected creditor classes representing approximately 90% in value of each class voted on the Plan. The Monitor reported at para. 19 of its 44th Report as to the results of the vote held December 9th as follows:

Class of Affected Percentage in Percentage in Creditors favour by Number favour by Dollar Value

Stelco	78.4%	87.7%
Stelwire	89.01%	83.47%
Stelpipe	94.38%	86.71%
CHT Steel	100%	100%
Welland Pipe	100%	100%

11 This favourable vote by the affected creditors is substantially in excess of the statutory two-thirds requirement. By itself that type of vote, particularly with such a large quorum present, would ordinarily be very convincing for a court not interfering with the informed decisions of busi-

ness people. With that guideline, plus the aspect that a plan need not be perfect, together with the lack of any affected creditor opposition to the Plan being sanctioned and the fact that the Plan including its ingredients and nature and amount of compromise compensation to be given to affected creditors having been exhaustively negotiated in hard bargaining by the larger creditor groups who are recognized as generally being sophisticated and experienced in this area, and the consideration of the elements in the next paragraph, it would seem to me that the Plan is fair, reasonable and equitable vis-à-vis the affected creditors and I so find. See Sammi, at p. 173; Re T. Eaton Co. (1999), 15 C.B.R. (4th) 311 (Ont. S.C.J.) at p. 313; Re Olympia & York Developments Ltd. (1993), 12 O.R. (3d) 500 (Gen. Div) at p. 510.

12 I also think it helpful to examine the situation pursuant to the analysis which Paperny J. did in Re Canadian Airlines Corp. (2000), 20 C.B.R. (4th) 1 (Alta. Q.B.), leave to appeal refused (2000), 20 C.B.R. (4th) 46 (Alta C.A. [In Chambers]). That proceeding also involved an application pursuant to the corporate legislation, the Business Corporations Act (Alberta), concerning the shares and shareholders of Canadian Airlines. In that case, Paperny J. found the following factors to be relevant:

(a) the composition of the vote: claims must have been properly classified, with no secret arrangements to give an advantage to a creditor or creditors; approval of the plan by the requisite majority of creditors is most important (in the case before me of Stelco: the challenge to classification was dismissed; there was no suggestion of secret arrangements; and, as discussed above, the quorum and size of the positive vote were very high);

(b) anticipated receipts in liquidation or bankruptcy: it is helpful if the Monitor or other disinterested person has prepared a liquidation analysis (in Stelco, the Monitor determined that on liquidation, affected creditor recovery would likely range from 13 to 28 cents on the dollar; it should also be observed that Stelco has engaged in extensive testing of the market as to possible capital raising or sale with the aid of established firms and professionals of great experience and had come up dry.);

(c) alternatives to the proposed plan: it is significant if other options have been explored and rejected as unworkable (in Stelco; see comment in (b));

(d) oppression of the rights of certain creditors (in Stelco, this was not a live issue as nothing of this sort was alleged);

(e) unfairness to shareholders (in Stelco, this will be dealt with later in my reasons; however allow me to observe that the interests of shareholders becomes engaged if they are not so far underwater that there is a reasonable prospect in the foreseeable future that the fortunes of a company would otherwise likely be turned around so that they would not continue to be submerged); and

(f) the public interest: the retention of jobs for employees and the support of the plan by the company's unions is important (in Stelco, the Plan does not call for reductions in employment; there is provision for continuation of the capital expenditure program and its funding; an important enterprise for the municipal and provincial levels of government would be preserved with continuing benefits for those communities; an important customer and supplier would continue in the industry and maintain competition; the

> USW International Union and its locals (except for local 1005) supported the Plan and indeed were instrumental in bringing Tricap Management Limited to the table (local 1005's position was that it did not wish to engage in the CCAA process in any meaningful way as it was content to rely upon its existing collective agreement which now still has several months to go before expiring).

However that is not the end of that issue: what of the shareholders?

13 Is the Plan fair, reasonable and equitable for the existing shareholders of S? They will be wiped out under the Plan and their shares eliminated. New equity will be created in which the existing shareholders will not participate. They have not been allowed to vote on the Plan.

14 It is well established that a reorganization pursuant to s. 191 of the CBCA may be made in conjunction with a sanction order under the CCAA and that such a reorganization may result in the cancellation of existing shares of the reorganized corporation based on those shares/equity having no present value (in the sense of both value "now" and the likelihood of same having value in the reasonably foreseeable future, absent the reorganization including new debt and equity injections and permitted indulgences or other considerations and adjustments). See Re Beatrice Foods Inc. (1996), 43 C.B.R. (4th) 10 (Ont. Gen. Div.) at para. 10-15; Re Laidlaw Inc. (2003), 39 C.B.R. (4th) 239 (Ont. S.J.C.); Algoma at para. 7; Cable Satisfaction International Inc. v. Richter & Associés Inc. (2004), 48 C.B.R. (4th) 205 (Que. S.C.) at p. 217. The Dickenson Report, which articulated the basis for the reform of corporate law that resulted in the enactment of the CBCA, described the object of s. 191 as being:

> to enable the court to effect any necessary amendment to the articles of the corporation in order to achieve the objective of the reorganization without having to comply with all the formalities of the Draft Act, particularly shareholder approval of the proposed amendment (emphasis added): R.W.V. Dickenson, J.L. Howard, L. Getz, Proposals for a New Business Corporations Law for Canada, vol. 1 (Ottawa: Information Canada. 1971) at p. 124.

15 The fairness, reasonableness and equitable aspects of a plan must be assessed in the context of the hierarchy of interests recognized by insolvency legislation and jurisprudence. See Canadian Airlines at pp. 36-7 where Paperny J. stated:

> Where a company is insolvent, only the creditors maintain a meaningful stake in its assets. Through the mechanism of liquidation or insolvency legislation, the interests of shareholders are pushed to the bottom rung of the priority ladder. The expectations of creditors and shareholders must be viewed and measured against an altered financial and legal landscape. Shareholders cannot reasonably expect to maintain a financial interest in an insolvent company where creditors' claims are not being paid in full. It is through the lens of insolvency that the court must consider whether the acts of the company are in fact oppressive, unfairly prejudicial or unfairly disregarded. CCAA proceedings have recognized that shareholders may not have "a true interest to be protected" because there is no reasonable prospect of economic value to be realized by the shareholders given the existing financial misfortunes of the company: Royal Oak Mines Ltd., supra, para. 4., Re

> Cadillac Fairview Inc., [1995] O.J. No. 707, (March 7, 1995), Doc. B28/95 (Ont. Gen. Div. [Commercial List]), and T. Eaton Company, supra. To avail itself of the protection of the CCAA, a company must be insolvent. The CCAA considers the hierarchy of interests and assesses fairness and reasonableness in that context. The court's mandate not to sanction a plan in the absence of fairness necessitates the determination as to whether the complaints of dissenting creditors and shareholders are legitimate, bearing in mind the company's financial state. The articulated purpose of the Act and the jurisprudence interpreting it, "widens the lens" to balance a broader range of interests that includes creditors and shareholders and beyond to the company, the employees and the public, and tests the fairness of the plan with reference to its impact on all of the constituents.
>
> It is through the lens of insolvency legislation that the rights and interests of both shareholders and creditors must be considered. The reduction or elimination of rights of both groups is a function of the insolvency and not of oppressive conduct in the operation of the CCAA. The antithesis of oppression is fairness, the guiding test for judicial sanction. If a plan unfairly disregards or is unfairly prejudicial it will not be approved. However, the court retains the power to compromise or prejudice rights to effect a broader purpose, the restructuring of an insolvent company, provided that the plan does so in a fair manner."

16 The question then is does the equity presently existing in S have true value at the present time independent of the Plan and what the Plan brings to the table? If it does then the interests of the EH and the other existing shareholders must be considered appropriately in the Plan. This is fairly put in K.P. McElcheran, Commercial Insolvency in Canada (Toronto, Lexis Nexis Canada Inc.: 2005) at p. 290 as:

> If, at the time of the sanction hearing, the business and assets of the debtor have a value greater than the claims of the creditors, a plan of arrangement would not be fair and reasonable if it did not offer fair consideration to the shareholders.

17 However if the shareholders truly have no economic interest to protect (keeping in mind that insolvency and the depth of that insolvency may vary according to which particular test of insolvency is applied in respect of a CCAA proceeding: as to which, see Re Stelco Inc., [2004] O.J. No. 1257 (S.C.J. [Commercial List]), leave to appeal dismissed [2004] O.J. No. 1903 (C.A.), leave to appeal dismissed, 336, [2004] S.C.C.A. No. 336 (S.C.C.) No. 30447). In Cable Satisfaction, Chaput J. at p. 218 observed that when shareholders have no economic interest to protect, then they have no claim to a right under the proposed arrangement and the "[m]ore so when, as in the present case, the shareholders are not contributing to any of the funding required by the Plan." I do note in the case of the Stelco Plan and the events leading up to it, including the capital raising and sale processes, that despite talk of an equity financing by certain shareholders, including the EH, no concrete offer ever surfaced.

18 If the existing equity has no true value at present, then what is to be gained by putting off to tomorrow (the ever present and continuous problem in these proceedings of manana - which never comes) what should be done today. The EH speculate, with no concrete basis for foundation as demonstrably illustrated by the eve of hearing Taylor affidavit discussed above, that something good may happen. I am of the view that that approach was accurately described in court by one counsel

as a desperation Hail Mary pass and the willingness of someone, without any of his own chips, in the poker game willing to bet the farm of someone else who does have an economic interest in Stelco.

19 I also think it fair to observe that in the determination of whether someone has an economic value, that analysis should be conducted on a reasonable and probable basis. In a somewhat different but applicable context, I observed in New Quebec Raglan Mines Ltd. v. Blok-Andersen, [1993] O.J. No. 727 at p. 3:

> The "highest price" is not the price which could be derived on the basis of the most optimistic and risky assumptions without any regard as to their likelihood of being realized. It also seems to me that prudence would involve a consideration that there be certain fall back positions. Even in betting on horses, the most savvy and luckiest punter will not continue to stake all his winnings of the previous race on the next (and so on). If he does, he will go home wearing the barrel before the last race is run.

Alternatively there is a saying: "If wishes were horses, then beggars would ride."

20 Unless I were to now dismiss the motion for sanctioning and approving the Plan because I found that it was not implementable and/or that it was not fair, reasonable and equitable to the existing shareholders (based upon the proviso that I did determine that the existing shareholders did have a valid present material equity of value), then I see no reason not to dismiss the motion of the EH concerning its request for an adjournment and its request for a further sale (or other related disposition) process. Allow me to observe that no matter how well intentioned the motion of the EH in that regard, I find that that request to be lacking in any valid substance. Rather, the evidence presented was in essence a chimera. I think it fair to observe that, with all the capital raising and sales processes to date which Stelco has undertaken in conjunction with its experienced and well placed professional advisers together with its Chief Restructuring Officer and the Monitor, the bushes have been exhaustively and well beaten as to any real possible interest. Despite three months of what one must presume to be diligent efforts, the EH have come up with nothing concrete. I do not find that the three factors mentioned by Taylor in his late-blooming affidavit of January 16th to be remotely close to convincing. The first two, if taken at face value, would lead one to the conclusion that no one has the time, interest or ability to take an interest in Stelco in any meaningful timeframe. The third presumes that the losing bidder for Dofasco, be it Arcelor or ThyssenKrupp, will almost automatically want Stelco - and at a price and upon terms which would result in present equity being attributed value. I must say in fairness that this is wishful thinking as neither of these warring bidders pursued any interest in Stelco during the previous processes. It is neither clear nor obvious why mere municipal proximity of Dofasco to Stelco's Hilton Works in Hamilton would now ignite any interest in Stelco.

21 I also think it fair to observe that not proceeding with the sanction hearing now and indeed starting a brand new search for someone who will think Stelco so worthwhile that it will offer such a large amount (with or without onerous conditions) is akin to someone coming into court when a receiver is seeking court approval on a sale - and that someone being allowed to know the price and conditions - and then being able to make an offer for a price somewhat higher. (I reiterate that here we do not even have an offer or a price.) I do not see that such a procedure would be consistent with the principles laid out in Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1 (Ont. C.A.). Given

that the affected creditors have rather resoundingly voted in favour of the Plan, all in accordance with the provisions of the CCAA and the Court orders affecting the sanction, I would be of the view that if the existing equity has no value, then the EH's request in this respect would, if granted, be of significant detriment to the integrity of the insolvency system and regime. I would find that inappropriate to attempt to justify proceeding along that line.

22 Allow me to return to the pivotal point concerning the question of whether the Plan is fair, reasonable and equitable, vis-à-vis the existing equity. The EH retained Navigant Consulting which relied upon the views of Metal Bulletin Research ("MBR") which, inter alia, predicted a selling spot price of hot roll steel at $525 U.S. per ton. Navigant's conclusion in its December 8, 2005 report was that the value of residual shareholder equity was between $1.1 to $1.3 billion or a per share value of between $10.76 and $12.71. However, when Stelco pointed out certain deficiencies in this analysis, Navigant took some of these into account and reduced its assessment of value to between $745 million to $945 million for residual shareholder value on per share value of $7.29 to $9.24, using a discounted cash flow ("DCF") approach. Navigant tested the DCF approach against the EBITDA approach. It is interesting to note that on the EBITDA analysis approach Navigant only comes up to a conclusion that the equity is valued at $8 million to $83 million or $0.09 to $0.81 per share. If the Court were to accept that as an accurate valuation, or something at least of positive value even if not in that neighbourhood, then I would have to take into account existing shareholder interests in determining whether the Plan was fair, reasonable and equitable - and not only vis-à-vis the affected creditors but also vis-à-vis the interests of the existing shareholders given that at least some of their equity would be above water. I understand the pain and disappointment of the existing shareholders, particularly those who have worked hard and long with perhaps their life savings tied up in S shares, but regretfully for them I am not able to come to a conclusion that the existing equity has a true positive value.

23 The fight in the Stelco CCAA proceedings has been long and hard. No holds have been barred as major affected creditors have scrapped to maximize their recovery. There were direct protracted negotiations between a number of major affected creditors and the new equity sponsors under the Plan, all of whom had access to the confidential information of Stelco pursuant to Non Disclosure Agreements. These negotiations established a value of $5.50 per share for the new common shares of a restructured Stelco. That translates into an enterprise value (not an equity value since debt/liabilities must be taken into consideration) of $816.6 million for Stelco, or a recovery of approximately 65% for affected creditors. The parties engaged in these negotiations are sophisticated experienced enterprises. There would be no particular reason to believe that in the competition involved here that realistic values were ignored. Further, the affected creditors generally were rather resoundingly of the view by their vote that an anticipated 65% recovery was as good as they could reasonably expect.

24 The 45th Report of the Monitor had a chart of calculations to determine the level of recovery of affected creditors at various assumed enterprise values up to and including the top end of Navigant's range of enterprise value (as contrasted with residual equity value). At the high end of Navigant's range of revised enterprise value, $1.6 billion, the Monitor calculated that affected creditors would still not receive full recovery of their claims.

25 The EH cited the sale of the EDS Canada claim to Tricap as being at a premium as evidence in support of Navigant's conclusion. However, the fact was that this claim was purchased not at a

premium, but rather at a discount. That would be confirmation of the opposite of which the EH has been contending.

26 Despite a very comprehensive capital raising and asset sale process, with the market alerted and well canvassed, and with the ability to conduct due diligence, no interested party came forwarded to conclude a deal. Even since the December 9, 2005 vote when the terms of the Plan were available, no interested party has come forward with any expression of interest which would attribute value to the existing shareholders.

27 Stelco's experts, UBS and BMO Nesbitt Burns, both have given opinions that there is no value to the existing equity. Their expert opinions were not challenged by cross-examination. Both these advisors are large sophisticated institutions; both have extensive experience in the steel industry.

28 UBS calculated the enterprise value of Stelco as being in the range of $550 million to $750 million; BMO Nesbitt Burns at $650 million to $850 million. On that basis the unsecured creditors would receive less than full recovery of their claims, which would lead to the conclusion that there is no value for the existing shareholders. The Monitor commissioned an independent estimate of the enterprise value from its affiliate, Ernst & Young Orenda Corporate Finance Inc.'s Valuation Group. That opinion came in at $635 million to $785 million.

29 I would note that Farley Cohen, the principal author of the Navigant report, does not have experience in dealing with integrated steel companies. I find it unusual that he would have customized his approach in calculating equity value by not deducting the Asset Based Lenders loan. Brad Fraser of BMO Nesbitt Burns stated that such customization was contrary to the practice at his firms both present and past and that the Navigant's approach was internally inconsistent with respect thereto as to 2005 to 2009 cash flows as contrasted with terminal value. The Navigant report appears to have forecasted a high selling price for steel combined with low costs for imports such as coal and scrap, which would be contrary to historical complementary movements between steel prices and these inputs.

30 Navigant relies on an average price of $525 US per ton as provided by MBR. This is a single source as to this forecast. While a single analyst may come up with a forecast which is shown by the passage of time to be dead on accurate, it would seem to me to be more realistic and prudent to rely on the consensus approach of considering the views of a greater number of "representative" analysts, especially when prices appear volatile for the foreseeable future. That consensus approach allows for consideration of the way that each analyst looks at the market and the factors and weights to be given. The UBS opinion reviewed the pricing forecast of eight analysts and BMO Nesbitt Burns' ten analysts. Interestingly, MBR's choice of a price at the top of the band would seem at odds as the statements on the MBR website foreseeing downward pressure on steel prices in 2006 because of falling prices in China; although this inconsistency was pointed out, there was no response forthcoming.

31 Navigant estimated Stelco's financial performance for the last quarter of 2005 and made a significant upward adjustment. However, the actual experience would appear to indicate that such an adjustment would overstate Stelco's results by $124 million.

32 Navigant's DCF approach involved a calculation of Stelco's enterprise value by adding the present value of a stream of cash flow from the present to 2009 and the present value of the terminal value determined as at 2009 so that the terminal value represents the majority (60% approximately)

of enterprise value as calculated by Navigant. MBR chose a 53-year average steel price despite significant changes over that time in the industry. However, coal and scrap costs were determined as at 2009. This produced the anomalous result that steel prices are rising while costs are falling. This would imply great structural difficulties (economically and functionally) in the steel industry generally and a lack of competition. A terminal value EBITDA margin for Stelco would then be implied at approximately 26% or some 11% higher than the EBITDA margin actually achieved by Stelco in the first quarter of 2005, the most profitable quarter in the history of Stelco.

33 Interestingly, since Navigant's approach in fact would decrease calculated value, UBS and BMO Nesbitt Burns used a weighted average cost of capital ("WACC") for Stelco in the range of 10% to 14%; Navigant used 24%. A higher WACC will result, all other things being equal, in a lower enterprise value. Navigant considered that there should be a 10% to 15% company-specific premium because of the risks associated with Stelco vis-à-vis the higher steel prices forecast by MBR. This would appear to imply that there was recognition that either MBR was aggressive in its forecasting or that price volatility would caution one to use consensus forecasting. Colin Osborne, a senior executive of Stelco, with considerable experience in the steel industry provided direct evidence on the substantial differences between each of Stelco, AK Steel, U.S. Steel and Algoma. Mr. Cohen acknowledged in cross-examination that these differences made Dofasco a more valuable company than Stelco. As set out at para. 74 of the Stelco Factum:

> 74. The specific difference identified by Mr. Osborne which made Dofasco unique include but are not limited to:
>
> (a) non-union, flexible work environment (vs. Stelco, Algoma, AK Steel and U.S. Steel);
> (b) legacy costs which are very low due to non-conventional profit sharing, which limits liability (vs. Stelco, AK Steel, Algoma and U.S. Steel);
> (c) high historical cap-ex spend per ton (vs. Stelco, Algoma and U.S. Steel);
> (d) a flexible steelmaking stream in terms of a hybrid EAF and blast furnace BOF stream in Hamilton and a mini-mill operation in the U.S. (vs. Stelco, Algoma, U.S. Steel and AK Steel which are all blast furnace based steel makers);
> (e) a value added product mix focused on coated products and tubing (vs. Stelco and Algoma which focus on hot roll); and
> (f) a strong raw material position with excess iron ore and self-sufficiency in coke (Algoma, Stelco and AK Steel all have dependence to various degrees on either iron ore or coke or both).

Dofasco and Stelco are not in my view fungible. There are incredible differences between these two enterprises, to the disadvantage of Stelco.

34 The reply affidavit of Mr. Fraser of BMO Nesbitt Burns calculated the effect of all of the acknowledged corrections to the initial Navigant report and other adjustments. The result of this exercise was a conclusion by him that there was no value available for existing shareholders. This, along with all the other affidavits provided on the Stelco side, was not cross-examined on.

35 While not referred to in the Factum of EH, there were a number of quite serious allegations raised in material filed by the EH against management of Stelco concerning bias and manipulation. Mr. Osborne responded to each of these allegations; he was not cross-examined. I find it unfortunate that such allegations appear to have been made on an unsubstantiated shotgun approach.

36 The position of the EH is that certain of the features of the Plan should be assumed as transportable directly and without change into a scenario where some insolvency rescuer emerges on the scene as the equivalent of a White Knight, one it would seem which has been awakened from slumber. I am of the view that presumes too much. For example, I take it that the Province would not automatically accept this potential newcomer without question; nor would it likely relish the resumption of weeks of hard bargaining. I would think it unwise, impudent and high stakes poker (with other peoples' money) to speculate as did Taylor in para. 41 of his December 23, 2005 affidavit:

> 41. Were Stelco to emerge from CCAA protection and were the province to carry out its threat to revoke Stelco's entitlement to the benefit of section 5.1 the end result would likely be a liquidation of the company. The Province would be responsible for a substantial portion of Stelco's pension promise. It would clearly not be in the Province's self-interest to force Stelco into liquidation. It was, in other words, an obvious bluff. Yet the notion of calling this bluff does not appear to have crossed management's mind.

This should be contrasted with the views of the Monitor in its 44th Report at para. 61:

> 61. It should also be noted that the Pension Plan Funding Arrangements and the $150 million New Province Note embodied in the Approved Plan were agreed to by the Province only in the context of the terms of the Approved Plan and, in particular, the capital structure, liquidity and other elements contemplated therein. The Province has advised that its proposed financing and the Pension Plan Funding Arrangements should not be assumed to be available if any of the elements of the Approved Plan are changed.

37 The end result is that given the above analysis, I have no hesitation in concluding that it would be preferable to rely upon the analysis of UBS, BMO Nesbitt Burns and Ernst & Young Orenda, both as to their direct views as to the enterprise value of existing Stelco and as to their criticism of the Navigant and MBR reports concerning Stelco. Therefore, I conclude that the existing shareholders cannot lay claim to there being any existing equity value. Given that conclusion, it would be inappropriate to justify cutting in these existing shareholders for any piece of the emergent restructured Stelco. If that were to happen, especially given the relative values and the depth of submersion of existing equity, then it would be unfair, unreasonable and inequitable for the affected creditors.

38 That then leaves the remaining question: Does it appear likely that the Plan will be implementable? I have been advised on Wednesday, January 18th that I would receive executed term sheets (which would address the issues raised by the Monitor discussed above) by 5 p.m., Friday, January 20th.

39 The motion and adjournment request of the EH is dismissed.

40 There was a request to extend the stay to March 31, 2006. I am of the view that it would be sufficient and desirable to extend the stay (subject, of course, to further extension) to March 3, 2006.

41 I have received the term sheets together with the Monitor's 48th Report by the 5 p.m. January 20th deadline and find them satisfactory as demonstrating to my analysis and satisfaction that the Plan is implementable as discussed above, subject to a comeback provision if anyone wishes to dispute the implementability issue (the onus remaining on Stelco). My decision today re: implementability should in no way be taken as deciding any corporate reorganization issue or anything of that or related nature. I therefore sanction and approve the Plan.

J.M. FARLEY J.

cp/e/qw/qlmpp/qlhcs/qlmll/qlana

Tab 11

Re

Central Capital Corporation
Re Royal Bank of Canada et al. and Central Capital Corporation
[Indexed as: Central Capital Corp. (Re)]

27 O.R. (3d) 494

[1996] O.J. No. 359

Nos. C21479 and C21477

Court of Appeal for Ontario,

Finlayson, Weiler and Laskin JJ.A.

February 7, 1996

Bankruptcy -- Insolvency -- Companies' Creditors Arrangement Act -- Vendor receiving preference shares with right of retraction -- Purchaser company unable to redeem shares because of insolvency -- Purchaser reorganizing under plan of arrangement -- Right to participate in reorganization as creditor depending upon whether person having claim provable in bankruptcy -- Vendor claiming that exercise of right of retraction a debt and a claim provable in bankruptcy -- Court characterizing transaction as equity -- Canada Business Corporations Act, R.S.C. 1985, c. C-44 -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

Debtor and creditor -- Companies' Creditors Arrangement Act -- Vendor receiving preference shares with right of retraction -- Purchaser company being unable to redeem shares because of insolvency -- Purchaser company reorganizing under plan of arrangement -- Right to participate in reorganization as creditor depending upon whether person having claim provable in bankruptcy -- Vendor claiming that exercise of right of retraction a debt and a claim provable in bankruptcy -- Court characterizing transaction as equity -- Canada Business Corporations Act, R.S.C. 1985, c. C-44 -- Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

In 1987, through a corporation, M sold shares to Central Capital Corp. and received in return Series B Senior Preferred Shares. These shares, which were to be listed on the stock exchange, contained a provision entitling the holder to retract the share at a specified price, i.e., to have them redeemed by

Central Capital Corp. on July 1, 1992 for $25 per share plus all accrued and unpaid dividends but providing that redemption would not be contrary to law. In 1989, the predecessor of SYH Corp. sold the shares of several insurance companies to Central Capital Corp. and in return received Series A and Series B Junior Preferred Shares. These shares contained a provision entitling the holder at its option to retract the shares on or after September 1994 for $1.00 per share plus all accrued and unpaid dividends, but subject to the provisions of the Canada Business Corporations Act (CBCA).

In December 1991, Central Capital, which was then insolvent, defaulted on its financial obligations, and, in 1992, creditors commenced proceedings under the Companies' Creditors Arrangement Act (CCAA). An administrator was appointed and assets were transferred to implement a two-pronged reorganization and plan of compromise in which certain creditors of Central Capital would exchange a portion of their indebtedness for shares and debentures of a new corporation and creditors of Central Capital would receive 90 per cent of the common shares in a reorganized Central Capital. The balance of common shares was to be allocated to the shareholders. To participate in the reorganization as a creditor, s. 12(1) of the CCAA required that a person have a claim provable in bankruptcy. Section 121(1) of the Bankruptcy and Insolvency Act (BIA) provided that all debts, present and future, shall be deemed to be provable claims.

In April and May 1992, M exercised his right of retraction, but Central Capital did not redeem the shares, and M subsequently submitted a proof of claim. In September 1992, SYH Corp. delivered a proof of claim. The administrator disallowed these claims because it would be contrary to the CBCA for Central Capital to redeem the shares due to its financial position and, in the case of SYH Corp., also because the date for redemption had not yet occurred. This decision was upheld on appeal, Feldman J. ruling that M and SYH Corp. were not creditors because they did not have a claim provable under the BIA. M and SYH Corp. appealed to the Court of Appeal.

Held, the appeal should be dismissed.

Per Weiler J.A.: To decide whether the obligation to redeem the preferred shares was a claim in bankruptcy, it was necessary to characterize the transaction. The court must look to the surrounding circumstances to determine whether the relationship here was that of a shareholder with equity or that of a creditor owed a debt. The sales of shares by M and by SYH Corp. were changes in a capital investment from a smaller to a larger entity. There were the hallmarks of a shareholding, i.e., there was: risk-taking; profit-sharing; transferability of investment by sale on the stock exchange or, in the case of SYH Corp., by private sale; and the right to participate in the share of assets on a liquidation after the creditors had been paid. The true nature of the transaction was that of an equity transaction. The equity nature of the transaction did not change into a debt by M attempting to exercise the right of retraction nor did it change as a result of the reorganization of Central Capital. The preferred shares were part of the capital of Central Capital, and s. 36 of the CBCA makes the ability of a corporation to redeem its shares subject to its articles and to a solvency requirement. In this case, by the terms of the preferred shares, an unsatisfied demand for retraction did not make any change in the holder's status as a shareholder entitled to receive dividends, to vote at meetings in certain circumstances, and to participate in a liquidation. Because Central Capital could not comply with the solvency requirements, redemption would be contrary to law. Further, the accrued but undeclared dividends on the preference shares were not made a debt by reason of their being part of the retraction price. Dividends may only be declared if a company is solvent. Any obligation to pay a dividend cannot be enforced when the company is insolvent. Accrued but unpaid dividends are akin to a return of capital and this was not altered by making these accrued dividends part of the re-

traction price. Finally, the nature of the preference shares did not provide the appellants with a claim provable in bankruptcy. Persuasive authority exists that a claim provable in bankruptcy must be one recoverable by legal process. In this case, although there was a right to receive payment, the effect of the insolvency meant that there was no right to enforce payment and no claim provable within the meaning of s. 121 of the BIA.

Per Laskin J.A. (concurring): Although the relations between each appellant and Central Capital had the characteristics of debt and equity, in substance they were shareholders and the exercise of their retraction rights did not convert them into creditors. In determining the substance of the relationship, the court looks to what the parties intended. In these appeals, what the parties intended was indicated in the share purchase agreements, the conditions attaching to the preference shares, in the articles of incorporation, and in the way Central Capital recorded the appellants' shares in its financial statements. These factors indicated that appellants were making an investment in capital and not extending credit; they chose equity, not debt. The appellants' status was not changed by the exercise of the rights of retraction. The share conditions provided that even after exercising their rights, the appellants continued to enjoy rights of shareholders. The right of retraction provided for the return of capital, not the repayment of a loan, and a preferred shareholder exercising this right on the terms that existed here ranked behind a company's creditors on a liquidation. The result should be the same on a reorganization. Moreover, holding that the appellants were creditors would defeat the purpose of s. 36(2) of the CBCA, which prohibited the redemption of the shares when there was insolvency. The purpose of this provision was to protect creditors and prevent shareholders from recouping their investments to the detriment of creditors. Creditors rely on these protections in making loans to companies. Permitting preferred shareholders to be turned into creditors by endowing their shares with retraction rights was contrary to the policy of creditor protection.

Per Finlayson J.A. (dissenting): The question to be decided was whether the appellants' shares created a debt, present or future, within the meaning of s. 121 of the BIA. The character of an instrument is revealed by its language and the circumstances of its creation. Although these instruments were shares until there was redemption, they also contained a specific promise to pay at a specified date. This was the language of debt. The circumstances of the issue of these shares showed that they were not issued to raise capital but rather were a means of payment for the acquisition of specified assets. Central Capital was using the retraction provisions as a vehicle for financing its expanding asset base. The fact that the appellants, as holders of the shares, had rights of shareholders in the corporation up to the time when the retraction clauses were exercisable did not affect their right to enforce payment of the retraction price when it became due. The insolvency of Central Capital and any impropriety of redeeming the shares because of Central Capital's financial position did not change their nature as debts and did not change the nature of the relationship of debtor and creditor. Further, the arguments against the appellants' claims ignored that debts under s. 121(1) of the BIA need only come beneath the broad umbrella of "debts and liabilities, present and future". The fact that the debts could not be paid after June 1992 did not mean that they were not provable claims.

Cases referred to

Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385, 5 Alta. L.R. (3d) 193, 143 N.R. 321, 7 B.L.R. (2d) 113, 16 C.B.R. (3d) 154; Custodian (The) v. Blucher, [1927] S.C.R. 420, [1927] 3 D.L.R. 40; East Chilliwack Agricultural Co-operative (Re) (1989), 58 D.L.R. (4th) 11, 42 B.L.R. 236, 74 C.B.R. (N.S.) 1 (B.C.C.A.); Fairhall v. Butler,

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APPEAL from an order of Feldman J. (1995), 29 C.B.R. (3d) 33, 22 B.L.R. (2d) 210 (Gen. Div.), in proceedings under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

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

FINLAYSON J.A. (dissenting): -- The appellant James W. McCutcheon and Central Guarantee Trust Company as Trustee for the Registered Retirement Savings Plan of James W. McCutcheon (hereinafter sometimes referred to collectively as "McCutcheon") and the appellant Consolidated S.Y.H. Corporation ("SYH") appeal from the order of the Honourable Madam Justice Feldman of the Ontario Court (General Division) dated January 9, 1995 (reported as Re Central Capital Corp. (1995), 29 C.B.R. (3d) 33, 22 B.L.R. (2d) 210). Feldman J. dismissed appeals from decisions dated January 20, 1993 and February 16, 1993 of the respondent Peat Marwick Thorne Inc., in its capacity as Interim Receiver, Manager and Administrator ("Administrator") of certain assets of Central Capital Corporation ("Central Capital"). The Administrator disallowed proofs of claim submitted by the appellants with respect to a plan of arrangement under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 ("CCAA"). Leave to appeal the order of Feldman J. was granted on March 17, 1995 by the Honourable Mr. Justice Houlden.

Overview of the Proceedings

These appeals arise out of the insolvency of Central Capital which in and prior to December 1991 defaulted under its obligations to various unsecured lenders, note holders and subordinated debt holders. In early December of 1991, Central Capital advised its creditors that, pending implementation of new financial arrangements, it had decided to discontinue payment of all interest and principal due under outstanding loans, with the exception of indebtedness due under secured notes issued to the Royal Trust Company. In an agreed statement of facts, which was prepared by the parties for the purposes of appeals from the disallowances of the Administrator, it was agreed that at all material times since in or prior to December 1991, Central Capital was insolvent. It had a total unsecured debt of $1,577,359,000 and, among other things:

(a) it was unable to pay its liabilities as they became due; and
(b) the realizable value of its assets was less than the aggregate of its liabilities.

By notice of application issued June 12, 1992, 39 of the creditors commenced an application pursuant to the CCAA for an order declaring the following: that Central Capital was a debtor com-

pany to which the CCAA applied; that Peat Marwick Thorne Inc. be appointed Administrator of the property, assets and undertaking of Central Capital; that a stay of proceedings against Central Capital, except with leave of the court, be granted; and that the applicants be authorized and permitted to file a plan of compromise or arrangement under the CCAA.

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

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

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

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

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

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

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

Issue

The agreed statements of facts sets out the issue in the appeal in the following language:

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

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

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

Overview of the Restructuring of Central Capital

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

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

The second stage of the restructuring involved a plan of arrangement under the CCAA. That plan as put forward by Central Capital recognized four classes of creditors, only one of which, namely that of "Senior Creditors", could apply to the appellants. The plan of arrangement, as amended, provided that Central Capital would issue to Senior Creditors pro rata on the basis of their senior claims a class of secured promissory notes in the aggregate principal amount of $20 million of secured debt, which were to be known as first secured notes. A similar arrangement was made for the issuance of $1 million of second secured promissory notes to subordinated creditors. Senior and subor-

dinated creditors included any creditor whose claim had been allowed under the CIGL claims procedure in the first stage, to the extent of that creditor's reduced claim.

The plan of arrangement also called for the creation of a new class of shares in Central Capital to be called the Central New Common Shares. Central Capital would issue to the above Senior and Subordinated Creditors 90 per cent of the new share capital of Central Capital in extinguishment of the balance of their debt. The Central Capital shareholders of all classes would have their existing shares converted into the remaining 10 per cent of the Central New Common Shares. All of the existing preferred and common shares would be cancelled upon implementation of the plan.

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

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

Facts as they Relate to the Claim of McCutcheon

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

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

Pursuant to art. 4.1 of the Senior Series B Provisions, each holder of Series B Senior Preferred Shares was entitled, subject to and upon compliance with the provisions of art. 4, to require Central

Capital to redeem all or any part of the Series B Senior Preferred Shares registered in the name of that holder on July 1, 1992 at a price equal to $25 per share, plus all accrued and unpaid dividends thereon, calculated to but excluding the retraction date.

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

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

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

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

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

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

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

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

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

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

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

Facts as they Relate to the Claim of SYH

Pursuant to an agreement of purchase and sale made as of June 30, 1989, as amended, Scottish & York Holdings Limited (the predecessor to SYH) sold to Central Capital the shares of Central Can-

ada Insurance Services Limited, Eaton Insurance Company, Scottish & York Insurance Co. Limited and Victoria Insurance Company of Canada (collectively the "Insurance Companies"), except for certain preference shares held by the directors of those corporations. In consideration of this transfer, Central Capital issued to Scottish & York Holdings Limited 60,116,000 Series A Junior Preferred Shares and 9,618,560 Series B Junior Preferred Shares.

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

The Articles also provided that Central Capital was obligated to retract the Series A Junior Preferred Shares and Series B Junior Preferred Shares, at the option of the holders of those shares, on the fifth anniversary of their issuance. The retraction price was $1.00 per share plus all accrued and unpaid dividends. Payment of the retraction price of these shares by Central Capital was subject to the provisions of the CBCA, which governs the affairs of Central Capital. For the purposes of this appeal, I believe that we can treat the balance of the provisions relating to these preferred shares as being the same as those governing the McCutcheon Series B Senior Preferred Shares.

Given that the operative date for proving claims against Central Capital was June 15, 1992, the retraction date governing the preferred shares of SYH was some two years removed. Notwithstanding, on September 8, 1992 SYH executed and delivered to the Administrator a proof of claim, a counterpart of the restated subscription and escrow agreement, an initial share subscription and an instrument of claims reduction form, all in the prescribed form and within the time required. The claim was that SYH was holding or entitled to hold the following shares of Central Capital:

(a) 60,116,000 Junior Preferred Series A shares;
(b) 9,618,560 Junior Preferred Series B shares;
(c) 4,611,095 Junior Preferred Series B shares accrued to June 15, 1992 but not yet issued to SYH;

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

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

Analysis

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

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

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

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

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

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

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

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

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

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

I have no difficulty in finding that the claims of the appellants in the case under appeal fall within all of the above definitions. As will be discussed herein, concern was expressed in this case over whether or not the appellants as creditors were entitled to "receive and enforce payment" on the "debt" because of the insolvency of Central Capital on June 15, 1992. I will deal with the specific arguments relating to the effect of insolvency on this particular indebtedness in due course, but for the moment I am content to observe that the above definitions contemplate only that the creditor's

right to recover is the reciprocal of the debtor's obligation to pay. For every debtor there must be a creditor. There may be cases where it is difficult to identify the person who in law may receive and enforce payment, but this is not such a one.

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

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

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

The rules relating to the competing rights of shareholders and creditors of an insolvent corporation have become so regulated by governmental action that one can readily lose sight of the common law basis for making a distinction. To understand the difference in treatment, we must re-examine what a share of a corporation represents. Initially, a share is issued by the corporation to raise share capital. The price of the share is money or the promise of money. Accordingly, an individual share is one of a number of separate but integral parts of the authorized capital of a corporation. Even though it is the shareholders who contribute to the capital of the corporation, the capital remains the property of the corporation. The shareholders, however, as owners of the shares of capital, effectively control the corporation. They have the responsibility of managing its affairs through their control over the board of directors and in popular terminology are considered to be the owners

of the corporation. However, the corporation is a separate entity in law, and if in the course of carrying out its business it incurs debts to third parties, those debts are those of the corporation. A corporation is an intangible and its capital therefore represents its substance to third parties having business dealings with the corporation. A preferred share is simply a share of a class of issued shares which contains a preference over other classes of shares, whether preferred or common: see Sutherland, Fraser and Stewart on Company Law of Canada, 6th ed. (1993), at pp. 157 and 195 for further discussion.

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

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

Shareholders are variously characterized as entrepreneurs, investors or risk-takers and as such they have the opportunities of benefitting from the successes of the corporation and suffering from its failures. While the corporation is an operating entity, the shareholders receive their rewards, if there are any, through the payment of dividends declared from time to time by the board of directors. While the source of these dividends is not restricted to surplus funds, the result of the payment of the dividend must not result in a return of capital to the shareholders. The classic justification for this rule was stated by Sir George Jessel, Master of the Rolls, in Flitcroft's Case (1882), 21 Ch. D. 519 at pp. 533-34, 52 L.J. Ch. 217 (C.A.):

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

Creditors, on the other hand, do not have an ownership or equity interest in the corporation. They are third parties who have loaned money or otherwise advanced credit to the corporation. They look to the company for payment in accordance with the terms of the contract creating the indebtedness. They are also restricted in their recovery to the amounts stipulated in the terms of indebtedness. They are entitled to payment regardless of the financial circumstances of the debtor corporation and accordingly are not restricted to receiving payment of the debt from surplus. They can be paid out of assets or through the creation of further indebtedness. It is immaterial how the corporation records this indebtedness in its internal books. In some circumstances the indebtedness could properly

reflect the acquisition of property from a creditor as a capital asset. This does not, however, convert the creditor into an investor. The vendor of the property remains a creditor and retains priority over shareholders in the event of a bankruptcy or insolvency.

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

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

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

The validity of an analysis directed to the substance of the transaction is supported by Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385, a judgment of the Supreme Court of Canada delivered by Iacobucci J. The case involved a number of corporations constituting a support group which entered into an arrangement to provide emergency financial assistance to Canadian Commercial Bank ("CCB"). On the ultimate failure of the bank, the issue arose as to whether the moneys advanced to CCB under this support arrangement were in the nature of a loan or in the nature of a capital investment. I find instructive to our situation Iacobucci J.'s observation at pp. 590-91:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255 million. Instead of trying to pigeonhole the entire agreement between the Participants and CCB in one of two categories, I see nothing wrong in recognizing the arrangement for what it is, namely, one of a hybrid nature, combining elements of both debt and equity but which, in substance, reflects a debtor-creditor relationship. Financial and capital markets have been most creative in the variety of investments and securities that

> have been fashioned to meet the needs and interests of those who participate in those markets. It is not because an agreement has certain equity features that a court must either ignore these features as if they did not exist or characterize the transaction on the whole as an investment. There is an alternative. It is permissible, and often required, or desirable, for debt and equity to co-exist in a given financial transaction without altering the substance of the agreement. Furthermore, it does not follow that each and every aspect of such an agreement must be given the exact same weight when addressing a characterization issue. Again, it is not because there are equity features that it is necessarily an investment in capital. This is particularly true when, as here, the equity features are nothing more than supplementary to and not definitive of the essence of the transaction. When a court is searching for the substance of a particular transaction, it should not too easily be distracted by aspects which are, in reality, only incidental or secondary in nature to the main thrust of the agreement.

(Emphasis in original)

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

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

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

The narrow issue of the effect of insolvency on a debt has been dealt with by the British Columbia Court of Appeal in Re East Chilliwack Agricultural Co-Operative (1989), 74 C.B.R. (N.S.) 1, 58 D.L.R. (4th) 11. In this case, the appellants were one-time members of three co-operative associations. The rules of the co-operatives permitted a member to withdraw upon written notice to the board of directors to that effect. The member was entitled to elect to have his shares redeemed either in equal instalments over five years or in one payment with interest at the end of five years. In April of 1987, the superintendent of co-operatives, under the authority of the Cooperative Association Act, R.S.B.C. 1979, c. 66, suspended the co-operatives' right to redeem their shares until their financial situation was no longer impaired. The three co-operatives subsequently went bankrupt and a two-fold issue came before the bankruptcy court: (1) whether those members whose notices of withdrawal had been accepted by the board of directors but who had not yet received the value of the shares were entitled to rank as unsecured creditors, and (2) whether those who had delivered no-

tices that had not been accepted were to be treated as unsecured creditors. The court of first instance found that the members were shareholders and answered both questions in the negative. That judge was reversed on appeal with the majority of the court deciding that the answer to both questions was yes. Hutcheon J.A. for the majority stated at p. 13:

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

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

It appears to me, with deference, that the issue of the effect of Central Capital's insolvency on the character of the retraction payments is something of a red herring. The contest in this appeal is between those who are conceded to be unsecured creditors and those whose claim to such status is contested. In both cases, any right to payment was suspended by Central Capital's announcement in December of 1991 that it was insolvent and that it had suspended all payments of principal and interest to unsecured creditors. This course of action was not freely chosen but was required by law. Any payments to creditors after the date of insolvency would be voidable at the instance of creditors on the basis that they were fraudulent preferences. In addition to ss. 95 and 96 of the Bankruptcy Act dealing with fraudulent preferences generally, there is provincial legislation in the form of the Fraudulent Conveyances Act, R.S.O. 1990, c. F.29, and the Assignments and Preferences Act, R.S.O. 1990, c. A.33, that would be applicable. Counsel for the unsecured creditors maintains that the right to redeem shares, including preference shares, was postponed by s. 36(2) of the CBCA, supra. I am not certain that s. 36(2) applies to the retraction provisions of the appellants' preference shares as opposed to the redemption privileges of Central Capital, but in my opinion the point is irrelevant to this appeal. Once Central Capital acknowledged its insolvency, it could neither redeem its shares nor honour its retraction obligations. The whole purpose for the creditors applying to the court for a stay of Central Capital's obligations, including those of the acknowledged unsecured creditors, was to arrange for a scheme of payments to all creditors that could not be subject to attack as preferences. There is no suggestion on the evidence before us that the claims of unsecured creditors accepted by the Administrator were claims that had crystallized prior to the insolvency of Central Capital. Nor is it suggested that any creditors were rejected because some or all of their claims were not payable until after the date of the insolvency. The fact of insolvency, by itself, does not provide a rational basis for distinguishing the claims of the appellants from those of other unsecured creditors.

Much also was made of the provision in the Articles authorizing the shares in question, which states that if the obligation to redeem "would be contrary to applicable law", then Central Capital "shall redeem only the maximum number of [shares] it is then permitted to redeem". Counsel for the

unsecured creditors submits that the reference to "applicable law" is to s. 36 of the CBCA. The reference certainly embraces the CBCA, but it is not restricted by its terms to that statute. For example, "applicable law" would also capture s. 101 of the Bankruptcy and Insolvency Act, which provides for penalties against directors and shareholders where insolvent companies redeem shares or pay dividends.

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

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

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

At the risk of oversimplifying this case, it appears to me that many of the arguments made against the appellants' claims to be creditors of Central Capital are impermissible in the context of the agreed statement of facts. The issue in appeal is frozen in time by the stipulation that the court is to determine if these retraction clauses created a debt within the meaning of the Bankruptcy and Insolvency Act on June 15, 1992. The arguments against the appellants' claims also ignore that debts under s. 121(1) of the Bankruptcy Act need not be payable at the date of the bankruptcy (or June 15, 1992 in our scenario). They need only come beneath the broad umbrella of "debts and liabilities, present and future, to which [Central Capital] is subject" on June 15, 1992. The fact that the debts could not be paid after June 15, 1992, does not mean that they were not provable claims pursuant to s. 121 of the Bankruptcy and Insolvency Act. Moreover, assuming the retraction clauses created a

debt payable on a future date, neither the order of Houlden J. nor the restrictions in the articles creating the shares themselves purported to extinguish that debt.

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

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

An additional factor raised by counsel during argument was that art. 7, supra, provides that in the event of the liquidation, dissolution or winding-up of Central Capital, whether voluntary or involuntary, or any other distribution of assets among its shareholders for the purpose of winding up its affairs, the holders of these preferred shares are entitled to recover "from the assets of Central Capital" the retraction price plus all accrued and unpaid dividends thereon. Such amount is to be paid prior to payment to junior ranking shareholders. The article further provides that "[u]pon payment of such amounts, the holders of [the preferred shares] shall not be entitled to share in any further distribution of assets of [Central Capital]". Because it is trite law that shareholders are entitled to recover from assets only after all ordinary creditors have been paid in full, counsel for the unsecured creditors submits that the fact that the clause contemplates priorities between shareholders on a winding-up or a liquidation of assets is clear evidence that they were shareholders only.

I have two responses to this submission. The first is the obvious, that we are not dealing with this contemplated event. We are dealing with a reorganization in which the parties have put a single question to the court: are the appellants creditors? Consideration of issues of priority or the valuation of claims have been taken away by the narrow scope of the agreed question. If the answer to the question posed is yes, then in accordance with the agreed statement of facts, the appellants are entitled to have their claims as creditors allowed under the subscription and escrow agreement and to participate in the amended plan of arrangement as senior creditors. If the answer is no, they are to be treated as the Administrator has treated them: they are not creditors at all and are restricted to receiving Central New Common Shares under the amended plan of arrangement.

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

Finally, with respect to SYH's claims, it was submitted that these claims were so contingent as to be virtually non-existent. The claims anticipate a retraction date that as of June 15, 1992 was some two years into the future. Upon approval of the amended plan of arrangement on December 18, 1992, the shares of SYH were cancelled and replaced by a new issue of shares, the Central New Common Shares. Counsel relied upon the finding of Feldman J. that there was then no discernable basis upon which the retraction could occur. Once again, with respect, this conclusion misses the point. Following the final order of Houlden J. approving the amended plan of arrangement, all the shares and all the debts of Central Capital disappeared. There was thereafter no discernable basis upon which any event contemplated by any debt or share instruments could occur. We are only concerned with the status of shareholders and creditors as of June 15, 1992.

Based on the reasons set out above, I have concluded that the retraction amounts do fall within the definition of debts and liabilities, present or future, to which Central Capital was subject on June 15, 1992. This does not apply to undeclared dividends, however, because until a dividend is declared no action on behalf of a shareholder lies to enforce its payment: see Fairhall v. Butler, [1928] S.C.R. 369 at p. 374, [1928] 3 D.L.R. 161. If undeclared dividends have been claimed by any of the appellants they should be disallowed. In all other respects the claims should be allowed.

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

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

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

In order to decide whether the obligation of Central Capital to redeem the preferred shares of the appellants is a claim provable in bankruptcy, it is necessary to characterize the true nature of the transaction. The court must look to the surrounding circumstances to determine whether the true nature of the relationship is that of a shareholder who has equity in the company or whether it is that of a creditor owed a debt or liability by the company: Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385. In this case, the decision is not an easy one. Where, as here, the agreements between the parties are reflected in the articles of the corporation, it is necessary to examine them carefully to characterize the true relationship. It is not disputed that if the true nature of the relationship is that of a shareholder-equity relationship after the retraction date and at the time of the reorganization, then the appellants do not have a claim provable in bankruptcy. Consequently, they will not have a claim under the CCAA.

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

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

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

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

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

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

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

Scottish & York Holdings Limited (the predecessor to SYH) sold its shares in certain insurance companies which it owned to Central Capital. Central Capital paid for these shares by the issue of Series A Junior Preferred Shares. These shares were not posted on a stock exchange. SYH had the right to have its shares redeemed by Central Capital on or after September 1994 at a price of $1.00 per share, subject to the provisions of the Canada Business Corporations Act, R.S.C. 1985, c. C-44 (the "CBCA").

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

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

to Central Capital's creditors would be traded for new claims and ownership interests in the reorganized corporation which would remain a going concern. The lenders chose to reorganize.

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

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

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

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

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

My analysis of the transaction is that when McCutcheon sold his shares in Central Guaranty and took back preferred shares in Central Capital as part payment, he transferred part of his capital investment from a smaller entity to a larger entity. Similarly, SYH transferred its investment in the shares of the insurance companies for shares in the larger entity of Central Capital. Both appellants could look to a larger asset base than before to generate a return on their capital. Until the retraction date, McCutcheon chose to take the risk of continuing his investment in Central Capital, which offered the prospect of a stable, yet relatively high, annual return through the receipt of 7 5/8 per cent dividends. Because the shares traded on the Toronto Stock Exchange, he would have had the option of realizing upon his investment by selling his shares for what they would bring on the open market, but he did not do so. In the case of SYH, although these shares were not required to be publicly

listed, the corporation's articles did not restrict their transfer. The corporation's articles indicate that these shares had some preference over other shares with respect to the right to receive dividends and in the distribution of assets after creditors are paid on a liquidation. As preferred shareholders, McCutcheon and SYH did not have a voice in company affairs unless the company failed to pay the dividends it had promised to pay. This is quite typical: see Welling, Corporate Law in Canada, 2nd ed. (1991) at p. 604; Ziegel et al., Cases and Materials on Partnership and Canadian Business Corporations, 2nd ed. (1989) at p. 1198. Risk-taking, profit-sharing, transferability of investment, and the right to participate in a share of the assets on a liquidation after the creditors have been paid are the hallmarks of a shareholder: see R.M. Bryden, "The Law of Dividends," contained in Ziegel ed., Studies in Canadian Company Law (1967) at p. 270. In my opinion, Feldman J. was correct that the true nature of the relationship between the parties initially was that of an equity transaction.

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

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

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

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

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

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

(b) Section 36 of the CBCA

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

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

(Emphasis added)

There is no dispute that Central Capital was unable to redeem McCutcheon's shares on the retraction date. Nor could it redeem SYH's shares on the date of the reorganization. The appellants agree that the effect of s. 36 renders the agreement between themselves and Central Capital unenforceable. It is the position of the appellants, however, that s. 36 does not extinguish a debt or liability which they say has been created. The appellants rely on the decision in Re East Chilliwack Agricultural Co-operative (1989), 74 C.B.R. (N.S.) 1, 58 D.L.R. (4th) 11 (B.C.C.A.), in support of their position that a debt or liability is created notwithstanding the solvency requirements of s. 36 respecting payment. The appellants' submission does not take into consideration the major differences between the decision in East Chilliwack and the present situation relating to the timing, effect of the solvency requirements and the provisions in the articles governing the relationship of the parties.

(1) In East Chilliwack, farmers who owned shares in an agricultural co-operative gave notice to the co-op of their intention to have their shares redeemed. After the notices had been given, the superintendent of co-operatives suspended the right of the co-op to redeem its shares. Here, the request to redeem the shares by McCutcheon and the retraction date occurred after Central Capital had sent out a notice that it would not be able to redeem the shares due to its financial position. SYH had no right to demand that its shares be retracted until the retraction date, which was some two years after the date of Central Capital's insolvency.

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

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

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

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

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

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

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

(5) Article 7 provides that in the event of a liquidation, dissolution or winding-up of the corporation the preferred shareholders have a right to receive $25 per Series B Senior Preferred Shares before the corporation pays any money or distributes assets to shareholders in any class subordinate or junior to the Series B Senior Preferred Shares. Similarly, SYH, as the holder of Series A and B

Junior Preferred shares, has the right, upon the dissolution or winding-up of the corporation, to receive a sum equivalent to the redemption amount for each series junior preferred share. This right is subject to the rights of shares ranking in priority to the shares of these series, but is ahead of the rights of the holders of common shares.

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

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

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

Looked at another way, after the retraction date and at the time of the reorganization, the common features of a debtor-creditor relationship are not in evidence in Central Capital's articles. The agreements between the parties contain no express provision that the redemption of the shares is in repayment of a loan. The corporation was not obliged to create any fund or debt instrument to ensure that it could redeem the shares on the retraction date. There is no indemnity in the event that the money is not repaid on the retraction date. There is no provision for the payment of any interest after the retraction date in the event that the money is not repaid on the retraction date. There is no provision that after the retraction date and in the event of insolvency, the appellants would have the right to have the company wound up. (See R. v. Imperial General Properties Ltd., [1985] 2 S.C.R. 288, 21 D.L.R. (4th) 741, for a case where the articles of the company contained this right.) There is no provision that upon a winding-up or insolvency the parties are entitled to rank pari passu with the creditors as was the case in Canada Deposit Insurance Corp. v. Canadian Commercial Bank, supra.

(d) The effect of the reorganization

Finlayson J.A. is of the view that it is immaterial that the articles provide, in the event of the liquidation, dissolution or winding-up of the company, that the appellants are only entitled to rank af-

ter the creditors but ahead of the junior ranking shareholders. In his view, this provision is irrelevant because we are not dealing with a liquidation but with a reorganization. He finds it significant that, like debtors, the preferred shareholders are not entitled to participate in any surplus once they have been paid. I am of the view that this provision in the articles is significant. It represents a clear indication that the holders of the retractable shares were not to be dealt with on the same footing as ordinary creditors even after the retraction date. Instead, they were to be dealt with as shareholders, albeit an elevated class. Under the CBCA all shares carry equal rights. Words used in the articles to differentiate a class of shares are nothing more than authorized deviations from this statutory position of equality: Welling, supra, at p. 683.

The appellants submit that a winding-up or liquidation is not the same as a reorganization. This is true. Both, however, are methods of dealing with insolvency. Both are methods for secured creditors to enforce their claims by seizing the assets in which they hold security interests. If the value of the corporation as a going concern exceeds the liquidation value of the assets, it is in the interest of all the debt holders that the corporation be preserved as a going concern. The purpose of both a liquidation and a reorganization is to permit the rehabilitation of the insolvent person unfettered by debt: Vachon v. Canada Employment & Immigration Commission, [1985] 2 S.C.R. 417, 23 D.L.R. (4th) 641. By virtue of s. 20 of the CCAA, arrangements under the Act mesh with the reorganization provisions of the CBCA so as to affect the company's relations with its shareholders. Shareholders have no right to dissent to a reorganization: s. 191(7), CBCA. On a reorganization, among other things, the articles may be amended to alter or remove rights and privileges attaching to a class of shares and to create new classes of shares: s. 173, CBCA. These statutory provisions provide a clear indication that, on a reorganization, the interests of all shareholders, including shareholders with a right of redemption, are subordinated to the interests of the creditors. Where the debts exceed the assets of the company, a sound commercial result militates in favour of resolving this problem in a manner that allows creditors to obtain repayment of their debt in the manner which is most advantageous to them.

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

Dividends

Although dividends were payable on the shares of McCutcheon and SYH, no dividends were in fact declared. The appellants contend that the dividends, which have accrued but which were not declared, are a debt or liability because they were stipulated to be part of the retraction price.

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

It is trite law that a dividend may only be declared if a company is solvent. For corporations governed by the CBCA, it appears that the common law tests for solvency have all been subsumed or overruled: R. v. McClurg, [1990] 3 S.C.R. 1020 at pp. 1039-40, [1991] 2 W.W.R. 244 at pp. 259-60.

Section 42 of the CBCA provides:

> 42. A corporation shall not declare or pay a dividend if there are reasonable grounds for believing that
>
> (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
> (b) the realizable value of the corporation's assets would thereby be less than the aggregate of its liabilities and stated capital of all classes.

Section 42 prevents the corporation from declaring or paying a dividend when it does not meet certain solvency requirements. There was no declaration of a dividend in the present case. Any obligation to pay a dividend as part of the retraction price cannot therefore be enforced when the company is insolvent. Dividends which have accrued but which are unpaid are not considered to be a debt because, on reading the articles as a whole, the provision for payment is not one which is made independent of the ability to pay: see Welling, supra, at p. 689, citing International Power Co. v. McMaster University, [1946] S.C.R. 178, [1946] 2 D.L.R. 81, where it was held there was no guarantee of payment and hence the accrued but unpaid dividends were not a debt. Instead, accrued but unpaid dividends are considered to be akin to a return of capital. Making these accrued dividends part of the retraction price does not alter this.

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

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

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

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

The Meaning of Debt

Debt is defined in a very broad manner in Black's Law Dictionary, 6th ed. (1990) at p. 403. It is the position of the appellants that this definition of "debt" is broad enough to include McCutcheon's right to have Central Capital redeem his shares. In the case of SYH, it is submitted that the right to redemption constitutes a future liability. It is the appellants' position that Feldman J. erred in hold-

ing that to have a provable claim, McCutcheon and Central Capital must be able to obtain a judgment against Central Capital for the retraction price and be entitled to seek payment on the judgment. Finlayson J.A. agrees with the appellant's position.

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

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

It will be readily apparent that in Black's the term "debt" is defined in two distinct ways. In order to constitute a debt as defined in the first paragraph, the obligation must be enforceable. In the second paragraph debt is defined more broadly as any duty or obligation even if unenforceable by legal action. Feldman J. considered the first portion of the definition in her reasons. If the first portion of the definition applies, no debt is created because the obligation is not enforceable under the CBCA. The appellants rely on the second portion of the definition. They also rely on the definition of the word "liability" in Black's which is also defined very broadly.

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

Section 40 does not include any reference to the obligation of a company to repurchase redeemable shares under s. 36. As a result s. 36 is not incorporated by reference into the definition of liability. While it might be suggested that this is a legislative oversight, the omission is also consistent with the position that only the articles of the corporation govern the relationships between the company and the holders of the retractable shares under s. 36. I have already stated my opinion that the articles of Central Capital do not make the obligation to redeem the shares a debt or, for that matter, a liability. Moreover, even if a provision like s. 40 is implied with respect to redeemable preferred shares, it would also be necessary to imply a provision like s. 40(3) which states that in the event of liquidation where the company has not performed its contract to redeem, the other party is entitled to be ranked subordinate to the rights of creditors but in priority to the shareholders. This is a clear expression of legislative intention that on insolvency the claim of those entitled to have their shares redeemed should not be placed on the same footing with the claims of creditors but should rank subordinate to them: see Nelson v. Rentown Enterprises Inc., [1994] 4 W.W.R. 579, 16 Alta. L.R.

(3d) 212 (C.A.), adopting the reasons of Hunt J. at 96 D.L.R. (4th) 586, 5 Alta. L.R. (3d) 149 (Q.B.). Policy reasons would again militate in favour of the result being the same on a reorganization.

Claims in Bankruptcy

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

Persuasive authority already exists to the effect that in order to be a provable claim within the meaning of s. 121 of the Bankruptcy and Insolvency Act the claim must be one recoverable by legal process: Farm Credit Corp. v. Holowach (Trustee of), [1988] 5 W.W.R. 87 at p. 90, 51 D.L.R. (4th) 501 (Alta. C.A.), leave to appeal to the Supreme Court of Canada dismissed at [1989] 4 W.W.R. lxx.

In Holowach, the seven members of the court were dealing with a situation in which some persons borrowed money from a mortgagee and mortgaged certain lands as security for repayment of the loan. The mortgagors then made an assignment in bankruptcy. The mortgagee filed a proof of claim for the full amount of the deficiency, that is, the amount of the indebtedness less the value of the land which the mortgagee was permitted to purchase. The Alberta Law of Property Act, R.S.A. 1980, c. L-8, precluded deficiency claims against individuals in foreclosure actions, although the effect of the legislation was not to extinguish or satisfy the debt. The mortgagee argued that it had a claim provable in bankruptcy under s. 95(1) of the Bankruptcy Act, R.S.O. 1970, c. B-3, now s. 121(1) of the Bankruptcy and Insolvency Act. The court rejected this argument, holding that a provable claim must be one recoverable by legal process. In coming to its conclusion, the court relied on Reference re Debt Adjustment Act, 1937, [1943] 1 All E.R. 240, [1943] 1 W.W.R. 378 (P.C.), and a number of decisions at the trial level which are collected at p. 91 of the decision.

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

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

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

CONCLUSION

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

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

The Issue

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

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

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

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

On June 15, 1992, Houlden J. provided that Central Capital could be reorganized under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, and he stayed proceedings against it.

Houlden J.'s order of July 9, 1992, which approved the restructuring of Central Capital, was made without prejudice to the right of the appellants to assert claims as creditors. Thus the question for this court is whether the appellants' retraction rights created debts of Central Capital in May 1992. In other words were McCutcheon and SYH Corporation creditors of Central Capital in May 1992? If they were creditors, then like the other unsecured creditors of Central Capital, they can elect to take shares in the newly incorporated company, Canadian Insurance Group Limited; if they were not creditors, then they remain shareholders of Central Capital under the restructuring plan.

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

(1) Although the relationship between each appellant and the company has characteristics of debt and equity, in substance both McCutcheon and SYH Corporation are shareholders, not creditors of Central Capital. Neither the existence of their retraction rights nor the exercise of those rights converts them into creditors;

(2) Finding that the appellants were creditors of Central Capital would defeat the purpose of s. 36(2) of the statute.

I. The Relationship Between the Appellants and Central Capital

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

I acknowledge, therefore, that redeemable or retractable preferred shares are somewhat different from conventional equity capital. What makes the appeals before us difficult is that although the appellants appear to hold equity, their right of retraction appears to be a basic characteristic of a debtor-creditor relationship: see Grover and Ross, supra, at pp. 47-49; Buckley, Gillen and Yalden, Corporations: Principles and Policies, 3rd ed. (1995), at pp. 938-40.

If the certificate or instrument contains features of both equity and debt -- in other words if it is hybrid in character -- then the court must determine the "substance" of the relationship between the holder of the certificate and the company. This is the lesson of Justice Iacobucci's judgment in Canada Deposit Insurance Corp. v. Canadian Commercial Bank, [1992] 3 S.C.R. 558, 97 D.L.R. (4th) 385. In that case the Supreme Court of Canada had to determine whether the financial assistance given by several lending institutions to try to rescue the Canadian Commercial Bank was "in the nature of a loan" or "in the nature of a capital investment". Justice Iacobucci discussed his approach to the problem at pp. 590-91 of his judgment:

> As I see it, the fact that the transaction contains both debt and equity features does not, in itself, pose an insurmountable obstacle to characterizing the advance of $255

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

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

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

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

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

acquire his preferred shares rather than acquiring them with cash. But he nonetheless decided to invest in Central Capital and to take the risk and the profits (through dividends) of his investment.

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

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

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

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

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

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

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

and yet can claim as creditors on the reorganization. Whether Central Capital's financial difficulties led to a liquidation or a reorganization, the issue is the same and the analysis and the result should also be the same.

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

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

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

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

Admittedly there is little authority in Canada on the issue confronting this court. Some of the cases that the respondent relies on -- for example, Re Patricia Appliance Shops Ltd. (1922), 52 O.L.R. 215, [1923] 3 D.L.R. 1160 (S.C.), Laronge Realty Ltd. v. Golconda Investments Ltd. (1986), 63 C.B.R. (N.S.) 74, 7 B.C.L.R. (2d) 90 (C.A.), and even Re Meade, [1951] 2 All E.R. 168, [1951] Ch. 774 (D.C.) -- are of limited assistance because the shareholders in those cases did not have retraction rights.

Perhaps the closest case -- and the appellants rely heavily on it -- is the judgment of the British Columbia Court of Appeal in Re East Chilliwack Agricultural Co-operative (1989), 74 C.B.R.

(N.S.) 1, 58 D.L.R. (4th) 11. In that case a majority of the court (Craig J.A. dissenting) held that a withdrawing member of a co-operative association who elected to have his shares redeemed in instalments over a five-year period should be treated on the subsequent bankruptcy of the association as an ordinary creditor rather than as a shareholder. I decline to apply East Chilliwack for three reasons. First, because the case was decided in 1989, the British Columbia Court of Appeal did not have the benefit of the Supreme Court of Canada's reasons in CDIC v. CCB, supra. In East Chilliwack Hutcheon J.A., writing for the majority, did not focus on what the parties intended when the member contracted with the co-operative. Instead he only considered the relationship between the member and the co-operative after the member had withdrawn. I do not think his approach is consistent with Justice Iacobucci's judgment in CDIC v. CCB, supra.

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

Third, the decision in East Chilliwack is at odds with most of the American case-law and I favour the American approach. When a company repurchases shares by instalment and bankruptcy intervenes, the prevailing American position is that the shareholder's claim is deferred to the claims of ordinary creditors. The decision of the Fifth Circuit Court of Appeals in Robinson v. Wangemann, 75 F.2d 756 (1935), is frequently cited. The facts of that case are virtually identical to the facts in East Chilliwack. A company had agreed to repurchase a stockholder's stock by instalments. Although the company was solvent when the agreement was made it went bankrupt before the repurchase was completed. The stockholder sought to prove as an ordinary creditor for the unpaid purchase price. Foster, Circuit Judge, writing for a unanimous court, rejected the stockholder's claim at p. 757:

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

At the heart of Robinson v. Wangemann is the finding that the selling stockholder is not a creditor in the sense of a person who loans money to a corporation, and therefore is not entitled to parity with the general creditors. The principle in Robinson v. Wangemann seeks to protect creditors by

refusing to permit selling stockholders, who were risk investors, to withdraw their capital on the same terms as general creditors in the event of insolvency. Section 40(3) of the Canada Business Corporations Act -- a section to which I shall return when considering s. 36(2) of the same statute -- codifies the principle in Robinson v. Wangemann for share repurchases, though not for share redemptions. See also Blumberg, The Law of Corporate Groups (1987), at pp. 205-10 and see contra Wolff v. Heidritter Lumber Co., 163 A. 140 (N.J.Ch., 1932).

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

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

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

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

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

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

> 36(2) A corporation shall not make any payment to purchase or redeem any redeemable shares issued by it if there are reasonable grounds for believing that

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

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

(i) its liabilities, and

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

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

To hold that the appellants have provable claims would defeat the purpose of s. 36(2) of the Canada Business Corporations Act. At common law a company could not repurchase its own shares on the open market or in the language of Trevor v. Whitworth (1887), 12 App. Cas. 409, [1886-90] All E.R. Rep. 46 (H.L.), a company could not "traffick in its own shares". The obvious reason was to prevent companies from using their assets to destroy the claims of their creditors. Modern corporate statutes, such as the Canada Business Corporations Act, modified the rule in Trevor v. Whitworth to permit repurchases provided the company's creditors would not be prejudiced. Thus the legislation insisted that the company could not repurchase its own shares unless it satisfied stated solvency tests. And so, s. 34(2) of the Canada Business Corporations Act provides:

> 34(2) A corporation shall not make any payment to purchase or otherwise acquire shares issued by it if there are reasonable grounds for believing that
>
> (a) the corporation is, or would after the payment be, unable to pay its liabilities as they become due; or
>
> (b) the realizable value of the corporation's assets would after the payment be less than the aggregate of its liabilities and stated capital of all classes.

In Nelson v. Rentown Enterprises Inc. (1993), 96 D.L.R. (4th) 586 at p. 589, 5 Alta. L.R. (3d) 149, affirmed (1994), 109 D.L.R. (4th) 608n, 16 Alta. L.R. (3d) 212 (C.A.), Hunt J. of the Alberta Queen's Bench wrote:

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

> Modern business statutes permit these share purchases to take place provided that the position of creditors and other shareholders is protected, by virtue of the application of the s. 34(2) tests.

Redemptions of preferred shares, unlike repurchases, were always permitted at common law as long as they were not made in contemplation of bankruptcy. But the solvency test in s. 36(2) of the Canada Business Corporations Act has the same purpose as the solvency test in s. 34(2): to prevent redemptions if they would allow the company to prejudice the claims of creditors. See Buckley et al., Corporations: Principles and Policies, supra, at pp. 968-71. To hold that the appellants' retraction rights gave rise to provable claims in the face of s. 36(2), thereby allowing the appellants to rank equally with the unsecured creditors, would undermine the purpose of the section. If a claim in a bankruptcy or reorganization proceeding is unenforceable under the statute, the claim is not entitled to recognition on a parity with the claims of unsecured creditors: see Blumberg, supra, at pp. 205-06; and Farm Credit Corp. v. Holowach (Trustee of) (1988), 68 C.B.R. (N.S.) 255, 51 D.L.R. (4th) 501 (Alta. C.A.).

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

> 40(3) Until the corporation has fully performed a contract referred to in subsection (1), the other party retains the status of a claimant entitled to be paid as soon as the corporation is lawfully able to do so or, in a liquidation, to be ranked subordinate to the rights of creditors but in priority to the shareholders.

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

The appellants rely on The Custodian v. Blucher, [1927] S.C.R. 420, [1927] 3 D.L.R. 40, but in my view this case does not assist them. In Blucher dividends were declared on stock but payment of the dividends was suspended during World War I. The Supreme Court of Canada held at p. 425 S.C.R., p. 43 D.L.R. that "[t]he right of recovery was in suspense during the war; but the debt nevertheless existed". In that case, however, the dividend was declared before the suspension of payment took place. Moreover, as Justice Finlayson points out in his reasons, courts have always accepted the proposition that when a dividend is declared it is a debt on which each shareholder can sue the corporation.

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

creditors by endowing their shares with retraction rights runs contrary to this policy of creditor protection.

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

Order accordingly.

Note 1: There is a discrepancy in the materials before this court on the relevant date for establishing a claim provable against Central Capital: SYH Corporation used May 1992, the date of the restated subscription and escrow agreement whereas McCutcheon and the unsecured creditors of Central Capital Corporation used June 15, 1992, the date of the court-ordered stay of proceedings against Central Capital. I have used the May 1992 date but nothing turns on the use of this date as opposed to the June 15, 1992 date.

Tab 12

Case Name:

Cuchuran v. Dubitz

[1945] A.J. No. 66

[1945] 3 W.W.R. 541

ALBERTA DISTRICT COURT

BOYD MCBRIDE D.C.J.

Judgment: November 16, 1945

(16 paras.)

Counsel:

J. Decore, for plaintiff.

H. S. Hurlburt, K.C., for defendant.

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1 **BOYD MCBRIDE, D.C.J.** -- This action is for an amount which plaintiff pleads he "was obliged to pay" to the Canadian Bank of Commerce arising out of the fact that several years ago he backed defendant at the bank.

2 The controversy between the parties raises a number of points of some importance under *The Farmers' Creditors Arrangement Act, 1934*, ch. 53 (now 1943-44, ch. 26) (Dom.), and the *Bankruptcy Act*, R.S.C., 1927, ch. 11, which statutes the defendant invokes as affording him a complete answer to the claim. On these points I have had the assistance of able argument by both counsel.

3 The facts are briefly as follows:

> On November 28, 1929, defendant, being on good terms with plaintiff, requested plaintiff to assist him in securing a loan from the bank, plaintiff to do so by lending his name as an accommodation party to a promissory note. Plaintiff agreed and the parties went together to the bank's Willingdon branch. The characteristics of such a transaction, and the nature of the liability being incurred, apparently were familiar to both. At the bank they signed a note for the amount of the loan, $309.80, and this amount was thereupon advanced and paid to defendant. The

note runs "I promise to pay," and was signed by each party as a maker. It was the joint and several obligation of each: Secs. 55 and 179 (2) the *Bills of Exchange Act*, R.S.C., 1927, ch. 16. Defendant defaulted on his implied covenant with plaintiff to provide funds to pay the note at maturity. As a result, periodic renewals, each running "I promise to pay," were signed and delivered by both parties to the bank.

4 On October 4, 1935, the amount owing to the bank stood at $373.70, and on that date a further renewal, payable May 1, 1936, was signed and delivered by both parties. The series of notes evidencing the debt has been filed as Ex. 1. In the meantime Parliament had enacted *The Partners' Creditors Arrangement Act, 1934*, ch. 53 (now 1943-44, ch. 26).

5 Some time prior to June, 1936, defendant, asserting himself to be an insolvent farmer and unable to meet his liabilities, made a proposal to his creditors for a composition, extension of time or scheme of arrangement under *The F.C.A. Act, 1934*: Sec. 6 (1); see also Part II of the *Bankruptcy Act*. The creditors refused approval and the Board of Review then intervened at defendant's written request and formally recognized his insolvency by formulating a proposal for him. It is important to note that his proposal became binding an all creditors (sec. 12 [6]) and that the board based it "upon the present and prospective capability of the debtor to perform the obligations prescribed:" Sec. 12 (8). The proposal, Ex. 3, is dated June 12, 1936. In broad outline it prescribed substantial reductions in defendant's secured and unsecured liabilities, and as to the obligation which we now have under consideration it provided in par. (1):

> "That the claim of The Canadian Bank of Commerce in respect of a promissory note made by the Applicant and endorsed by one George Cuchuran, be fixed at the sum of $188.43 as of the first day of December, 1935, which said sum shall bear interest at the rate of 5% per annum from the said date, and shall be payable as follows: One-fifth of the principal sum, and interest on the unpaid balance at the rate aforesaid, payable on the first day of December in each of the years 1936 to 1940, both inclusive."

6 I disregard the erroneous statement in this paragraph that the plaintiff was an endorser when in fact he was a maker of the note. It makes no difference in the issues before me: Sec. 55 of the *Bills of Exchange Act*. It is not disputed that the bank had the right, as it did, to prove for the full amount of the debt. I was satisfied an the evidence that defendant duly paid the bank the amount of his reduced liability, the above-mentioned $188.43, with 5 per cent interest, and the bank, having no further recourse against him, then made demand an plaintiff to pay the unpaid balance of the note, namely, $171.58, and he did so.

7 In these circumstances and by reason of having made this payment, plaintiff advances the proposition that there was Thereby created the relationship of debtor and creditor between defendant and himself arising at and from the moment of payment to the bank, which in point of time was admittedly long after the crucial date, May 1, 1935 (sec. 19, *F.C.A. Act*); he points out that he, plaintiff, did not concur under that section; he argues that in consequence *The F.C.A. Act* and the *Bankruptcy Act* do not apply, and he submits he is entitled to a judgment of this Court against defendant. The latter puts forward two main defences: First, that it was the debt itself which the Board of Review cut, not simply defendant's liability in respect of it, and that plaintiff was not required to pay the balance of the note, being under no legal liability for that amount, and, second, as an insol-

vent farmer who has paid the reduced amounts required of him by the Board of Review in settlement of his liabilities, he, defendant, cannot now be called upon to pay anything further, and that *The F.C.A. Act* and the *Bankruptcy Act* discharge him not only of the original obligation but also of the claim now put forward. Defendant's counsel puts this submission succinctly when he says: "If the plaintiff was legally bound to pay the bank it is his loss; in law such a payment furnishes no cause of action against defendant." I must determine which of these conflicting views is entailed to prevail.

8 It is directly in point to recall that *The F.C.A. Act* was enacted by Parliament 11 years ago during a period of severe agricultural depression in Canada, see its preamble, and that because its constitutional validity had been impeached a reference was made to the Supreme Court of Canada which held, [1936] S.C.R. 384, at 393, 17 C.B.R. 359, Cannon, J. dissenting, that the Act was a valid exercise by Parliament of its exclusive legislative authority extending to the subjects "Bankruptcy and Insolvency," head No. 21, sec. 91, of *The B.N.A. Act, 1867*, which majority judgment was subsequently affirmed by the Privy Council, [1937] 1 W.W.R. 320, [1937] A.C. 391, 106 L.J.P.C. 67, 18 C.B.R. 217. By its express terms *The F.C.A. Act*, except as therein otherwise provided, is to be read and construed as one with the *Bankruptcy Act*, and the *Bankruptcy Act* and Rules are made applicable: Sec. 2 (2).

9 During the course of argument it became clear that the second defence constituted the main problem. Before dealing with it, it is desirable that I dispose shortly of defence No. 1. I hold the proposition there advanced to be unsound. Plaintiff was a surety for defendant, the principal debtor, and there is no evidence or suggestion that the bank agreed to defendant's composition as formulated, or impliedly released any part of his debt or did anything else which might weaken its position or derogate from its rights. The liability of the parties, as already pointed out, was joint and several. The bank held no security on any property *of the defendant* and hence was an unsecured creditor, notwithstanding the accommodation party's obligation held by it, when defendant came under *The F.C.A. Act: Rowlatt on Principal and Surety*, 3rd ed., at pp. 5, 7 and 311; sec. 2 (*ii*), the *Bankruptcy Act* (as amended by 1932, ch. 39, sec. 2i [1]); *In re Coughlin & Co.; Guar. Co. of North America's Claim* [1923] 3 W.W.R. 1177, at the foot of p. 1183, 33 Man. R. 499. Furthermore under sec. 5A of *The F.C.A. Act* [added by 1935, ch. 20, sec. 2] and sec. 148 of the *Bankruptcy Act*, it seems clear that there is expressly preserved to a creditor the liability of "any person who was a surety or in the nature of a surety" and such person is not released. The Board of Review, I must take it, did not overlook sec. 5A and it was in fact fully aware of plaintiff's liability to the bank when it came to deal with defendant's application. It only however had before it and it dealt only with the liabilities of the defendant. It could not, on defendant's application, deal with or reduce plaintiff's liability and it did not purport to do so. Support for the view I have taken on this first branch of the defence is I think to be found in the unanimous judgment of the Court of Appeal in Manitoba in *Int. Loan Co. v. Kostinuk* [1936] 3 W.W.R. 481, 44 Man. R. 387, 18 C.B.R. 80, where a similar question as to a guaranteed mortgage debt was under consideration, and the mortgagor of the land had had his liability reduced after coming under *The F.C.A. Act*, and also in the unanimous judgment of the Court of Appeal of Saskatchewan in *Drummond v. Hutchinson* [1942] 1 W.W.R. 123, 23 C.B.R. 168. It follows that where the maker of a promissory note is discharged of his liability by virtue of the provisions of *The F.C.A. Act* the liability of an accommodation party (to whatever extent the note remains unpaid) is not thereby affected.

10 I turn now to the main defence, and success on it must I think necessarily rest on two propositions: (1) That there existed in plaintiff a contingent claim against defendant prior to May 1, 1935;

and (2) That by reason of the bank having filed and proved a claim under *The F.C.A. Act* for its unsecured debt, plaintiff's contingent claim--which otherwise might have been susceptible of proof--was debarred by the rule against double proof. Plaintiff's action seems prompted by or predicated to a large extent upon the supposition that the definition of "creditor" in sec. 2 (*d*) of *The F.C.A. Act* excludes from our consideration sec. 104 of the *Bankruptcy Act*. If that were sound, plaintiff's action might be well founded, as certainly he did not pay the bank until after May 1, 1935. But in my view it is an untenable argument running contrary to the whole trend of the authorities, and I reject it. Indeed the very fact that *The F.C.A. Act* nowhere sets out expressly or impliedly what creditors hold provable debts against the estate of an insolvent farmer, in my opinion, requires me to turn to sec. 104 and it becomes an important, if not the governing, provision, for our present purpose. This section makes express provision in regard to contingent claims, and this is consistent with the whole object and intention of Parliament as early laid down by James, L.J. in a well-known passage in his judgment in *Ex parte Llynvi Coal & Iron Co.; In re Hide* (1871) L.R. 7 Ch. 28, 41 L.J. Bk. 5, where speaking of the English *Bankruptcy Act, 1869*, ch. 71, he says at p. 32:

> " * * * the broad purview of the Act is that the bankrupt is to be a freed man, freed not only from debts, but from contracts, liabilities, engagements and contingencies of every kind."

11 See also the discussion of the history of bankruptcy and insolvency and the meaning of these words in the recent judgment of the Privy Council delivered by Viscount Maugham in *Reference re Debt Adjustment Act, 1937; Atty.- Gen. for Alta. v. Atty.-Gen. for Can.* [1943] 1 W.W.R. 378, [1943] A.C. 356, at 371, 112 L.J.P.C. 17, 24 C.B.R. 129; and while there was a gap from the time the former general bankruptcy law of Canada was repealed in 1880 until the coming into force of the new Act in 1919, it is elementary that the then existing English Act of 1914 was the prototype of our Act, and that since 1919 the English authorities have been continuously approved and applied by Canadian Courts. An Alberta authority almost directly in point is to be found in *In re Froment; Alta. Lbr. Co. Ltd. v. Department of Agriculture, Alta.* [1925] 2 W.W.R. 415, 5 C.B.R. 765, where Tweedie, J. holds it to be established law that the contingent liability of a surety who has not been called upon to pay, or has not in fact paid, forms a debt provable in the bankruptcy of the principal debtor (p. 423) this being of course subject to the rule against double proof. In this case, in contrast to the case at bar, the Bank of Montreal refrained from filing proof. See also *Duncan & Reilley's Bankruptcy in Canada*, 2nd ed., p. 551, with authorities cited in footnotes; and *In re Oriental Commercial Bank; Ex parte European Bank* (1871) L.R. 7 Ch. 99, at 103, 41 L.J. Ch. 217. Again in *In re Melton; Milk v. Towers* [1918] 1 Ch. 37, 87 L.J. Ch. 18, where a surety had given a bank a joint and several guarantee on a printed form, covering another's overdraft, and the. other became bankrupt, I find the Court of Appeal is unanimous, and that Swinfen Eady, L.J. has this to say against a surety proving in competition with the principal creditor, at p. 47:

> "There can be no double proof against the estate; and the rule against double proof has regard to the substance of the transaction, not to the form. It may well be that technically there are * * * two separate liabilities of the debtor arising out of the transaction. One is to * * * the bank for the money he owed. The other, which is a separate liability arising out of the contract of guarantee, is the debtor's liability to indemnify the sureties in respect of their liability to the principal creditor. Technically they are two separate liabilities, but in substance they are the same; and in respect of that liability there could not be a double proof against the

estate. The creditor could not prove for the amount of the debt and the surety bring in a proof for part of the same amount."

12 Reference may also be made to the unanimous judgment of the Court of Appeal in Manitoba in *In re Coughlin & Co., supra*, in 1923, where some of the authorities are reviewed and part of the above passage is quoted and approved.

13 At this point it should be noted that there is nothing in the evidence before me to suggest that plaintiff made any attempt at any time to prove a claim, contingent or otherwise, against defendant's estate. Returning to the foregoing authorities and to the principles so fully discussed and enunciated in them I feel I may usefully add two observations applicable to the present case. Firstly it was the plaintiff's obligation to pay the Canadian Bank of Commerce on maturity of the original note when defendant defaulted. If he had done so he would have stood in the bank's shoes on defendant's insolvency and would undoubtedly have suffered some loss on the formulation of the proposal. I cannot see how plaintiff can expect to be placed in a higher position and to be relieved entirely of loss simply because he too defaulted. Secondly, if every surety could come in later and sue, as in the case at bar, then an insolvent debtor who had furnished no sureties would be in a much more fortunate position than for example one who had provided sureties for most of his liabilities; or if the principal creditor and surety could both prove claims for the same obligation then, to provide for these two claims, the composition payable to the farmer's remaining creditors would require unfairly to be reduced. Any such state of affairs in my opinion would violate the whole underlying principles of bankruptcy and insolvency, and demonstrates how sound is the rule against double proof.

14 I hold therefore that here there was an existing contingent claim provable in bankruptcy and insolvency, and vested in plaintiff prior to May 1, 1935, but that immediately the Canadian Bank of Commerce filed proof of its claim against defendant in respect of the same obligation the rule against double proof came into play, operating against plaintiff to prevent him filing proof of his contingent claim, and that in the result defendant is thereby discharged of the contingent claim and plaintiff deprived of all right of action in respect of it.

15 Although what I have already said in my opinion disposes of this action, there remains for consideration one further point. As it was strongly argued by defendant's counsel I feel I should not overlook it, namely, that defendant on payment of his composition was discharged by virtue of the provisions of *The F.C.A. Act*, in the sense that the term discharge is used in part VI of the *Bankruptcy Act*. I do not think I am required to make a decision on this point and I do not do so. It is one which may arise directly in another and more appropriate case. Nevertheless if a decision be necessary for a proper and final disposition of the case at bar, then without extended search for authority, I would hold that defendant is so discharged. It is on this question of discharge and the correlated rights of parties that we find the most distinctive divergence between *The F.C.A. Act* and the *Bankruptcy Act*. Under *The F.C.A. Act* the *cessio bonorum* appears temporary only (sec. 11 [2]) and Parliament's whole purpose manifestly is to provide the insolvent farmer an opportunity to re-establish himself an the same farm free of the burden of overwhelming debts incurred during the depression, and to enable him to carry on in the meantime with as little interference or supervision as possible. There is no trustee in whom his property vests, and the divergence appears to be accentuated by secs. 141 *et seq.* of the *Bankruptcy Act*. As compared with an authorized assignor or a debtor against whom a receiving order has been made, our 'farmer is subject to little or no disability in the continuation of his farming business. No questions appear to arise, for example, of paying 50 cents

on the dollar, nor of subsequent earnings, nor of after-acquired property. Practically the farmer's sole obligation is to pay the amount of the composition, usually by instalments, as fixed by the proposal, to his respective creditors within the extended time allowed. When he has done so these creditors no longer have any right of action against him. *The F.C.A. Act* makes no provision for applying for a formal discharge. My view is that a farmer who has faithfully performed the terms imposed on him in his proposal is discharged by *The F.C.A. Act* as fully and effectually of all provable debts as under an order of discharge granted pursuant to the *Bankruptcy Act*. If I should be wrong in this, then I see nothing to prevent an application under the *Bankruptcy Act* being made for such an order.

16 Plaintiff's action is dismissed with costs.

Tab 13

Barclays Bank Ltd and others v TOSG Trust Fund Ltd and others

COURT OF APPEAL, CIVIL DIVISION

OLIVER, KERR AND SLADE LJJ

16, 17, 18, 19, 20, 23, 24, 25 MAY, 12 JULY 1983

Company - Winding up - Proof and ranking of claims - Rule against double proof - Test of whether rule against double proof applies - Application of rule against double proof - Guarantor's right of proof - Company taking out bond against insolvency - Banks paying over money under bonds when company becoming insolvent - Money used to pay creditors in part - Creditors assigning claims to third party - Banks proving for debt under bonds - Third party proving for debt under assignments - Whether both proofs admissible - If only one proof admissible, whether banks or third party having better right of proof.

In 1970 a group of holiday tour operators, which included C Ltd, set up a scheme to alleviate the consequences to holidaymakers and customers of the insolvency of any of their number. The scheme required individual tour operators who were members of the scheme to take out a banker's bond whereby the bank agreed to pay a specified sum to a company (TOSG), formed as part of the scheme, in the event of the operator becoming insolvent and unable to fulfil its obligations to holidaymakers and customers. The purpose of TOSG was to use money paid to it under the bonds to look after and repatriate holidaymakers stranded abroad and to protect customers who had made prepaid bookings from suffering financial loss. Under the terms of the bonds TOSG was entitled to call in the bond moneys from the bank as soon as the operator concerned became insolvent. The bonds contained no restriction on how TOSG expended or disbursed moneys it received but TOSG was required to pay back to the bank any surplus remaining after the claims of customers had been met. In accordance with the scheme C Ltd arranged for a number of banks to enter into bonds on its behalf in return for the payment of commission and the execution of counter-indemnities under which C Ltd agreed to indemnify the banks against any loss which they sustained under the bonds. In 1974 C Ltd could no longer fulfil its obligations to its customers and went into liquidation. The bond moneys were called in from the banks by TOSG which, after rescuing C Ltd's customers who were stranded abroad, then had some £1·43268m to reimburse claims by customers who had paid for holidays which C Ltd was no longer able to provide. Since that amount was unlikely to be sufficient to meet all such claims TOSG entered into an agreement with the Air Travel Reserve Fund Agency (a statutory body set up to compensate persons who lost holidays as a result of the collapse of tour operators) whereby TOSG would, to the extent the bond moneys made possible, reimburse customers who were owed money in return for such customers assigning to the agency their right to prove in the liquidation of C Ltd for the full amount of their claim and the agency would then satisfy customers' debts which remained unpaid by TOSG. In accordance with that agreement TOSG expended, and received assignments to the agency of claims amounting to, some £1·43268m while the agency satisfied the remaining claims, amounting to some £3·4309m. In the ensuing liquidation of C Ltd the banks proved under the counter-indemnities and the agency proved under the assignments for the £1·43268m paid out by TOSG. The liquidators took the view that the rule against double proof prevented the banks and the agency from both proving for the £1·43268m. The banks sought a declaration that they were entitled to prove for the £1·43268m but the judge held that the agency had the better right of proof, on the assumption that the rule against double proof applied, because the banks had in effect guaranteed C Ltd's liabilities to its customers and were therefore subject to the rule that the proof of a surety could not displace the proof of a creditor unless and until the surety fully discharged all his liabilities to the creditor, and therefore C Ltd's customers (and thus the agency) were entitled to prove as creditors

for the whole of their debts in priority to the banks (and without giving credit for moneys received from the banks via TOSG) unless and until the whole of their debts were satisfied and, moreover, considerations of broad equity favoured

the agency rather than the banks. The banks appealed, contending, inter alia, that they were entitled by subrogation to assume the rights of customers who had been paid out of the bond moneys.

Held - (1) (Per Oliver and Kerr LJJ) There could not be any subrogation between the banks and TOSG because there was no general principle that if money was lent or supplied by one person to another to enable that other to pay off a debt to a creditor the lender was automatically subrogated to the rights of the creditor, and there was no stipulation that TOSG was required to expend the bond moneys in a manner which entitled the banks to stand in TOSG's shoes (see p 638 *a* to *d f g* and p 649 *f g*, post); *Wylie v Carlyon* [1922] 1 Ch 51 and *Paul v Speirway Ltd (in liq)* [1976] 2 All ER 587 applied; *Brocklesby v Temperance Permanent Building Society* [1895] AC 173 explained.

(2) The effect of the bonds and counter-indemnities given by the banks was (i) that a debt due to the banks, provable in the liquidation of C Ltd, arose as soon as TOSG called in and was paid the bond moneys, and (ii) that, although TOSG was under no contractual obligation to the banks regarding the way in which it spent the bond moneys, nevertheless TOSG was required to refund to the banks any bond moneys which were not expended, thereby reducing pro tanto C Ltd's liability under the counter-indemnities. Furthermore, the effect of the payments by TOSG to customers who were owed money by C Ltd was that the customers' rights to prove in the liquidation of C Ltd were limited to the balance, if any, of their debts still outstanding after the payments made to them by TOSG, and the effect of the assignments to the agency was that the agency was in no better position to prove in the liquidation than the customers or TOSG would have been. In those circumstances it followed that--

(a) (per Oliver LJ) the rule against double proof in a liquidation did apply. The test of whether the rule against double proof applied was whether the two competing claims were in substance claims for payment of the same debt twice over, and, furthermore, that was to be determined at the time of payment of the dividend, at which point the question to be asked was whether two dividends were being sought in the winding up for a liability which the debtor would discharge by one payment if it were solvent. Applying that test, if C Ltd had become solvent after the calling in of the bond moneys and had used its own money to discharge the debts due to its customers, then because the bond moneys would have remained unused and C Ltd would have been required to return them to the banks it would at the same time have discharged its liability to the banks and would thus have only made one payment in discharging both liabilities. Furthermore (Kerr LJ concurring), when the rule against double proof was applied the banks had the better right of proof over the agency because, by analogy with the position of a surety, the banks' position vis-à-vis the customers of C Ltd (and therefore the agency as the assignee of the customers) was akin to that of a surety who had guaranteed a fluctuating account (ie the amount owed by C Ltd to its customers) up to a specified limit and who, if he paid up to that limit, was entitled to that extent to stand in the shoes of the creditor (ie C Ltd's customers) and to prove in priority to him. Moreover, on broad equitable principles the banks had the better right of proof, since they were out of pocket to the full nominal amount of their claims whereas the customers (and therefore the agency) were out of pocket to less than their full nominal claims by reason of having received the banks' money (see p 636 *a* to *j*, p 637 *e* to *j*, p 640 *f*, p 641 *d j* to p 642 *a*, p 643 *c* to *e h j*, p 644 *f* to *j*, p 648 *d e j*, p 650 *e j*, p 651 *e g h* and p 652 *h j*, post); *Ex p Rushforth* (1805) 10 Ves 409, *Hobson v Bass* (1871) LR 6 Ch App 792, dictum of Mellish LJ in *Re Oriental Commercial Bank, ex p European Bank* (1871) LR 7 Ch App at 102 and *Gray v Seckham* (1872) LR 7 Ch App 680 applied; *Ellis v Emmanuel* [1874-80] All ER 1081 considered; *The Liverpool (No 2)* [1960] 3 All ER 307 distinguished;

(b) (per Slade LJ) having regard to the particular facts and the substance of the relevant liability and applying the principle that there could only be one dividend for what was

[1984] 1 All ER 628 at 630

in substance the same debt even though there may have been two contracts, the rule against double proof in a liquidation did apply, because if TOSG had itself taken assignments from C Ltd's customers and then sought to prove for the £1·43268m it would in substance have been proving for the same debt as the banks. Furthermore (Kerr LJ concurring), applying the rule against double proof, the banks had the better right of proof because the relevant comparison was not between the respective rights of proof of the banks and C Ltd's customers but between the respective rights of proof of the banks and TOSG, and it could not reasonably be inferred that the parties intended at the time the bonding arrangements were made that TOSG would have the right to expend the bond moneys by purchasing assignments of debts from C Ltd's customers which would take priority over, and destroy, the banks' right to prove for the bond moneys in the liq-

uidation of C Ltd, since such an inference was inconsistent with the nature of the bonding arrangements and produced an inequitable result (see p 649 *j*, p 650 *e f*, p 651 *d*, p 653 *b c e* to *j*, p 654 *d e*, p 655 *d* to *f h* to p 656 *c g h*, post); dictum of Mellish LJ in *Re Oriental Commercial Bank, ex p European Bank* (1871) LR 7 Ch App at 102 applied;

(c) (per Kerr LJ) the rule against double proof did not apply because the common intention of the parties concerned in setting up the bonding scheme was that the banks were to be able to prove to the full extent of the bond moneys paid over while each customer was to be able to prove only for the balance of his debt still outstanding after the bond moneys had been paid out, and therefore there was no basis for the application of the rule. However, if, the rule did apply then the banks had the better right of proof (see p 645 *h j*, p 647 *d* to *f*, p 648 *j* to 649 *b* and p 651 *a*, post).

(3) Accordingly, the banks had the right to prove in the liquidation of C Ltd for the £1·43268m to the exclusion of the agency. The banks' appeal would therefore be allowed (see p 645 *b*, p 650 *g h*, p 651 *a c* and p 656 *h*, post).

Per Oliver LJ. Where money is lent or supplied by one person to another to enable that other to pay off a debt to a creditor the lender has a right to be subrogated to the rights of the creditor only if there is an agreement between the supplier of the money and the payer of the debt that the money is to be used for that purpose or, on equitable principles, if the supplier of the money is deprived of his right of recovery, eg because of the incapacity of the person to whom the money was lent (see p 638 *b c e*, post).

Notes

For the rule against double proofs and its application to sureties, see 3 *Halsbury's Laws* (4th edn) paras 712, 728, and for cases on proofs by sureties against a bankrupt principal debtor, see 4 *Digest* (Reissue) 303-306, *2691-2720*.

Cases referred to in judgments

Birkley v Presgrave (1801) 1 East 220, 102 ER 86.

Brocklesby v Temperance Permanent Building Society [1895] AC 173, HL.

Deering v Bank of Ireland (1886) 12 App Cas 20, HL; *rvsg* sub nom *Re Killen, a bankrupt* (1885) 15 LR Ir 388, CA Ir.

Dering v Earl of Winchelsea (1787) 1 Cox Eq Cas 318, 29 ER 1184, [1775-1802] All ER Rep 140.

Ellis v Emmanuel (1876) 1 Ex D 157, [1874-80] All ER Rep 1081, CA.

Fenton, Re, ex p Fenton Textile Association Ltd [1931] 1 Ch 85, [1930] All ER Rep 15, CA.

Gray v Seckham (1872) LR 7 Ch App 680, LJJ.

Hobson v Bass (1871) LR 6 Ch App 792, LC.

Hoey, Re, ex p Hoey (1918) 88 LJKB 273, DC.

Liverpool, The, (No 2) [1960] 3 All ER 307, [1963] P 64, [1960] 3 WLR 597, CA; *rvsg* [1960] 1 All ER 465, [1963] P 64, [1960] 2 WLR 541.

Melton, Re, Milk v Towers [1918] 1 Ch 37, [1916-17] All ER Rep 672, CA.

Midland Banking Co v Chambers (1869) LR 4 Ch App 398, LJJ.

Moss, Re, ex p Hallet [1905] 2 KB 307, [1904-7] All ER Rep 713, DC.

Oriental Commercial Bank, Re, ex p European Bank (1871) LR 7 Ch App 99, LJJ.

Paul v Speirway Ltd (in liq) [1976] 2 All ER 587, [1976] Ch 220, [1976] 2 WLR 715.

Rushforth, Ex p (1805) 10 Ves 409, 32 ER 903.

Sass, Re, ex p National Provincial Bank of England [1896] 2 QB 12.

Wylie v Carlyon [1922] 1 Ch 51.

Cases also cited

Daunt, Re, ex p Joint Discount Co (1871) LR 6 Ch App 455, LJJ.

Liggett (B) (Liverpool) Ltd v Barclays Bank Ltd [1928] 1 KB 48, [1927] All ER Rep 451.

Oralpo v Manson Investments Ltd [1977] 3 All ER 1, [1978] AC 95, HL.

Rees, Re, ex p National Provincial Bank of England (1881) 17 Ch D 98, CA.

Wheeldon v Burrows (1879) 12 Ch D 31, [1874-80] All ER Rep 669, CA.

Appeal

The plaintiffs, Barclays Bank Ltd, Lloyds Bank Ltd, National Westminster Bank Ltd and Wintrust Securities Ltd (the banks), appealed against so much of the judgment of Nourse J given on 27 February 1981 and the order made on 26 June 1981 as dismissed the bank's action against the first defendant, TOSG Trust Fund Ltd (TOSG), the twelfth defendant, Air Travel Reserve Fund Agency (the agency), and the thirteenth defendant, Clarksons Holidays Ltd (Clarksons), in which they sought, inter alia, a declaration against those defendants that the banks were entitled to prove in the liquidation of Clarksons to the exclusion of the agency in respect of all bond moneys expended by TOSG in paying creditors of Clarksons, and declared on the agency's counterclaim that the joint liquidators of Clarksons were entitled and bound to admit in full the proof of debt lodged with them by the agency. The facts are set out in the judgment of Oliver LJ.

Peter Millett QC and J B W McDonnell for the banks.

William Stubbs QC and Leslie Kosmin for TOSG and the agency.

David Oliver for the liquidators of Clarksons.

Cur adv vult

12 July 1983. The following judgments were delivered.

OLIVER LJ.

This is an appeal by the plaintiffs against an order of Nourse J made on 26 June 1981 dismissing their action against the first, twelfth and thirteenth defendants, the respondents to this appeal, and declaring on the twelfth defendant's counterclaim that the joint liquidators of the thirteenth defendant, Clarksons Holidays Ltd, were entitled and bound to admit in full the proof of debt lodged with them by the twelfth defendant.

The appeal raises an interesting and unusual question with regard to the applicability and the manner of application of what is known as the rule against double proof in the liquidation of an insolvent estate. The facts are fully set out in the careful judgment of the judge and need only to be summarised here. The thirteenth defendant, to which I will refer as 'Clarksons', was a wholly-owned subsidiary of Court Line Ltd, which, together with its constituent companies, collapsed during the height of the holiday season of the year 1974. Clarksons was one of Court Line's more prominent tour-operating subsidiaries and was at the material time among the market leaders in the package holiday field. For some years prior to the collapse, anxiety had been expressed among tour operators about the effect on the public image of the industry of the failure of operators to provide holidays for which members of the public had made bookings and paid in advance, and in 1969 a group of the more prominent operators (including Clarksons) formed what was known as the Tour Operators Study Group to consider problems confronting the industry, one of which was the absence at that time of any central organisation which could provide guarantees against failure or cessation of business of tour operators. As a result of that group's deliberations, a company limited by guarantee was formed in 1970 and that is the first defendant, TOSG Trust Fund Ltd, to which I will refer as 'TOSG'. The purpose of this company was to be the recipient of

[1984] 1 All ER 628 at 632

moneys contemplated as becoming payable under bonds or similar provision made by the members in the event of a member becoming unable to fulfil its obligations to its customers and to dispense those moneys in such way as might be most expedient to meet the emergency thus created. The principal object of TOSG in cl 3(A) of its memorandum of association was as follows:

> 'To manage, utilise, employ and expend funds and moneys paid and/or to be paid to the Company under or by virtue of Bonds, Letters of Credit, Policies of Insurance or similar arrangements obtained by members of the Tour Operators Study Group and issued in favour of the Company each being in respect of a Tour Operator Study Group member and/or its tour operator subsidiaries ("the member Group") or otherwise paid to the Company by such members, in generally alleviating the consequences to such member Group's customers of the business failure of the Tour Operators Study Group member or any other member Group Company in respect of whom such funds or moneys are received by the Company and in particular (but without prejudice to the generality of the foregoing) in making arrangements to procure the expeditious return by an appropriate means of transport to their departure point from the United Kingdom or Ireland of persons stranded abroad as a result of such member Group's business failure, in procuring that persons in the course of holidays abroad at the date of such member Group's business failure are enabled to complete their holidays in suitable accommodation and to return to their departure point from the United Kingdom or Ireland by an appropriate means of transport, in making all necessary travel and accommodation arrangements for persons who have purchased from such member Group, and paid in full, for holidays abroad which, as at the date of the member Group's business failure, had not been commenced and in making such payments as the Company may in its absolute discretion think fit to persons who had paid deposits to such member Group in respect of future holidays abroad and who (being customers of the member Group) otherwise suffer financial loss by reason of the member Group's business failure.'

The members of the study group then established a bonding scheme under which they mutually agreed to provide bonds in favour of TOSG in a form acceptable to that company and they entered into an agreement with TOSG regulating the manner in which TOSG could call up the bonds. The bonds were renewed annually and their amount was to be reviewed in each year but in fact remained from 1971 onwards at a figure equivalent to 5% of the relevant tour operator's turnover for the previous year, that figure being assumed (erroneously as it turned out) to be adequate to cover any failure on the worst possible basis.

Pursuant to these arrangements Clarksons, in October 1973, arranged for bonds to a total value of £2·43226m to be issued by five banks, the four appellants and Williams & Glyn's Bank Ltd, which was the plaintiff in a separate action heard at the same time as the action in which this appeal arises.

Those bonds were for the following amounts:

Williams & Glyn's Bank	£873,000
Lloyds Bank	£93,000
Wintrust Securities	£260,000
National Westminster Bank	£500,000
Barclays Bank	£500,000

They were all in the same form, were issued to TOSG and provided that the bank concerned undertook to pay the specified sum but subject to a condition that the bond should be void unless during the period of 12 calendar months commencing on 1 October 1973 any one or more of six specified events should occur. I need not enumerate those in detail. They included the event of TOSG notifying the issuing bank that any company in the Clarkson group could not carry out its obligations, the presentation of a winding-up petition and cessation of payment of debts.

[1984] 1 All ER 628 at 633

I ought, however, to read the final provision of the document, which is in these terms:

> 'And in consideration of the issue of this Bond the Fund hereby covenants with the Obligor that upon payment of the said sum of £ specified above by the Obligor to the Fund the Fund will undertake in writing with the Obligor that the Fund will repay to the Obligor on demand such part of the said sum as shall not be expended or required by the Fund in the performance and execution of its rights, duties, powers and discretions as set out in the Fund's Memorandum and Articles of Association, and that such Memorandum and Articles will not be altered during the currency of this Bond without the prior written consent of the Obligor (which shall not be unreasonably withheld) first obtained.'

At the same time each of the issuing banks obtained from Clarksons a counter-indemnity. The form of each indemnity was that normally used by the bank concerned. They are not identical and their precise terms do not matter, for it is not in issue that they created an obligation on Clarksons, in the event of the bond being called up, to indemnify the bank against any loss which it might sustain as a result of having executed the bond.

In August 1974 it became plain that the Court Line Group in general and Clarksons in particular were in such severe difficulties that operations could not continue, and on 15 August the Civil Aviation Authority withdrew Clarksons' civil aviation licence. At the same time Clarksons notified TOSG that it had ceased to trade and could no longer carry out its obligations to its customers. On the following day TOSG notified the banks in writing of the fulfilment of the pre-condition to the operation of the bond and called up the bond moneys immediately. These sums were paid to TOSG and Clarksons were notified by the paying banks. On the same day, 16 August, Clarksons presented its own petition for compulsory winding up and on 21 August Clarksons passed a special resolution to wind up voluntarily.

There then followed a hastily mounted rescue operation, the purpose of which was to enable those customers of Clarksons who were already abroad on holiday to complete their holidays and return to the United Kingdom, an operation which involved, of course, payment for hotel bills and for arrangements with air carriers. In this connection TOSG expended in round terms a sum of £956,000, as to which no question arises on this appeal. The question with which the court is now concerned related to the banks' share of a balance of some £1·43268m which remained in TOSG's hands and which was ultimately disbursed by TOSG in paying in full, so far as it would go, customers of Clarksons who had paid for holidays but had never had them.

TOSG had, under its memorandum of association, a complete discretion as to the manner in which it set about alleviating the losses of the holidaymakers, and clearly one approach, but by no means the only one, would have been simply to distribute the funds in its hands among all claimants pro rata to their claims, leaving them to prove for any balance unpaid in the liquidation. There were, however, a number of complications and the final determination and settlement of claims in this way might have taken a considerable time. In particular, there were a number of test cases pending, in cases where moneys had been paid to travel agents by customers and were still held by the agents at the time of the collapse, to determine whether the customer was entitled to a refund from the agent or whether the agent was accountable to the liquidator for the moneys held.

In the mean time, there had been a major development in the political scene, for the collapse had caused a major parliamentary stir and the government of the day was under pressure, and indeed was, I think, anxious, to make some permanent provision for safeguarding both the general public in the future and the victims of this particular disaster. Thus in 1975 there was passed the Air Travel Reserve Fund Act 1975 which brought into being an air travel reserve fund, financed initially by government loan but ultimately by contributions from the industry, for the purpose of compensating persons who had lost their holidays as a result of the collapse of tour operators during 1974 and

[1984] 1 All ER 628 at 634

to provide against similar events in the future. The twelfth defendant (to which I will refer as 'the agency') was established to manage and administer the fund.

It will be convenient here to summarise the relevant provisions of the 1975 Act and the regulations made under it. Section 2(1) states the general application of the fund, which is to be applied in making payments to or for the benefit of customers of air travel organisers in respect of losses or liabilities incurred by them in connection with travel contracts. Subsection (3) restricts the losses and liabilities payable under sub-s (1) to those incurred in consequence of the inability of the air travel organiser to meet his commitments under contracts the time for performance of which fell after 1 April 1974. Subsection (6) deals with the position where there is a bonding scheme such as the present by providing that for the purposes of sub-s (3) a loss or liability shall be treated as having been incurred in consequence of the organiser's inability to meet his contractual commitments if, since the booking was made, the bond has become payable. Subsection (7) is important. That provides that where money is available under such a bond (a) no payment shall be made out of the fund until all the money so available has been paid to or for the benefit of the customers in question or any class or description of those customers, and (b) sub-s (1) shall not apply to any loss or liability so far as it has been reimbursed from such bond moneys. Section 3 empowers the Secretary of State to make rules as to the application of the fund (known as 'benefit rules') and those were in fact made in July 1975.

Rule 3(1) and (2) limits the amount of any payment, in effect, to the amount actually paid by the customer, but r 3(7) provides that, where a customer is eligible for a payment from the fund, the agency shall pay him the total amount permissible under the rules. Rule 3(6) is in the following terms:

> 'Where a customer of an air travel organiser has received any sum in liquidation or bankruptcy proceedings brought against the air travel organiser, being a sum paid in respect of losses or liabilities to which section 2(1) of the Act applies, that sum shall be deducted from any payment out of the Fund which would otherwise have been made to him in accordance with these Rules.'

Finally, r 4 deals with the conditions to be satisfied before payments are made (including, eg, method of submission and establishment of claims) and r 4(4) provides that the agency may, before making a payment, require the customer to assign to the agency any rights which he may have against the air travel organiser, whether in liquidation or bankruptcy or otherwise.

Well before the 1975 Act was passed negotiations had been in train between TOSG and the Department of Trade with a view to agreeing arrangements under which payments to holidaymakers could be expedited, it having been apparent from the inception that the bond moneys were not going to be sufficient to meet all claims in full and that there would be a substantial balance for which the air travel reserve fund would become responsible when the 1975 Act came into force and the regulations made under it were promulgated. Those negotiations contemplated that, rather than waiting for

the complete ascertainment and settlement of all claims, TOSG would settled in full as many undisputed claims as could be discharged out of its available resources, leaving the agency to settle the balance. The original suggestion was that TOSG should take assignments of their claims in the liquidation from those customers whose debts were then paid in full, but it was ultimately considered more convenient that all outstanding claims should be dealt with by the agency so that TOSG could conclude entirely its administration of the bond moneys. Accordingly, it was agreed in principle that as each claim was paid by TOSG the customer concerned should be required to execute an assignment of his rights in favour of the agency. This was intended at first to be subject to the agreement of the banks who had put up the bond moneys, but in fact the only bank which was informed of the proposal was Lloyds, who registered a strong objection. Despite this, however, when the 1975 Act received the royal assent and the agency was formed, an agreement along these lines was entered into between TOSG and the agency and it is this that gave rise to the present proceedings. In the result TOSG settled in full claims of customers to

the extent of the moneys in its hands, each cheque sent out being conditional on the signature and return by the recipient of an assignment of his claims in the liquidation to the agency. The banks had, at any early stage, proved for the full sum of £2·43226m due to them under Clarksons' counter-indemnity when the bonds were issued and the agency now proved not only for the sums which it had disbursed in paying out claims of customers other than those paid out by TOSG but also in respect of the rights assigned by those customers who had been paid by TOSG.

There is no dispute that the banks are entitled to prove in the liquidation of Clarksons for that part of the sums paid by them under the bonds which is represented by the payments made for repatriating customers (£956,000) but it is the liquidators' contention that the balance of £1·43268m paid out to customers and thus reflected in the agency's proof is subject to the rule against double proof and that one or other of the two sets of proofs must be reduced accordingly.

At the trial before Nourse J it was common ground that the rule against double proof applied to the situation with which the court was confronted and the contest was simply one between the banks on the one hand and TOSG and the agency on the other as to who had the better right, in these circumstances, to prove for the moneys which had in fact been applied in or towards discharging the customers' claims. That is, perhaps, a simplification, because there were other issues of ultra vires and misfeasance which fell to be decided but are not in issue on the present appeal. So far as this court is concerned, there is no dispute either that it was intra vires TOSG to deal with the bond moneys in the way in which it did deal with them (including the procuring of assignments by customers to the agency) or that the agency was acting intra vires in arranging for and taking those assignments. There has, however, in this court been raised a further issue not argued in the court below, because shortly before the hearing of the appeal began the banks amended their notice of appeal in order to raise the question whether the rule against double proof applied at all. An application to strike that amendment out was refused by this court (although on terms as to costs) because, although the point was a new one, we took the view that, assuming it to be good, it would be inappropriate that this court should be put in the position, because of a concession in the court below, of deciding the appeal on a basis which, on that hypothesis, would be wholly wrong in law. It has thus been argued before us and should logically be dealt with first. It is put by counsel for the banks in two ways. First, he submits that the correct time for ascertaining whether the rule is to apply is at the date of the liquidation. This case is not an orthodox case of principal and surety. It is a case in which there were created as a matter of fact two quite distinct contracts with the debtor which had no necessary connection at all. As soon as the collapse occurred the condition of the bonds was fulfilled and the moneys became payable to TOSG. At that moment Clarksons became subject to a liability under the counter-indemnity which was quite independent of its liability to its customers. True the bond moneys or part of them might, in due course, if TOSG chose, be applied in paying to the customers what was due to them from Clarksons, but they might not. The whole fund might have to be expended, for instance, in a repatriation exercise. Thus, it is argued, the two liabilities were quite independent at the inception, and each creditor, be he bank or customer, can prove for his own debt. The mere fact that some part of the moneys provided by the banks may subsequently have been applied in paying out the customer liabilities cannot make the case one of double proof when it was not originally so. Thus, counsel for the banks submits, the liquidators should entertain proofs both from the banks and from the agency, even though that will, of course, be highly prejudicial to the other unsecured creditors.

His alternative formulation results in the banks alone being able to prove because, it is said, the agency has, so far as its proof rests on the assignments from customers paid out by TOSG, nothing for which it can prove. That is said to be so

for one of two reasons. First, it is said that immediately the banks' moneys were paid to the customers, the banks stood, by subrogation, in the shoes of the customers whose debts had been paid so that, the customers' rights having, eo instanti, passed to the banks, there was nothing on which the assignments could operate. The second way of putting it is slightly different but the

result is the same. It is said that for TOSG to arrange with the customers to keep the customers' debts alive notwithstanding the receipt by them of an equivalent sum of money was, and was known to the agency to be, contrary to an implied term to be deduced from the bonds and the counter-indemnities taken in conjunction.

I can deal with these submissions quite shortly, for, speaking for myself, I am unable to accept any of them. Counsel for the banks first way of putting his case is, in my judgment, based on two fundamentally wrong assumptions. In the first place, I am unable to accept that the proper time for determining whether or not the rule against double proof is to apply is the date of the liquidation. I accept the submission of counsel for TOSG and the agency that the rule ought more properly to be styled the rule against double dividends, for its object is to absolve the liquidator from paying out two dividends on what is essentially the same debt. That is a matter which very frequently, for instance in the case of principal and surety, cannot be determined until a payment to the creditor is made. No doubt it can be predicted at the commencement of the liquidation that a case for the application of the rule may arise or that it can never arise, but it may well be impossible to determine at that stage whether it will in fact.

Second, it is, as I think, a fallacy to argue, and this is really the basis of the argument of counsel for the banks, that, because overlapping liabilities result from separate and independent contracts with the debtor, that, by itself, is determinative of whether the rule can apply. The test is in my judgment a much broader one which transcends a close jurisprudential analysis of the persons by and to whom the duties are owed. It is simply whether the two competing claims are, in *substance*, claims for payment of the same debt twice over. It will be necessary to look more closely at the substance of the transactions which have given rise to the problems in the context of which claimant has the better right, but for the moment I accept the broad general proposition of counsel for TOSG and the agency that the rule against double proof in respect of two liabilities of an insolvent debtor is going to apply wherever the existence of one liability is dependent on and referable only to the liability to the other and where to allow both liabilities to rank independently for dividend would produce injustice to the other unsecured creditors.

The rule has nothing to say on the question of which of two proving creditors has the better right to claim a dividend in respect of his debt. It bears merely on the question whether both are to be admitted for dividend and stems from the fundamental rule of all insolvency administration that, subject to certain statutory priorities, the debtor's available assets are to be applied pari passu in discharge of the debtor's liabilities. One way of testing the matter is to ask, in relation to any liability for which proof has been lodged, whether it arises as a result of a payment made in discharge or partial discharge of another liability for which a proof has also been lodged. If the answer to that is affirmative, then it is clear that a distortion of the pari passu principle would occur if both proofs are admitted in full. A simpler test, perhaps, is to postulate the question: what would the position be as regards the payment of the liabilities in respect of which proofs have been lodged if the debtor were now solvent?

Counsel for the liquidator gives by way of illustration what I find a compelling example. Suppose that the insolvent debtor has two creditors, one for £40,000 and one for £20,000, the liability to the latter being guaranteed by a third party to the extent of £10,000. The surety is called on to pay and pays, thus giving rise to a liability in the debtor to indemnify him. Now if the debtor were in fact solvent the amount required to be found to satisfy all his liabilities would be £60,000; but, if the surety is admitted to prove for £10,000 alongside the principal creditor's proof for £20,000, the total liabilities in the insolvency will be £70,000. Thus for the purposes of the liquidation the claims of creditors are computed at a figure in excess of the amount required to discharge them, to the prejudice of the remaining creditor for £40,000. The rule is designed to prevent this occurring. This method of testing the position emerges from the judgment of Mellish LJ in *Re Oriental Commercial Bank, ex p European Bank* (1871) LR 7 Ch App 99. There bills of exchange were accepted by the European Bank against an undertaking by the Oriental Bank to provide funds to meet them on maturity. They were then handed to the Oriental Bank as agent for the drawer and indorsed by them and discounted. Both banks became

insolvent and the Agra Bank, the holder of the bill, in fact recovered the amount of the bills by proving in their respective liquidations. The European Bank then sought to lodge a proof in the insolvency of the Oriental Bank for, in effect, damages for breach of the undertaking by the latter to provide funds to meet the bills. In rejecting that proof Mellish LJ observed (at 102):

> 'It appears to me clearly that it is substantially the same debt: because if all parties had been solvent, whatever sums the *Oriental Commercial Bank* might have paid to the *Agra Bank*, although they would have paid it, no doubt, for the purpose of performing the contract they had entered into by their indorsement, yet, substantially, whatever sums they might have paid to the *Agra Bank* would have gone in reduction of the sum which the *Oriental Commercial Bank* had promised to pay to the *European Bank*. In that case the *Oriental Commercial Bank* could never have been called upon to pay these bills twice over. It would have made no difference that they had entered into two contracts with two separate parties that they would pay the bills ... It is clear that they would have performed both contracts by paying the bills once ... '

The true principle, he observed at the end of his judgment (at 103), is 'that there is only to be one dividend in respect of what is in substance the same debt'.

Similar reasoning is to be found in the dissenting judgment of Porter MR in Ireland in *Re Killen, a bankrupt* (1885) 15 LR Ir 388 (subsequently approved by the House of Lords sub nom *Deering v Bank of Ireland* (1886) 12 App Cas 20), where the cumulative proofs of the claimant in respect of different obligations arising out of the same transaction would have resulted in the amount claimed exceeding the amount of the principal debt.

Now, if, as in my judgment these cases show, the true rule is that there are not to be two dividends in respect of what is in substance the same debt, I can see no logical justification for seeking to fix the position at the commencement of the insolvency. One has, as it seems to me, to look at the position at the point at which the dividend is actually about to be paid and to ask the question then whether two payments are being sought for a liability which, if the company were solvent, could be discharged as regards both claimants by one payment.

Tested in this way, the instant case is, in my judgment, one where the rule against double proof does apply and the concession made in the court below was, in my opinion, properly made. It is, of course, true that, if one goes back to the inception of the liquidation, there were two quite separate liabilities. Clarksons owed the holidaymakers the amount which they had paid for a consideration which had wholly failed. It was also liable to the banks for the loss sustained as a result of the calling up of the bonds, the amount of which would depend on the extent to which the bond moneys would in fact be required to meet the holidaymakers' claims. If and so far as those claims were discharged from other sources, the bond moneys would not be required to meet them and, on the terms of the bonds, would fall to be refunded to the banks, thus reducing pro tanto the liability of Clarksons on the counter-indemnities. Thus if Clarksons became solvent in the course of the liquidation (if, for instance, inability to meet commitments which resulted in the bonds being called up had been due merely to a temporary liquidity crisis) the discharge by Clarksons of the debts due to its customers would, as in the *Oriental Commercial Bank* case, at the same time discharge the liability to the banks, disregarding any interest and expense factors, since the bond moneys would then be refunded to them. Thus if bond moneys are in fact applied towards the discharge or partial discharge of the customers' debts the allowance of proofs of debt both for the amount of bond moneys and for the full amount of the customers' debts necessarily involves the liabilities on which dividends are to be declared being computed at a figure in excess of the amount required to discharge those liabilities.

I turn, therefore, to the alternative submissions of counsel for the banks, the first of which is based on a right of subrogation which it is submitted arises from the fact that the debts due to the holidaymakers paid off by TOSG were in fact paid with moneys derived from the banks. It is said that *Brocklesby v Temperance Permanent Building Society* [1895] AC 173 is authority for the proposition that, where A's money is used to pay B's debt, A is subrogated to the rights of the creditor. For my part, I am unable to deduce any such wide principle from that case, which appears to me to rest on a quite different principle, namely that, where a landowner puts another in possession of his title deeds with authority to raise money on them as his agent, he is not entitled to rely on limitations on the authority of the agent which are not brought to the notice of the lender. Indeed, *Wylie v Carlyon* [1922] 1 Ch 51 is, I think, a clear authority against the wide

proposition that a right of subrogation stems from the mere fact that B's debt has been discharged with money in fact derived from A. One has to find, in the contract between the supplier of the money and the payer of the debt, some provision that the money is to be applied for that purpose. I can find nothing of this sort in the contract between the banks and TOSG. No doubt the payment of sums due to the holidaymakers was within TOSG's powers and no doubt this was known to the banks, but that is to say no more than that the banks paid the bond moneys to TOSG for whatever purpose TOSG might see fit to use them within its corporate powers, the only stipulation being that any moneys not so applied should be refunded. It was an out and out payment with, for relevant purposes, no reservations of any sort and was, in my judgment, no different in kind from the payment in *Paul v Speirway Ltd (in liq)* [1976] 2 All ER 587, [1976] Ch 220, save that here there was no obligation on TOSG to repay, other than in relation to moneys not required for its corporate purposes. When one comes to consider the position as between Clarksons and the banks, the case is, I think, a fortiori. Here there was an express right to indemnity giving a direct right of recovery to the banks. Leaving aside the insurance cases (which form a category of their own) and cases of express or implied contract, a right of subrogation arises on equitable principles where otherwise the payer might be deprived of any right of recovery, for instance where money has been lent to an infant and used to discharge debts incurred for necessaries or where money has been borrowed ultra vires or has been paid in discharge of a person's debts without his authority, and I am far from convinced, all other considerations apart, that the equitable principle applies where the payer has already a full and independent right of recovery against the debtor. But, whether that be so or not, I can see no such right in the present case, where TOSG was given an entirely free hand with the bond moneys. One can, perhaps, best test the matter in this way. Suppose that no counter-indemnity had been sought or given and disregard altogether Clarksons' insolvency. The banks undertake, for what they no doubt regard as an adequate consideration, to provide moneys to a third party in a certain event. If the event occurs and if some part of the moneys are applied in fact in paying debts of Clarksons, by what title could the banks claim, in effect, a recoupment for which they never stipulated as part of the original consideration? I can see none.

The alternative proposition of counsel for the banks is expressed thus. Where A provides money to B at C's request for the purpose, inter alia, of paying C's creditors and on terms that C will indemnify A, and B in fact applies the money for that purpose, B cannot keep the claims of C's creditors alive for his own benefit to the prejudice of A and C. He must either extinguish those claims or allow A to be subrogated to them. This is, however, a proposition which makes a number of assumptions and begs a number of questions; and, in the ultimate analysis, counsel for the banks was compelled to justify it by reference, not to any general principle of law, but to an implied term in the contract between A and B (the banks and TOSG) that B will do nothing to impede A's right of subrogation so far as the money is used to pay off debts. I find insuperable difficulties in this. In the first place, it assumes the right of subrogation, and for the reasons stated above, I can find none. But, second, I find it impossible to see any material from which such a term can be implied. There was no restriction at all on the use which TOSG might make of the bond moneys save those imposed by TOSG's own corporate constitution. It was certainly within TOSG's power, if it wished to, to buy up debts and apply any proceeds for its corporate purposes. Whence, then, is any such term to be implied? The banks' obligation was to pay in the stated events. TOSG's only express obligation was to repay anything not required for its corporate purposes; and there is simply no material

[1984] 1 All ER 628 at 638

from which one can infer, as a matter of business efficacy, an undertaking that the corporate powers would only be used in a certain way or would not be used in a particular way.

In my judgment, therefore, the problem has to be approached, as it was by Nourse J in the court below, on the footing that, subject to the operation of the rule against double proof, the assignments to the agency were effective and that the question of which of the two claimants has the better right to prove has to be resolved by the application of equitable principles. Nourse J approached this problem in two quite distinct ways. He recognised that the situation with which the liquidators were faced was an unusual one both by reason of the arrangements made between Clarksons and the banks and TOSG, which does not fit precisely within the framework of any of the decided cases, and by reason of the unusual feature that arrangements were made for the express purpose of keeping the claims of creditors alive for the benefit of someone other than the payer after they had in fact received 100p in the pound on the amounts of their respective claims. It was pointed out to him, however, that apart from a few authorities to which I shall have to refer briefly, all the learning on the subject of priority between rival claimants in respect of the same indebtedness is contained in a series of decisions governing the relationship of principal and surety, as, indeed, is not altogether surprising, for that is normally

where the contest arises, and he therefore took those cases as governing by analogy the instant case. Quite apart from that, however, he approached the case on the basis of what he referred to as the 'broad equity', arrived at by a consideration of which claimant had the better claim having regard to the intentions of the parties as deducible from their contractual rights and duties and the purpose for which those rights and duties were acquired or assumed. Counsel for the banks attacks the judge's conclusion on both grounds. As to the former, he says that if (which he challenges) it is right to take the cases of principal and surety as analogous at all, the judge drew the wrong conclusion about the category into which, as a matter of analogy, the instant case fell. As to the latter, counsel for the banks says that there was no material on which the judge was entitled to arrive at the conclusion at which he did arrive, namely that the claim of the agency was to be preferred to that of the banks.

The instant case is not, of course, literally a case of suretyship, for that involves a contract between creditor and surety. Here there is, of course, no contract between the banks and the holidaymakers or between TOSG and the holidaymakers. There are, however, obvious similarities. The liability of the banks was only to arise if Clarkson failed to fulfil its obligations to its customers; the funds provided by the banks were applicable in alleviating that failure; and the banks were, ultimately, to have recourse to Clarksons for what they had paid. The principal argument in the court below sought, however, to avoid this analogy and to apply, as a test of who had the prior right to prove, the question 'who is out of pocket?' That, in essence, rested on *The Liverpool (No 2)* [1960] 3 All ER 307, [1963] P 64. There are, in fact, a number of cases in which questions of priority have arisen in double proof situations not arising from the discharge by a surety of his obligations under a guarantee. Apart from *The Liverpool (No 2)*, however, they are all cases where, in addition to the principal debt, it has been sought to prove an additional and subsidiary liability, either to the principal debtor himself or to a third party (whether or not a surety) to maintain the value of the security or to indemnify against the failure to maintain it (see *Re Hoey, ex p Hoey* (1918) 88 LJKB 273, *Re Killen, a bankrupt* (1885) 15 LR Ir 388, *Re Moss, ex p Hallet* [1905] 2 KB 307, [1904-7] All ER Rep 713). They are useful illustrations of the test previously propounded of whether the proof under consideration will have the effect of computing the amount of the liabilities in an insolvent estate beyond the figure which would be required to extinguish the liabilities if the debtor were solvent, but they are otherwise of little help with the problem raised by this appeal. *The Liverpool (No 2)*, however, stands by itself and is prayed in aid by counsel for the banks as providing a guide in the circumstances of the instant case. There the tanker Liverpool, by negligent navigation, sank the coaster Ousel in the port of Liverpool. Liability was admitted, but the Liverpool obtained a decree limiting its liability under the Merchant Shipping Act 1894 and the question arose what claims could

[1984] 1 All ER 628 at 639

be admitted to prove against the limitation fund. One of the claims against the Liverpool was a claim in tort by the Mersey Docks and Harbour Board for the cost of raising and moving the Ousel in accordance with their statutory duties. The board also had a statutory remedy for the expenses against the Ousel which they exerted to the limited extent permitted by the Merchant Shipping Acts. The Ousel in its proof against the limitation fund included the amount of the board's limited statutory claim against it (in respect of which it had not, at that time, made any payment) and the question before the court was whether this claim could stand having regard to the board's claim, which made no allowance for anything recoverable from this source. At first instance, Lord Merriman P, applying the analogy of the surety cases, regarded the Ousel as being a surety for part of a debt of ascertained amount and held that the board's claim must be pro tanto reduced (see [1960] 1 All ER 465, [1963] P 64). This was reversed on appeal. Harman LJ found the principal and debtor analogy of little help in a case where there was no principal debtor, but applied it to this extent, that the authorities quite clearly established that a surety who has not paid is not permitted to prove for his contingent debt in competition with the principal creditor (see *Re Fenton, ex p Fenton Textile Association Ltd* [1931] 1 Ch 85, [1930] All ER Rep 15). The salient feature of *The Liverpool (No 2)* was that the Ousel had not in fact paid anything. Harman LJ expressed it thus ([1960] 3 All ER 307 at 314, [1963] P 64 at 86):

> 'In our judgment the answer is that the board has priority because it is actually out of pocket by the whole of its claim, whilst the Ousel is not because she has not yet been obliged to pay.'

This, it is argued, is the closest analogy with the instant case. Here the customers have received 100p in the pound on their debts from TOSG using the bank's money. The agency paid nothing for the assignments to it. Thus, if one is to look for the person who is out of pocket, there can be only one answer. The banks having paid must have the prior right of proof.

This argument is perfectly intelligible, and indeed almost unanswerable if one regards the payment of those customers who were paid to TOSG as an entirely separate transaction isolated from any other arrangement made with the agency, but to my mind it ignores the reality. If one is to look for analogies, it is, I think, essential first to analyse what the total effect of the arrangements was and the reasoning behind them. All the cases stress that in relation to the rule against double proofs it is the substance and not the form that is to be regarded (see eg *Re Melton, Milk v Towers* [1918] 1 Ch 37 at 60, [1916-17] All ER Rep 672 at 683, *Re Oriental Commercial Bank* (1871) LR 7 Ch App 99). When regard is had to what actually happened in the instant case, it is, I think, entirely clear that the transaction by which TOSG paid a certain number of customers in full cannot be treated as a transaction on its own isolated from the payment by the agency of the claims of the remaining unpaid customers. The fact is that, if one looks at the reality of the position and asks, 'Who is out of pocket?', the answer is that both the banks and the agency are out of pocket and in that situation *The Liverpool (No 2)* provides no help, since it provides no guidance as to what would have happened if the Ousel had paid either the whole or a part of its liability and the court declined to express any opinion on whether in exerting its claim against the Ousel the board could be compelled to give credit for any part of the sums received as a result of its claims against the Liverpool.

That the reality is as I have described it seems to me inescapable. Under the Air Travel Reserve Fund Act 1975 and the benefit rules the agency was obliged to pay any balance due to customers after taking into account the bond moneys and anything received by way of dividend in the liquidation, but it could not pay anything at all until the bond moneys were exhausted. A year had already passed during which customers were out of their money and since there were still outstanding claims which were the subject of test actions a further lengthy period would have to elapse before anybody could receive anything unless arrangements could be made to expedite payment to those customers whose claims were beyond dispute. It was in these circumstances that TOSG and the

[1984] 1 All ER 628 at 640

agency came to the very sensible arrangement that the bond moneys should be expended in full in paying out customers so that the pre-condition for the agency's making payments was satisfied. This could have been done in several ways. TOSG could have made pro rata payments to customers, leaving it to them either to prove for the balance and to bring into account any dividends received when the agency came to make payments in pursuance of its statutory obligation or to assign such rights of proof as they had to the agency against payment to them of any balance not paid out of the bond moneys.

In the event, it was an accident of administrative convenience rather than anything else which dictated the manner in which the problem was in fact dealt with. There was no difference in kind between the customers paid by TOSG and those paid by the agency and the reality is that a single class of creditors was receiving payments on account of their debts from both TOSG and the agency, the latter's contribution in the case of those customers paid by TOSG being indirectly provided by the assumption by the agency of the full responsibility for paying the others.

It was against this background that the judge felt it appropriate to apply the analogy of the suretyship cases and, in my judgment, he was right to do so. The assignments were mere machinery and what fell to be regarded was in reality a partial payment by TOSG of the totality of the obligation owed by Clarksons to all its customers as a single class. The position therefore fell to be tested as between the banks on the one hand, whose money had provided the payments, and the customers as a whole on the other hand, for the assignments could not assign any greater rights than the customers themselves had at the moment when they were paid.

The principles which emerge from the suretyship cases have been helpfully summarised both in the judgment of Nourse J and in the skeleton arguments prepared by counsel for the guidance of this court. The starting position is that a creditor is entitled in an insolvency to prove for the whole sum due to him at the date of the liquidation or receiving order without any obligation to give credit for any sum which he has since received from a third party, unless and until he has received 100p in the pound on his debt. That entitlement, however, may fall to be modified by reason of the rule against double proof where the third party is himself a creditor in the insolvency for the sum which he has paid, as in the case of a surety. Whether it is or not depends on whether the payment entitles the payer to be subrogated, to the extent of his

payment, to the creditor's right and it is in relation to this question that a number of clearly established rules are deducible from the surety cases.

The basic rule is that the proof of a surety cannot displace the proof of the principal creditor unless and until the surety has fully discharged all his liabilities to the creditor. A fortiori it cannot do so where no payment has been made and the liability to the surety remains contingent *(Re Fenton* [1931] 1 Ch 85, [1930] All ER Rep 15). So long as any liabilities of the surety are outstanding the creditor remains entitled to prove for the full amount of the debt due to him at the date of commencement of the winding up or the receiving order and the surety's proof is excluded.

It is here that there has grown up a distinction, which depends on the construction of the contract of suretyship and which is not altogether easy to understand, between cases where the surety guarantees part of an ascertained debt and cases where he is held to have guaranteed the whole debt but subject to a limitation of his liability to less amount than the whole. In the former case, the payment of the amount guaranteed entitles the surety to stand, pro tanto, in the creditor's shoes in the insolvency, since he has discharged the whole of his liability to the creditor. In the latter case, so long as any part of the whole debt remains outstanding, the surety, although he has paid up to the limit of his financial liability, is treated as not having discharged his liability to the creditor, presumably on the footing that there nevertheless remains an outstanding obligation on him to see that the whole debt is paid. The distinction may seem over-subtle, but it is clearly established by authority: see the judgment of Blackburn J in *Ellis v Emmanuel* (1876) 1 Ex D 157, [1874-80] All ER Rep 1081, where the authorities are reviewed.

This rule is, however, subject to a qualification. Where the guarantee is of the whole

[1984] 1 All ER 628 at 641

of a fluctuating balance (eg as in the case of a guarantee of the debtor's current account with a bank) with a limit on the liability of the surety, such a guarantee is to be construed as a guarantee of part only of the debt and the surety paying up to the limit of his liability will be entitled to that extent to stand in the creditor's shoes and prove in priority to him (see *Ex p Rushforth* (1805) 10 Ves 409, 32 ER 903, *Gray v Seckham* (1872) LR 7 Ch App 680). The right of the surety in these circumstances to prove in priority to the principal creditor can, however (as it normally is in bank guarantees), be excluded by the express terms of the contract of guarantee. A provision that the guarantee is to be in addition and without prejudice to any other securities held from or on account of the debtor and that it is to be a continuing security notwithstanding any settlement of account is probably sufficient for this purpose (see *Re Sass, ex p National Provincial Bank of England* [1896] 2 QB 12) but at least there must be some express clause in the contract which can fairly be construed as a waiver by the surety of his rights in favour of the principal creditor (contrast *Hobson v Bass* (1871) LR 6 Ch App 792 with *Midland Banking Co v Chambers* (1869) LR 4 Ch App 398). Such a provision will not readily be inferred merely from the form which the transaction takes (see *Gray v Seckham).*

Those being the principles, how are they to be applied by analogy to the instant case? Nourse J regarded the case as one where the proper analogy was that of a guarantor who guarantees the whole of a debt of fixed amount with a limitation on the amount of his liability, so that even after payment of the whole of the surety's liability the creditor remains entitled to prove for the whole sum. The reasoning behind this conclusion was that the object of TOSG was to alleviate the consequences of Clarksons' business failure. TOSG had a discretion about how this was to be done, but one way of carrying out the object was to recoup any shortfall remaining after the customers had received all available dividends in Clarksons' liquidation. Thus, it was argued, since the obligation of the banks was to be answerable for any balance remaining after all moneys available from other sources had been applied in reduction of the debt, the guarantee was a guarantee of the whole debt, subject only to a limitation on the amount which the banks were to pay. This feature of the relationship appears to have convinced the judge that the case of the guarantor of the whole of a fluctuating balance with a limitation on the amount of liability (as in *Hobson v Bass)* was not to be applied and as I understand his reasoning it was this.

The reason why that case is treated differently from the case of the debt of fixed amount is that it is considered inequitable in the creditor, who is at liberty to increase the balance or not, to increase it at the expense of the surety (see *Ellis v Emmanuel* (1876) 1 Ex D 157 at 163-164, [1874-80] All ER Rep 1081 at 1083). Since, the argument runs, it was con-

templated that Clarksons would be entitled to take on liabilities to customers without limitation and since in the event of Clarksons' insolvency TOSG *could* apply the bond moneys in discharging any balance remaining after the disappointed customers had received their dividends in the liquidation, there was in fact nothing inequitable in such indebtedness being increased and accordingly the case is to be treated in the same way as the guarantee of the whole of a debt of ascertained amount.

With respect to the judge and to counsel for TOSG and the agency, from whom the argument originated, I find an element of circularity in this reasoning, which really begs the question of priority by starting from an assumption that it must be decided in favour of the customers. Of course, factually and dependent on the order in which events take place, any surety may find himself paying, up to the amount of this liability, any balance remaining due to the creditor after he has received a dividend on the whole of his debt in the insolvency of the principal debtor. But the mere fact that the creditor may have received a dividend on the whole is not determinative at all of how that dividend falls to be treated when it comes to settling the accounts between the creditor and the surety who, ex hypothesi, has not been able to prove because he has not paid (see, for instance, *Gray v Seckham*, where the creditor had received his dividend before calling up the guarantees, and *Hobson v Bass*, where the sureties had paid but had not themselves proved in the bankruptcy).

It is, of course, true that in the instant case the moneys paid by the banks were paid, not to the creditors in the first instance, but to a third party, TOSG, against whom there

[1984] 1 All ER 628 at 642

would be no recourse for dividends received by the customers, but by the same token, the moneys having actually been paid by the banks, they would themselves have a right of proof under their counter-indemnity in the insolvency for the full amount paid, subject only to reduction of that amount by reason of the rule against double proof. As a practical matter, of course, the liquidator, who was faced with proofs both by the banks and by the customers, and knowing that some part of the bond moneys was bound to be paid in discharge of the indebtedness to the customers, would be bound to defer paying dividends on either until the question of double proof had been cleared up and it had been determined who had the better right to prove. Thus, to say that the bond moneys could be used by TOSG in discharging what was due to the customers after they had proved and received dividends in the liquidation begs the question of the extent to which their proofs should be allowed. It cannot itself be prayed in aid as solving the question. Nor can I, for my part, follow why the contemplation that Clarksons should be entitled to incur obligations without limit should take the case out of the ordinary rule. If the arrangements made in this case are to be treated, as I think they are, as analogous to a guarantee by the banks of Clarksons' liabilities to its customers, they appear to me clearly to be analogous to a guarantee of a balance which is going to fluctuate from time to time but subject to a limit on the surety's liability, and exactly the same considerations as apply in that case to prevent the surety's right of proof being prejudiced by the debtor's increasing his indebtedness appear to me to apply here. If that is right, then the question is whether there can be spelt out of the arrangement some express or implied term to the effect that, in the event of the debtor's insolvency, the banks would not prove for the amount which they had paid under their bonds until the customers had been paid in full. Certainly there is no express term to that effect and, speaking for myself, I am unable to find in the documents or the circumstances in which the bonds were given any such implied term. So far as the banks were concerned, their contract with Clarksons was that they would put up the bond moneys in consideration of the agreed fee and of a right of counter-indemnity which clearly contemplated a proof of debt for the moneys paid in the only likely event in which they would become payable. There is simply no room for any such implication here.

So far as TOSG was concerned, the banks simply entered into an obligation to pay over moneys for TOSG's complete disposition in the stated events. In its defence the agency plead an implied term arising under the bonds that TOSG should be entitled to utilise the bond moneys in any transaction authorised by its constitution and that in such event the banks 'would do nothing to hinder any such transaction or to prevent any such transaction from being effectual'. Speaking for myself I find it impossible to see from what material it is sought to make this implication, but in any event, as was pointed out in the course of the argument, such a term does not assist in the present context. It is said that it was within TOSG's powers to procure assignments to the agency of such rights of proof as the customers had but nothing done by the banks in the least interfered with that. To assist the agency it would, I think, be necessary to imply a term that the banks would not, by proving in the liquidation of Clarksons, do anything which might impede in any way the

maximum alleviation possible of the customers' losses. By any ordinary test for the implication of contractual terms, this is fanciful.

If, therefore, the analogy of the surety cases is treated as conclusive of the present case, then, in my judgment, the banks are in the position of the surety under the ordinary form of guarantee of a fluctuating account with a limit on the guarantor's liability and no term excluding the equity which ordinarily arises from that relationship. It would follow that as between the banks and the customers, the banks have the prior right of proof and that, that right must prevail against the agency, which cannot be in any better position than its assignors.

There remains, however, the judge's primary ground of decision. He pointed out that a decision of the case did not necessarily rest on which of two categories of suretyship case bore the closer affinity to it. The determinative factor was the application of equitable principles as applied to a true construction of the parties' intentions. He concluded:

> 'But in the end I do not need to rely on the analogy at all. I agree with [counsel

> for TOSG and the agency] that the decisive feature of the present case is the trust fund's power to recoup to the customers any shortfall remaining after they had received all available dividends in Clarksons' liquidation. Once you get to that stage it is apparent that it would indeed be most inequitable for the banks to claim, as against the customers, a rateable proportion of any dividends receivable or received by them. This is not a narrow equity but a broad one. And it is a surer basis for decision than any mere analogy.'

It will be observed that in arriving at the broad equity the judge is here relying on precisely the same argument as that which led him to assimilate the banks' position to that of guarantors of the whole of an ascertained indebtedness. In doing so, it seems that he was much influenced by some figures produced by the chairman of the agency, Sir Kenneth Selby, which were designed to contrast the position as it might have been with the position as it actually was. These figures demonstrated that the total amount due to customers was £4,357,677. On the footing that they all proved and assuming a dividend of 121/2p in the pound they would receive £544,710. If they were then paid by TOSG the bond moneys actually paid out (£1,267,759), the agency's liability in pursuance of its statutory duties would then have been £2,545,208. What the agency actually paid to customers was £3,089,918. Thus, it was argued, by adopting the method of paying out first against assignments, the agency would have spent more than its statutory liability to the extent it was unable to recover the customers' proofs of debt assigned to it, a sum of £158,470, on the footing that the banks are admitted to prove in priority to the customers paid by them. That figure, of course, includes the share of Williams & Glyn's Bank, which is not an appellant.

As an exercise in arithmetic this, of course, is admirable, but the assertion that the actual method of dealing with the claims involves an expenditure in excess of the agency's liability rests on the same assumption as the proposition which I have already ventured to criticise. The agency was under a statutory liability to make good anything not met from dividends or bond moneys, but the assertion that it would have expended less if it had waited until the customers received their dividends assumes that there is no question of double proof and therefore begs the question of what dividends were in fact available. These figures demonstrate the arithmetic. They do not, in my judgment, demonstrate the equity, and I cannot, for my part, share the judge's view that there is anything inequitable in allowing the banks who have paid real money to recover a dividend on the sums which they have paid and in reducing the proofs of the customers, who have received real money in priority to other creditors, by the amounts which they have in fact received. Leaving aside, for the moment, the suretyship analogy, if the amounts of the customers' claims had been equal to or less than the bond moneys, there could be no question whatever that the banks were entitled to prove for what they had paid. What is there then in the fact that the customers' debts exceed the amount of the bond moneys that displaces the banks claims? It is only the rule against double proof and that brings one back to the suretyship analogy. If one discards that as a guide, one is left with competitive claims between a class of creditors (the banks) who are out of pocket to the full nominal amount of their claims and a class of creditors (the customers) who are in fact out of pocket to an extent less than the full nominal amount of their claims because of their receipt of the banks' money. Unless there can be found in the arrangements under which the money was put up some implied term which precludes the payers from exerting the limited right of recoupment which they were careful to reserve against the debtor when those arrangements were made, I can see no

equity which dictates that the customers' claims should be preferred. It is said that it is illogical that the banks should enter into bonds which they knew were designed to alleviate losses to holidaymakers whilst at the same time reserving the right to 'claw back' from the holidaymakers what they might otherwise have got in the liquidation. This I find an emotive description of what seems to me a perfectly commonsense business arrangement and it really comes back to seeking to imply an intention on the part of the banks not simply that the bond money should be used to alleviate the losses of customers in such way as TOSG might think fit but that such losses should be alleviated to the maximum extent possible by

[1984] 1 All ER 628 at 644

eliminating the rights which the banks had reserved against the debtor. I find no material for any such implication and I cannot think that it would have occurred for one moment to any bystander, officious or otherwise, who was present when the arrangements were made.

I find myself, therefore, unable to reach the same conclusion as the judge. In my judgment both the suretyship analogy and the broad equity of the position favour the banks' claim as against that of the agency, and I would allow the appeal.

KERR LJ.

For convenience I will refer to the parties as 'Clarksons', 'the banks', 'TOSG', 'the holidaymakers', 'the agency' and 'the liquidators'. The issue on this appeal concerns the right to prove in Clarksons' liquidation for part of the 'bond moneys' provided by the four appellant banks to TOSG. The competing claimants for payment of a dividend by the liquidators on the amount of the bond moneys are the four banks and the agency. However, this is to some extent an over-simplification: each of the banks with which this appeal is concerned seeks to prove for the fixed amount of the bond which it has provided, viz Barclays for £500,000, Lloyds for £93,000, National Westminster for £500,000 and Wintrust for £260,000, and the agency is disputing each of these claims to proof. For convenience it may be simpler to treat the total bond moneys as one composite sum. But in analysing the position one must also constantly bear in mind that each of the banks is a separate claimant in respect of the amount of its bond, even though their claims must stand or fall together. Further, although it is convenient to refer to the bond moneys compendiously, the competing claims are in fact confined to the sums paid by TOSG to holidaymakers directly, to the exclusion of the repatriation costs as to which the banks' right to proof is not in dispute.

There are only three possible solutions. (1) The banks are entitled to prove to the exclusion of the agency. (2) The agency is entitled to prove to the exclusion of the banks. (3) The banks and the agency can both prove.

Either of the first two solutions would follow from the application of the so-called rule against double proof, though, in my view, they also fall to be considered independently from this rule. The third solution can only be correct if this rule has no application to the unusual situation in this case.

Before Nourse J the case proceeded on the basis that the rule against double proof was on all sides assumed to apply. He therefore had to choose between the first two solutions, but on this appeal we have to consider all three. To my mind this provides a better approach to seeking the solution which most closely accords with justice and the presumed intention of the parties concerned. The rule against double proof is highly technical in some facets of its application, but ultimately it is based on what the court regards as justice between all the creditors. Exceptionally it may fall to be applied in unforeseeable situations such as *The Liverpool (No 2)* [1960] 3 All ER 307, [1963] P 64, where the priority between competing claims has to be determined without reference to the parties' presumed intentions before the occurrence of the insolvency. Generally, however, it applies in cases in which there is something in the nature of a debtor-creditor-surety situation which precedes the insolvency. In such cases, the solutions at which the courts have arrived, as illustrated by the decisions to which Oliver LJ has referred, have taken account, expressly or tacitly, of what the parties concerned are to be regarded as having intended. It is on this basis that they have generally decided whether or not the rule applies and, if so, with what consequences as regards priorities. I think that this is particularly important in the

present case, since its unusual feature is that Clarksons, in conjunction with the banks and TOSG, set up the bonding arrangements with the express intention that they should take effect in the event of Clarksons' possible insolvency for the benefit of a particular class of creditors. I therefore feel that the safest course is to begin by examining the presumed intentions of the various parties at the time when the bonding arrangements were made.

The parties' intentions

The background can be summarised as follows. In order to strengthen their position

[1984] 1 All ER 628 at 645

as reliable tour operators in the eyes of members of the public who might book holidays with them, Clarksons, together with other major tour operators, wanted to set up a fund whose existence would be publicised and which would be immediately available to these customers in the event of Clarksons becoming insolvent, at least to the extent that they might run into cash-flow difficulties and become unable to meet their commitments to them, as had notoriously happened in a number of other cases. They therefore combined to set up TOSG as a vehicle for the receipt and application of a fund to be available for this purpose outside their possible liquidation. The main objectives of this fund appear from cl 3(A) of TOSG's memorandum of association. These were to 'alleviate' the consequences of any insolvency to the holidaymakers in two main respects, (i) to enable them to complete their holidays and to bring them home more or less as they had planned, and (ii) to refund to them any prepaid deposits, or prepayments made in full, so that these moneys would be available to them for making alternative holiday arrangements. The total amount of the bond moneys to be provided by Clarksons for these purposes was computed on the basis of 5% of their annual turnover, because it was hoped that, by and large, this could be sufficient to cover what might turn out to be Clarksons' maximum exposure in this respect. However, there was no requirement that Clarksons were to take any account of the total amount of the bond moneys in accepting bookings from their customers; and there was also no suggestion that the banks had any knowledge or concern about the relationship between the amounts which, individually and collectively, they agreed to guarantee by issuing the bonds and the amounts which might at any time be required to meet Clarksons' commitments within the objectives of cl 3(A).

There is also no indication, I think, that in issuing the bonds, the banks acted otherwise than individually to the extent of the various amounts which they undertook to pay to TOSG in the event of Clarksons' insolvency. However, this is of no importance, since, apart from whatever commission which may have been agreed with Clarksons for issuing the bonds, each bank required a counter-indemnity for the bond moneys from Clarksons in the usual way. Each such counter-indemnity was to take effect if and when the bonds were called by TOSG. It was common ground that TOSG, as well as the agency, when it came into existence later on, were well aware of the counter-indemnities.

Against this background, one can then ask oneself the first material question concerning the intention of the parties which set up the bonding arrangements: 'In the event of the bonds being called up, due to Clarksons' insolvency, was it envisaged that the banks would be entitled to prove for the amounts of their respective bonds in Clarksons' liquidation?' To this there can only be one answer: 'Yes, obviously, by reason of the counter-indemnities.' The common intention in this regard can be expressed by each bank saying, in effect, with the assent of Clarksons and TOSG: 'In the event of the bonds being called, we will immediately provide cash to TOSG to the extent of our bond. This will be applied by TOSG for the benefit of Clarksons' customers in accordance with TOSG's memorandum of association, and in particular cl 3(A). Any balance which is not needed for these purposes will be refunded to us. To the extent that there is no refund, we will be left with a claim in Clarksons' liquidation under our counter-indemnity.'

Since this was clearly the common intention of the parties concerned in setting up the bonding arrangements, I am bound to say that, right from the outset, I find it difficult to accept that any answer to the complex problems of this case can be correct in so far as it precludes the banks from proving in Clarksons' liquidation to the full extent of their counter-indemnities. Whatever may be the effect of the mysteries of the rule against double proof, to which I turn later, it would be strange indeed if it led to any other result.

I realise, however, that this approach is too simple and that, in ascertaining the parties' intentions, one must go on and pose a further, more complex, question to the parties who set up the bonding scheme, on the following lines: 'But, suppose that the bond moneys, or their residue after paying for the repatriation of stranded holidaymakers, are paid to customers of Clarksons who have paid deposits or prepaid for their holidays in full, but the bond moneys are found to be insufficient to reimburse them in full, what would then be the rights of the holidaymakers?' I think that the instant answer would be: 'Well, of course, they can claim in the liquidation of Clarksons for the balance.' This,

I think, is the right answer from every commonsense point of view, and it ought to be the right answer in law. However, suppose that the questioner then explained the rule against double proof and repeated the question, somewhat on the following lines: 'But, you see, the position is this. The bond moneys have been provided by the banks, at Clarksons' request and expense, to be applied by TOSG, at any rate as to the relevant part, in order to meet the debts owed by Clarksons to the holidaymakers, who will be one class of Clarksons' creditors in the event of Clarksons' insolvency. In a sense, therefore, the banks are in a position of sureties for the holidaymakers. In general, however, to simplify a legal rule called "the rule against double proof", a creditor can claim against the debtor the full amount of his debt, without having to give credit for anything received from a surety until he has had his debt repaid in full; and, in cases where the rule applies, the creditor can generally claim the full amount of his debt against the insolvent debtor to the exclusion of the surety. Alternatively, if there are competing claims by two creditors for what is in substance the same debt, then one must have priority over the other, because it would not be fair to the general body of creditors of the insolvent debtor that two dividends should be paid for what is in substance the same debt. What then?'

The intelligible part of the answer, no doubt after a good deal of head scratching, would in my view have been somewhat as follows: 'Well, I still think the same. I don't see how the banks can in any event be precluded from claiming on their counter-indemnities. They agreed to pay over the bond moneys for the benefit of the holidaymakers in the event of Clarksons becoming insolvent, but only on the basis that they would then be entitled to claim in Clarksons' liquidation under the counter-indemnities. I don't see how they can lose this right. I can see that Clarksons' liquidators should not pay a dividend on the bond moneys both to the banks and the holidaymakers. But the banks have paid out the bond moneys, and the holidaymakers will have received them, all as had been intended. The holidaymakers will find that they are fortunate to get these sums. And, after all, indirectly the bond moneys will have been made available to the holidaymakers by Clarksons themselves. Why, then, having received them with one hand, should the holidaymakers still be able to claim them from Clarksons' liquidators with the other? So, as I say, the banks should be entitled to a dividend on the bond moneys, and the holidaymakers to a dividend on the balance of their debt after giving credit for what they will have received out of the bond moneys. In so far as I understand your rule against double proof, I don't think that it was ever intended to apply here. But, if it does, then the banks must have the better claim.'

Those, I think, would have been the answers of the persons concerned in setting up the bonding arrangements to the problems raised by this case before the advent of the agency and the complications created by the assignments, to which I come later. I shall also have to deal with the inevitably much more sophisticated answers to these problems in the contrary sense given in the judgment of Nourse J and elaborated in the able argument of counsel for TOSG and the agency on this appeal. Meanwhile, however, in considering the presumed intentions of the various parties before Clarksons' insolvency, one should perhaps also bear in mind two other classes of persons in so far as they dealt with Clarksons in the knowledge of the bonding arrangements: the general body of Clarksons' creditors at any time, and in particular the holidaymakers themselves, who may well have made bookings with Clarksons partly in reliance on these arrangements. But, in my view, their answers would have been precisely to the same effect. The reason is that, from the point of view of justice and common sense, I do not see how they could have been different.

The original effect of the bonding arrangements

After giving answers on the foregoing lines, the holidaymakers would no doubt have added: 'Of course, if the law allows us more, then we would like to have it.' In my view, however, these answers were in accordance with the legal position at the stage when the bonds were established. None of the counsel who appeared on this appeal were able to refer us to any case in which an analogous position had been considered. But sometimes, in new situations, the court has

to find a just solution which stems simply from the nature of the transaction, the relationship between the parties and their presumed

common intention. For instance, the rules concerning rights and obligations of contribution in general average were originally based simply on 'common principles of justice' (see *Birkley v Presgrave* (1801) 1 East 220 at 227, 229, 102 ER 86 at 88, 89), and these rules were then applied by analogy in laying down the principles of contribution between co-sureties (see *Dering v Earl of Winchelsea* (1787) 1 Cox Eq Cas 318 at 322, [1775-1802] All ER Rep 140 at 143). In my view, the same approach applies here.

However, Nourse J reached a diametrically opposite conclusion, though under the constraint of the applicability of the rule against double proof, since the case before him proceeded on this basis. Having dealt with the analogy of the banks' position as sureties, to which I come later, he said:

> 'But in the end I do not need to rely on the analogy at all. I agree with [counsel for TOSG and the agency] that the decisive feature of the present case is TOSG's power to recoup to the customers any shortfall remaining after they had received all available dividends in Clarksons' liquidation. Once you get to that stage it is apparent that it would indeed be most inequitable for the banks to claim, as against the customers, a rateable proportion of any dividends receivable or received by them. That is not a narrow equity, but a broad one. And it is a surer basis for decision than any mere analogy.'

With the greatest respect, I find myself wholly in disagreement with this for a number of reasons. First, and quite generally, I think that every principle of 'broad equity' points in the directly opposite direction, for the reasons already mentioned. Second, I think that this definition of the 'decisive feature' begs the question. What is meant by 'all available dividends'? Are they the dividends payable after the banks have also proved for the bond moneys? Or is the assumption that the banks will have been excluded from proof? The test appears to me to be circular, since the question is whether or not the banks are entitled to prove. In this connection it must be borne in mind that the banks' prima facie right of proof will have arisen as soon as the bonds were called, so that, even if all the holidaymakers had then also proved at once for their full debts, the liquidators would have been faced with both claims to prove in full, as they are now. I therefore cannot see how this formulation can provide any answer to the problem. Third, I think that its premise in no way corresponds to the realities of what had been intended, and indeed happened. The whole purpose of the bonds was to provide a fund which, on Clarksons' insolvency, would be immediately available to TOSG for the benefit of the holidaymakers. It was never envisaged that the fund would be distributed only after the holidaymakers had proved in the liquidation and it was known what dividends the holidaymakers would receive. I appreciate, of course, that there could in theory have been an immediate partial distribution, with a reserve being held back until after completion of the liquidation. But this possibility seems to be too artificial to provide any sound basis, at any rate for the purpose of raising any 'broad equity'. The common intention, as well as the objects of TOSG, surely envisaged that every penny of the bond moneys should (apart from administrative expenses) be applied, as quickly as possible, to whatever extent was necessary to alleviate the plight of Clarksons' customers. The possibility of a reserve could only have arisen if there had been a surplus. I can see that, on that assumption, the test posed by Nourse J could have arisen, though subject to the reservations which I have already expressed about it, in deciding whether or not to return the surplus to the banks under the terms of the bonds. But where, as in the present case, the fund in fact proves to be insufficient to meet all the needs of the holidaymakers, it seems to me that this test provides no realistic basis in any event for arriving at a just solution of the problem.

It follows that in my view, leaving aside for the moment the advent of the agency and the effect of the assignments, the correct solution, on the basis of the parties' intentions and 'common principles of justice', is that the banks were to be entitled to prove for the full amount of the bonds, and that each holidaymaker was to be entitled to prove for the balance of his debt after giving credit for whatever he or she may have received out of the bond moneys. I formulate my conclusion at this stage in this way, because, but for

the advent of the agency, the available bond moneys would no doubt have been distributed pari passu between the relevant holidaymakers, as had indeed been TOSG's original intention; but this assumption does not affect what I would respectfully regard as the correct solution in principle. Accordingly, when the bonding scheme was set up, it was intended to operate in a way in which there would be no basis for the application of the rule against double proof.

The effect of the subsequent events

However, I must then turn to what in fact happened when the balance of the bond moneys was distributed by TOSG after the repatriation costs had been met. The facts have already been stated by Oliver LJ, and I need not repeat them. The agreement between TOSG and the agency was, if I may respectfully say so, an extremely sensible one, since it enabled the balance of the bond moneys, together with the new funds available to the agency, to be used to compensate all the relevant holidaymakers in full as quickly and conveniently as possible. However, what was the legal effect, if any, of TOSG paying one category of holidaymakers in full, until the bond moneys became exhausted, but subject in each case to taking an assignment in favour of the agency of these holidaymakers' debts, or of their right to prove in Clarksons' liquidation? This category consisted of those who had made prepayments to Clarksons direct, whereas it was thought that those who had made payments to travel agents would have to await the outcome of a test case. Subsequently they, together with those who had not been paid by TOSG out of the bond moneys, had their prepayments reimbursed by the agency in full. During the argument before us it was found convenient in this connection to refer to the holidaymakers paid by TOSG as 'the Browns' and to those paid by the agency as 'the Smiths', and to refer to the general body of both categories as 'the Brown-Smiths'. I will use the same terminology. The issue therefore turns on whether the banks are entitled to prove in Clarksons' liquidation to the extent of the sums paid to 'the Browns' to the exclusion of the agency, or vice versa, or whether the banks and the agency can both claim a dividend on these sums. It is of course not in dispute that the agency can prove in any event in respect of the payments which it made to 'the Smiths'.

I must begin by dealing shortly with two submissions put forward by counsel for the banks. The first was that the banks had a right to be subrogated to 'the Browns' as soon as 'the Browns' were paid out of the moneys provided by the banks, and that the assignments could not destroy this right of subrogation. In the same way as Oliver LJ I cannot accept this submission. Given the existence of the express counter-indemnities, of which both TOSG and the agency were aware at all times, and the unrestricted powers of TOSG, I cannot see any scope for any parallel implication of a right of subrogation to the same effect as the counter-indemnities.

Second, counsel for the banks submitted that, by requiring the assignments in favour of the agency, TOSG was in breach of some term to be implied as between TOSG and the banks, or possibily, as I understood him, in breach of trust to the banks, and that the banks could rely on these breaches against the agency, since it was in the position of an equitable assignee with notice. Again, I think that these submissions go too far. If one regards the agency as representing all 'the Smiths', I can see, as submitted by counsel for TOSG and the agency, that under the terms of the bonds, which incorporated the wide objects of TOSG, TOSG was entitled to do anything which might be of benefit to 'the Smiths'. Even on this assumption, however, there remains the question whether the assignments had the effect of excluding the banks' right of proof under the counter-indemnities or whether the banks and the agency can both prove. In my view the assignments have no effect on the conclusions which I have already expressed, for a number of alternative reasons which all lead to this result.

The first point in this connection is that I cannot accept any of the arguments of counsel for the banks, which in the end he did not strongly maintain, to the effect that the banks and the agency can both prove and receive a dividend in respect of the payments made by TOSG to 'the Browns'. This would be unfair to the general body of Clarksons' creditors and inconsistent with the principle of the rule against double proof, whether or not this rule is strictly applicable in the circumstances of this case.

[1984] 1 All ER 628 at 649

Second, as it seems to me, since 'the Browns' were paid by TOSG in full, out of the bond moneys which had been specifically arranged to be provided by Clarksons for their benefit in the event of Clarksons' insolvency, 'the Browns' had no right of proof thereafter, and nothing which they could effectively assign to the agency. There were then no debts owed by Clarksons to 'the Browns' which remained to be assigned. Council for TOSG and the agency countered this by

submitting that 'the Browns' cannot for this purpose be considered in isolation, but that, having regard to the reasons which underlay the agreement between TOSG and the agency, the division between 'Browns' and 'Smiths' should be ignored, and that the position should be tested by reference to 'the Brown-Smiths' as a whole, as though TOSG had made a partial payment towards the debts of all the relevant holidaymakers pari passu and had then taken assignments from all of them in favour of the agency. I was at first greatly attracted by this argument, but on reflection it seems to me again that it displaces reality in favour of theoretical possibilities, though on this occasion in a different context. Why should the legal effects of the assignments not be judged by reference to what actually happened? Admittedly, the agreement between TOSG and the agency could have been framed differently, and less conveniently, by each party paying all 'the Brown-Smiths' pari passu, and all of them could then have effected assignments in favour of the agency in consideration of the payments made to all of them by TOSG. But, since this did not in fact happen, why should the effect of the assignments fall to be determined on this hypothetical basis?

Third, however, let it be assumed that this is wrong, and that each transaction between TOSG and one of 'the Browns' is to be regarded as valid and effective in the sense that it constituted a purchase of each debt by TOSG in consideration of its assignment to the agency, and not a payment which extinguished the debt. What is the position then?

The first answer in my view is that the assignments would still have no substantial effect, because they would not entitle the agency to prove in Clarksons' liquidation in competition with the banks. For the reasons stated in the judgment of Slade LJ, which I have seen and with which I respectfully agree, the agency cannot, as TOSG's assignee, be in any better position than TOSG itself. However, it cannot possibly have been in the contemplation of any of the parties, when the bonding scheme was set up, that TOSG might be entitled to buy up the debts of the holidaymakers in order to seek to acquire claims in the liquidation which would rank in priority over the claims of the banks under the counter-indemnities. Any such suggestion as to the rights of TOSG would transgress the common intention of the parties to the bonding scheme to an even greater extent than in relation to the rights of the holidaymakers themselves, with which I have dealt at the beginning of this judgment.

Nevertheless, I can see the force of the argument, though to my mind only a technical one, that the correct analysis resulting from the assignments on these assumptions is that they have the effect of bringing the rule against double proof into operation between the agency and the banks. On that basis, however, it seems to me to be clear, for the reasons explained in the judgment of Oliver LJ, that the effect of the rule in the circumstances of this case is that the banks can prove to the exclusion of the agency. Here again I respectfully differ from Nourse J. He said:

> 'In all the circumstances, if the suretyship analogy is to be applied and carried through, the case is clearly one where there was a guarantee of the whole debt, subject to a limitation on the liability of the surety in the amount of the bond moneys.'

In my view, however, there was clearly no guarantee of the whole debt by the banks, either collectively or, as is more relevant, individually. If the language of the authorities concerning the rule against double proof is to be used at all, then each bank guaranteed, to use the word loosely and I think inaccurately, an indeterminate part of an unknown fluctuating balance up to the limit of its bond. With the greatest respect to Nourse J, I cannot begin to see how the terms of the bonds, albeit that they incorporated all the terms of TOSG's memorandum of association, can be regarded as having guaranteed the whole of any debt or debts whatever. I have already set out earlier in this judgment what appears to me to be a clear formulation of the position of the banks in this regard.

[1984] 1 All ER 628 at 650

Accordingly, even if the rule against double proof is applicable, it follows from the analysis of the authorities in the judgment of Oliver LJ that the banks can prove to the exclusion of the agency.

For all these reasons I would allow this appeal.

SLADE LJ.

I agree that this appeal should be allowed. Oliver LJ has stated the facts and I will not repeat them, save to the extent necessary to explain my own conclusions.

I think that the task of Nourse J was made more difficult by the fact that no argument was addressed to him in support of the contention that the rule against double proof has no application in the present case and that there is accordingly no reason why both the four plaintiff banks and Air Travel Reserve Fund Agency (the agency) should not prove in respect of the relevant debts. In this court we have had the assistance of submissions by counsel for the banks (albeit in the alternative) in support of this contention, and submissions from counsel for TOSG and the agency and counsel for the liquidators of Clarksons in opposition to it. In the end, for reasons which I will state, I have been convinced that the contention is unsustainable. Nevertheless, a substantial part of the argument in this court has centred round it and I have found it helpful in finally identifying what I regard as the important signposts in this jungle of obscure legal territory.

I have had the advantage of reading in draft the judgments of Oliver and Kerr LJJ. Since I agree with their conclusions that the rule against double proof does apply and that the claim of the banks takes priority to that of the agency, I hope that it will not appear discourteous if I deal less specifically than they have done with the able and multifarious arguments which all counsel have addressed to us. I propose to do little more than explain the route which leads me to these conclusions.

As soon as the banks paid the bond moneys to TOSG on 16 August 1974, they became immediately entitled to prove in the liquidation of Clarksons in respect of the full amounts so paid, by virtue of the counter-indemnities given them by Clarksons. Under the express provisions of the bonds, they had a right to demand repayment by TOSG of such part of the bond moneys as should not be expended by TOSG in the performance and execution of its rights, duties, powers and discretions as set out in TOSG's memorandum and articles of association. This right, however, was more theoretical than substantial, since Clarksons was hopelessly insolvent and there was no real prospect of TOSG failing to expend the whole of the bond moneys in this manner.

The banks, in my judgment, had a contractual right (arising by necessary implication from the terms of the bonds) to prevent TOSG from expending the bond moneys otherwise than in the performance and execution of its rights, duties, powers and discretions as set out in TOSG's constitution. Subject to this limitation, however, the choice was that of TOSG as to how it should spend the bond moneys and the banks could not, as a matter of contract, complain about such expenditure, even though it would inevitably prejudice pro tanto the banks' theoretical rights of subsequently obtaining recoupment by TOSG of unexpended bond moneys.

TOSG, having received the bond moneys, in accordance with the powers given it by its memorandum, expended some £956,000 in repatriating customers of Clarksons. The banks make no complaint about this expenditure. Though it diminished the banks' theoretical rights of recoupment against TOSG, TOSG were plainly entitled to effect it and it did not prejudice the banks' right of proof in the liquidation.

The dispute in the present case has arisen because of the arrangements made by TOSG and the agency in July 1975 for dealing with the residue of the bond moneys held by TOSG, in respect of the bonds provided by Clarksons. These arrangements have been set out more fully by Oliver LJ in his judgment, so I need only refer to their contents quite briefly.

The agreement of 23 July 1975 (the assignment agreement) made between the agency and TOSG provided, inter alia, that TOSG would pay out 'non-T.C. claims' (non test-case claims) in full as soon as reasonably practical, until the bond moneys (less a retention fund) were exhausted or until all non-TC claims had been paid in full, and that, when paying any claim, TOSG would obtain an assignment in favour of the agency from the

[1984] 1 All ER 628 at 651

payee of his right to prove in the liquidation of Clarksons for the full amount of his claim.

This provision was duly implemented in the manner contemplated by the assignment agreement. TOSG drew cheques amounting to about £1·43268m in favour of customers presenting non-TC claims, which were expressed as not to be honoured unless the assignment form on the back had been signed by the payee; and this form effected an assignment to the agency of all the customer's rights to prove in the liquidation of Clarksons in respect of overseas holidays, which proofs he had lodged with the joint liquidators.

It would have been possible for the agency and TOSG so to arrange matters so that, when TOSG paid over cheques in respect of the claims in question, it did so on the terms that the customers released all their claims in the liquidation, so that such claims were extinguished. However, the arrangements actually made were, instead, clearly intended to have the effect of operating as assignments of the relevant choses in action, consisting of the customers' rights to prove in the liquidation, and thus to keep the claims alive.

In the court below, it was submitted by the banks, inter alia, that the assignment agreement was ultra vires TOSG, in so far as it provided for the claims in the liquidation of customers who were paid by TOSG to be assigned to the agency. Nourse J, in my opinion, correctly rejected this submission and it has not been pursued in this court. At one stage in the argument before us, counsel for the banks sought to argue that TOSG, in arranging for the claims of customers who were paid by it to be assigned to the agency, was in breach of an implied term of the contract entered into between TOSG and the banks when the bonding arrangements were concluded. In my opinion, however, this contention is not well founded. I think that, as a matter of contract, the banks could not complain if TOSG used the bond moneys in any manner authorised by TOSG's constitution.

However, merely because TOSG was acting neither ultra vires nor in breach of contract in arranging these assignments, it does not follow that the assignments had the legal effect of substantially impairing the banks' rights of proof in the liquidation. For that is the effect of the claim of the agency. It boldly asserts not only that, by virtue of the assignments, it has become entitled to prove in the place of the relevant holidaymakers for the £1·43268m but that the banks' previously existing rights of proof have in effect pro tanto been wholly extinguished, because the rule against double proof applies and the agency's proof takes priority to that of the banks.

In considering this claim of the agency, I would begin by making these observations. The agency is itself a body set up by statute under the Air Travel Reserve Fund Act 1975, with the broad intention of mitigating the losses suffered by holidaymakers on account of the inability of air travel organisers to meet their financial commitments. Furthermore, it has unquestionably done much to assist those disappointed customers of Clarksons who were not repatriated or paid by TOSG. Nevertheless, these points and the identity of the agency as assignee of the relevant rights of proof are, in my opinion, immaterial for present purposes.

On their true legal analysis, in my opinion, the effect of the relevant transactions was that: (a) TOSG purchased for £1·43268 m the rights of proof of the respective holidaymakers in question (whom I will call 'the assigning holidaymakers'); (b) TOSG directed that the respective purchases should be completed by assignments, not to itself but to the agency.

In these circumstances, and I regard this as a point of crucial importance, the agency, in my opinion, stands in the position in which TOSG would now find itself if it had taken the assignments in favour of itself. Though it is common ground that rights of proof are in principle assignable as choses in action, TOSG manifestly could not have conferred on the agency better rights of proof in respect of the debts of the assigning holidaymakers than it could have obtained for itself. The fact that the assignee happens to be the agency is immaterial.

At this point I find my approach to this case rather different from that of the judge. In the course of his judgment, after saying that the rule against double proof prevented both the banks and the agency from together proving, he said:

[1984] 1 All ER 628 at 652

'[Counsel for the banks] accepts that the agency, as the assignee of the customers' rights to prove in the liquidation is in the same position vis-à-vis the banks as the customers themselves would have been. Accordingly, the only question which I have to decide is whether, at the material time, the banks or the customers had the better right of proof. The reduction of the question to that simple form does not mean that the answer is simple.'

As will appear from what I have already said, I look at the matter rather differently. Though I agree that the rights of proof of TOSG, through which the agency claims, could not have been *better* than those of the assigning holidaymakers through which TOSG would have claimed, I do not think it should be assumed that the rights of TOSG to prove in competition with the banks would necessarily have been as good as those of the assigning holidaymakers. For reasons which will appear, I think it was only the expenditure of moneys by TOSG in purchasing the relevant rights of proof in such manner as to keep the relevant debts of the holidaymakers alive which caused a double proof situation to crystallise. If such purchase had never taken place and the assigning holidaymakers had been left to prove in respect of their own debts, I think it possible that no question of double proof would have arisen as between them and the banks. Accordingly, in my judgment, the relevant inquiry is: what would have been the position of TOSG vis-à-vis the banks in relation to proof if the assignments had been taken by TOSG in favour of itself? Two questions thus fall to be answered. (1) On the footing that the relevant rights of proof had been assigned to TOSG itself, would the rule against double proof have applied so as to prevent TOSG and the banks from proving in competition with one another? (2) If the answer to question (1) is Yes, would TOSG or the banks have had the better right of proof?

As to question (1) above, the true principle of the rule against double proof, stated by Mellish LJ in *Re Oriental Commercial Bank, ex p European Bank* (1871) LR 7 Ch App 99 at 103, is that--

'there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts.'

Earlier in the same passage of his judgment, Mellish LJ had likewise made it plain that the rule is directed against payment of more than one dividend in respect of the same debt, rather than against presentation of more than one proof. In many cases, such as the present, where more than one proof has been presented, one may find what was sometimes described in argument as a 'potential double proof situation', which can only be finally resolved at a later stage, having regard to the facts subsisting at the time when a dividend is about to be paid (for example, having full regard to the arrangements made pursuant to the assignment agreement in the present case). The purpose of the rule is, of course, to ensure pari passu distribution of the assets comprised in the estate of an insolvent in pro rata discharge of his liabilities. The payment of more than one dividend in respect of what is in substance the same debt would give the relevant proving creditors a share of the available assets larger than the share properly attributable to the debt in question.

Difficulty may well arise in determining whether, in any given case, two proofs are in respect of what is in substance the same debt. Though various broad tests have been canvassed by both Bar and Bench in argument in this case, I have, for my own part, found none of them wholly satisfactory. The question can, I think, only be determined by reference to the particular facts of the case before the court, bearing in mind that it is the substance of the relevant liability, rather than the form, on which attention must be concentrated.

On the facts of the present case, I have come to the clear conclusion that, if TOSG had itself taken assignments of the rights of proof of the assigning holidaymakers and had then sought to prove in respect of the debts of those holidaymakers, it would have been proving for what were in substance the same debts as an equivalent part (£1·43268m) in respect of which the banks were proving. The matter may be tested this way. TOSG would unquestionably have been claiming in respect of the debts owed by Clarksons to

[1984] 1 All ER 628 at 653

the assigning holidaymakers. Though in form the banks' claims arise under the counter-indemnities given them by Clarksons in respect of the bond moneys, in substance they are attributable to the debts owed by Clarksons to the assigning holidaymakers, because: (i) it was only the actual expenditure of bond moneys by TOSG which pro tanto finally crystallised the liability of Clarksons to indemnify the banks, because it finally destroyed any possibility of the banks obtaining recoupment from TOSG; (ii) the particular expenditure of bond moneys by TOSG which finally crystallises

the liability of Clarksons to indemnify the banks in respect of the £1·43268m was expenditure in the purchase of these very same debts owed by Clarksons to the assigning holidaymakers.

In short, in the contingency now under discussion, the joint liquidators would find themselves faced with two competing proofs, namely one at the suit of TOSG in respect of the debts of the assigning holidaymakers and one at the suit of the banks which arose as a result of TOSG purchasing those very same debts. Subject to the rule against double proof, the substantial effect of the purchase of the debts by TOSG was, I think, to increase the provable liabilities of Clarksons by £1·43268m because, until that event, it was always possible that the banks would, in due course, recoup this amount from TOSG, and accordingly would not be entitled to receive any dividend in respect of it in the liquidation of Clarksons.

In these circumstances, regarding the matter as one of substance, I find it impossible to say that if TOSG had itself taken assignments of the rights of proof of the assigning holidaymakers and had then sought to prove for the £1·43268m, its proof and the banks' proofs for the equivalent amounts would not have been in respect of the same debts. It would not, in my view, have been open to TOSG and the assigning holidaymakers, even with the consent of the banks (which was never obtained), to prejudice the general body of creditors by effecting transactions of this kind.

If this be correct, it can make no difference in the context of the rule against double proof that TOSG in fact directed the assignments to be made in favour of the agency. The rule must still apply for the protection of the general body of creditors, whichever of the banks and the agency is entitled to invoke it, so as to exclude the other.

I now revert to question (2) above. On the hypothesis that TOSG had taken assignments of the relevant debts in favour of itself, who would have been entitled to the better rights of proof as between itself and the banks? The judge considered that the substance of the relationship between Clarksons, its customers, TOSG and the banks was that the banks were sureties for Clarksons' indebtedness to one class of its creditors, namely its holidaymaker customers. He recognised that the interposition of TOSG between the banks and the customers gave rise to a distinction, but thought that it was not one which affected the substance of the relationship. As he put it: 'TSOG was merely a trustee or, if you prefer it, in the broad sense an agent, for the customers.' On the footing that the banks were to be treated as sureties for Clarksons' indebtedness to its customers, he then proceeded to draw certain analogies with the suretyship cases.

As I have already mentioned, the judge regarded the crucial question for decision as being whether at the material time the banks or the holidaymakers had the better right of proof. On this assumption and on the footing that in substance the banks were sureties for Clarksons' indebtedness to the assigning holidaymakers, I recognise that some assistance might fall to be derived from the suretyship cases, by way of analogy.

Nevertheless, for reasons which I have tried to explain, I think that for the purpose of determining priorities in the liquidation, attention must be focused not so much on the relationship between the banks and the holidaymakers as on that between the banks and TOSG. Indeed, I do not think that the banks can be treated as having had any relationship at all with the holidaymakers. When the bonding arrangements were originally made, the banks did, of course, know and contemplate that, if Clarksons' business failed, and the bond moneys became payable to TOSG, TOSG would use them, so far as necessary, to alleviate the consequences to Clarksons' customers of such failure. If, however, at the time when the bonding arrangements had been made, it had been suggested to the banks that, in the event of the liquidation of Clarksons, the banks' rights in the liquidation would have fallen to be determined on the footing that they were sureties for Clarksons'

[1984] 1 All ER 628 at 654

liabilities to its holidaymakers, I think they would have replied, and would have been justified in replying, that their relationship was solely with TOSG and Clarksons. The banks would have appreciated that, if Clarksons went into liquidation and they became obliged to pay the bond moneys to TOSG, TOSG would be entitled to spend them for the benefit of Clarksons' holidaymakers in accordance with its constitution and that they would not be entitled to complain if it did. Nevertheless, the holidaymakers would have had no rights against the banks and would have owed them no duties. The banks themselves would have had no rights against the holidaymakers and owed them no duties. In the event

of the banks becoming obliged to pay the bond moneys to TOSG, their relevant rights would have been simply: (a) a right to prevent TOSG from spending the moneys otherwise than in accordance with its constitution; (b) a right to recover from TOSG any of the moneys not expended by it; (c) a right to prove in the liquidation of Clarksons in respect of the debts which arose in the banks' favour under the counter-indemnities, immediately the bond moneys were paid to TOSG, giving credit for any moneys which might thereafter be recouped to them by TOSG. This brief analysis, to my mind, illustrates how far removed from the relationship of creditor, surety and debtor was the relationship of TOSG, the banks and Clarksons at the time when the bonding arrangements were concluded. The suretyship analogy can only give firm guidance in determining the order of priorities of the banks and TOSG (through whom the agency claims) in the liquidation of Clarksons if one identifies TOSG with the holidaymakers and this, in my opinion, is not a justifiable process.

Nevertheless, the many suretyship cases to which we have been referred do, in my opinion, show that, where both principal creditor and surety are seeking to prove in a bankruptcy in respect of what is in substance the same debt, so that a double proof situation arises, the court will seek to determine the priorities of the two supposed rights of proof by reference to the expressed or presumed intentions of the parties, as manifested in the contract by which the surety undertook his liability. In particular, it will not allow a creditor, who is at liberty to increase the balance due from the debtor, to rely on any such increase in such a manner as to prejudice the surety's rights of proof in the bankruptcy of the debtor, where to do so would be inequitable having regard to the expressed or presumed intentions of the parties as so manifested (see, for example, *Ellis v Emmanuel* (1876) 1 Ex D 157 at 163-164, [1874-80] All ER Rep 1081 at 1083 per Blackburn J). To this limited extent, I think that the suretyship cases do afford some guidance by analogy in the present case for the purpose of determining the respective priorities of the rights of proof of the banks and TOSG (through whom the agency claims) in respect of the £1·43268m.

I, therefore, revert to a consideration of the expressed and presumed intentions of the banks and TOSG as at the date when the bonding arrangements were concluded. I do not think it is disputed that TOSG, when it entered into these arrangements, was well aware of the counter-indemnities which had been or were to be given by Clarksons to the banks in respect of any moneys that might become payable by the banks to TOSG. These counter-indemnities were, I think, part of the essential background of the bonding arrangements. Since the events on which the moneys were expressed to become payable under the bonds all presupposed that Clarksons would already be in, or on the verge of, an insolvent liquidation, TOSG must have well known that the banks intended to prove in the liquidation of Clarksons in respect of any such moneys. The present contention of the agency seems to me, on analysis, by necessary implication to involve the proposition that TOSG would have been at liberty (a) to expend the entirety of the bond moneys in purchasing debts of disappointed holidaymakers, (b) then to inform the banks that not a penny was repayable to them by TOSG under the bonds, because all the bond moneys had been properly spent, and (c) then to assert that the banks had no rights to prove for anything whatever in the liquidation, since they would be proving in respect of the same debts as TOSG, and TOSG had the prior right of proof.

I would accept propositions (a) and (b) but find myself quite unable to accept proposition (c). I accept that the purchase by TOSG of debts of disappointed holidaymakers would not actually have involved any breach by TOSG of any express or implied

contractual term of the arrangements. Nevertheless, the parties to the bonding arrangements cannot, in my opinion, reasonably be supposed to have contemplated, at the date when they were concluded, that TOSG would have the right to expend bond moneys in such manner as to elevate itself into the position of a proving creditor in Clarksons' liquidation, while at the same time finally destroying the subsisting rights of the banks both (i) to obtain any recoupment from TOSG in respect of the bond moneys, and (ii) to prove in the liquidation. Such an inference would, in my opinion, have been inconsistent with the nature of the bonding arrangements and would have produced a thoroughly inequitable result.

Accordingly, I conclude that the double proof rule applies in respect of the £1·43268m and that, if TOSG had taken an assignment of the assigning holidaymakers' debts in favour of itself, the banks would have had a better right of proof in respect of this sum. As I have already explained, I think that the agency can be in no better position than TOSG itself would have been. The banks, in my judgment, therefore have the better right of proof.

Nourse J, in reaching the contrary conclusion, relied in part on possible analogies with the reported cases concerned with principal and surety. I have already referred to this point. However, he attached greater importance on the fact that the power of TOSG 'to alleviate the consequences and so forth of Clarksons' business failure clearly enabled TOSG to recoup to the customers any shortfall remaining *after* they had received all available dividends in Clarkson's liquidation'. He concluded that in the end he did not need to rely on the analogy with the cases relating to principal and surety at all. He said:

> 'I agree with [counsel for TOSG and the agency] that the decisive feature of the present case is TOSG's power to recoup to the customers any shortfall remaining after they had received all available dividends in Clarksons' liquidation. Once you get to that stage it is apparent that it would indeed be most inequitable for the banks to claim, as against the customers, a rateable proportion of any dividends receivable or received by them. That is not a narrow equity, but a broad one. And it is a surer basis for decision than any mere analogy.'

With great respect to the judge, I am not able to agree with this reasoning for two reasons. First, the amount of the dividends available to Clarksons' customers in its liquidation must partially depend on the resolution of the very questions which are in issue in the present litigation. I find it difficult to see how in practice TOSG could possibly have awaited the completion of the liquidation of Clarksons before taking such steps as it was entitled and bound to take under its constitution for the relief of Clarksons' holidaymakers. Second, as I have already indicated, I think that, when broader questions of equity fall to be considered, the relevant comparison is not between the respective rights of proof of the banks and of the holidaymakers, but between the respective rights of proof of the banks and TOSG. When the latter comparison is made, for the reasons which I hope will have already appeared, I am of the clear opinion that any broader considerations of equity favour the banks in preference to TOSG and likewise in preference to the agency, which claims through TOSG.

For all these reasons. I would concur in allowing this appeal.

Appeal allowed. Leave to appeal to House of Lords granted on condition that if and to the extent that the liquidators are incurred with costs in the House of Lords the agency will pay the liquidators on an indemnity basis.

Solicitors: Wilde Sapte (for the banks); Norton Rose Botterell & Roche (for TOSG and the agency); Stephenson Harwood (for the liquidators of Clarksons).

Mary Rose Plummer Barrister.

Tab 14

Indexed as:

Deco Electric Ltd. v. Republic Building Systems Alberta Ltd.

[1983] A.J. No. 726

25 Alta. L.R. (2d) 347

45 A.R. 325

Action No. 8203-06972

Alberta Court of Queen's Bench
Judicial District of Edmonton

Master Funduk

March 25, 1983.

Counsel:

N. Nichols, for the plaintiff.
S. Noonan, for Lu-Mac Industries (execution creditor).
A. Stacy, for Atco Metal Ltd.

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1 **MASTER FUNDUK**:-- This is an application by the plaintiff for an order that money presently in court be paid to it. Two execution creditors of the defendant appeared on the application and opposed it. The facts are as follows.

2 On March 2, 1982, the plaintiff commenced an action in debt against the defendant. On the same day it obtained an order allowing it to issue a garnishee summons before judgment. Also on the same day it issued a garnishes summons.

3 The amount claimed in the garnishes summons was $10,238.39. The claim of the plaintiff was for $10,218.39, so the amount claimed in the garnishee summons was for the plaintiffs claim, and costs of $20.00.

4 On March 2, 1982, when the plaintiff issued the garnishee summons, there were no subsisting writs of execution with the Sheriff for the Judicial District of Edmonton, so the plaintiff could garnishee only for its claim.

5 About March 12, 1982, the garnishee paid into court the sum of $10,238.39.

6 In April, 1982, the defendant delivered a statement of defence.

7 In May, 1982, an order was obtained directing that out of the money in court the sum of $8,200.00 and costs be paid to the plaintiff and that the balance of the money be held pending the trial of the action. The balance, which is still in court, is $1,723.09.

8 On November 4, 1982, the plaintiff recovered judgment against the defendant for $3,173.04 and costs of $115.00. The plaintiff also obtained from the defendant a consent to payment out to the plaintiff of the balance of the money.

9 The Clerk of the court refused to accept the consent to payment out unless he had a clear Form A or, alternatively, an order of the court. In my view the Clerk was correct in taking that approach.

10 The money was paid into court pursuant to garnishee process. Accordingly, it could be paid directly to the plaintiff only under the aegis of Rule 480. If the plaintiff had been able to provide the Clerk with a clear Form A, the Clerk could have properly paid the money to the plaintiff pursuant to the consent to payment out. Lacking a clear Form A the Clerk could not comply with the consent to payment out.

11 I would note that Rule 480 is solely a procedural rule. Whether, the money be paid to a creditor by consent or by order of the court the overriding limitation is the Execution Creditore Act. Any payment to a creditor pursuant to Rule 480 cannot violate the Execution Creditors Act.

12 The difficulty the plaintiff faced is that by the time it got its judgment and consent to payment out there were three subsisting execution creditors.

13 In its notice of motion the plaintiff asks for "an Order to pay monies held to the credit of this action to the plaintiff". The notice of motion also states:

> AND FURTHER TAKE NOTICE that in support of this application the plaintiff relies on the following grounds and statutory provisions.
>
> 1. When the money was paid into court pursuant to the plaintiff's Garnishee Summons, there were not outstanding writs.
> 2. The Execution Creditors Act, a. 8(1).
> 3. Rule 470 of the Alberta Rules of Court.

14 The first issue is the Interpretation of a. 8(1) of the Execution Creditors Act, R.S.A. 1980, c. E-14. Counsel for the plaintiff submits that the court can order that the money be paid other than in accordance with how it would be distributed as required by the Act. Section 8 reads:

> 8(1) Except in cases where it is otherwise specifically provided by this Act, or where it is otherwise ordered by the court, all money paid into court by virtue of a garnishee summons shall without an order be paid by the clerk of the court to the sheriff of his judicial district,
>
> (a) if the garnishee summons is based on a judgment, immediately after the expiration of the 10th day after service of the summons on the judgment

debtor and on the garnishee or after any longer period that may be ordered by the court or judge, or

(b) if the garnishee summons is issued before judgment, immediately on the plaintiff entering judgment against the defendant or at any later time that may be ordered by the court of judge.

(2) Immediately on the receipt by the Sheriff of any money from the clerk of the court

(a) if there are no subsisting writs of execution against the debtor whose debt was garnisheed or against any of the persons entitled to the money, the sheriff shall immediately pay out the money or the part of the money in respect of which he has no subsisting writs of execution either to the persons entitled by law to receive it or to their solicitors, or

(b) if there is a subsisting execution against the debtor or any of the persons entitled by law to receive the money, the sheriff shall retain the money and shall distribute it as money levied under execution among the creditors of the debtor or the person entitled to receive the money, as the case may be. (emphasis added)

15 In my view, the emphasized phrase has nothing to do with how money caught by garnishee process is to be distributed among creditors of the debtor. The phrase is in subs. (1) and relates only to that subsection. Sub-section (1) is only a "transfer" provision, that is, it deals with the transfer of garnishee money by the Clerk to the Sheriff.

16 The Clerk can pay the garnishee money to the Sheriff without an order of the court. There are then two exceptions to that general provision. They are:

(a) where the Act otherwise specifically provides;
(b) where it is otherwise ordered by the court.

The "it" in the phrase in question has regard to the payment by the Clerk to the Sheriff.

17 In my view, it would be an unreasonable interpretation to find the phrase gives jurisdiction to the court to override the scheme of distribution set by the Act.

18 The general scheme of the Act is to provide for a pro rata sharing of execution proceeds between execution creditors of a judgment debtor. The philosophy is that it is more equitable to have a pro rata sharing rather than having execution creditors vying with each other to beat each other to the punch, as it were.

19 Section 2 provides that all property seized or attached by virtue of the processes indicated "shall be deemed to have been attached on behalf of all creditors entitled by this Act to share in any money received by the sheriff by reason of the seizure or attachment". What creditors are "entitled by this Act" to share? The title of the Act gives the answer: execution creditors of the judgment debtor, being those who have subsisting writs of execution filed with the Sheriff.

20 Garnishee is a specialized form of execution designed to attach a particular kind of property (a chose in action) which could not be attached by the ordinary writ of execution. The Act carries

this concept forward in s. 8(2)(b) by treating money caught by garnishee, for the purpose of distribution, as if it had been money levied under execution.

21 If the Sheriff had seized an automobile of the defendant, under a writ of execution, and sold it, could the court order that the sale proceeds would go to one only of four execution creditors of equal rank? Could the court order that because at the time of seizure there was only the one writ of execution the sale proceeds should not have to be shared with the other three execution creditors who filed writs of execution after the seizure had been made? To ask the questions is to answer them. As money caught by garnishee must be treated as if it was money levied under execution, for distribution purposes, the same answers apply.

22 Any suggestion that it is "unfair" to the plaintiff that the money in court must be distributed in accordance with the Act is out of place. It is very common for execution creditors to "slip in" between the time of execution or garnishee and the time for distribution. The Act even builds in a waiting period which allows other creditors to file writs of execution and then share in the fruits.

23 For example, a garnishee summons is issued on March 1, 1983, and served on the garnishee on the same day. On that day there are two subsisting writs of execution in the Sheriff's hands. On March 9 the garnishee pays money into court. Between March 1 and March 9 three further writs of execution are filed with the Sheriff. On March 27 the Clerk pays the money to the Sheriff. Between March 9 and March 27 a further writ of execution is filed with the Sheriff. The Sheriff holds the money for 14 days: s. 10. During that 14 days five more writs of execution are filed with the Sheriff. On April 11 the Sheriff distributes the money. He has to distribute pro rata between 11 execution creditors. What started off as two execution creditors has now mushroomed to 11 execution creditors.

24 The first two execution creditors might think it unfair that the other nine execution creditors, who were not execution creditors at the time the garnishee summons was issued, should share in the proceeds. However, as pointed out by Clement, J.A., in Nemethy v. Wilkinson Company Ltd. (1978), 10 A.R. 336; 7 Alta. L.R. (2d) 30, in s. 10 "the legislature has expressed in imperative terms the time for distribution of sale moneys in the sheriff's hands, and the creditors to whom the distribution is to be made".

25 Considering the object of the Act, to provide for an orderly distribution of money realized by any of the processes listed in s. 2, and the scheme of distribution envisaged by the Act, it would be startling to conclude the legislature intended that the court was to have an overriding discretion to interfere with the scheme of distribution.

26 In Coutts & Co. v. Inland Revenue Commissioners, [1953] A.C. 267 (H.L.), Lord Reid states at p. 281:

> ... In general, if it is alleged that a statutory provision brings about a result which is so startling, one looks for some other possible meaning of the statute which will avoid such a result, because there is some presumption that Parliament does not intend its legislation to produce highly inequitable results ...

27 In Artemiou v. Procopiou, [1966] 1 Q.B. 878 (C.A.), Danckwerts, J., states at p. 888:

> An intention to produce an unreasonable result is not to be imputed to a statute if there is some other construction available ...

28 If words in a statute are capable of two or more meanings the approach is:

> ... In deciding which of these two meanings the Legislature intended the section to bear, I think the construction should be adopted which, upon a reading of the Act and its amendments as an entire enactment, appears to better accord with the body of the enactment than does the alternative construction.

per White, J., in R. v. Board of Commissioners (1926), 54 N.B.R. 138, at p. 143 (N.B.C.A.).

29 Words in a statute must be read in the context of the statute:

> ... Every clause of a statute should be construed with reference to the context and the other clauses of the Act, so as, so far as possible, to make a consistent enactment of the whole statute or series of statutes relating to the subject matter ...

per Lord Davy in Canada Sugar Refining Company v. The Queen, [1898] A.C. 735, at 741 (P.C.).

30 In Attorney-General v. Prince Augustus, [1957] A.C. 436 (P.C.), Viscount Simonds states at p. 461:

> ... For words, and particularly general words, cannot be read in isolation: their color and content axe derived from their context. So it is that I conceive it to be my right and duty to examine every word of a statute in its context, and I use "context" in its widest sense, which I have already indicated as including not only other enacting provisions of the same statute, but its preamble, the existing state of the law, other statutes in pari materia, and the mischief which I can, by those and other legitimate means, discern the statute was intended to remedy.

31 I consider s. 8(1) to be solely a procedural matter which deals only with the mechanics of transferring money from the Clerk to the Sheriff. The phrase in question must be interpreted in that context and in the context that the general scheme of the Act is for a pro rata distribution among execution creditors of equal rank.

32 One can think of examples where the court might "otherwise order". For example, if the garnishee pays money into court and files an answer stating that the debt attached belongs or may belong to some third person, Rule 475(1)(d); would it be proper for that to be ignored and the Clerk pay the money to the Sheriff? In such a case the court might well find it necessary to put a "hold" on the money until the matter is cleared up.

33 Another example, which is quite common, is where there are no subsisting writs of execution. The garnisheeing creditor can then obtain an order under Rule 480, supported by a clear Form A, for the Clerk to pay the money directly to him. Such an order does not disturb the scheme of the Act. If there are no subsisting writs of execution and the Clerk pays the money to the Sheriff the Sheriff shall "immediately pay out the money": s. 8(2)(a). In such a case an order under Rule 480 is an alternative to a transfer under s. 8(1)(a) and an immediate payment out under s. 8(2)(a). An order under Rule 480 would be an "otherwise order(ed)".

34 I do not consider the phrase "or where it is otherwise ordered by the court" in s. 8(1) to allow the court to alter the scheme of distribution mandated by the Act. If the phrase is taken out of context it would literally mean the court could not only alter the scheme of distribution between

creditors of equal rank but could also alter the scheme of distribution between creditors of different rank.

35 For example, an employee of an execution debtor can get a limited priority by virtue of s. 16. Could the court, under the guise of the phrase in s. 8(1), order that the employee will not receive any priority? Could the court order the employee is to receive a priority for one years wages? I think not.

36 Section 6 of the Act has the same clause as that in s. 8(1). Section 6 provides:

> 6. If money is paid into court under any garnishee proceedings in the court, it shall be available for distribution by the sheriff among the execution creditors of the debtor whose debt is garnisheed except when
>
> (a) the money paid into court is not liable to attachment,
> (b) the amount paid into court does not exceed the sum of $50.00,
> (c) by virtue of any statute or rule of court the money is required to be paid to the debtor as being exempt from attachment, or
> (d) it is otherwise ordered by the court

37 The only reported decision I am aware of that deals with s. 6 is Independent Order of Foresters v. Board of Trustees of Northern Irrigation District and Provincial Treasurer of Alberta, [1943] 3 W.W.R. 297 (Alta. S.C.T.D.); [1944] 1 W.W.R. 206 (Alta. C.A.). The facts are as follows.

38 The plaintiff purchased some debentures of the defendant, thus becoming a creditor of the defendant. The payment of the amounts secured by the debentures was guaranteed by the Crown.

39 There was default by the defendant and the plaintiff obtained judgments against it. The plaintiff garnished and also seized certain bonds. The Crown also obtained a judgment against the defendant.

40 The issue, which was a stated case of law before O'Connor, J., was whether the Crown could, as an execution creditor, share under the Execution Creditors Act with the plaintiff. The issue was generated because the Crown also happened to be surety for the debts which the plaintiff had received judgments against the defendant for. Although the plaintiff had not sued the Crown on the suretyship the suretyship was admitted in the agreed statement of facts.

41 O'Connor, J., in holding that the Crown was not entitled to share with the plaintiff, discussed the "double proof" problem if both the creditor and the surety can rank on the debtors estate. He states at p. 300-01:

> (2) Counsel for the plaintiff contends that it is inequitable to pay the money to the treasurer since the province has guaranteed payment of the debentures.
>
> A surety who compromised, at 4s. on the pound, his liability for his principal's debt, was held not to be entitled to share in a dividend of debentures which the creditor had obtained in the bankruptcy of the principal debtor: Ex parte Corry; in re Fothergill (1876), 3 Ch.D. 445; 45 L.J. Bk. 153. James, L.J., said (p. 155):

> 'In this case, the surety has paid 4s. in the pound. What is his equity against the creditor? If the surety has paid 20s. in the pound, he may exercise whatever right the principal debtor had against the creditor. But the creditor may first require payment of 20s. in the pound, and all that the surety can say is 'You have got something very valuable under the arrangement. I am willing to discharge my obligation to you by paying 20s. in the pound and when I have done that you must hand me over the security.' That seems to me to be the sole equity.'

In in re Coughlin & Co. (1923), 3 W.W.R. 1179, 33 Man. R. 499; 4 C.B.R. 294, Fullerton, J.A., said, p. 1179:

> 'In considering the right of a surety who has made payment to rank upon the estate the cases draw a distinction between two classes of guarantees, one where the contract is to be construed as a security for a part only of the debt and the other where it is to be construed as a security for the whole amount due or to become due with a provision limiting the surety's liability to pay any amount beyond a named sum ... In a case of a guarantee of the latter class the creditor is entitled to rank for the whole amount as the surety cannot be permitted to compete with the creditor for dividends in respect of a debt which the surety himself has guaranteed.'

Dennistoun, J.A., said p. 1182:

> 'It is to be noted that it is the 'debt' which is provable. There may be several claimants in respect to the 'debt'., but there is only one debt., and double proof in respect to it is not permitted.'

The principle is not limited to bankruptey.

In in re Oriental Commercial Bank; Ex parte European Bank (1872), L.R. 7 Ch. 99; 41 L.J., Ch. 217, Mellish, L.J., said, p. 218:

> 'Upon the main question the case of Rigby v. Macnamara (1795), 2 Cox. Eq. Cas. 415, tends to show that the rule in bankruptcy against double proof applies also in the Court of Chancery, and consequently applies in case of companies being wound up.'

In Martin v. McMullen (1891), 18 O.A.R. 559, Maclennan, J.A., said, P. 565:

> 'The cases which have been cited are cases in which the creditor had proved or had obtained dividends on the bankruptcy of the debtor, but the principle involved seems to be a general principle of equity, applicable to all cases of suretyship.'

See also in re Sass; Ex parte National Provincial Bank of England (1896), 2 Q.B. 12; 65 L.J.Q.B. 481. (emphasis added)

42 I pause to note that the judgment the Crown had obtained against the debtor was for some money the Crown had paid to honour its suretyship. There was, accordingly, a "double proof" problem if the Crown could rank with the plaintiff. The money the Crown had paid still left some of the plaintiffs judgments unsatisfied.

43 O'Connor, J., then goes on to deal with the applicability of the above principles in light of the Execution Creditors Act. He states, at pp. 302-03:

> (3) Counsel for the plaintiff further contends that if the treasurer is excluded from participation in the moneys attached and the proceeds of the bonds seized, this will save multiplicity of actions, and cites clause (g) of s. 34 of the Judicature Act, R.S.A. 1942, c. 129, in support of the court's jurisdiction to do this. He cites s. 3 of the Execution Creditors Act, 1934, c. 8 (now R.S.A. 1942, c. 122) and, as to the garnishee, s. 6, and, as to the execution, s. 12 of the said Act, which sections are as follows:
>
> > '3. Except only in the cases where it is otherwise specifically provided by this Act, all property seized or attached by virtue of any writ of execution, writ of attachment, garnishee proceedings or proceedings in the nature of equitable execution shall be deemed to have been attached on behalf of all creditors who are entitled by this Act to share in any money received by the sheriff by reason of such seizure or attachment; and all moneys realized thereby shall be dealt with and distributed by the sheriff of the district in which such seizure or attachment is made under the provisions of this Act.
> >
> > 6. Where any money is paid into court under any garnishee proceedings in the Supreme Court of Alberta or any District Court, the same shall be available for distribution by the sheriff amongst the execution creditors of the debtor whose debt is garnished except only in each of the following cases, namely:
> >
> > (a) When the money paid into court is not liable to attachment;
> > (b) When the amount paid into court does not exceed the sum of twenty-five dollars;
> > (c) When by virtue of any statute or Rule of Court the money is required to be paid to the debtor as being exempt from attachment; and
> > (d) When it is otherwise ordered by a court or judge.
> >
> > 12. When the amount received by the sheriff in respect of an execution is not sufficient to pay the claims of creditors and the executions with costs in full, the sheriff shall firstly retain his fees, and secondly, in the event of any creditor being entitled under the provisions of this Act to priority for costs, the sheriff shall pay such costs to that creditor, and thirdly, shall pay the claim of any person who is enti-

> tled to be paid in preference to any other creditor, and fourthly shall distribute the balance (if any) rateably amongst such execution creditors as are entitled to share therein under the provisions of this Act.'

> The cases of Tobin v. Commercial Inv't Co. (1916), 10 W.W.R. 123; 22 B.C.R. 481; 34 W.L.R. 23; Knight v. Knight (1734), 3 P. Wms. 334; 24 E.R. 1088, and McGowan v. Middleton (1883), 11 Q.B.D. 464; 52 L.J.Q.B. 355, show that the court will adapt its procedure to prevent multiplicity of actions but the plaintiff's right to prevent the defendant from sharing in the moneys in the hands of the sheriff must depend on substantive law. It is not a question of procedure.
>
> It is contended that s. 6, clause (d), permits the court to do justice between the parties. Counsel for the defendant treasurer argues that clause (d) is intended to permit the court to order payment to a garnishee creditor in cases where it is obvious that the other execution creditors would not be entitled to the money under the Act; for example, where there were no subsisting writs of execution in the sheriff's hands, or where the garnishing creditor was a wage earner or was otherwise entitled to be paid the money in priority to other claims. He relies on Bowerman v. Phillips (1888), 15 O.A.R. 679, in which it was held that the Ontario Creditors Relief Act did not permit one creditor to attack the judgment of another if the debt was bona fide.
>
> I find the sections are intended to permit the court to do justice between the parties, according to settled principles of law and equity. (emphasis added).
>
> Secs. 6 and 12 were intended to enable the court to deal with such a case as this according to law.
>
> I find the debenture holders of the irrigation district are exclusively entitled under their charge to the money and bonds of the irrigation district which are now or may hereafter come into the hands of the sheriff.

44 Section 3 of the 1934 Act is ss. 2 and 3 of the present Act. Sections 6 and 12 of the 1934 Act are the same sections in the present Act. The only differences are in the manner the sections are set up.

45 Although he does not so expressly state, it is implicit O'Connor, J., found that the equitable principle that a surety could not compete with the creditor in ranking on the debtors estate had not been altered by the Act.

46 On appeal, Ford, J.A., in delivering the judgment of the court, states at p. 209:

> ... it appeared to counsel for the parties that it might be advisable first to have determined the question as to whether the Crown in the right of the province was entitled to share with the plaintiff in the issue, in moneys realized by garnishee or under writs of execution. For that purpose a special case was agreed upon and signed by solicitors for all three parties to the issue.

After referring to the special case and the trial decision he continues at p. 216:

> ... As summarized in the factum on behalf of the provincial treasurer their submissions are as follows:
>
> (1) The Execution Creditors Act does not permit the court to grant priority to one execution creditor at the expense of another except as provided by the Act;
> (2) Alternatively, the plaintiff cannot claim priority in respect of the portion of the judgment which does not represent monies paid under the guarantee;
> (3) ...

And at p. 217-218:

> The province of Alberta became surety for the whole debt without limitation. Where a surety is liable to the creditor for the whole amount of the debtor's liability there is a principle running through the cases, sufficient of which are referred to in the judgment appealed from, which does not permit of the surety competing with the creditor in the realization of the assets of the principal debtor. While this principle finds its usual application in bankruptcy it is one of general application, applicable to all cases of suretyship.
>
> There is, in my opinion, nothing in the Execution Creditors Act, R.S.A. 1942, c. 122, the relevant portion of which is set out in the learned trial judge's reasons, which prevents the application of this principle, where, as here, the surety is attempting to compete with the creditor, whose debt has been guaranteed in full, by a judgment obtained ... (by the Crown against the debtor) ...
>
> To give effect, in the present proceeding, to the equities as between the province as surety and the plaintiff as the primary creditor, by answering the question submitted in consonance with the principle stated, does not amount to a setting aside directly or indirectly, or the impeaching of the judgment obtained by the surety, as contended on behalf of the defendants, respondents. The point involved in the question is not whether the judgment was properly obtained but whether the judgment creditor, a surety for the whole debt is entitled, as against the plaintiff, to share in what is realized under the plaintiff's executions and garnishee summonses.
>
> Nor does the giving effect, in the present proceedings, to the equities, as between the surety and the principal creditor, nullify, 'virtually' or at all, the provision of the Execution Creditors Act as also contended on behalf of the defendants.

And at pp. 219-20:

> If both surety and creditor were allowed to share in the sheriff's distribution, there is, I think, no doubt that the creditor would immediately have the right to take proceedings against the surety to recover the balance due him. Indeed in my

> opinion, the creditors, having a charge thereon, would have the right to claim the very dividend which the surety has received.
>
> In the way the issues have been brought before the court there is quite as much reason for the court now preventing the surety ranking inequitably in the sheriff's distribution, as against the creditor, as there is to prevent a surety so ranking in bankruptcy or in a distribution for the benefit of creditors. I find nothing in the Execution Creditors Act against the court's power to do so.

47 In effect, what the plaintiff wants is to have a priority over the other subsisting execution creditors. The plaintiff and the other execution creditors are all of equal rank. The plaintiffs claim is not of a nature which the Act, other legislation or law or equity gives a higher status to than the other execution creditors. There are no equities between the plaintiff and the other execution creditors.

48 The plaintiff's position is founded solely on the fact that at the time it garnisheed there were no execution creditors of the defendant. That fact does not support any principle in law or equity to give the plaintiff a priority. except for its costs in accordance with s. 11. Giving a full priority to the garnisheeing creditor in such circumstances would destroy the efficacy of the Act. It would "fix" the time of distribution at when the garnishee was issued. It would eliminate all subsequent execution creditors. I do not believe the legislators could have intended that result in any particular case, especially on the whim of the court. It would literally be at the whim of the court.

49 In my view, the proper approach to s. 6(d) is that set out by O'Connor, J. It is a matter of substantive law, not procedure. There must be a sound principle of law or equity for the court to be able to require a distribution which does not literally follow the mandate of the Act.

50 In my view, there is no principle of law or equity which enables the plaintiff to have a priority over the other subsisting execution creditors.

51 The application to have the money paid directly to the plaintiff is dismissed.

52 The Clerk of the court will transfer the money to the Sheriff for distribution by him in accordance with the Act.

qp/s/rpv/jpn

Tab 15

Case Name:

Re COUGHLIN & Co.

[1922] M.J. No. 42

[1923] 1 D.L.R. 632

Manitoba King's Bench

Macdonald, J.

Judgment: December 4, 1922

(13 paras.)

Counsel:

E. F. Haffner, for the Guarantee Co. of North America.

C. K. Guild, for the assignee.

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1 MACDONALD, J.--This is an appeal from the decision of Salter & Arnold, authorised trustees of the above debtor, disallowing the claim of the Guarantee Company of North America arising in the following manner:--

2 The debtors were engaged in business as commission dealers in cattle and as such were required under the Act respecting livestock being the Live Stock and Live Stock Products Act, 1917 (Can.), ch. 32, sec. 4, to furnish sufficient and satisfactory security for the proper accounting by such commission merchants of the proceeds of any sales received by them and of any money paid to them to effect any purchase.

3 In compliance with this provision the debtors were bonded by the Guarantee Company of North America in the sum of $10,000, themselves joining in the bond as principals and the said guarantee company as surety, the bond being taken to His Majesty the King for the benefit of those coming within the scope of the said sec. 4 (2). The debtors incurred liabilities to various consignors of cattle by disposing of their cattle, collecting the proceeds, which proceeds were largely in excess of the said sum of $10,000, and failing to account to the owners of the cattle for the proceeds arising from the sale thereof, the said guarantee company was called upon to make good and did make good their guarantee by payment to His Majesty the King of the said sum of $10,000, which amount

has been distributed among the owners of the cattle disposed of (to whom I shall refer as special creditors), and the said guarantee company now make claim against the estate of the debtors for the said sum of $10,000, which claim the authorised trustee disallows, and this is an appeal against such disallowance.

4 In the application for the bond the debtors jointly and severally agree to indemnify and hold harmless the said guarantee company from and against any and all loss, damage, expense and costs incurred by it under and by reason of the said bond, and under this indemnity the guarantee company's claim to rank as creditor against the estate of the debtors. The point that I am called upon to decide is whether or not the guarantee company is entitled to rank against the estate as it now stands, irrespective of the unpaid claims due special creditors whose claims arise from the sale by the debtors of their cattle.

5 Under the Bankruptcy Act 1919 (Can.), ch. 36, sec. 44, sub-sec. 2, all debts and liabilities present or future to which the debtor is pledged at the date of the receiving order or the making of the authorised assignment, or to which he may become pledged before his discharge by reason of any obligation incurred before the date of the receiving order or of the making of the authorised assignment, shall be deemed to be debts provable in bankruptcy, or in any proceeding under an authorised assignment.Under this section the guarantee company are clearly creditors, having paid the sum of $10,000 under their bond and for which the debtors agreed to idenmify them; but are they entitled to rank against the estate before the special creditors are fully paid?

6 The bond is given, not to secure a part of any indebtedness that may arise, but is given to secure the full amount of any account incurred by the principals and although the amount of the bond is limited to $10,000, yet it is a guarantee that the principals shall pay in full. It is strongly contended by counsel for the trustee that the special creditors, having proved against the estate of the debtors for the full amount of their claim and having received a dividend thereon, and the guarantee company having subsequent to the payment of such dividends paid the amount of their guarantee, that the guarantee company cannot prove their claim because that would be in contravention of the rule in bankruptcy that there cannot be a double proof against the same estate in respect of the same debt. *Re Oriental Commercial Bank; Ex parte European Bank* (1871), L.K, 7 Ch. 99.

7 The true principle is that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts. That applies to a case of principal and surety. There could not be a double proof in respect of that obligation; *Re Melton, Milk v.Towers*, [1918] 1 Ch. 37, at p. 48.

8 A surety guaranteed a bank the payment of all sums of money which then were or might thereafter from time to time become due or owing to the bank from their customer S., but nevertheless the total amount recoverable from the surety was not to exceed ú300. The guarantee was to be a continuing security and any dividends which the bank might receive in the bankruptcy of S. were not to prejudice their right to recover from the surety to the full extent of the guarantee any sums which after the receipt of such dividend might remain owing to them by S.

9 S. became bankrupt and the bank after receiving the ú300 from the surety claimed to prove in the bankruptcy to the full amount due to them from S.

10 The trustee in bankruptcy contended that the proof ought to be reduced by the amount the bank had received from the surety.

11 Held that the bank were entitled to prove for their whole debt.

12 When bankruptcy supervened the right of the principal creditor the bank, was to prove for that amount unless there was a surety and that surety was a surety for a part of the debt. In that case if the surety had paid that part then by virtue of that payment the right of proof which would have been the right of proof of the principal creditor becomes *pro tanto* the right of proof of the surety. The surety has a right having paid part of the debt in that way to stand *pro tanto* in the shoes of the principal creditor; and even if the principal creditor has proved and has received the dividend and the surety comes and repays the full amount the principal creditor would then be trustee for the surety of the amount of the dividend which he had so received: *Re Sass; Ex parte National Provincial Bank of England*, [1896] 2 Q.B. 12.

13 Following this case and several other cases cited by counsel I have come to the conclusion that all I have to decide is whether as between Coughlin & Co., and the surety the surety became a surety for the whole of the debt or for part and in my judgment they became surety for the whole, notwithstanding the fact that the amount of the liability is limited, and they in consequence are not entitled to prove against the estate of the debtors, except subject to the prior claims of the special creditors to payment in full of their claims.

Tab 16

Case Name:

Isabelle Estate (Trustee of) v. Royal Bank of Canada

Between
A.C. Poirier & Associates Inc., as Trustee for the Estate of André Isabelle, appellant, and The Royal Bank of Canada, respondent

[2008] N.B.J. No. 345

2008 NBCA 69

299 D.L.R. (4th) 727

169 A.C.W.S. (3d) 697

47 C.B.R. (5th) 159

336 N.B.R. (2d) 332

2008 CarswellNB 463

No. 137/07/CA

New Brunswick Court of Appeal

J.T. Robertson, B.R. Bell and K.A. Quigg JJ.A.

Heard: April 16, 2008.
Judgment: September 25, 2008.

(62 paras.)

Bankruptcy and insolvency law -- Creditors and claims -- Creditors -- Appeal by Isabelle for leave to commence action under s. 38 of Bankruptcy and Insolvency Act allowed -- Isabelle was share-holder of bankrupt company -- As guarantor, Isabelle was a creditor within the meaning and scope of s. 38 of the Act -- This was a proper case for granting Isabelle the right to initiate a lawsuit against the Bank with respect to any breach of legal obligations it may have owed the bankrupt company -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38.

Appeal by the Isabelle from the dismissal of his motion for an order authorizing him to bring an action against the Bank for wrongdoing tied to events surrounding the bankruptcy of Heritage Flooring. A bankruptcy court judge had found the Bank guilty of exercising certain remedies against Heritage. The trustee had not proceeded with an action on behalf of bankrupt. Isabelle was a guarantor and minority shareholder of the bankrupt company, Heritage Flooring. The guarantee was given to the respondent, Royal Bank, as partial security for the $2 million revolving line of credit which the Bank had extended to Heritage. The other respondent, A.C. Poirier & Associates, was the trustee in bankruptcy of the bankrupt company. Isabelle's motion was dismissed on the ground that, as a shareholder of Heritage, he was not a creditor within the meaning of s. 38 of the Bankruptcy and Insolvency Act. On appeal, Isabelle argued that the motion judge erred because the motion was premised on Isabelle's status as guarantor and not as shareholder.

HELD: Appeal allowed and motion judge's decision set aside. As guarantor, Isabelle was a creditor within the meaning and scope of s. 38 of the Act. This was a proper case for granting Isabelle the right to initiate a lawsuit against the Bank with respect to any breach of legal obligations it may have owed Heritage. A potential defendant who was also a creditor of the bankrupt had no right to bring a s. 38 application for the purpose of ensuring that no other creditor obtained an order authorizing the other creditor to initiate a proceeding against the potential defendant.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38, s. 50.4(1), s. 69, s. 120, s. 187(11), s. 193(a), s. 193(c), s. 193(e)

Bankruptcy and Insolvency General Rules, C.R.C., c. 368, Rule 3, Rule 13, Rule 31(2)

New Brunswick Rules of Court, Rule 13.01, Rule 15.02(1), Rule 62.08

Appeal From:

On appeal from a judgment of the New Brunswick Court of Queen's Bench, September 4, 2007.

Court Summary:

History of Case:

Decision under appeal: 2007 NBQB 287.

Preliminary or incidental proceedings: N/A.

Counsel:

For the appellant: Lee McKeigan-Dempsey.

For the respondent: Hugh J. Cameron.

THE COURT: The respondent's motion to quash the appeal is dismissed and, correlatively, the appellant's motion for leave to appeal is granted, *nunc pro tunc*. The appellant is entitled to costs of $3,500 with respect to these motions.

The appeal is allowed and the decision of the motion judge is set aside. The appellant is entitled to the order sought under s. 38 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. It follows that the respondent's motions of April 2 and 3, 2007 are dismissed, except with respect to the decision to grant the Bank intervener status. The appellant is entitled to costs of $8,500 on the appeal.

The respondent's post-hearing motion is dismissed with costs of $5,000 to the appellant.

Costs are payable forthwith.

The judgment of the Court was delivered by

J.T. ROBERTSON J.A.:--

I. Introduction

1 Both parties are seeking to acquire a "chose in action" belonging to a bankrupt company. The property in question is the bankrupt company's right to sue its banker for wrongdoing. The right is presently vested in the bankrupt's trustee. However, once the trustee decides not to pursue the action, a creditor of the bankrupt may apply for a court order authorizing that creditor to pursue the action in its own name and at its own expense and risk. This right is provided for under s. 38 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 ("the *Act*"). Once the order issues, the trustee is required to transfer to the creditor title to the chose in action. Any benefit derived from the lawsuit is applied against the amount owing to the creditor and the costs of litigation. Any surplus belongs to the bankrupt's estate.

2 André Isabelle was a guarantor and minority shareholder of the bankrupt company, Plancher Héritage Ltée/Heritage Flooring Ltd. The guarantee was given to the respondent, The Royal Bank of Canada, as partial security for the $2 million revolving line of credit which the Bank had extended to Heritage Flooring. The other respondent, A.C. Poirier & Associates, is the trustee in bankruptcy of the now bankrupt company. Following the hearing of this appeal, Mr. Isabelle also fell into bankruptcy and once again A.C. Poirier & Associates was appointed trustee. Hence, the style of cause has been amended to reflect this reality. However, for clarity's sake, and unless otherwise noted, I refer to Mr. Isabelle as though he were the appellant.

3 This appeal stems from Mr. Isabelle's unsuccessful application (hereafter "motion") for an order authorizing him to initiate a lawsuit against the Bank for wrongdoing tied to events surrounding the bankruptcy of Heritage Flooring. In an earlier decision, another bankruptcy court judge found the Bank guilty of exercising certain remedies against Heritage in contravention of s. 69 of the *Act*. That decision was not appealed to this Court. On the understanding that a guarantor qualifies as a creditor under the *Act*, Mr. Isabelle filed his s. 38 motion, but only after the trustee elected not to pursue the action on behalf of Heritage Flooring. This explains why the Bank sought intervener status and opposed the motion. It does not explain why the Bank brought its own motion under s. 38 with a view to becoming both the plaintiff and defendant in the action that Heritage Flooring could have brought against the Bank but for the assignment in bankruptcy. All of the motions were heard together. While the Bank was granted standing, the motion judge reasoned that it was unnecessary to deal with its request for a s. 38 order because of the dismissal of Mr. Isabelle's motion. The decision under appeal is reported as *Re Plancher Héritage ltée/Heritage Flooring Ltd. (Bankrupt)* (2007), 320 N.B.R. (2d) 76, [2007] N.B.J. No. 324 (QL), 2007 NBQB 287.

4 Mr. Isabelle's motion was dismissed on the ground that, as a "shareholder" of Heritage Flooring, he is not a creditor within the meaning of s. 38 of the *Act*. Mr. Isabelle argues that the motion judge erred because the motion was premised on Mr. Isabelle's status as "guarantor" and not as "shareholder". The Bank reluctantly concedes that a guarantor qualifies as a creditor at law. However, the Bank insists that Mr. Isabelle fails to qualify as a creditor within the meaning and scope of s. 38 of the *Act* for no fewer than six reasons, some of which were neither pleaded nor argued in the court below. As well, the Bank opposes the appeal on procedural grounds. It asks for summary dismissal because of Mr. Isabelle's failure to seek and obtain leave to appeal as contemplated by s. 193(e) of the *Act*. With respect to this issue, Mr. Isabelle counters that leave was not required and, if mistaken, asks for leave to be granted *nunc pro tunc*. Mr. Isabelle points out that his Notice of Appeal contains a request for leave as is provided for under Rule 31(2) of the *Bankruptcy and Insolvency General Rules*, C.R.C., c. 368 ("the *BIA Rules*").

5 In my view, leave to appeal should have been sought and obtained prior to the appeal hearing. But I also hold this omission is not fatal and leave should be granted *nunc pro tunc*. As to the Bank's standing, I am of the view that a motion judge retains a narrow discretion to decide whether a creditor and potential defendant should be granted the right to oppose an application brought under s. 38 of the *Act*. This is not to suggest that a potential defendant has an unfettered right to meddle in the affairs of another creditor seeking an order under s. 38. Indeed, these reasons for judgment will stand in the way of those who believe it is permissible for a creditor to be both the plaintiff and defendant in the same action (the so-called "hermaphroditic litigant"). Section 38 was never intended to be used as a litigation tactic for short-circuiting the need to defend a valid cause of action. As to whether the motion judge erred in granting the Bank intervener status, I hold that in the circumstances of this case it is too late to undo what has been done. To revoke the Bank's standing at this late stage would work an injustice on Mr. Isabelle. For this reason, I am not prepared to set aside the motion judge's decision to grant the Bank standing. As to the ultimate issue on appeal, I conclude that, as guarantor, Mr. Isabelle is a creditor within the meaning and scope of s. 38 and that none of the Bank's arguments represents an impediment to granting the order sought. In short, this is a proper case for granting Mr. Isabelle the right to initiate a lawsuit against the Bank with respect to any breach of legal obligations it may have owed Heritage Flooring. This includes not only statutory breaches, such as those tied to s. 69 of the *Act*, but also contractual breaches and breaches of obligations imposed at law or in equity. It follows that the Bank's s. 38 motion to acquire the chose in action must be dismissed.

6 One other matter of contention arises on this appeal and attests to the Bank's unbridled resolve in seeking immunity for breaches of any legal obligations. Fifteen days after the hearing of the present appeal, Mr. Isabelle made an assignment in bankruptcy. Immediately after, while the decision on appeal was still under reserve, and without first discussing the matter with Mr. Isabelle's trustee in bankruptcy or Mr. Isabelle's counsel on appeal, the Bank wrote to this Court informing us that, pursuant to Rule 13.01 of the *Rules of Court*, the matter was "automatically stayed" because of the assignment in bankruptcy. The Court was then asked "to confirm" this understanding, otherwise the Bank "would be required to seek a date for the hearing of a motion in that regard." I shall address this unorthodox litigation tactic more fully below. For the moment, it is sufficient to note that the Court declined the invitation to provide the Bank with legal advice. After pursuing other litigation tactics without success, the Bank did in fact bring a motion asking that our pending decision be permanently stayed or, alternatively, that we grant an order for security for costs as against Mr. Isa-

belle's trustee. We dismissed the motion with reasons to follow. The promised reasons commence at para. 51 of these reasons.

7 Frankly, once the facts of this case are laid bare, one must seriously question whether the Bank's litigation strategy is premised on a "scorched earth" policy. The highway to this appeal is littered with too many motions, frivolous arguments and the citation of irrelevant case law with one singular objective: to guarantee the Bank's immunization from lawsuit by anyone who seeks damages for its wrongful conduct. Otherwise, why would the Bank refuse to consent to an order granting a one-day extension of time for perfecting the within appeal and force Mr. Isabelle to pursue a motion in this Court so as to obtain the required extension? In my view, the answer is self-evident.

II. Background

8 Mr. Isabelle was one of four persons who gave a limited guarantee ($150,000) to the Bank with respect to the debts of Plancher Héritage Ltée/Heritage Flooring Ltd., a company in which he was also a minority shareholder. The guarantee was a condition precedent to the Bank granting Heritage Flooring a revolving line of credit. On February 2, 2004, the Bank demanded full payment of the outstanding indebtedness within 15 days. On February 11, 2004, Heritage filed a Notice of Intention to Make a Proposal, pursuant to s. 50.4(1) of the *Act*. With the filing of the Notice of Intention, Heritage Flooring was automatically entitled to a stay, pursuant to s. 69 of the *Act*, with respect to a creditor exercising any remedies. Notwithstanding the prohibition, the Bank subsequently removed all of the monies in Heritage's operating accounts ($205,000) and capped Heritage's credit limit significantly below the amount permitted under the terms of their agreement. In proceedings reported as *Re Heritage Flooring Ltd.* (2004), 279 N.B.R. (2d) 1, [2004] N.B.J. No. 286 (QL), 2004 NBQB 168, a judge of the Court of Queen's Bench found that the Royal Bank had unilaterally exercised remedies in breach of s. 69 of the *Act*. As stated earlier that decision was not appealed to this Court. On March 24, 2004, Heritage Flooring filed an assignment in bankruptcy. A.C. Poirier & Associates was appointed trustee in bankruptcy. Subsequently the Bank appointed a receiver under its security agreement. The Bank liquidated more than $2 million in inventory and accounts receivable for less than $900,000. As for the $400,000 left owing, the Bank issued demands for payment to all four guarantors.

9 On April 11, 2005, the Bank commenced an action against all four guarantors. In his Statement of Defence and Counterclaim, Mr. Isabelle pleaded that Heritage Flooring had valid claims against the Bank for breaches of contractual and statutory obligations. Mr. Isabelle also indicated his intention to join Heritage Flooring as a party to the action. The Bank was successful in having several paragraphs of Mr. Isabelle's Statement of Defence struck and, as well, his Counterclaim. The Counterclaim hinged on Mr. Isabelle obtaining an order under s. 38 of the *Act* authorizing him to sue the Bank. Subsequently, Mr. Isabelle filed an Amended Statement of Defence. However, the Bank successfully challenged the amended paragraphs. The motion judge compared the proposed amendments with the paragraphs originally struck and concluded that, as there was no material difference, the amending paragraphs could not stand. Once this occurred, Mr. Isabelle had no defence to the action on the guarantee. Thus, the Bank was granted summary judgment against Mr. Isabelle for the amount of the guarantee plus interest ($175,343.76). We are told that the judgment with interest has climbed to half a million dollars. The summary judgment decision is reported as *Royal Bank of Canada v. Profor Kedgwick Ltd., André Isabelle, Gérard Charest and Marcel Gauthier*, [2008] N.B.J. No. 65 (QL), 2008 NBQB 78.

10 Rather than appealing the summary judgment, Mr. Isabelle sought leave to appeal the decision to strike the paragraphs of the Amended Statement of Defence that would have provided Mr. Isabelle with a defence to the action. The application for leave to appeal was dismissed: *Royal Bank of Canada v. Profor Kedgwick Ltee.*, [2008] N.B.J. No. 110 (C.A.) (QL). It is a question of fact whether the amending paragraphs were, in essence, the same as those originally struck. At the same time, I am not prepared to endorse the summary judgment decision lest it be cited as authority in subsequent cases. Let me explain my concern.

11 As I read the summary judgment decision, the motion judge concluded that Mr. Isabelle had no valid defence to the action for two reasons. The first rests on the rule in *Foss v. Harbottle* (1843), 2 Hare 460, 67 E.R. 189. However, that case has nothing to do with guarantors. It addresses whether a shareholder can bring a derivative action on behalf of a company that has endured wrongdoing at the hands of third party. Second, the motion judge concluded that any wrongdoing on the part of the Bank could only be addressed by the trustee in bankruptcy of Heritage Flooring. This understanding of the law is correct if one is seeking damages from the Bank for wrongful conduct. There is no doubt that Mr. Isabelle was seeking damages under his counterclaim which in turn was premised on obtaining an order under s. 38 of the *Act*. But Mr. Isabelle was also attempting to raise valid defences to the Bank's demand for payment under the contract of guarantee. Cases such as *Northland Bank* v. *Roine Estate* (1992), 11 C.B.R. (3d) 133 (BCSC), [1992] B.C.J. No. 380 (QL), support the notion that a guarantor such as Mr. Isabelle may have a valid defence to a demand for payment made by the creditor of the principal debtor. In that case, the creditor breached a loan agreement with the principal debtor by an unauthorized use of loan proceeds and the unauthorized withholding of a loan disbursement. In the present case, we have a wrongful appropriation of moneys from a bank account and a wrongful withholding of credit. Yet in *Northland Bank* the wrongful conduct resulted in the discharge of the guarantor of his obligation to the creditor under the contract of guarantee. Whether or not Mr. Isabelle would have been discharged under his contract of guarantee with the Bank is one issue. But to deny him the right to defend the action on the guarantee and to grant summary judgment to the Bank is, with great respect, not a precedent I wish to see cited in this Court.

12 On March 2, 2007, prior to the summary judgment issuing, Mr. Isabelle requested the trustee of Heritage Flooring to commence an action against the Bank. On March 23, 2007, the trustee advised Mr. Isabelle that the inspectors of the bankrupt estate declined the invitation to commence proceedings. On April 2, 2007, Mr. Isabelle filed a "motion" with the Registrar of Bankruptcy seeking authorization to commence an action against the Bank as provided for under s. 38 of the *Act*. In response, and on the same day, the Bank filed a motion asking for an order enjoining the trustee from transferring any cause of action to any creditor, except the Bank. The Bank pleaded that under its security agreement with Heritage Flooring, the Bank was the owner of all of Heritage's after-acquired property including any right of action Heritage possessed as against the Bank. On this basis, the Bank sought the s. 38 order that would have rendered it both plaintiff and defendant in the same action. As well, the Bank pleaded that as an inspector of the bankrupt estate, Mr. Isabelle was prohibited from acquiring the right to sue the Bank because of s. 120 of the *Act*. As well, the Bank asked that all motions be referred to a judge of the Court of Queen's Bench. On the following day, April 3, 2007, the Bank filed yet another motion for leave to intervene with respect to Mr. Isabelle's motion and sought other ancillary relief intended to thwart Mr. Isabelle's motion. On April 4, the Registrar referred all of the motions to the judge whose decision is now under appeal. The motion judge dismissed Mr. Isabelle's motion for the reason noted above, but declined to

rule on the Bank's motions. The motion judge was of the view that they were moot having regard to the dismissal of Mr. Isabelle's motion. What the motion judge failed to appreciate was that the Bank was also seeking to acquire Heritage Flooring's right of action against the Bank.

III. The Need for Leave to Appeal

13 Prior to the hearing of the scheduled appeal, the Bank brought a motion seeking an order to quash the appeal on the ground that the appellant failed to seek and obtain leave to appeal from a judge of this Court, as contemplated by s. 193 of the *Act*. Since the motion to quash was brought only a few weeks before the scheduled hearing, the motion was referred to the full panel and heard together with the scheduled appeal. Section 193 reads as follows:

> Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:
>
> (a) if the point at issue involves future rights;
> (b) if the order or decision is likely to affect other cases of a similar nature in the bankruptcy proceedings;
> (c) if the property involved in the appeal exceeds in value ten thousand dollars;
>
> (d) from the grant of or refusal to grant a discharge if the aggregate unpaid claims of creditors exceed five hundred dollars; and
>
> (e) in any other case by leave of a judge of the Court of Appeal.

14 Mr. Isabelle contends that leave was not required as his appeal falls within s. 193(a) and (c). The Bank contends otherwise and argues that the appeal falls within s. 193(e). I shall first deal with Mr. Isabelle's arguments.

A. *Future Rights - s. 193(a)*

15 Mr. Isabelle argues the underlying issue involves a future right within the meaning of s. 193(a) of the *Act*. According to his argument, Heritage Flooring's right to proceed against the Bank is currently vested in the trustee in bankruptcy, and it is only through a successful s. 38 application that Mr. Isabelle would be able to pursue such an action. Thus, according to Mr. Isabelle, since his ability to proceed would only come into existence once the s. 38 order issues, the appeal is one which involves a "future right". In support, counsel for Mr. Isabelle cites *Houlden & Morawetz Bankruptcy and Insolvency Analysis*, s. 34(1), which cites *Re J. McCarthy & Sons Co. of Prescott Ltd.* (1916), 38 O.L.R. 3 at 7 (S.C.A.D.), [1916] O.J. No. 4 (QL) for the proposition that "[t]he words 'future rights' should be given a wide and liberal interpretation." The Bank relies heavily on two cases to argue that future rights are not involved in the present appeal. The first in time is *Re Catalina Exploration & Development Ltd. Elias and Catalina Exploration & Development Ltd. v. Hutchison* (1981), 27 A.R. 1 (C.A.), [1981] A.J. No. 896 (QL), which involved an action against the trustee in bankruptcy that could not be commenced without leave. At paragraphs 15-16 and 22-24, Chief Justice McGillivray acknowledged the lack of clarity concerning "future rights" in rejecting the *McCarthy* analysis:

> I confess to difficulty in perceiving what exactly Parliament sought to do by providing for an appeal without leave in a case involving future rights while requiring leave in cases which do not involve future rights. Indeed, I find the authorities leave me in a state of uncertainty as to what a future right is at all, leave alone what there is about a future right that would require a treatment of cases involving future rights different from cases that do not involve future rights. [...]
>
> In the *McCarthy* case, it was said that future rights were involved in giving a creditor leave to sue instead of proving its claim in the bankruptcy. The court said that mode of trial *i.e.* by jury or otherwise, or unrestricted rights of appeal were future rights. If future proceedings involve "future rights" within the meaning of the *Bankruptcy Act*, it is difficult to think of any case in which it could not be said that future rights were involved. I am unable to agree with the decision in the *McCarthy* case.
>
> [...]
>
> A right in a legal sense exists when one is entitled to enforce a claim against another or to resist the enforcement of a claim advanced by another. A present right exists presently; a future right is inchoate in that while it does not exist, it may arise in the future. For the adjective "future" to have any meaning, it cannot refer to that which presently exists. Does the claim alleged against the trustee presently exist? It is a current allegation of existing facts though they may be procedurally blocked by a need to obtain leave to assert the claim.
>
> To give "future" the meaning that includes that which a litigant may obtain by success in litigation in the future is to say that a right of appeal exists in all cases. Any claim advanced is, in that sense, a future right to a judgment which does not yet exist. It would seem to me for clause (a) of section 163 [now 193] to have any meaning that it must refer to rights which could not at the present time be asserted but which will come into existence at a future time.
>
> It is sufficient to say that in my opinion a presently existing right to seek leave to sue a trustee in respect of presently existing facts is not a future right and the appellant does not bring the case within [that subsection].

16 Although the alleged "future right" in this case relates to a cause of action vested in the trustee, rather than to a cause of action against the trustee as in *Elias*, a similar analysis should apply. The s. 38 assignment would not result in a new right "com[ing] into existence at a future time", but would rather assign the trustee's present right. Such was the conclusion in *Re Zammit* (1998), 3 C.B.R. (4th) 193 (Ont. C.J. (Gen. Div.)), [1998] O.J. No. 604 (QL), the other case which the Bank cites. Registrar Ferron elaborated on this point at para. 7 of *Zammit*:

> The creditor still advances, not his or her own action but the trustee's claim. If it were otherwise the relief afforded by the section would be substantially curtailed. For example, a proceeding to set aside a fraudulent preference under section

> 95(1) of the *Bankruptcy and Insolvency Act* is an action reserved to the trustee. The proceeding provides that certain conveyances, payments etc., made under the circumstances set out in the section "be deemed fraudulent and void as against the trustee in bankruptcy". Obviously, no creditor can advance that proceeding unless authorized by section 38. Section 38 does not create a cause of action in the creditor but merely allows the creditor standing in the trustee's place to advance a proceeding vested in the trustee which the trustee for whatever reason declines to take.

17 At the hearing of the appeal, Mr. Isabelle countered with *Re Braich* (2007), 250 B.C.A.C. 53, [2007] B.C.J. No. 2847 (QL), 2007 BCCA 641. At para. 8 of that decision, Tysoe J.A., in Chambers, expressed "some reservations about the narrowness" of the *Elias* interpretation of the term "future rights", although he admitted that it was unnecessary to settle on the precise scope of "future rights". The same is true in the present case. Suffice it to say, the weight of authority supports the view that a cause of action that presently exists is not a "future right" merely because a court order is required to pursue it. For this reason, Mr. Isabelle's submission with respect to s. 193(a) fails.

B. *Property over $10,000 - s. 193(c)*

18 In his Notice of Appeal, Mr. Isabelle states that "[t]he refusal to grant the Appellant's s. 38 motion prevents the Appellant from pursuing a claim against the Bank for damages suffered by the bankrupt in excess of $10,000, as contemplated by subsection 193(c) of the [*Act*]." While Mr. Isabelle advanced little argument on this point, he did submit an excerpt from *Houlden & Morawetz Analysis* that referred to cases that appear to support his position. The most recent of these cases is *Re Galaxy Sports Inc.* (2003), 183 B.C.A.C. 192, [2003] B.C.J. No. 1271 (QL), 2003 BCCA 322, which found that an appeal as of right existed under s. 193(c) for similarly remote amounts of money. In that case, Galaxy's proposal to its creditors was approved as required by s. 54(2)(d) of the *Act*, but certain of the chair's decisions with respect to admitting or rejecting proofs of claim for the purpose of voting were appealed pursuant to s. 108(1). Concurrently, the trustee sought court approval of the proposal. The motion judge reserved approval of the proposal until the "threshold issue of requisite creditor approval" was resolved. Directions were sought as to whether an appeal as of right existed under s. 193(a) or (c) of the *Act*, or whether leave was required. A key term of the proposal was an action against Galaxy's suppliers for fraudulent misrepresentation and breach of fiduciary duty. The trustee expressed the opinion that the creditors stood to recover $584,000 under the proposal, compared to $62,000 if Galaxy fell into bankruptcy. The Chambers judge, relying on *McNeill v. Roe, Hoops & Wong* (1996), 39 C.B.R. (3d) 147 (B.C.C.A.), [1996] B.C.J. No. 284 (QL), endorsed the following as the applicable test under s. 193(c): "the 'property involved in the appeal'... may be determined by comparing the order appealed against the remedy sought in the notice of appeal". Since the speculative difference was greater than $10,000, an appeal as of right existed. This determination was not challenged before a full panel of the Court in *Re Galaxy Sports Inc.* (2003), 45 C.B.R. (4th) 42, [2003] B.C.J. No. 1744 (QL), 2003 BCCA 418. By the same logic, Mr. Isabelle would have an appeal as of right if the property ultimately in jeopardy exceeded $10,000; the immediate award on appeal would not itself need to exceed $10,000.

19 In response to Mr. Isabelle's argument, the Bank refers to Houlden, Morawetz & Sarra, *Bankruptcy and Insolvency Law of Canada*, looseleaf (Toronto: Thomson Carswell, 2007) at s. 34 for the proposition that there is no right of appeal under s. 193(c) of the *Act* if the remedy sought is

not "appreciable in money." In *Elias,* McGillivray C.J.A., also rejected the appellant's argument that an appeal as of right existed under this subsection, quoting at para. 27 from Justice Rinfret in the expropriation case of *Gatineau Power Company and Freeman F.T. Cross*, [1929] S.C.R. 35; [1928] S.C.J. No. 73 (QL):

> Thus, the whole matter in controversy, even if traced back to the Commission - and we do not think it should be - is merely the right to have that body entertain an application for authority to expropriate. Such right is not appreciable in money. Still less so is the right of appeal to the Court of King's Bench which is the sole matter in controversy on the projected appeal here. The consequence of the authorization by the Commission might result in a proceeding in which the amount involved would exceed two thousand dollars; but the ultimate award on the expropriation is not the matter in controversy in this appeal; and, as was said in *Lachance v. La Societe de Prets et de Placements de Quebec*, 26 S.C.R. 200:
>
> > 'our jurisdiction does not depend on the possible consequences of a possible judgment'.

20 A similar result obtained in *Simonelli v. Mackin* (2003), 320 A.R. 330, [2003] A.J. No. 142 (QL), 2003 ABCA 47, at para. 24: "... if Simonelli's appeal is successful, the claim will be struck. If it is not, the matter will be heard and decided. Therefore, the "loss" resulting from refusing the application to strike is not an award exceeding $10,000 in value. Rather, the loss is the risk of a determination on the merits."

21 In my respectful view, this Court should follow the lead of *Elias* and *Simonelli*. The purposive analysis in *Elias* with respect to s. 193(a) of the *Act* is equally applicable to s. 193(c): it is difficult to think of a case involving a corporate bankrupt in which the amount ultimately in issue would not exceed $10,000. Consequently, there would be little utility to the other four subsections under s. 193 if such cases were subject to an appeal as of right. Since the issue on appeal in this case does not directly involve an amount in excess of $10,000 there can be no appeal as of right under s. 193(c). The central issue in this case is whether or not the motion judge erred by failing to consider whether the appellant, as a guarantor, is a creditor of the bankrupt. Since the issue on appeal does not involve an amount in excess of $10,000, there can be no appeal as of right under s. 193(c).

C. *Seeking Leave - A Bifurcated process? Yes*

22 The fact that Mr. Isabelle failed to seek and obtain leave prior to perfecting his appeal does not mean that the appeal should be automatically quashed. It must be decided whether the legislative scheme demands a bifurcated process for dealing with leave applications: that is to say, whether the application for leave to appeal must be dealt with in a separate proceeding and prior to the hearing of the appeal on its merits. The alternative is to permit the leave application to be heard together with the merits of the appeal, as happened in the present case, and as is true of certain appeals launched under the *Criminal Code*. Mr. Isabelle assumed that the alternative procedure was the correct one. In his Notice of Appeal, he asked "for a determination as to whether he may appeal the decision as of right, pursuant to ss. 193(a) and (c) of the [*Act*], and should it be determined that the Appellant cannot appeal the decision as of right, the Appellant seeks leave to appeal the decision pursuant to s. 193(e) of the [*Act*]". In short, Mr. Isabelle filed a Notice of Appeal which also included a request for leave in the event it was determined that an appeal did not exist as of right. In-

tuitively, however, one would think that a separate hearing on the leave application is required. Yet there is evidence that suggests otherwise. Let me explain.

23 The procedural route Mr. Isabelle followed would appear to be sanctioned by Rule 31(2) of the *Bankruptcy and Insolvency General Rules*. Rule 31(2) provides that where an appeal is brought under s. 193(e) of the *Act* (that is to say with leave of a judge of this Court), "the notice of appeal must include the application for leave to appeal." Rule 31(2) of the *BIA Rules*, C.R.C., c. 368, prescribes the procedure to follow on an appeal under s. 193(e):

> (2) If an appeal is brought under paragraph 193(*e*) of the Act, the notice of appeal must include the application for leave to appeal.

24 Moreover, the Registrar of Bankruptcy for New Brunswick (who is also the Registrar of this Court) has issued a practice directive stating that the Notice of Appeal should contain sufficient particulars to allow a determination as to whether leave is required. The Registrar's Directive is dated February 10, 2004 and titled "Appeals in Bankruptcy". All of this suggests that the leave application and the appeal can be heard together. On the other hand, s. 193(e) of the *Act* speaks unequivocally of the need to obtain "leave from a judge of the Court of Appeal."

25 In my view, a bifurcated process for dealing with leave applications and appeals is mandated by the *Act* and to be preferred over one that sees both proceedings being dealt with contemporaneously. There is an obvious reason to justify this approach. On the hearing of most leave applications it is impossible for the applicant not to address the merits of the appeal when arguing the existence of valid grounds for doubting the correctness of the impugned decision. In truth, the arguments made in support of and in opposition to the leave application are the very same arguments to be pursued on the appeal. It is for these reasons that I am prepared to follow the lead of the Ontario Court of Appeal in *Re 518494 Ontario Ltd. (c.o.b. Petrochem)* (1985), 12 O.A.C. 392, [1985] O.J. No. 239 (QL) and adopt a general rule requiring leave applications to be dealt with independently of the hearing of the appeal. An appellant who is proceeding on the assumption that leave to appeal is not required should move for leave to appeal before a single judge of this Court <u>as soon as</u> the respondent raises the issue of whether leave to appeal is required. In future, this is the safe procedure to be followed; it would prevent a respondent's motion to quash an appeal without a hearing on the merits. I hasten to add that the onus is on the respondent to bring to the Court's attention the appellant's failure to first seek the requisite leave. Otherwise, the court will normally proceed on the basis that leave is not required.

D. *The Failure to Seek Leave - Is it fatal? No*

26 The question we must now address is whether Mr. Isabelle's failure to obtain leave prior to the hearing of the within appeal is fatal and, hence, the Bank's motion to quash the appeal should be allowed. In support, the Bank cites *Petrochem* and *Re Hrebecka* (1999), 12 C.B.R. (4th) 47 (C.A.), [1999] O.J. No. 2782 (QL). *Re Hrebecka* involved a motion to quash before a full panel of the Ontario Court of Appeal and states as follows, in its entirety: "The evidence discloses that the amount in issue is under $10,000, an amount requiring leave pursuant to s. 193 of the *Bankruptcy Act*. No such leave was sought or obtained. The motion is accordingly granted and the appeal is quashed with costs." It appears from this brief decision that the appellant in that case failed to invoke s. 193(e) as was done in this case. *Petrochem* is slightly more detailed, although still distinguishable. The instructive paragraph is the fourth of five:

> In this case the appellant combined its notice of appeal and application for leave as required [by the *Rules*]; but, instead of applying to a single judge for leave, it brought its application for leave and its appeal before a full panel of this Court. This was wrong. The appellant should first have moved before a single judge for leave. It is only if leave to appeal is granted that the appellant can proceed with its appeal. In the future this is the procedure that is to be followed where leave is required under s. 163(e) [now 193(e)].

27 It bears noting that the only ground of appeal involved in *Petrochem* was subsection (e), and that the Court went on to decide the application for leave rather than automatically quashing it for procedural deficiency. In my view, this Court retains the discretion to whether the appeal should be quashed because of the failure to obtain leave. Section 187(9) of the *Act*, under the heading Authority of the Courts, mandates a flexible approach to procedural error:

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

28 This Court also has the authority, under s. 187(11) of the *Act*, to extend time "either before or after the expiration thereof on such terms, if any, as it thinks fit to impose." These provisions are consistent with the approach described in New Brunswick's *Rules of Court* for other types of proceedings, in order to secure "the just, least expensive and most expeditious determination of every proceeding on its merits" (Rule 1.03(2)). The Bank has had sufficient notice of the matters on appeal, so it cannot be said that injustice has resulted from any irregularity. For these reasons, the motion to quash the appeal for failing to obtain leave prior to the hearing of the appeal is dismissed.

E. *Should Leave Be Granted, Nunc Pro Tunc? Yes*

29 Having regard to the introductory paragraphs of these reasons, it can come as no surprise that I am prepared to grant the required leave. Nonetheless, for the sake of completeness, I will deal with this issue as though no ruling had been made on the merits of the appeal. The case law reveals a number of factors that should be considered, or possible grounds for granting leave: (1) whether the appeal raises an arguable ground, often referred to as a serious issue; (2) whether there is reason to doubt the correctness of the decision; (3) whether the impugned decision raises a question of importance; (4) whether there is conflicting jurisprudence on the point; and (5) whether the granting of leave will unduly delay pending proceedings. It is self-evident that this appeal raises several issues of significance to bankruptcy law and for this reason alone leave should be granted. This would be true even if I had formed the opinion that the motion judge was correct in dismissing Mr. Isabelle's motion. Moreover, the granting of leave does not lead to delay as there can be no underlying proceedings until such time as Mr. Isabelle is granted a s. 38 order. For these reasons, I would grant the requisite leave to appeal, *nunc pro tunc*.

IV. The Issue of Standing - The Bank as Intervener - The Hermaphroditic Litigant

30 The motion judge referred to Rule 3 of the *BIA Rules* and Rule 15.02 of the *Rules of Court* in support of his holding that the Bank should be permitted to intervene. Rule 3 of the *BIA Rules*

effectively states that in cases not provided for under the *Act* or *BIA Rules*, the court's practice in civil matters is to be followed. Rule 15.02(1) of the New Brunswick *Rules of Court* provides for "Leave to Intervene" in cases where a person has an interest in the subject matter of the proceeding or may be adversely affected by a judgment in a proceeding. On this basis, the motion judge ruled that he possessed the jurisdiction to grant the Bank intervener status. Regrettably, in a subsequent paragraph of his decision (para. 31), the motion judge goes on to dismiss the request for intervener status when dealing with a number of the Bank's motions that he felt did not need to be addressed as they were no longer germane. In my view, this was a "slip" and, therefore, the contradictory reference must be ignored.

31 Before turning to the question of whether the motion judge retains the discretion to grant intervener status with respect to s. 38 proceedings, I wish to note that there is a difference in law between someone who is granted status as intervener and one who obtains status as a party (see *United Brotherhood of Carpenters and Joiners of America, Local 1386 v. Bransen Construction Ltd. et al.* (2002), 249 N.B.R. (2d) 93, [2002] N.B.J. No. 114 (QL), 2002 NBCA 27). For purposes of deciding this appeal, however, I am going to ignore the distinction and focus on the issue of whether the motion judge erred in granting the Bank standing to oppose Mr. Isabelle's motion for a s. 38 order. My understanding of the law is as follows.

32 Generally, only the trustee need be served with notice of motion (often referred to as an application) brought under s. 38 of the *Act*. Specifically, there is no need to serve the proposed or potential defendant with notice, unless the order is one that would impose an obligation on that party. Otherwise, the creditor need only show that the trustee has refused or neglected to proceed with the lawsuit (see cases collected in Houlden, Morawetz & Sarra, at Cs. 46). The law goes on to provide that even if the potential defendant has notice of the s. 38 application, he or she has no standing to appear on the application, nor can the potential defendant cross-examine on the material filed in support of the application. Inevitably, *Re Nesi Energy Marketing Canada Inc.* (1998), 233 A.R. 347, [1998] A.J. No. 1203 (QL), 1998 ABQB 912, is cited in support of these propositions.

33 The general rule is inapplicable when the potential defendant is also a creditor of the bankrupt. The law accepts that notice of the s. 38 application must be given to all creditors so that they have the opportunity to join in the lawsuit, but for a limited purpose and subject to one important condition precedent. Where the defendant in the proposed lawsuit is also a creditor, he or she is entitled to participate in the s. 38 proceedings for the limited purpose of preserving his or her right to share rateably in the spoils of the action, provided the creditor is willing to share in the expense of the proceedings including costs: *Re B. Donovan Interiors Ltd.* (1990), 3 C.B.R. (3d) 196 (N.S.S.C.), [1990] N.S.J. No. 447 (QL). It is only within this contrived context that the creditor be both plaintiff and defendant in the same s. 38 lawsuit (see Houlden, Morawetz & Sarra, at Cs. 46 and Cs. 49). Interestingly, there is no requirement to notify the creditors in advance of the application for an order. It is only important that they be given a reasonable opportunity to decide whether or not to participate in the proposed lawsuit (see Houlden, Morawetz & Sarra, at Cs. 46). Above all else the potential defendant cannot be a full plaintiff in the proposed lawsuit.

34 In summary, the law of bankruptcy does not recognize the right of a potential defendant (and creditor of the bankrupt) to become both the plaintiff and the defendant in the same action. For this reason, the concept of the "hermaphroditic litigant" is a misnomer. This understanding of the law is reinforced in an article that counsel for the Bank provided to us on the hearing of the appeal and yet the Bank persisted with its argument that the law fully accepts the concept of the hermaphroditic

litigant: David R.M. Jackson "The Hermaphrodite Litigant: Suing Yourself Under Section 38 of the BIA", (2002) 17:2 Nat. Creditor/Debtor Rev. 21. That article does point out that there is some debate among the courts as to the extent to which a potential defendant and creditor of the bankrupt may influence litigation decisions, but none of the cases cited recognize the right of the potential defendant/creditor to acquire the chose in action or to take full control of the litigation.

35 Regrettably, some seem to believe that it is permissible for a potential defendant and creditor of a bankrupt to become the plaintiff in order to eliminate another creditor's right to obtain an assignment of the chose in action from the trustee in bankruptcy. This could be accomplished in one of two ways: either the potential defendant attempts to gain standing in the other creditor's s. 38 application or, in the alternative, the potential defendant brings his or her own s. 38 motion and asks that both motions be heard together. Bluntly stated, these litigation tactics constitute an abuse of legal process. Unfortunately, that reality does not seem to deter some potential defendants.

36 In the present case, the Bank's April 2, 2007 motion was brought under s. 38 and claims the contractual right to be both the plaintiff and the defendant in the lawsuit that would otherwise have been brought by Heritage Flooring against the Bank. This is true notwithstanding the above noted article which clearly states that a creditor/defendant's participation in the underlying lawsuit is severely restricted. But the Bank is not the first potential defendant to engage in such foolish thinking. There is also an unreported New Brunswick decision in which the potential defendant (and creditor of the bankrupt) attempted to acquire intervener status on a s. 38 application brought by another creditor. The potential defendant was seeking to acquire the chose in action for $250,000, thereby preventing the other creditor from pursuing an action for breach of a franchise agreement in which the damages to be claimed were in the "millions". The motion judge rightly refused to hear from the potential defendant (who had not even made a formal motion for intervener status) let alone grant it standing. The application for leave to appeal to this Court was dismissed (see *Toner and Toner v. KPMG Inc.*, (2008) February 20, No. 12749, leave to appeal dismissed [2008] N.B.J. No. 111 (QL)).

37 Bluntly stated, a potential defendant who is also a creditor of the bankrupt has no right to bring a s. 38 application for the purpose of ensuring that no other creditor obtains an order authorizing that other creditor to initiate a proceeding against the potential defendant. This is why the Bank's April 2, 2007 motion should have been dismissed to the extent that it sought to invoke s. 38 as a basis for asserting the Bank's right to be both plaintiff and defendant in an action that could only be vigorously and honestly pursued by someone adverse in interest to the Bank.

38 To this point, it seems clear that the Bank has no right to standing on Mr. Isabelle's s. 38 motion. But what of the case in which the potential defendant wishes to argue that the applicant is not, for example, a creditor within the meaning and scope of s. 38 and, therefore, the order sought should not issue. If the potential defendant is not given notice of the s. 38 proceedings, and the trustee does not oppose the order, then presumably the potential defendant has the right to raise the issue on a preliminary motion once the lawsuit is filed. This is because the doctrine of "issue estoppel" is inapplicable as the potential defendant, now defendant, was not a party to the s. 38 proceedings. But I am still left with the question whether the law should recognize the right of a motion judge to exercise a narrow discretion and to grant the potential defendant intervener status.

39 In my view, there may be cases in which the potential defendant should be permitted to oppose the granting of the applicant's s. 38 motion rather than deferring the matter until after the action is commenced. Why? Because the potential defendant might well avoid the need to defend a

lawsuit that should never have been commenced in the first place. These are the cases in which the potential defendant raises a discrete and genuine issue of law that if decided in favour of the potential defendant might well avoid the need to defend a lawsuit that should never have been commenced in the first place. For this reason, I am prepared to accept that a motion judge should retain a "narrow discretion" to decide whether a potential defendant should be granted standing on the s. 38 motion brought by a creditor. Thus, for example, where a potential defendant contends that the applicant for the motion does not qualify as a creditor within the meaning and scope of s. 38, it makes sense for the potential defendant to intervene in circumstances where there is no other party opposing the s. 38 motion. However, I want to reemphasize that the discretion to grant intervener status is a narrow one and is not to be abused. If there is a scintilla of evidence to suggest that the potential defendant is simply engaging in a litigation tactic intended to wear down the s. 38 applicant, the motion judge should refuse to grant the potential defendant standing. However, if standing is granted, it will be necessary for the motion judge to specify the extent of the intervener's participation (*e.g.* cross-examination on affidavits).

40 Returning to the case at hand, the question is whether the motion judge erred in granting the Bank standing. Had I been the motion judge, I would not have granted the requisite standing. The Bank did more than raise a discrete legal issue. It raised frivolous issues and cited countless cases with one objective in mind - to ensure that the Bank remained immune from liability with respect to alleged and established wrongdoing and at any cost. But I cannot undo what has already been done. It is simply too late to decide whether the motion judge erred in granting the Bank standing. The Bank has already participated fully in the proceedings and nothing is achieved by striking it as a party at this late stage. Indeed, if we were to strike the Bank as a party, there could be no order as to costs. For these reasons, I am not prepared to set aside the motions judge's decision to grant the Bank standing.

A. *Is the Guarantor of a Debt of the Bankrupt a Creditor of the Bankrupt? Yes*

41 The motion judge did not answer the question posed above. Rather, he held that a "shareholder" of a corporate debtor and bankrupt does not qualify as a creditor within the meaning of s. 38 of the *Act.* Given *Re Grandview Ford Lincoln Sales Ltd.,* (2001) 22 C.B.R. (4th) 210 (Ont.Gen.Div.), [2001] O.J. No. 251 (QL), no one challenges the motion judge's ruling. Mr. Isabelle argues, however, that the motion judge erred in failing to appreciate that the motion was premised on his status as "guarantor". The Bank now recognizes the motion judge's error and concedes that, as a general proposition, a guarantor qualifies as a creditor of the bankrupt. This is true under common law principles even if the principal debtor has made no demand for payment or, once a valid demand has been made on the guarantor, no money has been paid pursuant to it. In short, a contingent liability entitles a guarantor to claim status as a creditor: *Bank of Nova Scotia v. Holland* (1979), 32 C.B.R. (N.S.) 153 (Ont. S.C. (H.C.J.)), [1979] O.J. No. 1190 (QL). Moreover, the law is equally clear that the guarantor's contingent claim is a debt provable in bankruptcy, whether or not the guarantor has been called on to pay or has paid. On this point, see generally *Re Froment,* 5 C.B.R. 765, [1925] 3 D.L.R. 377 (Alta.S.C.), [1925] A.J. No. 60 (QL); *B.N.R. Holdings Ltd. v. Royal Bank* (1992) 14 C.B.R. (3d) 233, [1992] B.C.J. No. 198 (QL) and *Re Maple City Ford Sales (1986) Ltd.* (1998), 39 O.R. (3d) 702 (Gen. Div.), [1998] O.J. No. 2714 (QL).

42 In summary, a guarantor of the debt of a bankrupt qualifies as a creditor. However, this finding does not answer the question of whether Mr. Isabelle qualifies as a creditor within the meaning and scope of s. 38 of the *Act* and is therefore entitled to an order authorizing him to com-

mence an action against the Bank. In short, this Court must decide whether the s. 38 order sought should issue.

B. *Should the Section 38 Order Issue? Yes*

43 My analysis begins with some general comments about the conditions precedent to a creditor obtaining an order under s. 38 of the *Act*. The primary requirement is that the creditor must request the trustee to pursue the action and the trustee must neglect or refuse to do so. In the present case, that condition precedent has been satisfied. There is also discussion in the jurisprudence whether the applicant must establish that the proposed lawsuit has merit. In some cases, the threshold test is stated in terms of establishing a "*prima facie*" case. I am not confident that the law should require anything more than the applicant demonstrate "serious issue". It is for the plaintiffs to decide whether they believe they have a valid cause of action that is worth the time and money required. Moreover, to allow the potential defendant to argue on the motion that a *prima facie* case has not been established would undermine the purpose of s. 38 and offend the understanding that the right to intervene is a limited one. In any event, whatever the threshold be, it is clear that it has been met in this case because of the finding of Bank wrongdoing made in other bankruptcy proceedings. The fact of the matter is that by breaching s. 69 of the *Act*, the Bank opened itself to a lawsuit in which the damages, whether compensatory, punitive or both, might well exceed the indebtedness of Mr. Isabelle and Heritage Flooring combined. This is not to suggest that, in an ensuing action between these parties, the allegations of wrongdoing must be tied to the breaches of s. 69. In fact, they may extend to all breaches whether they are contractual, statutory or common law in nature (*e.g.*, insufficient time for repayment).

44 The Bank insists that Mr. Isabelle is not a creditor within the meaning or scope of s. 38 of the *Act* for six reasons. First, the Bank argues that Mr. Isabelle is not entitled to claim status as a creditor because he failed to file a Proof of Claim as required under s. 124(2) and, second, he was prohibited from doing so because of the rule against "double proof". The Bank insists that only if a guarantor has paid the principal creditor in full is that guarantor entitled to prove his or her claim in the bankruptcy of the debtor. Third, the Bank asserts that, pursuant to a separate contract ("Postponement of Claim"), Mr. Isabelle has no right to pursue the cause of action in his own name as any such right is vested in the Bank. Fourth, the Bank insists that Mr. Isabelle's application under s. 38 should be dismissed for want of "specificity". Fifth, the Bank advances the bold argument that there is no property (chose in action/cause in action) to be transferred to Mr. Isabelle. According to the Bank, because of its security agreement (the "after-acquired-property" clause) with Heritage Flooring any property that would otherwise form part of the bankrupt's estate, including any cause of action that Heritage has as against the Bank, instead belongs to the Bank. Sixth, the Bank invokes s. 120(1) of the *Act*. That provision states that no "inspector" is entitled to acquire for himself any property of the bankrupt estate without the prior approval of the court. The Bank argues that Mr. Isabelle, as an inspector, is not entitled to the order sought.

45 Of the six arguments noted above, only the fifth and sixth are found in the documentary record filed in this Court. Arguments one through four, inclusive, were raised for the first time in the respondent Bank's written submission to this Court. Since appellants submit written argument first, Mr. Isabelle understandably failed to deal with these issues. Moreover, even if the Bank had argued these four points before the motion judge, the Bank should have filed a Notice of Contention as provided for under Rule 62.08 of the *Rules of Court*. Furthermore, even if the Bank had argued these points before the motion judge, on the appeal to this Court, the Bank should have filed a Notice

of Contention to the effect that he reached the correct result for reasons that he failed to consider. This was not done to the prejudice of Mr. Isabelle. Understandably, his written submission to this Court, as appellant, failed to deal with these issues. Much time was spent addressing the many issues surrounding the need for leave to appeal. Moreover, Mr. Isabelle cannot be faulted for failing to ask for the right to submit a supplemental submission. There was need to do so in light of the Bank's failure to file a Notice of Contention.

46 While this Court is under no obligation to deal with the four issues not properly raised, I must dispel any perception that they might have altered the outcome of this appeal. The plea of lack of "specificity" is frivolous as is the plea of the rule against "double proof". I have already outlined the general nature of the claim against the Bank. The specifics of the claim will be outlined in the Statement of Claim. As to the rule against double proof, it has no application. That common-sense rule is intended to prevent both the guarantor and the principal debtor from sharing in the proceeds of the estate with respect to a single debt. Those are not the facts of our case. Mr. Isabelle does not seek to be enriched at the expense of other creditors. In any event, had the issue of "Proof of Claim" been properly raised, it would have been a simple matter for this Court to exercise its jurisdiction under s. 187(9) and permit Mr. Isabelle (his trustee in bankruptcy) to file such before commencing his s. 38 action against the Bank. As it presently stands, no objection to Mr. Isabelle's motion was made before the motion judge on this technical ground. The Bank's argument based on the "Postponement of Claim" contract has no application with respect to the liabilities of the Bank to Heritage Flooring. The postponement contract essentially provides that if Heritage Flooring owes money to both the Bank and Mr. Isabelle, the Bank gets paid first. It also provides that all of the liabilities of Heritage Flooring to Mr. Isabelle and all sums payable by the former to the latter are assigned to the Bank. The contract says nothing about monies the Bank may owe to Heritage Flooring for breach of its statutory and contractual obligations and the right of Mr. Isabelle to obtain an assignment of any right of action now vested in the trustee in bankruptcy. Note that if Mr. Isabelle's action against the Bank were to succeed, Heritage Flooring would not be indebted to Mr. Isabelle, the Bank would.

47 Finally, the Bank must recognize that its failure to properly raise the four issues outlined above is not an invitation to raise them in subsequent proceedings. As the Bank sought and obtained legal standing in the court below, that was the proper time for raising the issues and, hence, the Bank is forever foreclosed from raising them in any subsequent proceedings taken pursuant to the order granted under s. 38.

48 The Bank is left with only two arguments in support of its position that a s. 38 order may not issue to Mr. Isabelle. First, the Bank contends that any right Heritage Flooring may have to sue the Bank is the Bank's property, not the trustee's, by virtue of the Bank's "General Security Agreement" with Heritage Flooring dated January 30, 2001. But for a valid security agreement, all property owned by the bankrupt is vested in the trustee pursuant to s. 71 of the *Act*. But it is equally true that the interest of a secured creditor in the property of the bankrupt never becomes the property of the trustee unless the trustee pays out the claim of the secured creditor. The effect of the pertinent statutory provisions is that the interest of the secured creditor in the bankrupt's property never loses its priority over the claims of other creditors: *MacKesey v. Royal Bank* (1991) 86 D.L.R. (4th) 637 (Sask. C.A.), [1991] S.J. No. 572 (QL). Heritage Flooring did execute a security agreement in favour of the Bank, charging all of Heritage's present and after acquired property to the Bank, including all choses in action. From here, the Bank asks us to make a quantum leap by accepting that any right of action that Heritage Flooring acquired against the Bank with respect to the latter's wrong-

doing comes within the ambit of the after-acquired-property clause. In other words, the Bank maintains that it owns the right to sue itself. Obviously this cannot be so. If we were to accept the Bank's argument, no debtor would be able to sue a secured creditor for breaching the parties' security agreement, or other legal obligations, so long as that security agreement contained an after-acquired-property clause. I shall say no more of this issue except that a contractual provision drafted with that objective might be struck on the ground of being offensive to public policy.

49 The Bank's other argument is tied to s. 120(1) of the *Act*. That provision states that no "inspector" is entitled to acquire any property of the bankrupt estate without the prior approval of the court. The Bank then argues that: "[i]t is clear that Andre Isabelle is attempting, in his position as Inspector, to act for himself and not for the benefit of the general body of creditors." With great respect, it is not clear to me that Mr. Isabelle is not acting in the best interests of the other creditors. They still have a right to participate in the lawsuit and share in the spoils. Quite properly, Mr. Isabelle points out that if successful against the Bank, in whole or part, Heritage Flooring would be claiming damages (compensatory and punitive) which may well exceed the amount that Heritage owes the Bank. In my view, there is nothing improper about Mr. Isabelle seeking an order under s. 38 even though he is an inspector under the *Act*. Wisely, counsel for Mr. Isabelle notes that court approval may be sought, even at this late stage in the proceedings, having regard to the powers of the court set out in s. 187(9) of the *Act*. If necessary, I would grant the requisite approval, *nunc pro tunc*.

50 In conclusion, the motion judge erred in refusing to grant Mr. Isabelle the order sought under s. 38 of the *Act*. Therefore, the appeal should be allowed and the decision below set aside. The appellant is entitled to an order under s. 38 of the *Act* authorizing him to commence an action for damages against the Bank with respect to any breaches of any legal obligations which the Bank owed Heritage Flooring. This includes not only statutory breaches, such as those tied to s. 69 of the *Act*, but as well contractual breaches and breaches of obligations imposed at law or in equity (*e.g.*, insufficient time to repay loan). It necessarily follows that the Bank's motions aimed at acquiring the same cause of action must be dismissed.

C. *The Post-Hearing Motion*

51 As noted at the outset, 15 days after the hearing of the present appeal, Mr. Isabelle made an assignment in bankruptcy. Immediately following this event and while the decision on appeal was still under reserve, and without first discussing the matter with Mr. Isabelle's trustee in bankruptcy or Mr. Isabelle's counsel on appeal, counsel for the Bank wrote to the Court informing us, that pursuant to Rule 13.01 of the *Rules of Court*, the matter was "automatically stayed" because of the assignment. Rule 13.01 states, in part, that where at any stage of a "proceeding" the interest or liability of a party is transferred to another party, the proceeding shall be stayed until an order to continue issues. Quaere: Is a decision under reserve a proceeding? The Court was then asked "to confirm" this understanding of the law, otherwise the Bank "would be required to seek a date for the hearing of a motion in that regard." In response, the Court declined the invitation to provide the Royal Bank with legal advice. The Bank should have first discussed the matter with the trustee and Mr. Isabelle's counsel rather than simply forwarding them a copy of its letter, so the parties could decide what course of action to follow. This was not done. Instead, the correspondence from the Bank to the Registrar reads as a letter of intimidation which brought about the opposite effect. Mr. Isabelle's trustee in bankruptcy and his counsel on appeal each responded with a letter, in what amounts to an informal submission, addressed to the Registrar. Each disputed the Bank's understanding of the law,

cited relevant authorities and then asked that this Court deliver its decision in the usual manner. In response, the Bank forwarded an affidavit together with an *ex parte* order to the Registrar of this Court, purportedly drafted in conformity with Rule 13 of the *Rules of Court*.

52 Rule 13 provides that where at any stage of a proceeding the interest or liability of a party is transferred to another person (*e.g.,* the trustee in bankruptcy), the proceeding is stayed until an order to continue issues. Should the party with carriage of a proceeding fail to obtain such an order within 30 days of the transfer, an interested party may do so. In the present case, 30 days had passed since Mr. Isabelle fell into bankruptcy and, hence, the Bank had the right to seek the continuance order. However, the order provided to the Registrar would have given the carriage of the proceedings to the Bank such that it would be both the appellant and respondent. The Registrar refused to sign the order and rightly so. Eventually an order was signed directing that the proceeding be continued with "A.C. Poirier & Associates Inc. as Trustee for the Estate of André Isabelle as appellant". As the Bank did not obtain the order it sought, it brought a motion to permanently stay the rendering of our decision or, alternatively, an order for security of costs. We dismissed both requests with costs and reasons to follow. Here are our reasons.

53 In support of its many arguments, the Bank cites no less than 10 decisions. Only one decision is relevant to the motion for the permanent stay and that decision is contradicted by two others that the Bank failed to bring to our attention. However, the three cases deal with the question of whether, in the absence of a continuance order, a decision under reserve is automatically stayed once one of the parties becomes bankrupt. Since a continuance order issued in this case, it is unnecessary to address the jurisprudence (see *Adams-Eden Furniture Ltd. (c.o.b. Whitehorse Furniture Ltd.) v. Kansa General Insurance Inc.*, [1995] M.J. No. 314 (QL) aff'd [1995] M.J. No. 258 (QL) and compare with *Hunter Douglas Ltd. v. Kool Vent Awnings Ltd.* (1957), 37 C.B.R. 154 (Que. S.C., in Bankruptcy), [1958] C.C.S. No. 127 (QL) and *Rea v. Patmore* (1999) 253 A.R. 363, [1999] A.J. No. 1288 (QL), 1999 ABQB 1069).

54 The Bank had no option but to abandon its argument that the decision under reserve was automatically stayed pursuant to Rule 13.01 of the *Rules of Court*. Any stay that did exist, and this is by no means a given, was lifted with the granting of the continuance order. The Bank then argued that the permanent stay rested on ss. 67(1) and 71 of the *Act*. Section 67(1)(d) states that the property of the bankrupt shall comprise such powers over property as might have been exercised by the bankrupt for his or her own benefit. Section 71 states that the property of the bankrupt passes to the trustee and that the bankrupt ceases to have the capacity to deal with his or her property. It should be readily apparent that these provisions do not operate to prevent this Court from rendering its decision on appeal. This is not to deny that once this Court concludes that a s. 38 order should issue, the right to pursue an action against the Bank then vests in Mr. Isabelle's trustee.

55 The Bank's next argument is that the release of our decision should be stayed on the ground of "mootness". The Bank advanced two reasons. First, it points out that in a document entitled "Statement of Affairs" prepared by Mr. Isabelle with the assistance of his trustee, the value of the s. 38 application is stated as "$0". The Bank seizes upon this fact to argue that the decision under appeal is worthless even if Mr. Isabelle is successful and, hence, there is no live issue between the parties. In his response affidavit, the trustee points out that in those cases where the value of an asset or liability is unknown with any reasonable certainty, it is necessary for the bankrupt to use "$1" or "$0" for the estimated realizable value. This makes good sense and renders the Bank's argument frivolous as is its next argument. The Bank argues that if Mr. Isabelle was a creditor of Heritage

Flooring at the time the appeal was heard, he is no longer a creditor as any debt owed to him by Heritage Flooring is an asset in his bankruptcy and has been assigned to his trustee by operation of law. Clearly, Mr. Isabelle does not lose his status as creditor because he is now bankrupt. It just means that his trustee is the one vested with the right to decide what further action should be taken with respect to all of his assets.

56 Next, the Bank argues that a stay should issue because Mr. Isabelle's trustee has not indicated whether he is interested in pursuing an action against the Bank should Mr. Isabelle's appeal succeed. The Bank cites two cases in support of its argument. For the sake of completeness, I will canvass the cases even though they do not remotely support the argument presented. The first decision is *Hall-Chem Inc. v. Vulcan Packaging Inc.* (1994), 21 O.R. (3d) 89 (Ont. C.A.), [1994] O.J. No. 2692 (QL). In that case "V" had obtained judgment against "B" for $338,000. B appealed but was ordered to give security. B moved to vary the order but while the motion and appeal were pending he filed an assignment in bankruptcy. B's trustee took the position that both proceedings were stayed under s. 69.3(1) of the *Act*. When the motion came before the Ontario Court of Appeal, the Court held that s. 69.3(1) was not applicable. The applicable section was s. 71(2) which vested B's cause of action in the trustee and it was for the trustee to advise B's counsel and for B's counsel to seek instructions as to whether the trustee intended to abandon or proceed with the appeal. Finally, the Court held that the trustee should have sought an order for continuance as provided for under the equivalent of our Rule 13.02 of the *Rules of Court*.

57 The present case is clearly distinguishable from *Hall-Chem*. In that case, the trustee had to decide whether to pursue the motion and the appeal pending before the Court of Appeal. In the present case, the motion and appeal were already heard prior to Mr. Isabelle falling into bankruptcy. Until our decision issues there is nothing his trustee can do. The trustee is entitled to await the decision of this Court to determine whether it should proceed to sue the Bank based on the totality of the surrounding circumstances. Without knowing the reasons underscoring our decision to grant the order Mr. Isabelle sought, it would be unwise for his trustee to make a decision in the abstract.

58 The Bank also insists that *Mann v. Northern B.C. Enterprises Ltd.* (2005), 46 C.C.E.L. (3d) 253, [2005] B.C.J. No. 1485 (QL), 2005 BCCA 367 is a pivotal case. The essential facts involve a trial judge who had allowed an undischarged bankrupt to represent his company in an action for damages for wrongful dismissal in circumstances where the bankrupt's trustee, who held the shares, was not prepared to take any steps to have the company represented at trial. However, I am unable to appreciate how *Mann* is analogous to the case under appeal. Mr. Isabelle is not a shareholder attempting to represent Heritage Flooring in an action against the Bank. Nor is Mr. Isabelle pursuing the present appeal contrary to the wishes of his trustee. The trustee is simply awaiting a decision of this Court in order to determine what action should be taken. Armed with an order under s. 38 of the *Act*, the trustee must decide whether to exercise Mr. Isabelle's right to sue the Bank. Until that decision is made and until the trustee applies for the order granted on this appeal there are no proceedings pending before any court.

59 It is worth reminding all litigators that effective advocacy does not include the indiscriminate proliferation of issues supported by a plethora of case law. It is not the intended role of an appellate court to sift through countless issues and case law to see whether there is something which "sticks". Such litigation tactics obfuscate the true issues and may ultimately undermine the credibility of all advocates and their client's interests. More often than not, the indiscriminate recitation of cases is looked on as an ineffective means of strengthening a weak case. This is why it is important

for counsel to be as judicious in their selection of the case law to be cited in support of an argument as it is important to isolate those issues that legitimately advance the interests of their client.

60 Ultimately, the Bank conceded that the granting of a stay is a discretionary decision but asked that it be exercised in favour of the Bank because of the prejudice it would suffer should it succeed on the appeal and be awarded costs. Of course, the Bank's argument presumes the trustee will be unable to pay any cost award. In the alternative, the Bank asked for an order for security of costs under Rule 58.10 of the *Rules of Court*. Knowing that my colleagues endorse my reasons for judgment with respect to the disposition of the main appeal, the issues of prejudice and costs are truly moot. That said the law in this Province is clear: (1) an order for security for costs may only issue when it is in the "interests of justice"; and (2) "impecuniosity" is not a sufficient ground for granting such an order (see *Re Dugas Estate (Bankrupt)* (2003), 261 N.B.R. (2d) 99 (C.A.), [2003] N.B.J. No. 230 (QL) and *HSBC Bank Canada v. Elm City Chrysler Ltd. et al.* (2007), 323 N.B.R. (2d) 137, [2007] N.B.J. No. 346 (QL)).

61 For these reasons, we dismissed the Bank's post-appeal hearing motion. As the motion was conceived in desperation and nurtured by heaps of irrelevant case law and frivolous arguments, the cost award must reflect these realities. Accordingly, the trustee is entitled to costs of $5,000 on this motion.

VIII. Conclusion

62 In conclusion, I would dismiss the respondent's motion to quash the appeal because of the appellant's failure to obtain leave as required under s. 193(e) of the *Act*. Instead, I would allow the application for leave to appeal, *nunc pro tunc*. As the respondent's motion involved the preparation of extensive written submissions, distinct from those submitted on the main appeal, I would award the appellant costs of $3,500 on this motion. I would also allow the appeal and set aside the motion judge's decision dismissing the appellant's motion brought under s. 38 of the *Act*. The appellant is entitled to an order under s. 38 of the *Act* authorizing him to commence an action for damages against the Bank with respect to a breach of any legal obligation which the Bank owed Heritage Flooring. This includes not only statutory breaches, such as those tied to s. 69 of the *Act*, but as well contractual breaches and breaches of obligations imposed at law or in equity. It necessarily follows that the Bank's motions of April 2, 2007 should be dismissed and the same is true with respect to its motion of April 3, 2007, except with respect to the decision to grant the Bank intervener status. I would award costs of $8,500 to the appellant on the appeal. With respect to the post-hearing motion, the appellant is entitled to costs of $5,000 for the reasons discussed above. In sum, costs of $17,000 are payable forthwith.

J.T. ROBERTSON J.A.
We concur:
B.R. BELL J.A.
K.A. QUIGG J.A.

cp/e/qlrxc/qlpxm/qlrxg/qlcas/qlhcs/qlrxg/qlaxr

Tab 17

Re

Maple City Ford Sales (1986) Limited
Bank of Montreal v. Maple City Ford Sales (1986) Limited et al.
[Indexed as: Maple City Ford Sales (1986) Ltd. (Re)]

39 O.R. (3d) 702

[1998] O.J. No. 2714

Court File Nos. 35-044093 and 5234

Ontario Court (General Division)

Browne J.

June 18, 1998

Bankruptcy -- Creditors -- Rule against double proof -- Guarantors of bankrupt seeking authority under s. 38 of Bankruptcy and Insolvency Act to sue principal creditor for trespass and wrongful conversion when trustee in bankruptcy refusing to pursue action -- Respondents disputing that guarantors having status as creditors entitled to relief under s. 38 -- Rule against double proofs not applicable -- Guarantors of bankrupt having status as creditors -- Application under s. 38 granted nunc pro tunc -- Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 38.

M Ltd. was indebted to the Bank of Montreal and First City Trust Co., and Mc and M had guaranteed repayment of the indebtedness. The Bank petitioned M Ltd. into bankruptcy, but before having done so, the Bank had commenced an action against M Ltd. and against Mc and M as guarantors. The Bank sued for the deficiency in its recovery of M Ltd.'s indebtedness. In that action, M Ltd. delivered a counterclaim claiming damages for trespass and wrongful conversion. After the receiving order was granted, the trustee in bankruptcy indicated that it did not have funds to pursue the counterclaim, which was a potential asset of the estate. The trustee refusing to act, Mc and M applied under s. 38 of the Bankruptcy and Insolvency Act for an order authorizing them to proceed with the counterclaim in their own names, at their own expense and risk. An order under s. 38 being available only to a creditor of the bankrupt, the respondents disputed that Mc and M had the status of creditors and relied upon the rule against double proofs which precludes a guarantor from filing a provable claim when the principal creditor has filed a claim.

Held, the application should be granted.

Mc and M had acquired the status of creditors and for the purposes of an application under s. 38 it was not necessary to determine precisely the amount of their claim. While exactitude would be required for the purpose of determining voting or dividend rights, the exact amount of their provable claim could be determined later, if required. It was not necessary to make a valuation decision at this time and it followed that the rule against double proofs was not violated as there was no risk of double counting. The application under s. 38 should be granted, and with the civil action having been commenced before any of the bankruptcy proceedings, it was appropriate to make the order nunc pro tunc to the date of the bankruptcy.

Cases referred to

Coughlin & Co. (Re) (1923), 4 C.B.R. 294, [1923] 4 D.L.R. 971, [1923] 3 W.W.R. 177 (Man. C.A.); Degroote v. Canadian Imperial Bank of Commerce (1996), 45 C.B.R. (3d) 132 (Ont. Gen. Div.), affd (1998), 37 O.R. (3d) 651, 2 C.B.R. (4th) 45 (C.A.) (sub nom. Re Montego Forest Products Ltd.); Film House Ltd. (Re) (1974), 19 C.B.R. 231 (Ont. S.C.) [vard (1974), 19 C.B.R. (N.S.) 231 (Ont. S.C.)]; McCrie v. Gray (1940), 22 C.B.R. 390 (Ont. S.C.); Polar Products Inc. v. Hong Kong Bank of Canada (1992), 14 C.B.R. (3d) 225 (B.C.S.C.); Rizzo & Rizzo Shoes Ltd. (Re) (1995), 32 C.B.R. (3d) 96 (Ont. Gen. Div.)

Statutes referred to

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, ss. 37, 38 Business Corporations Act, R.S.O. 1990, c. B.16. ss. 245, 246

Rules and regulations referred to

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 11

APPLICATION for an order pursuant to s. 38 of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3.

James Fisher, for Trustee in Bankruptcy.
Anthony J.G. Van Klink, for plaintiff, Bank of Montreal.
H. Richard Bennett, for defendants, David Brock McKeand and Malger Leasing Ltd.

BROWNE J.: -- David Brock McKeand ("McKeand") and Malger Leasing Ltd. ("Malger") claim as creditors of Maple City Ford Sales (1986) Limited (the "Bankrupt") seeking certain relief. The status of McKeand and Malger as creditors is in dispute. The relief sought is in the alternative firstly for relief pursuant to s. 38 of the Bankruptcy and Insolvency Act of Canada, R.S.C. 1985, c. B-3 ("BIA"). In the alternative, relief further to s. 37 BIA. In the further alternative, leave to continue the civil action 5234/91 as a derivative action pursuant to ss. 245 and 246 of the Business Corporations Act, R.S.O. 1990, c. B.16 ("BCA"). Relief is also sought further to Rule 11 of the Rules of Civil Procedure granting leave to continue action 5234/91. The relief sought is on a nunc pro tunc basis.

There is a cross-motion by the Bank of Montreal (the "Bank") in action 5234/91 requesting that the counterclaim with the exception of one paragraph be dismissed. Certain of the relief sought in the Bank's motion has been adjourned sine die. It is agreed that if the applicants McKeand and Malger are successful that result will dispose of the Bank's motion for the relief as described.

The bankrupt is indebted to the Bank and to First City Trust Company. Those debts have been guaranteed by McKeand and Malger. The primary debtors have filed proofs of claim with the trustee. Neither McKeand nor Malger have filed proofs of claim with the trustee.

June 19, 1991 was a day of much activity. The civil action was commenced. There was on the same date a demand made by the Bank of Montreal and also on the same date, outside of bankruptcy proceedings, an ex parte order appointed a receiver. On July 25, 1991 all four defendants filed a statement of claim and counterclaim.

On October 15, 1991 a petitioner for a receiving order was filed.

The civil action continued through discoveries, setting down for trial and on March 18, 1993, a decision was rendered dismissing the plaintiff's motion against the three personal defendants for summary judgment. On the same date the statement of defence and the counterclaim were amended. The action was pre-tried on November 28, 1996 and scheduled for trial in January 1997 which trial was adjourned. There was a further adjournment of the trial in June 1997.

As an aside, in the material before me are filed three pre-trial memoranda. I questioned the appropriateness of that material being before me and refused to consider any of the pre-trial material.

The petition was disputed. There was a hearing in July 1992 with reasons being released in August 1992 [reported 14 C.B.R. (3d) 188]. In the result a receiving order was issued. That decision was appealed to the Ontario Court of Appeal, which appeal was dismissed October 10, 1996 [reported 41 C.B.R. (3d) 181]. Leave to appeal that decision was refused by the Supreme Court of Canada June 26, 1997.

By letter dated December 6, 1996 solicitors on behalf of certain named parties including the applicants wrote in their capacity as creditors of the bankrupt requesting the trustee to continue the counterclaim against the Bank of Montreal. As a result of that letter the trustee wrote to the creditors of the bankrupt on December 10, 1996, which letter includes the following:

> On June 19, 1991, Bank of Montreal ("Bank") appointed Ernst & Young Inc. as Receiver and Manager of Maple City Ford Sales (1986) Limited ("Company") pursuant to security it held which encumbered all assets of the Company. After realizing on the Company's assets, the Bank incurred a significant shortfall. On October 15, 1991, the Bank filed a Petition for a Receiving Order against the Company appointing Ernst & Young Inc. as Trustee in Bankruptcy. The Receiving Order was issued on July 30, 1992 and a creditor meeting was held on September 17, 1992 at which time Ernst & Young Inc.'s appointment as Trustee was affirmed. No Inspectors were appointed at the meeting. The Company filed an appeal of the Receiving Order and on October 10, 1996 the appeal was dismissed.
>
> Prior to October 15, 1991, the date of bankruptcy, the Bank commenced a legal action against the Company and the guarantors of the Company's indebtedness for recovery of

> its shortfall, In response, the Company filed a counterclaim against the Bank claiming damages of $5,000,000 for trespass and wrongful conversion.
>
> The counterclaim against the Bank may represent a potential asset for the estate. As Trustee, we have no funding available within the estate to investigate the merits of the counterclaim or seek a legal opinion as to the likelihood of success should the counterclaim be pursued. As a result of the lack of funding it is the Trustee's intention to abandon any further action in this regard. Accordingly, we hereby give notice that the creditors of the estate have the right to make application to the Court pursuant to Section 38 of the Bankruptcy and Insolvency Act to commence and prosecute proceedings in their own name and at their own expense and risk regarding this matter.

By October 1997 the position of the trustee was to question the authority of the applicants to follow the procedure of s. 38 unless directed to do so by the court. In other words the trustee took the position the applicants were not creditors or even if creditors, were not for other reasons entitled to rely upon s. 38.

Section 38 includes the following:

> 38(1) Where a creditor requests the trustee to take any proceeding that in his opinion would be for the benefit of the estate of a bankrupt and the trustee refuses or neglects to take the proceeding, the creditor may obtain from the court an order authorizing him to take the proceeding in his own name and at his own expense and risk, on notice being given the other creditors of the contemplated proceeding, and on such other terms and conditions as the court may direct.
>
> (2) On an order under subsection (1) being made, the trustee shall assign and transfer to the creditor all his right, title and interest in the chose in action or subject-matter of the proceeding, including any document in support thereof.
>
> (3) Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.

The applicants' position is that they are creditors and having the status of creditors, they are entitled to relief provided in s. 38.

The responding position is that the applicants are not creditors and that they cannot therefore avail themselves of s. 38. The further responding position relies upon a rule described as the rule against double proofs which is said to be applicable where a principal creditor has filed a claim a guarantor has no provable claim and cannot file a double proof with the trustee.

In Re Film House Ltd. (1974), 19 C.B.R. 231 (Ont. S.C.) at p. 233, Houlden J. considered the position of a guarantor who had not been called upon to pay the principal debtor. The issue before the registrar and on appeal involved a creditor's voting rights, if any. From p. 233 the registrar comments as follows:

> Now it is quite clear from Re Froment; Alta. Lumber Co. v. Dept. of Agriculture, Alta., 5 C.B.R. 765, [1925] 2 W.W.R. 415, [1925] 3 D.L.R. 377 (Alta.), that the contingent liability of a guarantor, who has not been called upon to pay or who has not in fact paid, is a debt provable in bankruptcy of the debtor.

The registrar was dealing with the valuation of a liability at a point in time for the purpose of voting. On p. 233 the registrar comments as follows:

> In a sense there is a valuation for purposes of filing a claim, for purposes of voting and for other purposes and a valuation for the purpose of receiving a dividend.

On the facts of this case the principal creditor had chosen not to file a proof of claim for the purpose of voting. Houlden J. at p. 234 provided that:

> If the principal creditor had elected to vote the claim, then the surety would have had no right to vote.

In Polar Products Inc. v. Hong Kong Bank of Canada (1992), 14 C.B.R. (3d) 225 (B.C.S.C.) at p. 227, the facts were quite similar to the case at bar. The applicants therein had requested the trustee to commence an action. With the trustee refusing to launch the action, a motion was brought for relief pursuant to s. 38. The applicants had not filed proofs of claim and in the first instance, relief was not granted for failure to qualify as creditors because of the failure to file proofs of claim. They were given leave to renew the application. After filing proofs of claim the matter again came before the court. In the material before the court it was not possible to quantify the claim at that particular point in time. The court comments at p. 227 as follows:

> I conclude that the applicants have established on a balance of probabilities that they are creditors of the bankrupt in a substantial amount but that the precise amount of indebtedness is unproven and is probably incapable of being proved except by an extensive (and no doubt expensive) accounting and perhaps after a trial of the issue.

The court quotes s. 38 and addresses as a first question whether the applicants are creditors within the section. At p. 228 that issue is discussed as follows:

> Section 2, the definition section, defines "creditor" as meaning "a person having a claim, preferred, secured or unsecured, provable as a claim under this Act".
>
> The word "creditors" appears in many sections of the Act. It has been held that the statutory definition can be satisfied only by "claims proven to the satisfaction of the trustee and/or the court": Re Currell (1985), 57 C.B.R. (N.S.) 173 (Ont. S.C.). That decision dealt with the interpretation of "creditors" in s. 115 of the Act [R.S.C. 1970, c. B-3], which deals with the bankrupt's entitlement to any surplus remaining after payment in full of "his creditors". In that context, it is clear that a claim could be considered proven only if proved as to its amount as well as its existence. But the same degree of precision is not required at this stage in order to deal with the issue raised under s. 38(1) although, if the creditor succeeds in effecting a recovery, the amount of his claim will have to be established precisely in order to apply s. 38(3):

> (3) [Benefits belong to creditor] Any benefit derived from a proceeding taken pursuant to subsection (1), to the extent of his claim and the costs, belongs exclusively to the creditor instituting the proceeding, and the surplus, if any, belongs to the estate.
>
> I therefore hold that the claims are sufficiently proven to qualify the applicants as creditors for the purposes of s. 38(1).

(Emphasis added)

In DeGroote v. Canadian Imperial Bank of Commerce (1996), 45 C.B.R (3d) 132 (Ont. Gen. Div.), Lax J. was considering s. 38 and the status of a corporation claiming to be a creditor. In the result she concluded at p. 136:

> On balance, I am satisfied that [the corporate applicant] has a claim "provable" in bankruptcy which is all that is required to bring itself within the broad definition of "creditor" under the Act. Whether or not the claim is ultimately proved is irrelevant to the issue I am asked to consider.

It is clear that there are different times and different values within the bankruptcy process for claims to be considered. At the end of the day there must be precision with reference to the figures used for dividend purposes. Before that time, there may be no need for that exactitude. Exactitude would be required for the purpose of voting. In my view exactitude is not required to establish status as a creditor. I am satisfied that the applicants herein have at this stage the required status as creditors even though they ultimately may or may not be entitled to a dividend, if there are any dividends. It is my conclusion that at this time the claim of the applicant now exists as a provable claim the exact amount of which can be determined later, if required.

In the appeal from Lax J.'s decision by endorsement February 4, 1998 [reported 37 O.R. (3d) 651], the appeal was dismissed. The court provided [at p. 654]:

> It is not every case that will lend itself to the granting of a s. 38 order nunc pro tunc and circumstances alter cases: the facts presented in many cases may not engage the discretion of the court to make such an order, whereas the facts presented in others may invite the exercise of that discretion.

In Re Coughlin & Co. (1923), 4 C.B.R. 294, [1923] 4 D.L.R. 971 (Man. C.A.), the headnote includes the following:

> A surety for the whole debt with a limit on his liability is a creditor under sec. 44 of The Bankruptcy Act after he has paid the amount of the limited liability; but he may nevertheless be postponed in ranking on the assets by reason of the rule against double proofs so that his claim shall not rank in opposition to the claim of the creditor whose debt was the subject of the guarantee but who was not paid in full because of the stipulated limit to the surety's liability.
>
> At p. 299 the court provides as follows:

> It is to be noted that it is the "debt" which is provable. There may be several claimants in respect of the "debt," but there is only one debt, and double proof in respect to it is not permitted.

The respondent bank's position is that where there is a guarantee for a whole debt even if limited in amount the guarantor cannot prove a claim in bankruptcy until the time that the principal creditor is paid in full.

The principles involved for the above position were considered by Urquhart J. in McCrie v. Gray (1940), 22 C.B.R. 390 (Ont. S.C.). On the facts in this case the creditor took the position that he was liable as a surety to a bank. The bank had not filed a claim in the bankruptcy estate nor had it made a claim against the surety but a claim against the surety was anticipated. Urquhart J. comments at p. 394 as follows:

> . . . if the Bank of Montreal makes a claim upon the estate and receives its dividend, it is obvious that the creditor, even though he must pay the balance, cannot succeed in a claim against the estate. For example, assuming that twenty cents on the dollar be paid, if the Bank of Montreal makes its claim and receives twenty per cent, and then claims against the creditor for the remaining eighty per cent, the creditor could not rank against the estate for the remainder and get twenty per cent of the eighty per cent because that would have the effect of this debt bearing a dividend of close to forty per cent at any rate considerably more than other creditors' claims would bear. There cannot be two claims for the one debt. In re Coughlin & Co., 4 C.B.R. 294, [1923] 3 W.W.R. 1177, 33 Man. R. 499, 3 Can. Abr. 779.
>
> If, however, the Bank of Montreal does not see fit to claim for its debt but compels payment of the debt from the surety the applicant creditor is subrogated to the rights of the Bank of Montreal and can make a claim therefor.

On the facts of the above case the claim was allowed and valued at the full amount due upon the surety. Most similar cases deal with an attempt to quantify amounts for voting purposes or for dividend payment purposes. It is in my view not necessary to make a valuation decision at this point in time. The rule dealing with double proofs is not violated as it follows that there is but one debt for each of the two principal creditors, their debts being separate from each other. In the result I find the applicants to have status as creditors within s. 38. Their claims are provable at this time in an amount unascertained. There is no violation by their contingent claims upon the rule against doubt proofs of a single debt. There would at this stage be no risk of double counting. The risk of double counting appears to be the mischief to which the rule pertaining to double proofs is directed and I find there to be no mischief in fact to date for the purposes of s. 38.

The civil action against the three personal defendants will continue whatever the decision made upon this application may be.

With the civil action being commenced before any of the bankruptcy proceedings it is in my view appropriate that relief be nunc pro tunc to the date of bankruptcy namely, October 15, 1991.

Having found that relief is available further to s. 38, s. 37 does not apply: see Re Rizzo & Rizzo Shoes Ltd. (1995), 32 C.B.R. (3d) 96 (Ont. Gen. Div.). Again, in my view having found that relief is available under s. 38 relief under the BCA is not available.

Section 38 provides that relief may be granted on such terms and conditions as the court may direct.

The material to which I was referred raises serious questions as to amounts due for debt to the bankrupt from the applicants and raises the question of the applicants' ability to conduct the proceedings at their "own risk and expense".

As I have indicated earlier, the relief granted will be on a nunc pro tunc basis. The relief granted includes the following. The applicants are entitled to file forthwith and as a precondition to the balance of relief proofs of claim, in the bankrupt estate. An order shall go further to Rule 11 of the Rules of Civil Procedure granting the applicants and/or Maple City leave to continue to prosecute the counterclaim in action 5234/91. The applicants may at their risk and expense on notice to other creditors and giving of security for costs as hereinafter provided continue the counterclaim as hereinbefore provided. The trustee may continue the civil action further to s. 38 upon satisfaction of the preconditions, namely, filing proof of claim, giving of notice, paying of security for costs, receive an assignment and transfer by the trustee of all right, title and interest in the chose in action subject to s. 38(3) and/or such accounting as may be required.

Estimates for the length of trial are estimated between two weeks to eight weeks. I accept on the basis of a balance of probabilities that the estate has claims provable against the applicants in an amount or amounts which I am unable to ascertain with any degree of confidence at this stage in the proceedings. I was asked to consider that there be security for such indebtedness. I declined to accept that invitation. However, in the context of the risks and costs of prosecuting the counterclaim, I require that the applicant pay into court in the civil action as a precondition to the relief herein, the sum of $55,000 to be held subject to such order as may be made within that action.

If leave is required in the civil action for the plaintiff to continue to prosecute the claim against the bankrupt, such leave is granted.

The motion brought on behalf of the Bank other than as adjourned is dismissed.

Order to go in favour of the applicants pursuant to these reasons.

If the parties cannot agree upon costs, written submissions may be submitted within 30 days from the date of release of these reasons.

Application granted.

Tab 18

Case Name:
Labarre (Syndic de)

IN THE MATTER OF THE BANKRUPTCY OF
GAETAN LABARRE, Bankrupt
LA BANQUE TORONTO-DOMINION, Petitioner
Vs.
ST-GEORGES, HEBERT INC., Respondent

[2004] Q.J. No. 13895

No.: 500-11-019569-025

Quebec Superior Court
District of Montreal

The Honourable Dionysia Zerbisias, J.S.C.

Heard: January 21 and June 8, 2004.
Judgment: June 29th, 2004.

(23 paras.)

Counsel:

Claude Savoie (Savoie & Savoie), attorney for Petitioner.
Jean El Masri (El Masri Dugal), attorney for Respondent.

JUDGMENT

1 Petitioner appeals from the disallowance by the Trustee of its proof of claim as a non-secured creditor in the estate of the Bankrupt.

2 The circumstances are as follows.

3 On January 10, 2003, Petitioner filed a proof of claim in the amount of $50,107.19 (capital $43,491.68; interest $6,615.51) as an unsecured creditor in the estate of the Bankrupt Gaétan Labarre.

4 In support of its claim, Petitioner filed the following documents:

A) statement of interest calculations;

B) statement of collocation setting out the distribution of funds from the judicial sale of an immoveable property owned by the Bankrupt, situated at 180 Domaine Caché, Laval, Quebec;

C) a Deed of Sale executed on June 12, 1995 between Les Constructions Marc Picard Inc. and the Bankrupt wherein the Bankrupt assumed repayment of the balance due under a loan made by Petitioner to Les Constructions Marc Picard Inc.; the balance assumed was $86,719.00 bearing interest at 8.375% per annum;

D) copy of the Declaration in an action instituted by Petitioner against the Bankrupt and Les Constructions Marc Picard Inc. on April 9, 2001, for the amount of $43,491.68 plus interest, which declaration sets out the details of the Bank's claim.

5 Nowhere in the Proof of Claim, nor in the supporting documents is there any mention that in addition to the proceeds from the judicial sale in the amount of $61,683.60 received by Petitioner, that Petitioner had also received from Canada Mortgage and Housing Corporation (hereinafter the CMHC) two payments, on November 11, 2000 and February 2001, in the amounts of $34,236.15 and $3,583.37 respectively on account of the same loan.

6 Mr. Labarre had filed an assignment in bankruptcy, on December 28, 2002, after payment of these sums from CMHC to Petitioner but prior to judgment being rendered in the Petitioner's action against him. Mr. Labarre was subsequently discharged from his bankruptcy on September 29, 2003.

7 On February 17, 2003 the Trustee disallowed the claim filed by Petitioner on the grounds that it was inaccurate and contained false information; that there was nothing due and outstanding to Petitioner itself; that Petitioner was acting as the undeclared representative of a third party, CMHC; and that having received payment from CHMC, it had no further interest as a creditor against the estate.

8 Petitioner appealed from the disallowance on March 19, 2003 on the grounds that

A) it is the authorized agent of CMHC under Canada Mortgage and Housing Corporation Act, R.S.C. 1985, c. C-7 and the National Housing Act, R.S.C. 1985, c. N-11.

B) it has been designated an approved lender under these laws and that as such, it is subrogated, pursuant to those laws and to Article 2474 C.C.Q. in the rights of and can take action on behalf of the C.M.H.C.

9 With the greatest respect, I cannot agree with the Petitioner's position.

10 The Bankruptcy and Insolvency Act, R.S.C., 1985, c. B-3 (hereinafter BIA) sets out the rules regarding the filing of proof of claims at Sections 121 and following. Sections 124 and 125 stipulate how and who may file a proof of claim, and the penalties for false claims:

> 124.(1) [Creditors shall prove claims] Every creditor shall prove his claim, and a creditor who does not prove his claim is not entitled to share in any distribution that may be made.

(2) [Proof by delivery] A claim shall be proved by delivering to the trustee a proof of claim in the prescribed form.

(3) [Who may make proof of claims] The proof of claim may be made by the creditor himself or by a person authorized by him on behalf of the creditor, and, if made by a person so authorized, it shall state its authority and means of knowledge.

(4) [Shall refer to account] The proof of claim shall contain or refer to a statement of account showing the particulars of the claim and any counter-claim that the bankrupt may have to the knowledge of the creditor and shall specify the vouchers or other evidence, if any, by which it can be substantiated...

> 125.[Penalty for filing false claim] Where a creditor or other person in any proceedings under this Act files with the trustee a proof of claim containing any wilfully false statement or wilful misrepresentation, the court may, in addition to any other penalty provided in this Act, disallow the claim in whole or in part as the court in its discretion may see fit.

11 Form 31 BIA provides the form whereby claims must be made. The proof of claim fyled herein, complies with that form. In it, Petitioner affirms the debt due on the date of the bankruptcy, and that the debt is still outstanding on the date of the claim.

12 Since proof of claims are generally filed by laypersons it is an accepted principle of law that a liberal approach must be used in the examination of these claims: technicalities are to be avoided, and clerical errors to be overlooked. On the other hand, the proof of claim must be as accurate as possible and must provide supporting documents and sufficient details, failing which the claim is deemed not to have any standing.

13 Amendments of claims should be allowed where an honest error has been made. The Court, in the exercise of its general authority, has the power to excuse formal defects and irregularities under s.187(9) BIA which provides that proceedings in bankruptcy should not be invalidated by any formal defect or irregularity, unless a substantial prejudice or injustice, which cannot be remedied by an order of the Court, has been caused.

14 Petitioner's position cannot be maintained on either of the grounds invoked.

15 Under s. 5(1) of the Act to Amend the National Housing Act and The Canada Mortgage and Housing Corporation Act, S.C., 1999, c. C-66 Petitioner has been designated as an approved lender.

16 Section 10 provides that where CMHC pays one of its approved lenders an insured loan, it is CMHC which is subrogated in the rights of the lender:

> "(1) The Corporation may make payments to approved lenders or to holders of insured loans, and may make loans or payments to borrowers or their assignees, for the purpose of avoiding or curing, in whole or in part, default under insured loans or facilitating variation of the terms of payment of insured loans, or for any other purposes that the Corporation considers appropriate to protect its interest as an insurer.

(2) If the Corporation makes a payment to an approved lender or holder of an insured loan under subsection (1), the Corporation is subrogated, to the extent of the amount of the payment, to all the rights and interests of the lender or holder in respect of that amount, and may maintain an action in respect of those rights and interests in the name of the lender or, holder or in the name of the Corporation. Any money recovered by the lender or holder must first be applied against money owing to the lender or holder on account of the insured loan.

(3) The Corporation may waive the right of subrogation referred to in subsection (2)."

(Underlining added)

17 Section 20 provides that CMHC may designate an approved lender to act as its agent:

> 20. "The Corporation may authorize an approved lender to act as agent for the Corporation in the exercise of any of its powers or functions under this Part, including in a situation involving a loan made or administered by the lender."

18 In both these instances therefore, either the Petitioner has lost its rights to the extent of the payment it has received from CMHC, the latter being subrogated in the lender's right against the Borrower, or, if Petitioner has been appointed the agent of CMHC, the mandate must be disclosed.

19 Furthermore, Article 2474 Civil Code of Quebec, S.Q. 1991, c.64, provides that whenever there is payment by an insurer to an insured, there is subrogation or a transfer of rights from the insured to the insurer:

> 2474. "The insurer is subrogated to the rights of the insured against the person responsible for the loss, up to the amount of indemnity paid. The insurer may be fully or partly released from his obligation towards the insured where, owing to any act of the insured, he cannot be so subrogated."

20 In the present instance, it is the Petitioner, the insured or payee, who is attempting to invoke the rights of CMHC, the insurer or payor. However, under Art. 2474 C.C.Q by the operation of the law itself, there has been a transfer of rights from Petitioner in favour of CMHC to the extent of the payment received from it: Trépanier vs Plamondon, [1985] R.D.J. 277 (C.A.Q.). Since every person must exercise their civil rights under the name assigned to them, (Art. 5 C.C.Q.), and no person can plead in the name of another (Article 59 C.C.P.), Petition is precluded from acting on behalf of CMHC, save as may be provided under the BIA which specifies that representatives must declare their authority when fyling proofs of claim on behalf of others.

21 In any case, Petitioner has not complied with the requirement of the law by indicating pursuant to s. 124(3) BIA on whose behalf and by what authority it is acting.

22 This is not a question of a mere technicality or formality, but one of substance. A trustee must be furnished with sufficient accurate information to permit him to evaluate the claim against the bankrupt. The other creditors must have sufficient information to contest those claims. Finally there is the rule against double proof which is designed to assure the distribution of a bankrupt's assets on a pro-rata basis among unsecured creditors by insuring that the trustee does not pay two dividends on what is essentially the same claim: Re. Olympia and York Developments Ltd (1998), 4 C.B.R. (4th) 189 (Ont. Gen. Div.).

23 FOR THESE REASONS THEREFORE, THE COURT:

A) DISMISSES the Appeal;

B) RESERVES the right of Petitioner and/or CMHC to file their claims in the proper form within fifteen days of the present judgment;

C) ORDERS that no distribution of dividends be made in the estate until such time as the claims have been fyled, or, upon the expiry of the delay, whichever first occurs;

D) THE WHOLE WITH COSTS in favour of Respondent-Trustee.

DIONYSIA ZERBISIAS, J.S.C.

cp/i/qlspt

Tab 19

Indexed as:

Riddler (Re)

IN THE MATTER of The Proposal of Alan Wayne Riddler

[1991] B.C.J. No. 36

3 C.B.R. (3d) 273

24 A.C.W.S. (3d) 1052

Vancouver Registry Nos. 150692 and 1097/85

British Columbia Supreme Court
Vancouver, British Columbia
(In Chambers)

Campbell C.J.S.C.

Heard: September 18, 1990
Judgment: January 9, 1991

Bankruptcy -- Creditors -- Pre-proposal and post-proposal claims -- Proof of claim -- Rule against double proof.

Appeal from the trustee's order of disallowance. An executor misappropriated funds from an estate of which he was sole executor. He subsequently filed a proposal for bankruptcy. The new executrix commenced an action against the bankrupt, his banker and solicitors for misappropriation of trust funds. She also filed a claim with the trustee as a secured creditor in respect of the funds. The trustee disallowed the claim and the executrix appealed, seeking an order to set aside the trustee's disallowance and allowing her claim as ordinary creditor. The claim included funds allegedly misappropriated before the filing of the bankruptcy proposal by the first executor and interest accruing thereafter. The original action was settled by the other named defendants except the bankrupt.

HELD: Appeal allowed in part. The effective date of determining a claim in a proposal is the date it is filed. Thus the appellant could not claim any sum accruing by way of interest or litigation cost after that date. The appellant had provided adequate proof of her claim against the bankrupt. However, she would not be allowed to claim for an amount equal to the settlement moneys since this would offend the rule against double proof.

STATUTES, REGULATIONS AND RULES CITED:

Bankruptcy Act, R.S.C. 1985, c. B-3, ss. 69, 124, 125, 135.

Counsel for the Creditor; P.D. Le Dressay.
Counsel for the Trustee: K.S. Campbell.

CAMPBELL C.J.S.C.:-- The creditor, Joy Armstrong, Executrix of the estate of James T. Riddler, deceased, ("the applicant") appeals pursuant to s. 135(4) of the Bankruptcy Act, R.S.C. 1985, c. B-3 ("the Act") from the Trustee's disallowance of her claim filed in these bankruptcy proposal proceedings. She seeks an order setting aside the disallowance and allowing her claim as an ordinary creditor in the amount of $131,353.40.

The facts as revealed by the material filed are somewhat complicated.

James T. Riddler died November 18, 1975 having on October 15, 1975 executed his will which appointed Alan Wayne Riddler as Executor. Letters probate in favour of Alan Wayne Riddler as sole Executor of the deceased's estate were granted to Alan Wayne Riddler ("A.W. Riddler") on February 12, 1980.

In August 1980, A.W. Riddler withdrew $60,000.00 from the estate bank account and transferred it into his personal account. He then purchased a term deposit receipt for $60,000.00 in his own name and pledged it to the Bank of Montreal as security for personal advances. The term deposit was redeemed by the bank and applied against his personal indebtedness.

On February 2, 1983, A.W. Riddler borrowed $60,000.00 from the Bank of Montreal to reinstate the term deposit receipt apparently in an attempt to replenish the deceased's estate. This was also redeemed by the bank and applied to reduce A.W. Riddler's personal indebtedness. A.W. Riddler in an affidavit filed herein September 13, 1988, says that this was done without his knowledge or consent.

On July 18, 1985, A.W. Riddler made a proposal in bankruptcy, The proposal lists assets totalling $105,240.00. The liabilities listed include: $86,000.00 owing to secured creditors; $6,973.94 owing to preferred creditors and $36,696.67 owing to unsecured creditors. The estate of James T. Riddler is not listed as a creditor.

The Registrar was directed by an order of Taylor J. on September 12, 1985 to take the accounts of A.W. Riddler as Executor of the estate of James T. Riddler. One Registrar's Report covering the accounts for the period from November 18, 1979, to March 31, 1984, dated November 3, 1986, shows the amount owed by A.W. Riddler to the estate as of March 31, 1984 to be $69,158.00. A second Registrar's Report filed November 20, 1986, shows that A.W. Riddler owed the estate $139,415.00 as of November 3, 1986. I have no evidence of how the indebtedness increase between March 31, 1984 and November 3, 1986 is calculated. It also seems unusual that the indebtedness as of March 31, 1984 of $69,158.00 would increase as of the proposal date, July 18, 1985, to $131,353.00 the amount, as will appear later the Trustee was subsequently, subject to certain condi-

tions, prepared to accept. This calculation is purportedly explained in the letter of November 10, 1988, which is exhibit 10 to the affidavit of John Bottom.

On December 12, 1986, the court removed A.W. Riddler as the Executor of the estate and appointed Joy Armstrong, a beneficiary and mother of the deceased, as Executrix.

An action was commenced on November 13, 1987 by Joy Armstrong in her capacity as Executrix of the estate, against A.W. Riddler for misappropriation of trust funds ("the 1987 litigation"). Other defendants named in the action included the Bank of Montreal, A.W. Riddler's former solicitors and his former accountants. That action was commenced without the leave of this court as required by s. 69 of the Bankruptcy Act. Subsequently, that leave was obtained from Gibbs J. on August 11, 1988.

On February 19, 1988, the Trustee sent notice to the applicant to prove any claim against the proposer within 30 days, failing which the Trustee stated he intended to distribute the estate of A.W. Riddler ("the proposer") without regard for any such claim.

On March 4, 1988, a proof of claim was submitted by the applicant. It claimed a secured interest in the amount of $139,415.00 on the "basis of trust and tracing". The Trustee disallowed this proof of claim on the ground that it claimed a priority position that did not exist under the Act. A second proof of claim claiming a proprietary interest in the proposal estate was submitted by the applicant on May 9, 1988. This was disallowed by the Trustee on the basis of insufficient evidence. The applicant appealed both disallowances to this court and both were upheld by Gow J. on October 4, 1988.

A third proof of claim, the subject of this application, was filed by the applicant as an ordinary creditor on October 14, 1988. This was for $135,702.36. No statement of account, as required by the Bankruptcy Act, was included to show how this amount was calculated. The Registrar's report earlier referred to which showed that as of November 3, 1986, the proposer was indebted to the applicant in the amount of $139,415.00 subject to his entitlement to a ten per cent share of the net distribution of the James T. Riddler estate was attached to the Proof of Claim. There is no indication in the Registrar's report as to how much, if any, of the amount claimed to be owing by the proposer arose between July 18, 1985 (the effective date of the proposal) and November 3, 1986, nor of the value of his ten per cent interest in the James T. Riddler estate to be set off against his debt.

The Trustee's solicitor pointed out these deficiencies in a letter dated October 25, 1988, to the applicant's solicitor.

In a letter dated November 10, 1988, referred to earlier as exhibited to the Bottom affidavit, the solicitor for the applicant wrote to the Trustee's solicitor purporting to give details of the calculation of the claim and included an interest schedule. According to this, as of July 18, 1985, the date of the proposal, the proposer owed the applicant $131,353.40 plus costs ordered by Taylor J. on a solicitor/ client basis totalling $7,483.20 making a total indebtedness of $138,836.60. The Trustee through his solicitor then advised he was prepared to accept the applicant's proof of claim "as wholly unsecured for the amount of $131,353.40" subject to a full and general release of the Trustee and the estate of the proposer from the applicant and the estate of James Riddler. This offer was not accepted by the applicant.

On or about December 12, 1989, the 1987 litigation settled by all defendants except the proposer. The Bank of Montreal ("the bank") paid $106,000.00 to settle the claim against it. The remaining defendants, apart from the proposer, paid a further amount of $22,000.00. All but the bank waived

entitlement to claim against the proposer. The proposer was not a party to the settlement agreement, nor has the proposer been a party to any such agreement with the bank.

Robert Dresser', solicitor for the Trustee, in his affidavit sworn September 18, 1990, states that he was informed by counsel for the bank that the bank would not prove a claim against the proposal estate for the amount paid by the bank under settlement. The bank, however, did not assign its right to claim against the proposer to the applicant.

After protracted correspondence and discussions between the solicitor for the Trustee and for the applicant after the filing of the Proof of Claim on October 4, 1988, the Trustee, on July 19, 1990, gave Notice of Disallowance of that claim. This application followed.

In that correspondence and those discussions subsequent to the settlement of the 1987 litigation, the applicant has taken the position that she is entitled to invoke the rule in Clayton's Case. Accordingly, she has purported to apply the funds received from the settlement to her post-proposal claims, first for costs and interest incurred in the 1987 litigation, second against the proposer's debt for solicitor/client costs incurred subsequent to the proposal, and third in respect of interest.

In a letter to the applicant's solicitor dated October 5, 1988, the Trustee's solicitor's stated:

> "Although the Registrar's report should provide evidence of the claim, you must bear in mind that toe claim is provable only for the debt as it stood as at the date of the filing of the proposal. You may not prove a claim for interest thereafter or for any costs of other charges which may have been incurred subsequent to the filing of the proposal."

In several subsequent letters to and discussions with the applicant's solicitors the Trustee's solicitors have objected to the form and content of the proof of claim and have sought an accounting from the applicant as to the means by which the claimed amount is calculated and the amount claimed owing as of the effective proposal date of July 18, 1985.

In addition, they requested that the applicant file an amended proof of claim to take into account the funds received pursuant to the 1987 litigation settlement. The applicant has not adjusted her claim and "stands by" the proof of claim as currently presented and further contends that the settlement of the 1987 litigation has nothing to do with the bankruptcy.

The pre-proposal claim would be comprised of the principal amount of the claim which appears to be $60,000.00 plus interest. The post-proposal claim would appear to consist of interest accruing since July 18, 1985, and the applicant's costs in the 1987 litigation.

It appears the costs of the 1987 litigation are in excess of $68,000.00. Interest accruing since the date of the proposal was $79,824.25 as of March 1990.

The first issue is whether the applicant can make a claim in the proposal estate for matters arising after the effective date of the proposal.

Section 62 of the Act is unequivocal in stating that the effective date for determining claims in a proposal is the date it is filed. That section provides:

> 62. (1) Where an insolvent person makes a proposal, the trustee shall file a copy thereof with the official receiver and the time of the filing of the proposal shall constitute the

time for the determination of the claims of the creditors and for all other purposes of this Act.

(2) A proposal accepted by the creditors and approved by the court is binding on all the creditors with claims provable under this Act and affected by the terms of the proposal but does not release the debtor from the debts and liabilities referred to in section 178, unless the creditor assents thereto.

The proposal here was filed July 18, 1985. Clearly then the applicant cannot include in her proof of claim any amount for interest arising after July 18, 1985, nor can she claim the costs of the 1987 litigation since these were incurred after the effective date of the proposal. Thus, she can only claim the principal amount of her claim against the proposer, together with whatever interest had accrued on it to the effective date of the proposal. Equally clearly, the proof of claim filed includes postproposal amounts, including interest.

Thus, the applicant is only entitled to file a proof of claim as of July 18, 1985. This eliminates the interest and costs of the 1987 litigation and all other matters arising subsequent to that date.

The next issue is whether the applicant has provided adequate proof of her claim against the proposer.

The relevant provisions of the Act are sections 124(1)(2)(4) (5), 125 and 135(1)(2)(4). These state:

124. (1) Every creditor shall prove his claim, and a creditor who does not prove his claim is not entitled to share in any distribution that may be made.

(2) A claim shall be proved by delivering to the trustee a proof of claim in the prescribed form.

(4) The proof of claim shall contain or refer to a statement of account showing the particulars of the claim and any counter-claim that the bankrupt may have to the knowledge of the creditor and shall specify the vouchers or other evidence, if any, by which it can be substantiated.

(5) The proof of claim shall state whether the creditor is or is not a secured or preferred creditor.

125. Where a creditor or other person in any proceedings under this Act files with the trustee a proof of claim containing any wilfully false statement or wilful misrepresentation, the court may, in addition to any other penalty provided in this Act, disallow the claim in whole or in part as the court in its discretion may see fit.

135. (1) The trustee shall examine every proof of a claim and the grounds of the claim, and may require further evidence in support of

> (2) Where the trustee considers a claimant is not entitled to rank on the estate of the bankrupt, or is not entitled to rank for the full amount of his claim, or if directed by a resolution passed at any meeting of creditors or inspectors, he may disallow the claim in whole or in part, and in that case shall give to the claimant a notice of disallowance, and the notice shall contain the reasons for disallowance.
>
> (4) The disallowance referred to in subsection (2) is final and conclusive unless, within thirty days after the service or mailing of the notice or such further time as the court may on application made within the same thirty days allow, the claimant appeals to the court in accordance with the General Rules from the trustee's decision.

Section 124 is mandatory in its terms. A creditor filing a proof of claim must append a statement of account showing full particulars of the claim, failing which the trustee has the discretion to disallow the claim in whole or in part: ss. 124(4), 125 and 135(4). The claimant must, in a statement of accounts, show the particulars of the claim, specify vouchers or any other evidence by which the claim can be substantiated. Thus, the proof of claim should be sufficient to enable the trustee to make an informed decision on the merits: Re Corduroy's Unlimited Inc. (1962), 4 C.B.R. (N.S.) 250 (Que.S.C.); Re Norris (1988), 57 C.B.R. (N.S.) 246 (Ont.S.C.) and Re Rix (1984), 53 C.B.R. (N.S.) 67 at pp. 72-74 (B.C.S.C.).

Counsel for the Trustee submits that the creditor's obligation to provide reliable, accurate information extends to any and all events after the initial filing of the proof of claim which affect the amount of the claim. He also submits that the rule against double proofs is premised upon this obligation and relies on the following authorities in support of this proposition: Re Film House Ltd. (1974), 19 C.B.R. (N.S.) 231 (Ont.S.C); Re Hammond Organs Studio of Kelowna Ltd, (1981), 40 C.B.R. (N.S.) 293 (B.C.S.C.); Re Tuxedo Silver Ltd. (1961), 4 C.B.R. (N.S.) 95 (Man.Q.B.); and Re Rix, supra. (The rule against double proofs will be discussed infra.)

Counsel for the Trustee also submits that on an application under s. 135 for review of a disallowance by the Trustee, the creditor will not be permitted to recast or reformulate the claim. It is contended that the application must stand or fall on the basis of the material leading to the notice of disallowance.

Counsel for the applicant says that there has been a proper accounting and contends that the Trustee's objections to the arithmetical calculations are immaterial. It is his position that the indebtedness of the proposer was fixed by an order of the Registrar of the Court as being $139,415.00 as of November 3, 1986. He further relies on the decision of the B.C. Court of Appeal in Hill v. Hill (1966), 56 W.W.R. 260 to argue that the amount of the indebtedness is res judicata. This decision is cited for the following proposition:

> "For the purposes of estoppel by res judicata, a judgment on merits stands for every point, whether of assumption or admission, which was in substance the ratio of and fundamental to the decision." (Per Tysoe J.A. at p. 268)

I question whether the proposer's indebtedness is in fact res judicata within the meaning of Hill v. Hill. As stated earlier, the Registrar's Report dated November 20, 1986, indicates the proposer was indebted to the estate in the amount of $139,415.00 as of November 3, 1986, subject to his entitle-

ment to a ten per cent share of the net distribution of the estate. There is no indication in the Registrar's Report as to how much, if any, of the amount said to be owing arose between July 18, 1985 (the effective date of the proposal) and November 3, 1986. Nor is there an indication of the value of the ten per cent interest in the estate to be set off against the debt. Thus, it cannot be said that the Registrar's report provides conclusive proof of the statement of accounts.

It was also argued that the applicant provided detailed calculations of the interest and costs for this claim in a letter dated November 10, 1988. This letter showed that as of July 18, 1985, the proposer owed $135,353.40 plus costs ordered on a solicitor/client basis totalling $7,483.20. However, there was no reference made to the value of the proposer's ten per cent interest in the estate as an amount to be set off against his overall debt.

On the other hand, counsel for the Trustee submits that no basis has been provided by which the applicant's claim can be determined. He points out that the applicant failed to provide a full and proper accounting with the proof of claim despite numerous requests for such information and that the value assigned to the claim has changed repeatedly since it was first presented and that none of these valuations have been supported by an accounting the Trustee can properly rely upon. Thus, he says, the Trustee was well within its discretion to disallow the claim pursuant to s. 135.

The difficulty with that position is that the Trustee was prepared to accept the applicant's proof of claim as wholly unsecured in the amount of $131,353.40 subject to a full and general release. This offer is evidence of the Trustee's willingness to accept the amount in the applicant's proof of claim and thus negates his arithmetical objections. The applicant on the other hand was willing to have the claim accepted in this amount but was unwilling to provide the release required by the Trustee.

In these circumstances it seems appropriate to accept the proof of claim in the amount of $131,353.40 less a credit of the ten per cent entitlement of the proposer in the Estate of James T. Riddler, deceased, and subject to the considerations to which I now turn.

As stated earlier, the applicant takes the position that she is entitled to invoke the rule in Clayton's Case and, accordingly has applied the funds received from the settlement of the 1987 litigation to her post-proposal claims.

Her counsel submits that she is under no duty whatsoever to account to the Trustee for funds received in settlement of the 1987 litigation from the defendants other than the proposer and says there is no evidence that the settlement funds were paid or accepted on the basis of any joint liability or indebtedness of the proposer. He submits that the settlement funds thus relate to a separate claim. However, he adds that, assuming that the settlement funds relate to the entire claim, the creditor is not bound to attribute the settlement funds to any part of the claim. He relies on Clayton's Case, 1 M.E.R. 571 as authority for the proposition that absent a specific appropriation being made by the payor, the creditor may appropriate the payment as he sees fit.

The modern restatement of this rule is found in Corey Bros. & Co. Ltd. v. The "Mecca", [1887] A.C. 286 (H.L.). Lord MacNaghten stated:

> "... if the debtor does not make any appropriation at the time when he makes the payment the right of application devolves in the creditor .... But it has long been held and it is now quite settled that the creditor has the right of election up to the very last moment,' and he is not bound to declare his election in express terms. He may declare it by bringing an action or in any other way that makes his

> meaning and intention plan .... The presumed intention of the creditor may no doubt be gathered from a statement of account, or anything else which indicates an intention one way or the other and is communicated to the debtor, provided there are no circumstances pointing in an opposite direction. But so long as the election rests with the creditor, and he has not determined his choice, there is no room, as it seems to me, for the application of rules of law such as the rule of civil law, reasonable as it is, that if the debts are equal the payment received is to be attributed to this debt first contracted. (at pp. 293-294)

This passage was affirmed in Waisman & Ross v. Crown Trust, [1970] S.C.R. 553.

Thus, it is argued that since the defendant payors in the 1987 litigation made no specific appropriation with respect to the settlement funds, the election is with the applicant and her appropriation, express or implied, will govern the application of the funds. In this case, the applicant clearly indicated in her solicitor's letter to the Trustee's solicitor dated March 20, 1990, that the settlement funds were not being applied to the preproposal indebtedness of the proposer.

In my view, Clayton's Case is distinguishable from the case at bar. The payments in this case were not made by the debtor (i.e. the proposer) rather the payments were made by co-defendants in settlement of the 1987 litigation. Clayton's Case also involved a current account between the debtor and creditor. Here, we have a claim against the proposer and a personal action against him and the other co-defendants. I agree with counsel for the Trustee in his submission that authorities such as Clayton's Case anticipate a single, global claim against a single defaulting debtor. In this case, the proposal estate is a distinct person from A.W. Riddler. Counsel suggests that the question is not how claims as against a single person ought to be allocated, but rather how a single credit ought to be allocated between two separate "persons" having separate debts.

While there seems to be no authority directly on this point, he suggests that those cases which deal with the allocation between bankruptcy estates and subsequent creditors may be of some assistance. For example, in Re Anderson (1978), 21 O.R. (2d) 539 (Ont.C.A.), after acquired assets were allocated to those claims arising first in time. He suggests that this would be consistent with the well-known accounting principle of "first in - first out". While counsel conceded that there is also a general accounting principle that payments are to be allocated first to interest and then to principal, he submits that this general rule cannot be applied where, as here, the obligation in issue should be divided into two distinct debts.

Finally, counsel submitted that the "first in - first out" approach, would cause no prejudice to the applicant. She still has the full amount paid by the bank, plus the unrestricted ability to continue to pursue the proposer in the 1987 litigation for whatever she believes is owed after making any and all proper discounts or deductions. Accordingly, the submission is that if the applicant's claim is to be allowed, it ought to be restricted to the amount she is able to prove on the basis of material already provided to the Trustee, net of whatever settlement funds she has already received.

In the unique circumstances of this case these submissions of counsel for the Trustee are logical, sensible and fair.

Counsel for the Trustee also made extensive submissions based on the "rule against double proofs", i.e. where there is one debt with several claimants to that debt, the debt may only be proved once in bankruptcy: In Re Coughlin & Co.; Guaranty Co. of North America's Claim, [1923] 3

W.W.R. 1177 (Man.C.A.) cited in Re Tuxedo silver Ltd. (1961), 4 C.B.R. 95 (Man.Reg.). This rule appears to emerge from the law relating to surety.

Two additional cases were cited by counsel for the Trustee on this point. Both deal with guarantors He relies on these authorities in support of his submission that the settlement amounts should be deducted from the proof of claim. First, in Re Hammond Organ Studios of Kelowna Ltd. (1981), 40 C.B.R. (N.S.) 293 (B.C.S.C.), the bank was ordered to account in its claims against the estate the amount paid by the guarantors instead of claiming the full amount of the debt. It was reasoned that this would give the bank an unfair advantage over other creditors since there would be a duplicated claim for the amount paid by the guarantors. Second, in Re Film House Ltd. (1974), 19 C.B.R. (N.S.) 231 (Ont.S.C.), the court held, inter alia, that the surety in this case was only entitled to vote at a creditor's meeting after giving credit for the value of any security held by the creditor.

Of those defendants in the 1987 litigation who settled all but the bank have waived their entitlement to a claim in the proposal estate. The bank has not assigned its right to claim in the proposal estate to the applicant. .However, the bank has apparently agreed that it will not file a proof of claim against the proposer for the amount it paid under the settlement.

While the circumstances here do not involve a guarantor or surety, it is logical that the reasoning in the cases cited be extended to the unique circumstances of this case. Accordingly, the applicant ought to deduct the settlement amounts from the proof of claim. To hold otherwise is tantamount to allowing the applicant to collect twice on the same debt. This, in turn, would operate to the detriment of the other creditors of the proposer.

I conclude that the applicant should not be entitled to claim for an amount equal to the settlement moneys since this would offend the rule against double proofs.

Thus, the proof of claim will be allowed in the amount due July 15, 1985, which on the material before me is $131,353.40, less the ten per cent of the James T. Riddler estate due the proposer and less the amounts totalling $128,000.00 received by the applicant in her settlement of the 1987 litigation.

Counsel did not address the issue of costs. Nevertheless the conclusion I have reached gives technical success to the applicant in that her proof of claim has been allowed, subject to deductions. However, the practical result is that the Trustee has been successful in that the claim as allowed is for what will be a nominal amount. In these circumstances it is appropriate that each party bear their own costs.

CAMPBELL C.J.S.C.

Tab 20

Indexed as:

Olympia & York Developments Ltd. (Re)

IN THE MATTER OF the Bankruptcy of Olympia & York Developments Limited, a corporation incorporated under the laws of the Province of Ontario and having its principal place of business in the City of Toronto, in the Municipality of Metropolitan Toronto

[1998] O.J. No. 2114

66 O.T.C. 290

3 C.B.R. (4th) 304

79 A.C.W.S. (3d) 879

Court File No. 97-BK-00161

Ontario Court of Justice (General Division)
In Bankruptcy

Registrar Ferron

May 21, 1998.

(13 pp.)

Company law -- Nature of corporations -- Distinct legal personality -- Lifting the corporate veil -- Contracts by companies -- Bankruptcy -- Claims provable -- Double proof.

This was an appeal by Lyonnais and Deloitte from the disallowance of their claims in the bankruptcy of Olympia & York Developments. Olympia & York Resources was a wholly owned subsidiary of Olympia & York Developments. Both Olympias had gone into bankruptcy. After the bankruptcy of Olympia & York Developments and its subsidiary, Abitibi sold the shares of Abitibi-Price and Gulf that had been pledged to it as security. The trustee disallowed the appellants' on the ground that they were reflections of the single indebtedness of Olympia & York to Abitibi and that therefore to admit both claims would constitute double recovery.

HELD: The appeal was allowed. If Olympia & York Developments were to pay Abitibi under the guarantee, it would not affect its obligation to Olympia & York Resources Credit Corporation under the promissory note. Similarly, if Olympia & York Developments discharged its obligations under the promissory note, the obligation under the guarantee would subsist. Since one payment could not discharge both debts, the claims of Lyonnais and Deloitte did not constitute double claims. There was nothing in this case that would allow the court to disregard Olympia & York Resources Credit Corporation's separate existence from Olympia & York Developments. There was no evidence that Abitibi was misled in loaning funds to the former. The claims of Olympia & York Resources Credit Corporation and Abitibi were separate and distinct. Any debt recovery realized by Abitibi from the sale of shares held as security did not reduce Olympia & York Developments' indebtedness to Olympia & York Resources Credit Corporation.

Statutes, Regulations and Rules Cited:

Corporate Creditors Arrangement Act.

Counsel:

Geoffrey B. Morawetz, for Coopers & Lybrand Limited, trustees of the Estate of Olympia & York Developments Limited.
B. Zarnett, for unsecured creditors of Olympia & York Developments Limited.
R. Chartrand & J. Macdonald, for Credit Lyonnais Canada in its capacity as security agent for Abitibi and Gulf Lenders.

---

1 REGISTRAR FERRRON:-- Credit Lyonnais acting as security agent for Abitibi and Gulf Lenders ("A&G") and Deloitte & Touche as trustee of the estate of Olympia & York Resources Credit Corporation ("OYRCC:) appeal the disallowances of their claims in the estate of Olympia & York Developments Limited, ("OYDL"). The disallowances are in the following terms:

> The A&G Disallowance.
>
> "Based on the documents and information provided to the trustee, the claim appears to be based on the same loan transaction and is in respect of the same indebtedness as the claim of Deloitte & Touche Inc., in its capacity as trustee in bankruptcy of Olympia & York Resources Credit Corporation. As such, the claim constitutes a double proof against the estate.
>
> OYRCC Disallowance.
>
> "Based on the documents and information provided to the trustee, the claim appears to be based on the same loan transaction and is in respect of the same indebtedness as the claim of Credit Lyonnais Canada, acting as security agent for the A&G Lenders. As such, the claim constitutes a double proof against the estate and the claim is disallowed in full."

> "In the alternative, if the claimant has a claim, by the Order of Mr. Justice Farley, dated February 13, 1997, and April 14, 1997, the claimant must account for payments received on the realization of assets held as security in the sum of U.S. $1,281,281,018.00. Accordingly, the claimants claim will be disallowed, in part, to the extent of the realization on security."

2 The trustee is prepared to allow one claim, that is the claim of the principal creditor A&G Lenders, in an amount limited by the deduction order of Farley, J. referred to in the trustee's disallowance. OYRCC is the wholly-owned subsidiary of OYDL. Both OYRCC and OYDL are in bankruptcy. OYDL commenced negotiations with the A&G Lenders in 1988 for credit facilities. In connection therewith the corporate holdings of OYDL were re-organized resulting in the corporate structure described in the closing agenda documents (Exhibit A to the affidavit of Irwin Berl Nadler sworn February 26, 1982.) The re-organization was completed in or about March 1989 and the loans referred to resulting from the negotiations in 1988 were advanced in March 1989. The credit facility was in the amount of 2.5 billion dollars US and was made available not to OYDL but to OYRCC its subsidiary. I think that there is now no serious dispute that all the funds under the terms of the loan agreements were made available to OYRCC and were so paid either directly to it or indirectly to OYDL on its instructions.

3 In the re-structuring of the OYDL family of companies OYRCC became the sole shareholder of all the shares of O & Y Resources Corporation which, in turn, held all the shares of O & Y Energy Holdings Limited and O & Y Forest Products Holdings Limited. O & Y Energy Holdings Limited owned the majority (70%) of the issued and outstanding shares of Gulf Canada Resources Limited and O & Y Forest Products Holdings Limited owned 79% of the issued and outstanding shares of Abitibi-Price Incorporated. In passing it should be noted that the corporate profile was again altered by the plan implemented under the Companies Creditors Arrangement Act in 1993.

4 In order to secure the advance of funds under the loan agreements by A&G Lenders to OYRCC the latter company delivered to A&G Lenders the following:

1. A Pledge Agreement granting the security agent, Credit Lyonnais, (the Appellant) the first security interest in all the shares of O & Y Resources Corporation;
2. Guarantees from O & Y Resources Corporation guaranteeing the advances by A&G Lenders to OYRCC;
3. An agreement from O & Y Resources Corporation pledging to A&G Lenders its interest in the shares of O & Y Energy Holdings Limited and O & Y Forest Products Holdings Limited; and
4. Four separate guarantees of OYDL with respect to the four advances to OYRCC made by A&G Lenders. Each guarantee contained, inter alia, a clause relieving A&G Lenders of the necessity of exhausting its remedies against OYRCC before being entitled to payment by OYDL in the event of default and a clause which strictly limited OYDL's right of subrogation.

5 After the bankruptcy of OYDL and OYRCC, A&G Lenders sold the shares in Abitibi-Price Incorporated pledged to it and certain of the Gulf Canada Resources Limited shares and applied the proceeds to its indebtedness. The issue of whether the proceeds from the disposition of those shares

and the recovery from other assets by A&G could be deducted from A&G Lenders' claim against the estate of OYDL is pending before the Court of Appeal. The same issue arises in this appeal in respect of the claim of OYRCC against OYDL. The trustee of OYDL argues that the same reasoning which led to the orders of April 13 and 14, 1997, should apply to OYCC's and claim that the claim of that company should be reduced regardless of the issue of double proof.

6 The advances by A&G Lenders to OYRCC totalling 2.5 billion dollars were subsequently on-loaned by the subsidiary to its parent OYDL. Whether a resulting genuine debtor/creditor relationship between OYDL and OYRCC in fact exists or whether, having regard to the close corporate relationship which existed between the parent and the subsidiary, the circumstances surrounding the genesis of the credit facility, the terms of re-payment and the evidence of the loan, such a relationship could not have arisen is the central issue in this appeal.

7 The evidence of the indebtedness put forward in the claim by OYRCC in the estate of OYDL consists of:

1. A Promissory Note for $2.5 billions dollars U.S;
2. Repayment agreement; and
3. A note in the January 31, 1991 financial statement of OYRCC which, after reciting the credit facility extended to it by A&G Lenders stated,

> "The proceeds were invested in a note receivable from Olympia & York Developments Limited maturing on the same date as the loan and bearing interest at all times equal to the aggregate of ...".

8 The wording of the note is interesting. The word "invested" suggests more than just a passing on of funds through a conduit pipe, and the fact that the loan to OYDL is so connected to the loan of the A&G Lenders to OYRCC, might be considered to give some credence to the suggestion that both loans are one and the same debt.

9 The claim of OYRCC is, as mentioned, founded on a promissory note given by OYDL to OYRCC and that of A&G Lenders on a guarantee of the OYRCC liability by OYDL. No one has questioned the formal validity of these instruments and no one has denied their respective claims. That is, in respect of the claim of OYRCC, the trustee does not say that its claim does not exist but that its alleged indebtedness is a mere reflection of the indebtedness of OYDL to the A&G Lenders and that because of this it is not entitled to a dividend based on its claim. In other words, the trustee of OYDL alleges that, notwithstanding the claims of OYRCC and the A&G Lenders are evidence by different instruments they are in reality the same debt and to admit both claims would constitute a double proof.

10 The rule against double proof developed from the law of suretyship and, in its fundamental form, holds that a guarantor's claim against the principal debtor for indemnity is the same debt as that of the unpaid principal creditor and that to allow both to claim in the estate of the principal debtor would result in the payment of two dividends on the same debt and accordingly, contravene the central tenet of all bankruptcy law, that is, equality among creditors of the same class.

11 Clearly, the situation in the case before me is not a surety situation in the sense used in the cases dealing with double proof, notwithstanding that all the actors, that is, surety, principal debtor and principal creditor, are present. In Barclays Bank Limited v. TOSG Trust Fund Limited [1984] 1

All. E.R. 268, Oliver, L.J., suggested a test for discovering whether the rule has been contravened. He said at page 637:

> "Now, if, as in my judgment these cases show, the true rule is that there are not to be two dividends in respect of what is in substance the same debt, I can see no logical justification for seeking to fix the position at the commencement of the insolvency. One has, as it seems to me, to look at the position at the point at which the dividend is actually about to be paid and to ask the question then whether two payments are being sought for a liability which if the company were solvent, could be discharged as regards both claimants by one payment."

12 The application of that test in the case before me does not result in an affirmative answer. If OYDL were to pay the A&G Lenders under the guarantee this could not affect the loan due to OYRCC under its note. Similarly, if OYDL were to pay OYRCC and thus discharge the Promissory Note, the obligation under the guarantee would still exist and be enforceable. One payment would not discharge both claimants debts against OYDL and, accordingly, on the test suggested by Oliver, L.J. the rule is not offended.

13 It seems to me then, that in order for the trustee of OYDL to be able to say that both claims in issue are but different sides of the same debt, it must be shown that OYRCC has no separate corporate existence. In this respect it is true OYRCC is very closely connected with OYDL, that it has the same Board of Directors as its parent, that its income is derived principally from the interest paid by OYDL under the Promissory Note and that it has few creditors. Yet as Robert Walker, J. pointed out in re: Polly Peck International PLC [1996] 2 All. E.R. 433, at 447 quoting from Adams v. Cape Industries PLC, "save in cases which turn on the wording of particular statutes or contracts the court is not free to disregard the principal of Salomon v. Salomon & Co. Ltd., merely because it considers that justice so requires."

14 The case of Polly Peck International PLC (supra) deals with a fact situation remarkably similar to the facts of the case before me. There the court considered in great detail the points raised in this appeal. It was argued in various forms that because of the closeness of the parent and subsidiary and the fact that the on-lending by the subsidiary and the parent was so much a part of the principal loan arrangements which in fact funded the on-lending, that the subsidiary should be considered to lack a separate corporate personality and the loan by the lenders to the subsidiary should be considered to be a loan directly to the principal.

15 It was put this way at p. 441.

> "Having investigated PPIF's claim (the subsidiary) in the scheme, the supervisors have become concerned that, due to what appeared to them to be the lack of separate corporate personality on the part of PPIF, the court might hold that the corporate veil should be lifted so preventing PPIF from maintaining a claim separate from the bond holders' claims against PPIF (the parent company). Alternatively, even if PPIF is entitled to a separate claim, such claim might be held to arise out of what is, in substance, the same debt (being the debt to the bond holders), so that PPIF would be barred from receiving a dividend in addition to that payable to the bond holders by the rule against double proof."

16 The court carefully considered the factors mentioned and concluded that their existence could not justify the court in disregarding the separate corporate existence of subsidiary."

17 There is nothing in the case before me which would, similarly, allow me to disregard the separate corporate existence of OYRCC. If one acceded to the position taken by the trustee of OYDL and concluded that OYRCC's loan to its parent company was of no significance, the transaction involving the loan from A&G Lenders would have to be seen as something of a sham and that A&G Lenders were misled in loaning funds to OYRCC which until this point no one denied. Had a corporate existence separate and distinct from its parent including the capacity to borrow and loan funds.

18 Finally, the court in the Polly Peck case, quoted from McEntire v. Crossley Bros. Ltd. [1895] A.C. 457, where the court said:

> "The substance of the agreement must ultimately be found in the language of the contract itself. The duty of the court is to examine every part of the agreement, every stipulation which it contains, and to consider their mutual bearing upon each other; but it is entirely beyond the function of the court to disregard the plain meaning of any term of the agreement unless there can be found within its four corners other language and other stipulations which necessarily deprive such term of its primary significance."

19 I have examined agreements between the various parties and in my opinion it is clear that OYRCC has a claim based upon a Promissory Note distinct and separate from the claim of the A&G Lenders on its guarantees. There is nothing in the documentation or the dealings between the parties should lead me to conclude that OYRCC is not a separate and distinct entity which on loaned its own funds to OYDL on the strength of a Promissory Note for which it is now entitled to claim payment. Accordingly, both claims which are the subject of these appeals should be admitted in the estate of OYDL. Moreover, the claim of OYRCC being quite separate and distinct from the claim of A&G Lenders must be admitted as filed. The funds received by A&G Lenders in its realization procedures from, among other sources, the pledge of shares taken in connection with its loan cannot be considered in order to reduce the claim of OYRCC.

20 I need hardly point out that the claim of A&G Lenders while admitted must be in the reduced amount pending the determination of the quantum issue before that court.

21 Costs may be spoken to.

REGISTRAR FERRON

qp/s/alp

Tab 21

Case Name:

Muscletech Research and Development Inc. (Re)

RE: IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended AND IN THE MATTER OF Muscletech Research and Development Inc. and those Entities Listed on Schedule "A" hereto, Applicants

[2007] O.J. No. 695

30 C.B.R. (5th) 59

156 A.C.W.S. (3d) 22

2007 CarswellOnt 1029

Court File No. 06-CL-6241

Ontario Superior Court of Justice
Commercial List - Toronto, Ontario

J.D. Ground J.

Heard: February 15, 2007.
Judgment: February 22, 2007.

(27 paras.)

Insolvency law -- Legislation -- Companies' Creditors Arrangement Act -- Application by the insolvent applicants for the sanction of a distribution plan to resolve large number of product liability and other lawsuits allowed -- Applicants complied with the Act and did nothing that was contrary to it -- Plan was fair and reasonable.

Application by certain applicants under the Companies' Creditors Arrangement Act for the sanction of their distribution plan -- Plan proposed distributions to each creditor in the General Claimants Class and each creditor in the Personal Injury Claimants Class -- Such distributions were to be funded from the contributed funds paid to the Monitor by the subject parties defined in the Plan -- Plan was not a restructuring plan but was a unique liquidation plan funded entirely by parties other than the applicants -- Purpose and goal of the applicants seeking relief under the Act was to achieve

global resolution of a large number of product liability and other lawsuits that were commenced principally in the United States by numerous claimants and which related to products formerly advertised, marketed and sold by Muscletech Research and Development Inc. -- Applicants' successful restructuring depended on the resolution of the product liability claims -- HELD: Application allowed -- Applicants complied with all the requirements of Act and had adhered to previous court orders -- They were insolvent and had total claims in excess of $5 million -- Nothing was done that was not authorized by the Act -- Plan was fair and reasonable -- Applicants had no assets and no funds with which to fund a distribution to creditors -- Without the contributed funds there would be no distribution and no Plan and the applicants' only alternative would be bankruptcy -- Unsecured creditors would receive nothing in the event of a bankruptcy -- Part of the Plan was that certain affected parties to the litigation would receive releases -- Releases were necessary because without them no funds would be contributed -- If the Plan was not sanctioned the parties would continue to be mired in extensive and expensive litigation that would have no predictable outcome.

Statutes, Regulations and Rules Cited:

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2, s. 6, s. 12

Corporations Tax Act, s. 107

Excise Tax Act, s. 270

Income Tax Act, s. 159

Counsel:

Fred Myers and David Bish, for CCAA Applicants.

Derrick Tay and Randy Sutton, for Iovate Companies.

Natasha MacParland and Jay Schwartz, for the RSM Richter Inc.

Steven Gollick, for Zurich Insurance Company.

A. Kauffman, for GNC Oldco.

Sheryl Seigel, for General Nutrition Companies Inc. and other GNC Newcos.

Pamela Huff and Beth Posno for Representative Plaintiffs.

Jeff Carhart, for Ad Hoc Tort Claimants Committee.

David Molton and Steven Smith, for Brown Rudnick.

Brent McPherson, for XL Insurance America Inc.

Alex Ilchenko, for Walgreen Co.

Lisa La Horey, for E&L Associates, Inc.

ENDORSEMENT

1 **J.D. GROUND J.**:-- The motion before this court is brought by the Applicants pursuant to s. 6 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA") for the sanction of a plan (the "Plan") put forward by the Applicants for distributions to each creditor in the General Claimants Class ("GCC") and each creditor in the Personal Injury Claimants Class ("PICC"), such distributions to be funded from the contributed funds paid to the Monitor by the subject parties ("SP") as defined in the Plan.

2 The Plan is not a restructuring plan but is a unique liquidation plan funded entirely by parties other than the Applicants.

3 The purpose and goal of the Applicants in seeking relief under the CCAA is to achieve a global resolution of a large number of product liability and other lawsuits commenced principally in the United States of America by numerous claimants and which relate to products formerly advertised, marketed and sold by MuscleTech Research and Development Inc. ("MDI") and to resolve such actions as against the Applicants and Third Parties.

4 In addition to the Applicants, many of these actions named as a party defendant one or more of: (a) the directors and officers, and affiliates of the Applicants (i.e. one or more of the Iovate Companies); and/or (b) arm's length third parties such as manufacturers, researchers and retailers of MDI's products (collectively, the "Third Parties"). Many, if not all, of the Third Parties have claims for contribution or indemnity against the Applicants and/or other Third Parties relating to these actions.

The Claims Process

5 On March 3, 2006, this court granted an unopposed order (the "Call For Claims Order") that established a process for the calling of: (a) all Claims (as defined in the Call For Claims Order) in respect of the Applicants and its officers and directors; and (b) all Product Liability Claims (as defined in the Call For Claims Order) in respect of the Applicants and Third Parties.

6 The Call For Claims Order required people who wished to advance claims to file proofs of claim with the Monitor by no later than 5:00 p.m. (EST) on May 8, 2006 (the "Claims Bar Date"), failing which any and all such claims would be forever barred. The Call For Claims Order was approved by unopposed Order of the United States District Court for the Southern District of New York (the "U.S. Court") dated March 22, 2006. The Call For Claims Order set out in a comprehensive manner the types of claims being called for and established an elaborate method of giving broad notice to anyone who might have such claims.

7 Pursuant to an order dated June 8, 2006 (the "Claims Resolution Order"), this court approved a process for the resolution of the Claims and Product Liability Claims. The claims resolution process set out in the Claims Resolution Order provided for, *inter alia*: (a) a process for the review of proofs of claim filed with the Monitor; (b) a process for the acceptance, revision or dispute, by the Applicants, with the assistance of the Monitor, of Claims and/or Product Liability Claims for the purposes of voting and/or distribution under the Plan; (c) the appointment of a claims officer to resolve disputed claims; and (d) an appeal process from the determination of the claims officer. The Claims Resolution Order was recognized and given effect in the U.S. by Order of the U.S. Court dated August 1, 2006.

8 From the outset, the Applicants' successful restructuring has been openly premised on a global resolution of the Product Liability Claims and the recognition that this would be achievable pri-

marily on a consensual basis within the structure of a plan of compromise or arrangement only if the universe of Product Liability Claims was brought forward. It was known to the Applicants that certain of the Third Parties implicated in the Product Liability Actions were agreeable in principle to contributing to the funding of a plan, provided that as a result of the restructuring process they would achieve certainty as to the resolution of all claims and prospective claims against them related to MDI products. It is fundamental to this restructuring that the Applicants have no material assets with which to fund a plan other than the contributions of such Third Parties.

9 Additionally, at the time of their filing under the CCAA, the Applicants were involved in litigation with their insurer, Zurich Insurance Company ("Zurich Canada") and Zurich America Insurance Company, regarding the scope of the Applicants' insurance coverage and liability for defence expenses incurred by the Applicants in connection with the Product Liability Actions.

10 The Applicants recognized that in order to achieve a global resolution of the Product Liability Claims, multi-party mediation was more likely to be successful in providing such resolution in a timely manner than a claims dispute process. By unopposed Order dated April 13, 2006 (the "Mediation Order"), this court approved a mediation process (the "Mediation") to advance a global resolution of the Product Liability Claims. Mediations were conducted by a Court-appointed mediator between and among groups of claimants and stakeholders, including the Applicants, the Ad Hoc Committee of MuscleTech Tort Claimants (which had previously received formal recognition by the Court and the U.S. Court), Zurich Canada and certain other Third Parties.

11 The Mediation facilitated meaningful discussions and proved to be a highly successful mechanism for the resolution of the Product Liability Claims. The vast majority of Product Liability Claims were settled by the end of July, 2006. Settlements of three other Product Liability Claims were achieved at the beginning of November, 2006. A settlement was also achieved with Zurich Canada outside the mediation. The foregoing settlements are conditional upon a successfully implemented Plan that contains the releases and injunctions set forth in the Plan.

12 As part of the Mediation, agreements in respect of the funding of the foregoing settlements were achieved by and among the Applicants, the Iovate Companies and certain Third Parties, which funding (together with other funding being contributed by Third Parties) (collectively, the "Contributed Funds") comprises the funds to be distributed to affected creditors under the Plan. The Third Party funding arrangements are likewise conditional upon a successfully implemented Plan that contains the releases and injunctions set forth in the Plan.

13 It is well settled law that, for the court to exercise its discretion pursuant to s. 6 of the CCAA and sanction a plan, the Applicants must establish that: (a) there has been strict compliance with all statutory requirements and adherence to previous orders of the court; (b) nothing has been done or purported to be done that is not authorized by the CCAA; and (c) the Plan is fair and reasonable.

14 On the evidence before this court I am fully satisfied that the first two requirements have been met. At the outset of these proceedings, Farley J. found that the Applicants met the criteria for access to the protection of the CCAA. The Applicants are insolvent within the meaning of Section 2 of the CCAA and the Applicants have total claims within the meaning of Section 12 of the CCAA in excess of $5,000,000.

15 By unopposed Order dated December 15, 2006 (the "Meeting Order"), this Court approved a process for the calling and holding of meetings of each class of creditors on January 26, 2007 (collectively, the "Meetings"), for the purpose of voting on the Plan. The Meeting Order was approved

by unopposed Order of the U.S. Court dated January 9, 2007. On December 29, 2006, and in accordance with the Meeting Order, the Monitor served all creditors of the Applicants, with a copy of the Meeting Materials (as defined in the Meeting Order).

16 The Plan was filed in accordance with the Meeting Order. The Meetings were held, quorums were present and the voting was carried out in accordance with the Meeting Order. The Plan was unanimously approved by both classes of creditors satisfying the statutory requirements of the CCAA.

17 This court has made approximately 25 orders since the Initial Order in carrying out its general supervision of all steps taken by the Applicants pursuant to the Initial CCAA order and in development of the Plan. The U.S. Court has recognized each such order and the Applicants have fully complied with each such order.

The Plan is Fair and Reasonable

18 It has been held that in determining whether to sanction a plan, the court must exercise its equitable jurisdiction and consider the prejudice to the various parties that would flow from granting or refusing to grant approval of the plan and must consider alternatives available to the Applicants if the plan is not approved. An important factor to be considered by the court in determining whether the plan is fair and reasonable is the degree of approval given to the plan by the creditors. It has also been held that, in determining whether to approve the plan, a court should not second-guess the business aspects of the plan or substitute its views for that of the stakeholders who have approved the plan.

19 In the case at bar, all of such considerations, in my view must lead to the conclusion that the Plan is fair and reasonable. On the evidence before this court, the Applicants have no assets and no funds with which to fund a distribution to creditors. Without the Contributed Funds there would be no distribution made and no Plan to be sanctioned by this court. Without the Contributed Funds, the only alternative for the Applicants is bankruptcy and it is clear from the evidence before this court that the unsecured creditors would receive nothing in the event of bankruptcy.

20 A unique feature of this Plan is the Releases provided under the Plan to Third Parties in respect of claims against them in any way related to "the research, development, manufacture, marketing, sale, distribution, application, advertising, supply, production, use or ingestion of products sold, developed or distributed by or on behalf of" the Applicants (see Article 9.1 of the Plan). It is self-evident, and the Subject Parties have confirmed before this court, that the Contributed Funds would not be established unless such Third Party Releases are provided and accordingly, in my view it is fair and reasonable to provide such Third Party releases in order to establish a fund to provide for distributions to creditors of the Applicants. With respect to support of the Plan, in addition to unanimous approval of the Plan by the creditors represented at meetings of creditors, several other stakeholder groups support the sanctioning of the Plan, including Iovate Health Sciences Inc. and its subsidiaries (excluding the Applicants) (collectively, the "Iovate Companies"), the Ad Hoc Committee of MuscleTech Tort Claimants, GN Oldco, Inc. f/k/a General Nutrition Corporation, Zurich American Insurance Company, Zurich Insurance Company, HVL, Inc. and XL Insurance America Inc. It is particularly significant that the Monitor supports the sanctioning of the Plan.

21 With respect to balancing prejudices, if the Plan is not sanctioned, in addition to the obvious prejudice to the creditors who would receive nothing by way of distribution in respect of their

claims, other stakeholders and Third Parties would continue to be mired in extensive, expensive and in some cases conflicting litigation in the United States with no predictable outcome.

22 The sanction of the Plan was opposed only by prospective representative plaintiffs in five class actions in the United States. This court has on two occasions denied class action claims in this proceeding by orders dated August 16, 2006 with respect to products containing prohormone and dated December 11, 2006 with respect to Hydroxycut products. The first of such orders was appealed to the Ontario Court of Appeal and the appeal was dismissed. The second of such orders was not appealed. In my reasons with respect to the second order, I stated as follows:

> ... This CCAA proceeding was commenced for the purpose of achieving a global resolution of all product liability and other lawsuits commenced in the United States against Muscletech. As a result of strenuous negotiation and successful court-supervised mediation through the District Court, the Applicants have succeeded in resolving virtually all of the outstanding claims with the exception of the Osborne claim and, to permit the filing of a class proof of claim at this time, would seriously disrupt and extend the CCAA proceedings and the approval of a Plan and would increase the costs and decrease the benefits to all stakeholders. There appears to have been adequate notice to potential claimants and no member of the putative class other than Osborne herself has filed a proof of claim. It would be reasonable to infer that none of the other members of the putative class is interested in filing a claim in view of the minimal amounts of their claims and of the difficulty of coming up with documentation to support their claim. In this context the comments of Rakoff, J. in *Re Ephedra Products Liability Litigation* (2005) U.S. Dist. LEXIS 16060 at page 6 are particularly apt.
>
>> Further still, allowing the consumer class actions would unreasonably waste an estate that was already grossly insufficient to pay the allowed claims of creditors who had filed timely individual proofs of claim. The Debtors and Creditors Committee estimate that the average claim of class [*10] members would be $ 30, entitling each claimant to a distribution of about $ 4.50 (figures which Barr and Lackowski do not dispute; although Cirak argues that some consumers made repeated purchases of Twinlabs steroid hormones totaling a few hundred dollars each). Presumably, each claimant would have to show some proof of purchase, such as the product bottle. Because the Debtor ceased marketing these products in 2003, many purchasers would no longer have such proof. Those who did might well find the prospect of someday recovering $ 4.50 not worth the trouble of searching for the old bottle or store receipt and filing a proof of claim. Claims of class members would likely be few and small. The only real beneficiaries of applying Rule 23 would be the lawyers representing the class. *Cf Woodward*, 205 B.R. at 376-77. The Court has discretion under Rule 9014 to find that the likely total benefit to class members would not justify the cost to the estate of defending a class action under Rule 23.
>
> [35] In addition, in the case at bar, there would appear to be substantial doubt as to whether the basis for the class action, that is the alleged false and misleading

> advertising, would be found to be established and substantial doubt as to whether the class is certifiable in view of being overly broad, amorphous or vague and administratively difficult to determine. (See *Perez et al. v. Metabolife International Inc.* (2003) U.S. Dist. LEXIS 21206 at pages 3-5). The timing of the bringing of this motion in this proceeding is also problematic. The claims bar date has passed. The mediation process is virtually completed and the Osborne claim is one of the few claims not settled in mediation although counsel for the putative class were permitted to participate in the mediation process. The filing of the class action in California occurred prior to the initial CCAA Order and at no prior time has this court been asked to approve the filing of a class action proof of claim in these proceedings. The claims of the putative class members as reflected in the comments of Rakoff, J. quoted above would be limited to a refund of the purchase price for the products in question and, in the context of insolvency and restructuring proceedings, *de minimus* claims should be discouraged in that the costs and time in adjudicating such claims outweigh the potential recoveries for the claimants. The claimants have had ample opportunity to file evidence that the call for claims order or the claims process as implemented has been prejudicial or unfair to the putative class members.

23 The representative Plaintiffs opposing the sanction of the Plan do not appear to be rearguing the basis on which the class claims were disallowed. Their position on this motion appears to be that the Plan is not fair and reasonable in that, as a result of the sanction of the Plan, the members of their classes of creditors will be precluded as a result of the Third Party Releases from taking any action not only against MuscleTech but against the Third Parties who are defendants in a number of the class actions. I have some difficulty with this submission. As stated above, in my view, it must be found to be fair and reasonable to provide Third Party Releases to persons who are contributing to the Contributed Funds to provide funding for the distributions to creditors pursuant to the Plan. Not only is it fair and reasonable; it is absolutely essential. There will be no funding and no Plan if the Third Party Releases are not provided. The representative Plaintiffs and all the members of their classes had ample opportunity to submit individual proofs of claim and have chosen not to do so, except for two or three of the representative Plaintiffs who did file individual proofs of claim but withdrew them when asked to submit proof of purchase of the subject products. Not only are the claims of the representative Plaintiffs and the members of their classes now barred as a result of the Claims Bar Order, they cannot in my view take the position that the Plan is not fair and reasonable because they are not participating in the benefits of the Plan but are precluded from continuing their actions against MuscleTech and the Third Parties under the terms of the Plan. They had ample opportunity to participate in the Plan and in the benefits of the Plan, which in many cases would presumably have resulted in full reimbursement for the cost of the product and, for whatever reason, chose not to do so.

The representative Plaintiffs also appear to challenge the jurisdiction of this court to authorize the Third Party Releases as one of the terms of the Plan to be sanctioned. I remain of the view expressed in paragraphs 7-9 of my endorsement dated October 13, 2006 in this proceeding on a motion brought by certain personal injury claimants, as follows:

> With respect to the relief sought relating to Claims against Third Parties, the position of the Objecting Claimants appears to be that this court lacks jurisdiction to

make any order affecting claims against third parties who are not applicants in a CCAA proceeding. I do not agree. In the case at bar, the whole plan of compromise which is being funded by Third Parties will not proceed unless the plan provides for a resolution of all claims against the Applicants and Third Parties arising out of "the development, advertising and marketing, and sale of health supplements, weight loss and sports nutrition or other products by the Applicants or any of them" as part of a global resolution of the litigation commenced in the United States. In his Endorsement of January 18, 2006, Farley J. stated:

> "the Product Liability system vis-à-vis the Non-Applicants appears to be in essence derivative of claims against the Applicants and it would neither be logical nor practical/functional to have that Product Liability litigation not be dealt with on an all encompassing basis."

Moreover, it is not uncommon in CCAA proceedings, in the context of a plan of compromise and arrangement, to compromise claims against the Applicants and other parties against whom such claims or related claims are made. In addition, the Claims Resolution Order, which was not appealed, clearly defines Product Liability Claims to include claims against Third Parties and all of the Objecting Claimants did file Proofs of Claim settling [sic] out in detail their claims against numerous Third Parties.

It is also, in my view, significant that the claims of certain of the Third Parties who are funding the proposed settlement have against the Applicants under various indemnity provisions will be compromised by the ultimate Plan to be put forward to this court. That alone, in my view, would be a sufficient basis to include in the Plan, the settlement of claims against such Third Parties. The CCAA does not prohibit the inclusion in a Plan of the settlement of claims against Third Parties. In *Re Canadian Airlines Corp.* (2000), 20 C.B.R. (4th) Paperny J. stated at p. 92:

> While it is true that section 5.2 of the CCAA does not authorize a release of claims against third parties other than directors, it does not prohibit such releases either. The amended terms of the release will not prevent claims from which the CCAA expressly prohibits release.

24 The representative Plaintiffs have referred to certain decisions in the United States that appear to question the jurisdiction of the courts to grant Third Party Releases. I note, however, that Judge Rakoff, who is the U.S. District Court Judge is seized of the *MuscleTech* proceeding, and Judge Drain stated in a hearing in *Re TL Administration Corporation* on July 21, 2005:

> It appears to us to be clear that this release was, indeed, essential to the settlement which underlies this plan as set forth at length on the record, including by counsel for the official claimants committee as well as by the other parties involved, and, as importantly, by our review of the settlement agreement itself, which from the start, before this particular plan in fact was filed, included a re-

> lease that was not limited to class 4 claims but would extend to claims in class 5 that would include the type of claim asserted by the consumer class claims.
>
> Therefore, in contrast to the Blechman release, this release is essential to confirmation of this plan and the distributions that will be made to creditors in both classes, class 4 and class 5.
>
> Secondly, the parties who are being released here have asserted indemnification claims against the estate, and because of the active nature of the litigation against them, it appears that those claims would have a good chance, if not resolved through this plan, of actually being allowed and reducing the claims of creditors.
>
> At least there is a clear element of circularity between the third-party claims and the indemnification rights of the settling third parties, which is another very important factor recognized in the Second Circuit cases, including Manville, Drexel, Finely, Kumble and the like.
>
> The settling third parties it is undisputed are contributing by far the most assets to the settlement, and those assets are substantial in respect of this reorganization by this Chapter 11 case. They're the main assets being contributed.
>
> Again, both classes have voted overwhelmingly for confirmation of the plan, particularly in terms of the numbers of those voting. Each of those factors, although they may be weighed differently in different cases, appear in all the cases where there have been injunctions protecting third parties.
>
> The one factor that is sometimes cited in other cases, i.e., that the settlement will pay substantially all of the claims against the estate, we do not view to be dispositive. Obviously, substantially all of the claims against the estate are not being paid here. On the other hand, even, again, in the Second Circuit cases, that is not a dispositive factor. There have been numerous cases where plans have been confirmed over opposition with respect to third-party releases and third-party injunctions where the percentage recovery of creditors was in the range provided for under this plan.
>
> The key point is that the settlement was arrived at after arduous arm's length negotiations and that it is a substantial amount and that the key parties in interest and the court are satisfied that the settlement is fair and it is unlikely that substantially more would be obtained in negotiation.

25 The reasoning of Judge Rakoff and Judge Drain is, in my view, equally applicable to the case at bar where the facts are substantially similar.

26 It would accordingly appear that the jurisdiction of the courts to grant Third Party Releases has been recognized both in Canada and in the United States.

27 An order will issue sanctioning the Plan in the form of the order submitted to this court and appended as Schedule B to this endorsement.

J.D. GROUND J.

* * * * *

SCHEDULE "A"

HC Formulations Ltd.

CELL Formulations Ltd.

NITRO Formulations Ltd.

MESO Formulations Ltd.

ACE Formulations Ltd.

MISC Formulations Ltd.

GENERAL Formulations Ltd.

ACE US Trademark Ltd.

MT Canadian Supplement Trademark Ltd.

MT Foreign Supplement Trademark Ltd.

HC Trademark Holdings Ltd.

HC US Trademark Ltd.

1619005 Ontario Ltd. (f/k/a New HC US Trademark Ltd.)

HC Canadian Trademark Ltd.

HC Foreign Trademark Ltd.

* * * * *

SCHEDULE "B"

Court File No. 06-CL-6241

ONTARIO

SUPERIOR COURT OF JUSTICE

(COMMERCIAL LIST)

THE HONOURABLE	)	THURSDAY, THE 15TH
	)	
MR. JUSTICE GROUND	)	DAY OF FEBRUARY, 2007

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

AND IN THE MATTER OF MUSCLETECH RESEARCH AND DEVELOPMENT INC. AND THOSE ENTITIES LISTED ON SCHEDULE "A" HERETO

Applicants

SANCTION ORDER

THIS MOTION, made by MuscleTech Research and Development Inc. ("MDI") and those entities listed on Schedule "A" hereto (collectively with MDI, the "Applicants") for an order approving and sanctioning the plan of compromise or arrangement (inclusive of the schedules thereto) of the Applicants dated December 22, 2006 (the "Plan"), as approved by each class of Creditors on January 26, 2007, at the Meeting, and which Plan (without schedules) is attached as Schedule "C" to this Order, and for certain other relief, was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING: (a) the within Notice of Motion, filed; (b) the Affidavit of Terry Begley sworn January 31, 2007, filed; and (c) the Seventeenth Report of the Monitor dated February 7, 2007 (the "Seventeenth Report"), filed, and upon hearing submissions of counsel to: (a) the Applicants; (b) the Monitor; (c) Iovate Health Sciences Group Inc. and those entities listed on Schedule "B" hereto; (d) the Ad Hoc Committee of MuscleTech Tort Claimants (the "Committee"); (e) GN Oldco, Inc. f/k/a General Nutrition Companies; (f) Zurich Insurance Company; (g) GNC Corporation and other GNC newcos; and (h) certain representative plaintiffs in purported class actions involving products containing the ingredient prohormone, no one appearing for the other persons served with notice of this Motion, as duly served and listed on the Affidavit of Service of Elana Polan, sworn February 2, 2007, filed,

DEFINITIONS

1. **THIS COURT ORDERS** that any capitalized terms not otherwise defined in this Order shall have the meanings ascribed to such terms in the Plan.

SERVICE AND MEETING OF CREDITORS

2. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient notice, service and delivery of the Plan and the Monitor's Seventeenth Report to all Creditors.
3. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient notice, service and delivery of the Meeting Materials (as defined in the Meeting Order) to all Creditors, and that the Meeting was duly convened, held and conducted, in conformity with the CCAA, the Meeting Order and all other Orders of this Court in the CCAA Proceedings. For greater certainty, and without limiting the foregoing, the vote cast at the Meeting on behalf of Rhodrick Harden by David Molton of Brown Rudnick

Berlack Israelis LLP, in its capacity as representative counsel for the Ad Hoc Committee of MuscleTech Tort Claimants, is hereby confirmed.

4. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient notice, service and delivery of the within Notice of Motion and Motion Record, and of the date and time of the hearing held by this Court to consider the within Motion, such that: (i) all Persons have had an opportunity to be present and be heard at such hearing; (ii) the within Motion is properly returnable today; and (iii) further service on any interested party is hereby dispensed with.

SANCTION OF PLAN

5. **THIS COURT ORDERS AND DECLARES** that:

   (a) the Plan has been approved by the requisite majorities of the Creditors in each class present and voting, either in person or by proxy, at the Meeting, all in conformity with the CCAA and the terms of the Meeting Order;
   (b) the Applicants have acted in good faith and with due diligence, have complied with the provisions of the CCAA, and have not done or purported to do (nor does the Plan do or purport to do) anything that is not authorized by the CCAA;
   (c) the Applicants have adhered to, and acted in accordance with, all Orders of this Court in the CCAA Proceedings; and
   (d) the Plan, together with all of the compromises, arrangements, transactions, releases, discharges, injunctions and results provided for therein and effected thereby, including but not limited to the Settlement Agreements, is both substantively and procedurally fair, reasonable and in the best interests of the Creditors and the other stakeholders of the Applicants, and does not unfairly disregard the interests of any Person (whether a Creditor or otherwise).

6. **THIS COURT ORDERS** that the Plan be and is hereby sanctioned and approved pursuant to Section 6 of the CCAA.

PLAN IMPLEMENTATION

7. **THIS COURT ORDERS** that the Applicants and the Monitor, as the case may be, are authorized and directed to take all steps and actions, and to do all things, necessary or appropriate to enter into or implement the Plan in accordance with its terms, and enter into, implement and consummate all of the steps, transactions and agreements contemplated pursuant to the Plan.

8. **THIS COURT ORDERS** that upon the satisfaction or waiver, as applicable, of the conditions precedent set out in Section 7.1 of the Plan, the Monitor shall file with this Court and with the U.S. District Court a certificate that states that all conditions precedent set out in Section 7.1 of the Plan have been satisfied or waived, as applicable, and that, with the filing of such certificate by the Monitor, the Plan Implementation Date shall have occurred in accordance with the Plan.

9. **THIS COURT ORDERS AND DECLARES** that as of the Plan Implementation Date, the Plan, including all compromises, arrangements, transactions, releases, discharges and injunctions provided for therein, shall inure to the benefit of and be binding and effective upon the Creditors, the Subject Parties and all other Persons affected thereby, and on their respective heirs, administrators, executors, legal personal representatives, successors and assigns.

10. **THIS COURT ORDERS AND DECLARES** that, as of the Plan Implementation Date, the validity or invalidity of Claims and Product Liability Claims, as the case may be, and the quantum of all Proven Claims and Proven Product Liability Claims, accepted, determined or otherwise established in accordance with the Claims Resolution Order, and the factual and legal determinations made by the Claims Officer, this Court and the U.S. District Court in connection with all Claims and Product Liability Claims (whether Proven Claims and Proven Product Liability Claims or otherwise), in the course of the CCAA Proceedings are final and binding on the Subject Parties, the Creditors and all other Persons.

11. **THIS COURT ORDERS** that, subject to the provisions of the Plan and the performance by the Applicants and the Monitor of their respective obligations under the Plan, and effective on the Plan Implementation Date, all agreements to which the Applicants are a party shall be and remain in full force and effect, unamended, as at the Plan Implementation Date, and no Person shall, following the Plan Implementation Date, accelerate, terminate, rescind, refuse to perform or otherwise repudiate its obligations under, or enforce or exercise any right (including any right of set-off, dilution or other remedy) or make any demand under or in respect of any such agreement, by reason of:

    (a) any event that occurred on or prior to the Plan Implementation Date that would have entitled any Person thereto to enforce those rights or remedies (including defaults or events of default arising as a result of the insolvency of the Applicants);
    (b) the fact that the Applicants have: (i) sought or obtained plenary relief under the CCAA or ancillary relief in the United States of America, including pursuant to Chapter 15 of the *United States Bankruptcy Code*, or (ii) commenced or completed the CCAA Proceedings or the U.S. Proceedings;
    (c) the implementation of the Plan, or the completion of any of the steps, transactions or things contemplated by the Plan; or
    (d) any compromises, arrangements, transactions, releases, discharges or injunctions effected pursuant to the Plan or this Order.

12. **THIS COURT ORDERS** that, from and after the Plan Implementation Date, all Persons (other than Unaffected Creditors, and with respect to Unaffected Claims only) shall be deemed to have waived any and all defaults then existing or previously committed by the Applicants, or caused by the Applicants, or non-compliance with any covenant, warranty, representation, term, provision, condition or obligation, express or implied, in any contract, instrument, credit document, guarantee, agreement for sale, lease or other agreement, written or oral, and any and all amendments or supplements thereto (each, an "Agreement"), existing between such Person and the Applicants or any other Person and any and all notices of default and demands for payment under any

Agreement shall be deemed to be of no further force or effect; provided that nothing in this paragraph shall excuse or be deemed to excuse the Applicants from performing any of their obligations subsequent to the date of the CCAA Proceedings, including, without limitation, obligations under the Plan.

13. **THIS COURT ORDERS** that, as of the Plan Implementation Date, each Creditor shall be deemed to have consented and agreed to all of the provisions of the Plan in their entirety and, in particular, each Creditor shall be deemed:

    (a) to have executed and delivered to the Monitor and to the Applicants all consents, releases or agreements required to implement and carry out the Plan in its entirety; and

    (b) to have agreed that if there is any conflict between the provisions, express or implied, of any agreement or other arrangement, written or oral, existing between such Creditor and the Applicants as of the Plan Implementation Date (other than those entered into by the Applicants on or after the Filing Date) and the provisions of the Plan, the provisions of the Plan take precedence and priority and the provisions of such agreement or other arrangement shall be deemed to be amended accordingly.

14. **THIS COURT ORDERS AND DECLARES** that any distributions under the Plan and this Order shall not constitute a "distribution" for the purposes of section 159 of the *Income Tax Act* (Canada), section 270 of the *Excise Tax Act* (Canada) and section 107 of the *Corporations Tax Act* (Ontario) and the Monitor in making any such payments is not "distributing", nor shall be considered to have "distributed", such funds, and the Monitor shall not incur any liability under the above-mentioned statutes for making any payments ordered and is hereby forever released, remised and discharged from any claims against it under section 159 of the *Income Tax Act* (Canada), section 270 of the *Excise Tax Act* (Canada) and section 107 of the *Corporations Tax Act* (Ontario) or otherwise at law, arising as a result of distributions under the Plan and this Order and any claims of this nature are hereby forever barred.

APPROVAL OF SETTLEMENT AND FUNDING AGREEMENTS

15. **THIS COURT ORDERS** that each of the Settlement Agreements be and is hereby approved.

16. **THIS COURT ORDERS** that each of the Confidential Insurance Settlement Agreement and the Mutual Release be and is hereby approved.

17. **THIS COURT ORDERS** that copies of the Settlement Agreements, the Confidential Insurance Settlement Agreement and the Mutual Release shall be sealed and shall not form part of the public record, subject to further Order of this Honourable Court; provided that any party to any of the foregoing shall have received, and is entitled to receive, a copy thereof.

18. **THIS COURT ORDERS AND DIRECTS** the Monitor to do such things and take such steps as are contemplated to be done and taken by the Monitor under the Plan and the Settlement Agreements. Without limitation: (i) the Monitor shall hold and distribute the Contributed Funds in accordance with the terms of the Plan, the Settlement Agreements and the escrow agreements referenced in Section 5.1 of the Plan; and (ii) on the

Plan Implementation Date, the Monitor shall complete the distributions to or on behalf of Creditors (including, without limitation, to Creditors' legal representatives, to be held by such legal representatives in trust for such Creditors) as contemplated by, and in accordance with, the terms of the Plan, the Settlement Agreements and the escrow agreements referenced in Section 5.1 of the Plan.

RELEASES, DISCHARGES AND INJUNCTIONS

19. **THIS COURT ORDERS AND DECLARES** that the compromises, arrangements, releases, discharges and injunctions contemplated in the Plan, including those granted by and for the benefit of the Subject Parties, are integral components thereof and are necessary for, and vital to, the success of the Plan (and without which it would not be possible to complete the global resolution of the Product Liability Claims upon which the Plan and the Settlement Agreements are premised), and that, effective on the Plan Implementation Date, all such releases, discharges and injunctions are hereby sanctioned, approved and given full force and effect, subject to: (a) the rights of Creditors to receive distributions in respect of their Claims and Product Liability Claims in accordance with the Plan and the Settlement Agreements, as applicable; and (b) the rights and obligations of Creditors and/or the Subject Parties under the Plan, the Settlement Agreements, the Funding Agreements and the Mutual Release. For greater certainty, nothing herein or in the Plan shall release or affect any rights or obligations under the Plan, the Settlement Agreements, the Funding Agreements and the Mutual Release.
20. **THIS COURT ORDERS** that, without limiting anything in this Order, including without limitation, paragraph 19 hereof, or anything in the Plan or in the Call For Claims Order, the Subject Parties and their respective representatives, predecessors, heirs, spouses, dependents, administrators, executors, subsidiaries, affiliates, related companies, franchisees, member companies, vendors, partners, distributors, brokers, retailers, officers, directors, shareholders, employees, attorneys, sureties, insurers, successors, indemnitees, servants, agents and assigns (collectively, the "Released Parties"), as applicable, be and are hereby fully, finally, irrevocably and unconditionally released and forever discharged from any and all Claims and Product Liability Claims, and any and all past, present and future claims, rights, interests, actions, liabilities, demands, duties, injuries, damages, expenses, fees (including medical and attorneys' fees and liens), costs, compensation, or causes of action of whatsoever kind or nature whether foreseen or unforeseen, known or unknown, asserted or unasserted, contingent or actual, liquidated or unliquidated, whether in tort or contract, whether statutory, at common law or in equity, based on, in connection with, arising out of, or in any way related to, in whole or in part, directly or indirectly: (A) any proof of claim filed by any Person in accordance with the Call For Claims Order (whether or not withdrawn); (B) any actual or alleged past, present or future act, omission, defect, incident, event or circumstance from the beginning of the world to the Plan Implementation Date, based on, in connection with, arising out of, or in any way related to, in whole or in part, directly or indirectly, any alleged personal, economic or other injury allegedly based on, in connection with, arising out of, or in any way related to, in whole or in part, directly or indirectly, the research, development, manufacture, marketing, sale, distribution, fabrication, advertising, supply, production, use, or ingestion of products sold, developed or distributed by or on behalf of the Applicants; or (C) the CCAA Proceedings; and no Person

shall make or continue any claims or proceedings whatsoever based on, in connection with, arising out of, or in any way related to, in whole or in part, directly or indirectly, the substance of the facts giving rise to any matter herein released (including, without limitation, any action, cross-claim, counter-claim, third party action or application) against any Person who claims or might reasonably be expected to claim in any manner or forum against one or more of the Released Parties, including, without limitation, by way of contribution or indemnity, in common law, or in equity, or under the provisions of any statute or regulation, and that in the event that any of the Released Parties are added to such claim or proceeding, it will immediately discontinue any such claim or proceeding.

21. **THIS COURT ORDERS** that, without limiting anything in this Order, including without limitation, paragraph 19 hereof, or anything in the Plan or in the Call For Claims Order, all Persons (regardless of whether or not such Persons are Creditors), on their own behalf and on behalf of their respective present or former employees, agents, officers, directors, principals, spouses, dependents, heirs, attorneys, successors, assigns and legal representatives, are permanently and forever barred, estopped, stayed and enjoined, on and after the Plan Implementation Date, with respect to Claims, Product Liability Claims, Related Claims and all claims otherwise released pursuant to the Plan and this Sanction Order, from:

    (a) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Released Parties or any of them;
    (b) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Released Parties or any of them or the property of any of the Released Parties;
    (c) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against one or more of the Released Parties;
    (d) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind; and
    (e) taking any actions to interfere with the implementation or consummation of the Plan.

<u>DISCHARGE OF MONITOR</u>

22. **THIS COURT ORDERS** that RSM Richter Inc. shall be discharged from its duties as Monitor of the Applicants effective as of the Plan Implementation Date; provided that

the foregoing shall not apply in respect of: (i) any obligations of, or matters to be completed by, the Monitor pursuant to the Plan or the Settlement Agreements from and after the Plan Implementation Date; or (ii) matters otherwise requested by the Applicants and agreed to by the Monitor.

23. **THIS COURT ORDERS** that, subject to paragraph 22 herein, the completion of the Monitor's duties shall be evidenced, and its final discharge shall be effected by the filing by the Monitor with this Court of a certificate of discharge at, or as soon as practicable after, the Plan Implementation Date.

24. **THIS COURT ORDERS AND DECLARES** that the actions and conduct of the Monitor in the CCAA Proceedings and as foreign representative in the U.S. Proceedings, as disclosed in its reports to the Court from time to time, including, without limitation, the Monitor's Fifteenth Report dated December 12, 2006, the Monitor's Sixteenth Report dated December 22, 2006, and the Seventeenth Report, are hereby approved and that the Monitor has satisfied all of its obligations up to and including the date of this Order, and that in addition to the protections in favour of the Monitor as set out in the Orders of this Court in the CCAA Proceedings to date, the Monitor shall not be liable for any act or omission on the part of the Monitor, including with respect to any reliance thereof, including without limitation, with respect to any information disclosed, any act or omission pertaining to the discharge of duties under the Plan or as requested by the Applicants or with respect to any other duties or obligations in respect of the implementation of the Plan, save and except for any claim or liability arising out of any gross negligence or wilful misconduct on the part of the Monitor. Subject to the foregoing, and in addition to the protections in favour of the Monitor as set out in the Orders of this Court, any claims against the Monitor in connection with the performance of its duties as Monitor are hereby released, stayed, extinguished and forever barred and the Monitor shall have no liability in respect thereof.

25. **THIS COURT ORDERS** that no action or other proceeding shall be commenced against the Monitor in any way arising from or related to its capacity or conduct as Monitor except with prior leave of this Court and on prior written notice to the Monitor and upon further order securing, as security for costs, the solicitor and his own client costs of the Monitor in connection with any proposed action or proceeding.

26. **THIS COURT ORDERS** that the Monitor, its affiliates, and their respective officers, directors, employees and agents, and counsel for the Monitor, are hereby released and discharged from any and all claims that any of the Subject Parties or their respective officers, directors, employees and agents or any other Persons may have or be entitled to assert against the Monitor, 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 date of issue of this Order in any way relating to, arising out of or in respect of the CCAA proceedings.

CLAIMS OFFICER

27. **THIS COURT ORDERS** that the appointment of The Honourable Mr. Justice Edward Saunders as Claims Officer (as defined in the Claims Resolution Order) shall automatically cease, and his roles and duties in the CCAA Proceedings and in the U.S. Proceedings shall terminate, on the Plan Implementation Date.

28. **THIS COURT ORDERS AND DECLARES** that the actions and conduct of the Claims Officer pursuant to the Claims Resolution Order, and as disclosed in the Monitor's Reports to this Court, are hereby approved and that the Claims Officer has satisfied all of his obligations up to and including the date of this Order, and that any claims against the Claims Officer in connection with the performance of his duties as Claims Officer are hereby stayed, extinguished and forever barred.

MEDIATOR

29. **THIS COURT ORDERS** that the appointment of Mr. David Geronemus (the "Mediator") as a mediator in respect of non-binding mediation of the Product Liability Claims pursuant to the Order of this Court dated April 13, 2006 (the "Mediation Order"), in the within proceedings, shall automatically cease, and his roles and duties in the CCAA Proceedings and in the U.S. Proceedings shall terminate, on the Plan Implementation Date.

30. **THIS COURT ORDERS AND DECLARES** that the actions and conduct of the Mediator pursuant to the Mediation Order, and as disclosed in the Monitor's reports to this Court, are hereby approved, and that the Mediator has satisfied all of his obligations up to and including the date of this Order, and that any claims against the Mediator in connection with the performance of his duties as Mediator are hereby stayed, extinguished and forever barred.

ESCROW AGENT

31. **THIS COURT ORDERS** that Duane Morris LLP shall not be liable for any act or omission on its part as a result of its appointment or the fulfillment of its duties as escrow agent pursuant to the escrow agreements executed by Duane Morris LLP and the respective Settling Plaintiffs that are parties to the Settlement Agreements, excluding the Group Settlement Agreement (and which escrow agreements are attached as schedules to such Settlement Agreements), and that no action, application or other proceedings shall be taken, made or continued against Duane Morris LLP without the leave of this Court first being obtained; save and except that the foregoing shall not apply to any claim or liability arising out of any gross negligence or wilful misconduct on its part.

REPRESENTATIVE COUNSEL

32. **THIS COURT ORDERS** that Representative Counsel (as defined in the Order of this Court dated February 8, 2006 (the "Appointment Order")) shall not be liable, either prior to or subsequent to the Plan Implementation Date, for any act or omission on its part as a result of its appointment or the fulfillment of its duties in carrying out the provisions of the Appointment Order, save and except for any claim or liability arising out of any gross negligence or wilful misconduct on its part, and that no action, application or other proceedings shall be taken, made or continued against Representative Counsel without the leave of this Court first being obtained.

CHARGES

33. **THIS COURT ORDERS** that, subject to paragraph 33 hereof, the Charges on the assets of the Applicants provided for in the Initial CCAA Order and any subsequent Orders in the CCAA Proceedings shall automatically be fully and finally terminated, discharged and released on the Plan Implementation Date.

34. **THIS COURT ORDERS that:** (i) the Monitor shall continue to hold a charge, as provided in the Administrative Charge (as defined in the Initial CCAA Order), until the fees and disbursements of the Monitor and its counsel have been paid in full; and (ii) the DIP Charge (as defined in the Initial CCAA Order) shall remain in full force and effect until all obligations and liabilities secured thereby have been repaid in full, or unless otherwise agreed by the Applicants and the DIP Lender (as defined in the Initial CCAA Order).

35. **THIS COURT ORDERS AND DECLARES** that, notwithstanding any of the terms of the Plan or this Order, the Applicants shall not be released or discharged from their obligations in respect of Unaffected Claims, including, without limitation, to pay the fees and expenses of the Monitor and its respective counsel.

STAY OF PROCEEDINGS

36. **THIS COURT ORDERS** that, subject to further order of this Court, the Stay Period established in the Initial CCAA Order, as extended, shall be and is hereby further extended until the earlier of the Plan Implementation Date and the date that is 60 Business Days after the date of this Order, or such later date as may be fixed by this Court.

37. **THIS COURT AUTHORIZES AND DIRECTS** the Monitor to apply to the U.S. District Court for a comparable extension of the Stay Period as set out in paragraph 36 hereof.

INITIAL CCAA ORDER AND OTHER ORDERS

38. **THIS COURT ORDERS** that:

    (a) except to the extent that the Initial CCAA Order has been varied by or is inconsistent with this Order or any further Order of this Court, the provisions of the Initial CCAA Order shall remain in full force and effect until the Plan Implementation Date; provided that the protections granted in favour of the Monitor shall continue in full force and effect after the Plan Implementation Date; and

    (b) all other Orders made in the CCAA Proceedings shall continue in full force and effect in accordance with their respective terms, except to the extent that such Orders are varied by, or are inconsistent with, this Order or any further Order of this Court in the CCAA Proceedings; provided that the protections granted in favour of the Monitor shall continue in full force and effect after the Plan Implementation Date.

39. **THIS COURT ORDERS AND DECLARES** that, without limiting paragraph 0 above, the Call For Claims Order, including, without limitation, the Claims Bar Date, releases, injunctions and prohibitions provided for thereunder, be and is hereby confirmed, and shall operate in addition to the provisions of this Order and the Plan, in-

cluding, without limitation, the releases, injunctions and prohibitions provided for hereunder and thereunder, respectively.

APPROVAL OF THE SEVENTEENTH REPORT

40. **THIS COURT ORDERS** that the Seventeenth Report of the Monitor and the activities of the Monitor referred to therein be and are hereby approved.

FEES

41. **THIS COURT ORDERS** that the fees, disbursements and expenses of the Monitor from November 1, 2006 to January 31, 2007, in the amount of $123,819.56, plus a reserve for fees in the amount of $100,000 to complete the administration of the Monitor's mandate, be and are hereby approved and fixed.
42. **THIS COURT ORDERS** that the fees, disbursements and expenses of Monitor's legal counsel in Canada, Davies Ward Phillips & Vineberg LLP, from October 1, 2006 to January 31, 2007, in the amount of $134,109.56, plus a reserve for fees in the amount of $75,000 to complete the administration of its mandate, be and are hereby approved and fixed.
43. **THIS COURT ORDERS** that the fees, disbursements and expenses of Monitor's legal counsel in the United States, Allen & Overy LLP, from September 1, 2006 to January 31, 2007, in the amount of USD$98,219.87, plus a reserve for fees in the amount of USD$50,000 to complete the administration of its mandate, be and are hereby approved and fixed.

GENERAL

44. **THIS COURT ORDERS** that the Applicants, the Monitor or any other interested parties may apply to this Court for any directions or determination required to resolve any matter or dispute relating to, or the subject matter of or rights and benefits under, the Plan or this Order.

EFFECT, RECOGNITION, ASSISTANCE

45. **THIS COURT AUTHORIZES AND DIRECTS** the Monitor to apply to the U.S. District Court for the Sanction Recognition Order.
46. **THIS COURT ORDERS** that this Order shall have full force and effect in all provinces and territories in Canada, outside Canada and against all Persons against whom it may otherwise be enforceable.
47. **THIS COURT REQUESTS** the aid, recognition and assistance of other courts in Canada in accordance with Section 17 of the CCAA and the Initial CCAA Order, and requests that the Federal Court of Canada and the courts and judicial, regulatory and administrative bodies of or by the provinces and territories of Canada, the Parliament of Canada, the United States of America, the states and other subdivisions of the United States of America including, without limitation, the U.S. District Court, and other nations and states act in aid, recognition and assistance of, and be complementary to, this Court in carrying out the terms of this Order and any other Order in this proceeding. Each of Applicants and the Monitor shall be at liberty, and is hereby authorized and

empowered, to make such further applications, motions or proceedings to or before such other court and judicial, regulatory and administrative bodies, and take such other steps, in Canada or the United States of America, as may be necessary or advisable to give effect to this Order.

cp/e/qlgxc/qlpwb

Tab 22

Case Name:

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.

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 and Arrangement involving Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 4446372 Canada Inc. and 6932819 Canada Inc., Trustees of the Conduits Listed In Schedule "A" Hereto

Between

The Investors represented on the Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper listed in Schedule "B" hereto, Applicants (Respondents in Appeal), and Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., 6932819 Canada Inc. and 4446372 Canada Inc., Trustees of the Conduits listed in Schedule "A" hereto, Respondents (Respondents in Appeal), and Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal Inc., Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Domtar Inc., Domtar Pulp and Paper Products Inc., GIRO Inc., Vêtements de sports R.G.R. Inc., 131519 Canada Inc., Air Jazz LP, Petrifond Foundation Company Limited, Petrifond Foundation Midwest Limited, Services hypothécaires la patrimoniale Inc., TECSYS Inc., Société générale de financement du Québec, VibroSystM Inc., Interquisa Canada L.P., Redcorp Ventures Ltd., Jura Energy Corporation, Ivanhoe Mines Ltd., WebTech Wireless Inc., Wynn Capital Corporation Inc., Hy Bloom

Inc., Cardacian Mortgage Services, Inc., West Energy Ltd., Sabre Enerty Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd. and Standard Energy Inc., Respondents (Appellants)

[2008] O.J. No. 3164

2008 ONCA 587

45 C.B.R. (5th) 163

296 D.L.R. (4th) 135

2008 CarswellOnt 4811

168 A.C.W.S. (3d) 698

240 O.A.C. 245

47 B.L.R. (4th) 123

92 O.R. (3d) 513

Docket: C48969 (M36489)

Ontario Court of Appeal
Toronto, Ontario

J.I. Laskin, E.A. Cronk and R.A. Blair JJ.A.

Heard: June 25-26, 2008.
Judgment: August 18, 2008.

(121 paras.)

Bankruptcy and insolvency law -- Proceedings in bankruptcy and insolvency -- Practice and procedure -- General principles -- Legislation -- Interpretation -- Courts -- Jurisdiction -- Federal -- Companies' Creditors Arrangement Act -- Application by certain creditors opposed to a Plan of Compromise and Arrangement for leave to appeal sanctioning of that Plan -- Pan-Canadian Investors Committee was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that formed the subject matter of the proceedings -- Plan dealt with liquidity crisis threatening Canadian market in Asset Backed Commercial Paper -- Plan was sanctioned by court -- Leave to appeal allowed and appeal dismissed -- CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court -- Companies' Creditors Arrangement Act, ss. 4, 6.

Application by certain creditors opposed to a Plan of Compromise and Arrangement for leave to appeal the sanctioning of that Plan. In August 2007, a liquidity crisis threatened the Canadian market in Asset Backed Commercial Paper (ABCP). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on US sub-prime mortgages. By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007, pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that formed the subject matter of the proceedings. The Plan was sanctioned on June 5, 2008. The applicants raised an important point regarding the permissible scope of restructuring under the Companies' Creditors Arrangement Act: could the court sanction a Plan that called for creditors to provide releases to third parties who were themselves insolvent and not creditors of the debtor company? They also argued that if the answer to that question was yes, the application judge erred in holding that the Plan, with its particular releases (which barred some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

HELD: Application for leave to appeal allowed and appeal dismissed. The appeal raised issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There were serious and arguable grounds of appeal and the appeal would not unduly delay the progress of the proceedings. In the circumstances, the criteria for granting leave to appeal were met. Respecting the appeal, the CCAA permitted the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where the releases were reasonably connected to the proposed restructuring. The wording of the CCAA, construed in light of the purpose, objects and scheme of the Act, supported the court's jurisdiction and authority to sanction the Plan proposed in this case, including the contested third-party releases contained in it. The Plan was fair and reasonable in all the circumstances.

Statutes, Regulations and Rules Cited:

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

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 4, s. 6

Constitution Act, 1867, R.S.C. 1985, App. II, No. 5, s. 91(21), s. 92(13)

Appeal From:

On appeal from the sanction order of Justice Colin L. Campbell of the Superior Court of Justice, dated June 5, 2008, with reasons reported at [2008] O.J. No. 2265.

Counsel:

See Schedule "A" for the list of counsel.

The judgment of the Court was delivered by

R.A. BLAIR J.A.:--

A. INTRODUCTION

1 In August 2007 a liquidity crisis suddenly threatened the Canadian market in Asset Backed Commercial Paper ("ABCP"). The crisis was triggered by a loss of confidence amongst investors stemming from the news of widespread defaults on U.S. sub-prime mortgages. The loss of confidence placed the Canadian financial market at risk generally and was reflective of an economic volatility worldwide.

2 By agreement amongst the major Canadian participants, the $32 billion Canadian market in third-party ABCP was frozen on August 13, 2007 pending an attempt to resolve the crisis through a restructuring of that market. The Pan-Canadian Investors Committee, chaired by Purdy Crawford, C.C., Q.C., was formed and ultimately put forward the creditor-initiated Plan of Compromise and Arrangement that forms the subject-matter of these proceedings. The Plan was sanctioned by Colin L. Campbell J. on June 5, 2008.

3 Certain creditors who opposed the Plan seek leave to appeal and, if leave is granted, appeal from that decision. They raise an important point regarding the permissible scope of a restructuring under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 as amended ("CCAA"): can the court sanction a Plan that calls for creditors to provide releases to third parties who are themselves solvent and not creditors of the debtor company? They also argue that, if the answer to this question is yes, the application judge erred in holding that this Plan, with its particular releases (which bar some claims even in fraud), was fair and reasonable and therefore in sanctioning it under the CCAA.

Leave to Appeal

4 Because of the particular circumstances and urgency of these proceedings, the court agreed to collapse an oral hearing for leave to appeal with the hearing of the appeal itself. At the outset of argument we encouraged counsel to combine their submissions on both matters.

5 The proposed appeal raises issues of considerable importance to restructuring proceedings under the CCAA Canada-wide. There are serious and arguable grounds of appeal and -- given the expedited time-table -- the appeal will not unduly delay the progress of the proceedings. I am satisfied that the criteria for granting leave to appeal in CCAA proceedings, set out in such cases as *Re Cineplex Odeon Corp.* (2001), 24 C.B.R. (4th) 21 (Ont. C.A.), and *Re Country Style Food Services* (2002), 158 O.A.C. 30, are met. I would grant leave to appeal.

Appeal

6 For the reasons that follow, however, I would dismiss the appeal.

B. FACTS

The Parties

7 The appellants are holders of ABCP Notes who oppose the Plan. They do so principally on the basis that it requires them to grant releases to third party financial institutions against whom they say they have claims for relief arising out of their purchase of ABCP Notes. Amongst them are an airline, a tour operator, a mining company, a wireless provider, a pharmaceuticals retailer, and several holding companies and energy companies.

8 Each of the appellants has large sums invested in ABCP -- in some cases, hundreds of millions of dollars. Nonetheless, the collective holdings of the appellants -- slightly over $1 billion -- represent only a small fraction of the more than $32 billion of ABCP involved in the restructuring.

9 The lead respondent is the Pan-Canadian Investors Committee which was responsible for the creation and negotiation of the Plan on behalf of the creditors. Other respondents include various major international financial institutions, the five largest Canadian banks, several trust companies, and some smaller holders of ABCP product. They participated in the market in a number of different ways.

The ABCP Market

10 Asset Backed Commercial Paper is a sophisticated and hitherto well-accepted financial instrument. It is primarily a form of short-term investment -- usually 30 to 90 days -- typically with a low interest yield only slightly better than that available through other short-term paper from a government or bank. It is said to be "asset backed" because the cash that is used to purchase an ABCP Note is converted into a portfolio of financial assets or other asset interests that in turn provide security for the repayment of the notes.

11 ABCP was often presented by those selling it as a safe investment, somewhat like a guaranteed investment certificate.

12 The Canadian market for ABCP is significant and administratively complex. As of August 2007, investors had placed over $116 billion in Canadian ABCP. Investors range from individual pensioners to large institutional bodies. On the selling and distribution end, numerous players are involved, including chartered banks, investment houses and other financial institutions. Some of these players participated in multiple ways. The Plan in this proceeding relates to approximately $32 billion of non-bank sponsored ABCP the restructuring of which is considered essential to the preservation of the Canadian ABCP market.

13 As I understand it, prior to August 2007 when it was frozen, the ABCP market worked as follows.

14 Various corporations (the "Sponsors") would arrange for entities they control ("Conduits") to make ABCP Notes available to be sold to investors through "Dealers" (banks and other investment dealers). Typically, ABCP was issued by series and sometimes by classes within a series.

15 The cash from the purchase of the ABCP Notes was used to purchase assets which were held by trustees of the Conduits ("Issuer Trustees") and which stood as security for repayment of the notes. Financial institutions that sold or provided the Conduits with the assets that secured the ABCP are known as "Asset Providers". To help ensure that investors would be able to redeem their notes, "Liquidity Providers" agreed to provide funds that could be drawn upon to meet the demands of maturing ABCP Notes in certain circumstances. Most Asset Providers were also Liquidity Providers. Many of these banks and financial institutions were also holders of ABCP Notes ("Noteholders"). The Asset and Liquidity Providers held first charges on the assets.

16 When the market was working well, cash from the purchase of new ABCP Notes was also used to pay off maturing ABCP Notes; alternatively, Noteholders simply rolled their maturing notes over into new ones. As I will explain, however, there was a potential underlying predicament with this scheme.

The Liquidity Crisis

17 The types of assets and asset interests acquired to "back" the ABCP Notes are varied and complex. They were generally long-term assets such as residential mortgages, credit card receivables, auto loans, cash collateralized debt obligations and derivative investments such as credit default swaps. Their particular characteristics do not matter for the purpose of this appeal, but they shared a common feature that proved to be the Achilles heel of the ABCP market: because of their long-term nature there was an inherent timing mismatch between the cash they generated and the cash needed to repay maturing ABCP Notes.

18 When uncertainty began to spread through the ABCP marketplace in the summer of 2007, investors stopped buying the ABCP product and existing Noteholders ceased to roll over their maturing notes. There was no cash to redeem those notes. Although calls were made on the Liquidity Providers for payment, most of the Liquidity Providers declined to fund the redemption of the notes, arguing that the conditions for liquidity funding had not been met in the circumstances. Hence the "liquidity crisis" in the ABCP market.

19 The crisis was fuelled largely by a lack of transparency in the ABCP scheme. Investors could not tell what assets were backing their notes -- partly because the ABCP Notes were often sold before or at the same time as the assets backing them were acquired; partly because of the sheer complexity of certain of the underlying assets; and partly because of assertions of confidentiality by those involved with the assets. As fears arising from the spreading U.S. sub-prime mortgage crisis mushroomed, investors became increasingly concerned that their ABCP Notes may be supported by those crumbling assets. For the reasons outlined above, however, they were unable to redeem their maturing ABCP Notes.

The Montreal Protocol

20 The liquidity crisis could have triggered a wholesale liquidation of the assets, at depressed prices. But it did not. During the week of August 13, 2007, the ABCP market in Canada froze -- the result of a standstill arrangement orchestrated on the heels of the crisis by numerous market participants, including Asset Providers, Liquidity Providers, Noteholders and other financial industry representatives. Under the standstill agreement -- known as the Montréal Protocol -- the parties committed to restructuring the ABCP market with a view, as much as possible, to preserving the value of the assets and of the notes.

21 The work of implementing the restructuring fell to the Pan-Canadian Investors Committee, an applicant in the proceeding and respondent in the appeal. The Committee is composed of 17 financial and investment institutions, including chartered banks, credit unions, a pension board, a Crown corporation, and a university board of governors. All 17 members are themselves Noteholders; three of them also participated in the ABCP market in other capacities as well. Between them, they hold about two thirds of the $32 billion of ABCP sought to be restructured in these proceedings.

22 Mr. Crawford was named the Committee's chair. He thus had a unique vantage point on the work of the Committee and the restructuring process as a whole. His lengthy affidavit strongly informed the application judge's understanding of the factual context, and our own. He was not cross-examined and his evidence is unchallenged.

23 Beginning in September 2007, the Committee worked to craft a plan that would preserve the value of the notes and assets, satisfy the various stakeholders to the extent possible, and restore confidence in an important segment of the Canadian financial marketplace. In March 2008, it and the

other applicants sought CCAA protection for the ABCP debtors and the approval of a Plan that had been pre-negotiated with some, but not all, of those affected by the misfortunes in the Canadian ABCP market.

The Plan

a) Plan Overview

24 Although the ABCP market involves many different players and kinds of assets, each with their own challenges, the committee opted for a single plan. In Mr. Crawford's words, "all of the ABCP suffers from common problems that are best addressed by a common solution." The Plan the Committee developed is highly complex and involves many parties. In its essence, the Plan would convert the Noteholders' paper -- which has been frozen and therefore effectively worthless for many months -- into new, long-term notes that would trade freely, but with a discounted face value. The hope is that a strong secondary market for the notes will emerge in the long run.

25 The Plan aims to improve transparency by providing investors with detailed information about the assets supporting their ABCP Notes. It also addresses the timing mismatch between the notes and the assets by adjusting the maturity provisions and interest rates on the new notes. Further, the Plan adjusts some of the underlying credit default swap contracts by increasing the thresholds for default triggering events; in this way, the likelihood of a forced liquidation flowing from the credit default swap holder's prior security is reduced and, in turn, the risk for ABCP investors is decreased.

26 Under the Plan, the vast majority of the assets underlying ABCP would be pooled into two master asset vehicles (MAV1 and MAV2). The pooling is designed to increase the collateral available and thus make the notes more secure.

27 The Plan does not apply to investors holding less than $1 million of notes. However, certain Dealers have agreed to buy the ABCP of those of their customers holding less than the $1-million threshold, and to extend financial assistance to these customers. Principal among these Dealers are National Bank and Canaccord, two of the respondent financial institutions the appellants most object to releasing. The application judge found that these developments appeared to be designed to secure votes in favour of the Plan by various Noteholders, and were apparently successful in doing so. If the Plan is approved, they also provide considerable relief to the many small investors who find themselves unwittingly caught in the ABCP collapse.

b) The Releases

28 This appeal focuses on one specific aspect of the Plan: the comprehensive series of releases of third parties provided for in Article 10.

29 The Plan calls for the release of Canadian banks, Dealers, Noteholders, Asset Providers, Issuer Trustees, Liquidity Providers, and other market participants -- in Mr. Crawford's words, "virtually all participants in the Canadian ABCP market" -- from any liability associated with ABCP, with the exception of certain narrow claims relating to fraud. For instance, under the Plan as approved, creditors will have to give up their claims against the Dealers who sold them their ABCP Notes, including challenges to the way the Dealers characterized the ABCP and provided (or did not provide) information about the ABCP. The claims against the proposed defendants are mainly in tort: negligence, misrepresentation, negligent misrepresentation, failure to act prudently as a dealer/advisor,

acting in conflict of interest, and in a few cases fraud or potential fraud. There are also allegations of breach of fiduciary duty and claims for other equitable relief.

30 The application judge found that, in general, the claims for damages include the face value of the Notes, plus interest and additional penalties and damages.

31 The releases, in effect, are part of a *quid pro quo*. Generally speaking, they are designed to compensate various participants in the market for the contributions they would make to the restructuring. Those contributions under the Plan include the requirements that:

a) Asset Providers assume an increased risk in their credit default swap contracts, disclose certain proprietary information in relation to the assets, and provide below-cost financing for margin funding facilities that are designed to make the notes more secure;
b) Sponsors -- who in addition have cooperated with the Investors' Committee throughout the process, including by sharing certain proprietary information -- give up their existing contracts;
c) The Canadian banks provide below-cost financing for the margin funding facility and,
d) Other parties make other contributions under the Plan.

32 According to Mr. Crawford's affidavit, the releases are part of the Plan "because certain key participants, whose participation is vital to the restructuring, have made comprehensive releases a condition for their participation."

The CCAA Proceedings to Date

33 On March 17, 2008 the applicants sought and obtained an Initial Order under the CCAA staying any proceedings relating to the ABCP crisis and providing for a meeting of the Noteholders to vote on the proposed Plan. The meeting was held on April 25th. The vote was overwhelmingly in support of the Plan -- 96% of the Noteholders voted in favour. At the instance of certain Noteholders, and as requested by the application judge (who has supervised the proceedings from the outset), the Monitor broke down the voting results according to those Noteholders who had worked on or with the Investors' Committee to develop the Plan and those Noteholders who had not. Re-calculated on this basis the results remained firmly in favour of the proposed Plan -- 99% of those connected with the development of the Plan voted positively, as did 80% of those Noteholders who had not been involved in its formulation.

34 The vote thus provided the Plan with the "double majority" approval -- a majority of creditors representing two-thirds in value of the claims -- required under s. 6 of the CCAA.

35 Following the successful vote, the applicants sought court approval of the Plan under s. 6. Hearings were held on May 12 and 13. On May 16, the application judge issued a brief endorsement in which he concluded that he did not have sufficient facts to decide whether all the releases proposed in the Plan were authorized by the CCAA. While the application judge was prepared to approve the releases of negligence claims, he was not prepared at that point to sanction the release of fraud claims. Noting the urgency of the situation and the serious consequences that would result from the Plan's failure, the application judge nevertheless directed the parties back to the bargaining table to try to work out a claims process for addressing legitimate claims of fraud.

36 The result of this renegotiation was a "fraud carve-out" -- an amendment to the Plan excluding certain fraud claims from the Plan's releases. The carve-out did not encompass all possible claims of fraud, however. It was limited in three key respects. First, it applied only to claims against ABCP Dealers. Secondly, it applied only to cases involving an express fraudulent misrepresentation made with the intention to induce purchase and in circumstances where the person making the representation knew it to be false. Thirdly, the carve-out limited available damages to the value of the notes, minus any funds distributed as part of the Plan. The appellants argue vigorously that such a limited release respecting fraud claims is unacceptable and should not have been sanctioned by the application judge.

37 A second sanction hearing -- this time involving the amended Plan (with the fraud carve-out) -- was held on June 3, 2008. Two days later, Campbell J. released his reasons for decision, approving and sanctioning the Plan on the basis both that he had jurisdiction to sanction a Plan calling for third-party releases and that the Plan including the third-party releases in question here was fair and reasonable.

38 The appellants attack both of these determinations.

C. LAW AND ANALYSIS

39 There are two principal questions for determination on this appeal:

1) As a matter of law, may a CCAA plan contain a release of claims against anyone other than the debtor company or its directors?
2) If the answer to that question is yes, did the application judge err in the exercise of his discretion to sanction the Plan as fair and reasonable given the nature of the releases called for under it?

(1) Legal Authority for the Releases

40 The standard of review on this first issue -- whether, as a matter of law, a CCAA plan may contain third-party releases -- is correctness.

41 The appellants submit that a court has no jurisdiction or legal authority under the CCAA to sanction a plan that imposes an obligation on creditors to give releases to third parties other than the directors of the debtor company.[1] The requirement that objecting creditors release claims against third parties is illegal, they contend, because:

a) on a proper interpretation, the CCAA does not permit such releases;
b) the court is not entitled to "fill in the gaps" in the CCAA or rely upon its inherent jurisdiction to create such authority because to do so would be contrary to the principle that Parliament did not intend to interfere with private property rights or rights of action in the absence of clear statutory language to that effect;
c) the releases constitute an unconstitutional confiscation of private property that is within the exclusive domain of the provinces under s. 92 of the *Constitution Act*, 1867;
d) the releases are invalid under Quebec rules of public order; and because
e) the prevailing jurisprudence supports these conclusions.

42 I would not give effect to any of these submissions.

Interpretation, "Gap Filling" and Inherent Jurisdiction

43 On a proper interpretation, in my view, the CCAA permits the inclusion of third party releases in a plan of compromise or arrangement to be sanctioned by the court where those releases are reasonably connected to the proposed restructuring. I am led to this conclusion by a combination of (a) the open-ended, flexible character of the CCAA itself, (b) the broad nature of the term "compromise or arrangement" as used in the Act, and (c) the express statutory effect of the "double-majority" vote and court sanction which render the plan binding on all creditors, including those unwilling to accept certain portions of it. The first of these signals a flexible approach to the application of the Act in new and evolving situations, an active judicial role in its application and interpretation, and a liberal approach to that interpretation. The second provides the entrée to negotiations between the parties affected in the restructuring and furnishes them with the ability to apply the broad scope of their ingenuity in fashioning the proposal. The latter afford necessary protection to unwilling creditors who may be deprived of certain of their civil and property rights as a result of the process.

44 The CCAA is skeletal in nature. It does not contain a comprehensive code that lays out all that is permitted or barred. Judges must therefore play a role in fleshing out the details of the statutory scheme. The scope of the Act and the powers of the court under it are not limitless. It is beyond controversy, however, that the CCAA is remedial legislation to be liberally construed in accordance with the modern purposive approach to statutory interpretation. It is designed to be a flexible instrument and it is that very flexibility which gives the Act its efficacy: *Canadian Red Cross Society (Re)* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div.). As Farley J. noted in *Re Dylex Ltd.* (1995), 31 C.B.R. (3d) 106 at 111 (Ont. Gen. Div.), "[t]he history of CCAA law has been an evolution of judicial interpretation."

45 Much has been said, however, about the "evolution of judicial interpretation" and there is some controversy over both the source and scope of that authority. Is the source of the court's authority statutory, discerned solely through application of the principles of statutory interpretation, for example? Or does it rest in the court's ability to "fill in the gaps" in legislation? Or in the court's inherent jurisdiction?

46 These issues have recently been canvassed by the Honourable Georgina R. Jackson and Dr. Janis Sarra in their publication "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters,"[2] and there was considerable argument on these issues before the application judge and before us. While I generally agree with the authors' suggestion that the courts should adopt a hierarchical approach in their resort to these interpretive tools -- statutory interpretation, gap-filling, discretion and inherent jurisdiction -- it is not necessary in my view to go beyond the general principles of statutory interpretation to resolve the issues on this appeal. Because I am satisfied that it is implicit in the language of the CCAA itself that the court has authority to sanction plans incorporating third-party releases that are reasonably related to the proposed restructuring, there is no "gap-filling" to be done and no need to fall back on inherent jurisdiction. In this respect, I take a somewhat different approach than the application judge did.

47 The Supreme Court of Canada has affirmed generally -- and in the insolvency context particularly -- that remedial statutes are to be interpreted liberally and in accordance with Professor

Driedger's modern principle of statutory interpretation. Driedger advocated that "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": *Re Rizzo & Rizzo Shoes Ltd.*, [1998] 1 S.C.R. 27 at para. 21, quoting E.A. Driedger, *Construction of Statutes*, 2nd ed. (Toronto: Butterworths, 1983); *Bell Expressvu Ltd. Partnership v. R.*, [2002] 2 S.C.R. 559 at para. 26.

48 More broadly, I believe that the proper approach to the judicial interpretation and application of statutes -- particularly those like the CCAA that are skeletal in nature -- is succinctly and accurately summarized by Jackson and Sarra in their recent article, *supra*, at p. 56:

> The exercise of a statutory authority requires the statute to be construed. The plain meaning or textualist approach has given way to a search for the object and goals of the statute and the intentionalist approach. This latter approach makes use of the purposive approach and the mischief rule, including its codification under interpretation statutes that every enactment is deemed remedial, and is to be given such fair, large and liberal construction and interpretation as best ensures the attainment of its objects. This latter approach advocates reading the statute as a whole and being mindful of Driedger's "one principle", that the words of the Act are to be read in their entire context, in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament. It is important that courts first interpret the statute before them and exercise their authority pursuant to the statute, before reaching for other tools in the judicial toolbox. Statutory interpretation using the principles articulated above leaves room for gap-filling in the common law provinces and a consideration of purpose in *Québec* as a manifestation of the judge's overall task of statutory interpretation. Finally, the jurisprudence in relation to statutory interpretation demonstrates the fluidity inherent in the judge's task in seeking the objects of the statute and the intention of the legislature.

49 I adopt these principles.

50 The remedial purpose of the CCAA -- as its title affirms -- is to facilitate compromises or arrangements between an insolvent debtor company and its creditors. In *Chef Ready Foods Ltd. v. Hongkong Bank of Canada* (1990), 4 C.B.R. (3d) 311 at 318 (B.C.C.A.), Gibbs J.A. summarized very concisely the purpose, object and scheme of the Act:

> Almost inevitably, liquidation destroyed the shareholders' investment, yielded little by way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment. The government of the day sought, through the C.C.A.A., to create a regime whereby the principals of the company and the creditors could be brought together under the supervision of the court to attempt a reorganization or compromise or arrangement under which the company could continue in business.

51 The CCAA was enacted in 1933 and was necessary -- as the then Secretary of State noted in introducing the Bill on First Reading -- "because of the prevailing commercial and industrial depression" and the need to alleviate the effects of business bankruptcies in that context: see the

statement of the Hon. C.H. Cahan, Secretary of State, *House of Commons Debates (Hansard)* (April 20, 1933) at 4091. One of the greatest effects of that Depression was what Gibbs J.A. described as "the social evil of devastating levels of unemployment". Since then, courts have recognized that the Act has a broader dimension than simply the direct relations between the debtor company and its creditors and that this broader public dimension must be weighed in the balance together with the interests of those most directly affected: see, for example, *Elan Corp. v. Comiskey (Trustee of)* (1990), 1 O.R. (3d) 289 (C.A.), *per* Doherty J.A. in dissent; *Re Skydome Corp.* (1998), 16 C.B.R. (4th) 125 (Ont. Gen. Div.); *Re Anvil Range Mining Corp.* (1998), 3 C.B.R. (4th) 93 (Ont. Gen. Div.).

52 In this respect, I agree with the following statement of Doherty J.A. in *Elan, supra,* at pp. 306-307:

> ... [T]he Act was designed to serve a "broad constituency of investors, creditors and employees".[3] Because of that "broad constituency" the court must, when considering applications brought under the Act, *have regard not only to the individuals and organizations directly affected by the application, but also to the wider public interest.* [Emphasis added.]

Application of the Principles of Interpretation

53 An interpretation of the CCAA that recognizes its broader socio-economic purposes and objects is apt in this case. As the application judge pointed out, the restructuring underpins the financial viability of the Canadian ABCP market itself.

54 The appellants argue that the application judge erred in taking this approach and in treating the Plan and the proceedings as an attempt to restructure a financial market (the ABCP market) rather than simply the affairs between the debtor corporations who caused the ABCP Notes to be issued and their creditors. The Act is designed, they say, only to effect reorganizations between a corporate debtor and its creditors and not to attempt to restructure entire marketplaces.

55 This perspective is flawed in at least two respects, however, in my opinion. First, it reflects a view of the purpose and objects of the CCAA that is too narrow. Secondly, it overlooks the reality of the ABCP marketplace and the context of the restructuring in question here. It may be true that, in their capacity as ABCP *Dealers*, the releasee financial institutions are "third-parties" to the restructuring in the sense that they are not creditors of the debtor corporations. However, in their capacities as *Asset Providers* and *Liquidity Providers*, they are not only creditors but they are prior secured creditors to the Noteholders. Furthermore -- as the application judge found -- in these latter capacities they are making significant contributions to the restructuring by "foregoing immediate rights to assets and ... providing real and tangible input for the preservation and enhancement of the Notes" (para. 76). In this context, therefore, the application judge's remark at para. 50 that the restructuring "involves the commitment and participation of all parties" in the ABCP market makes sense, as do his earlier comments at paras. 48-49:

> Given the nature of the ABCP market and all of its participants, it is more appropriate to consider all Noteholders as claimants and the object of the Plan to restore liquidity to the assets being the Notes themselves. The restoration of the li-

> quidity of the market necessitates the participation (including more tangible contribution by many) of all Noteholders.
>
> In these circumstances, *it is unduly technical to classify the Issuer Trustees as debtors and the claims of the Noteholders as between themselves and others as being those of third party creditors*, although I recognize that the restructuring structure of the CCAA requires the corporations as the vehicles for restructuring. [Emphasis added.]

56 The application judge did observe that "[t]he insolvency is of the ABCP market itself, the restructuring is that of the market for such paper ..." (para. 50). He did so, however, to point out the uniqueness of the Plan before him and its industry-wide significance and not to suggest that he need have no regard to the provisions of the CCAA permitting a restructuring as between debtor and creditors. His focus was on *the effect* of the restructuring, a perfectly permissible perspective, given the broad purpose and objects of the Act. This is apparent from his later references. For example, in balancing the arguments against approving releases that might include aspects of fraud, he responded that "what is at issue is a liquidity crisis that affects the ABCP market in Canada" (para. 125). In addition, in his reasoning on the fair-and-reasonable issue, he stated at para. 142: "Apart from the Plan itself, there is a need to restore confidence in the financial system in Canada and this Plan is a legitimate use of the CCAA to accomplish that goal."

57 I agree. I see no error on the part of the application judge in approaching the fairness assessment or the interpretation issue with these considerations in mind. They provide the context in which the purpose, objects and scheme of the CCAA are to be considered.

The Statutory Wording

58 Keeping in mind the interpretive principles outlined above, I turn now to a consideration of the provisions of the CCAA. Where in the words of the statute is the court clothed with authority to approve a plan incorporating a requirement for third-party releases? As summarized earlier, the answer to that question, in my view, is to be found in:

> a) the skeletal nature of the CCAA;
> b) Parliament's reliance upon the broad notions of "compromise" and "arrangement" to establish the framework within which the parties may work to put forward a restructuring plan; and in
> c) the creation of the statutory mechanism binding all creditors in classes to the compromise or arrangement once it has surpassed the high "double majority" voting threshold and obtained court sanction as "fair and reasonable".

Therein lies the expression of Parliament's intention to permit the parties to negotiate and vote on, and the court to sanction, third-party releases relating to a restructuring.

59 Sections 4 and 6 of the CCAA state:

> 4. Where a compromise or an arrangement is proposed between a debtor company and its unsecured creditors or any class of them, the court may, on the application in a summary way of the company, of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of the creditors or class

of creditors, and, if the court so determines, of the shareholders of the company, to be summoned in such manner as the court directs.

6. Where a majority in number representing two-thirds in value of the creditors, or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting or meetings thereof respectively held pursuant to sections 4 and 5, or either of those sections, agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding

(*a*) on all the creditors or the class of creditors, as the case may be, and on any trustee for any such class of creditors, whether secured or unsecured, as the case may be, and on the company; and

(*b*) in the case of a company that has made an authorized assignment or against which a bankruptcy order has been made under the *Bankruptcy and Insolvency Act* or is in the course of being wound up under the *Winding-up and Restructuring Act*, on the trustee in bankruptcy or liquidator and contributories of the company.

Compromise or Arrangement

60 While there may be little practical distinction between "compromise" and "arrangement" in many respects, the two are not necessarily the same. "Arrangement" is broader than "compromise" and would appear to include any scheme for reorganizing the affairs of the debtor: Houlden and Morawetz, *Bankruptcy and Insolvency Law of Canada*, loose-leaf, 3rd ed., vol. 4 (Toronto: Thomson Carswell) at 10A-12.2, N para. 10. It has been said to be "a very wide and indefinite [word]": *Re Refund of Dues under Timber Regulations*, [1935] A.C. 184 at 197 (P.C.), affirming S.C.C. [1933] S.C.R. 616. See also, *Re Guardian Assur. Co.*, [1917] 1 Ch. 431 at 448, 450; *Re T&N Ltd. and Others (No. 3)*, [2007] 1 All E.R. 851 (Ch.).

61 The CCAA is a sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest. Parliament wisely avoided attempting to anticipate the myriad of business deals that could evolve from the fertile and creative minds of negotiators restructuring their financial affairs. It left the shape and details of those deals to be worked out within the framework of the comprehensive and flexible concepts of a "compromise" and "arrangement." I see no reason why a release in favour of a third party, negotiated as part of a package between a debtor and creditor and reasonably relating to the proposed restructuring cannot fall within that framework.

62 A proposal under the *Bankruptcy and Insolvency Act*, R.S., 1985, c. B-3 (the "BIA") is a contract: *Employers' Liability Assurance Corp. Ltd. v. Ideal Petroleum* (1959) Ltd. [1978] 1 S.C.R. 230 at 239; *Society of Composers, Authors & Music Publishers of Canada v. Armitage* (2000), 50 O.R. (3d) 688 at para. 11 (C.A.). In my view, a compromise or arrangement under the CCAA is directly analogous to a proposal for these purposes, and therefore is to be treated as a contract between the debtor and its creditors. Consequently, parties are entitled to put anything into such a plan that could lawfully be incorporated into any contract. See *Re Air Canada* (2004), 2 C.B.R. (5th) 4 at para. 6 (Ont. S.C.J.); *Olympia & York Developments Ltd. v. Royal Trust Co.* (1993), 12 O.R. (3d) 500 at 518 (Gen. Div.).

63 There is nothing to prevent a debtor and a creditor from including in a contract between them a term providing that the creditor release a third party. The term is binding as between the debtor and creditor. In the CCAA context, therefore, a plan of compromise or arrangement may propose that creditors agree to compromise claims against the debtor and to release third parties, just as any debtor and creditor might agree to such a term in a contract between them. Once the statutory mechanism regarding voter approval and court sanctioning has been complied with, the plan -- including the provision for releases -- becomes binding on all creditors (including the dissenting minority).

64 *Re T&N Ltd. and Others, supra,* is instructive in this regard. It is a rare example of a court focussing on and examining the meaning and breadth of the term "arrangement". T&N and its associated companies were engaged in the manufacture, distribution and sale of asbestos-containing products. They became the subject of many claims by former employees, who had been exposed to asbestos dust in the course of their employment, and their dependents. The T&N companies applied for protection under s. 425 of the U.K. *Companies Act 1985*, a provision virtually identical to the scheme of the CCAA -- including the concepts of compromise or arrangement.[4]

65 T&N carried employers' liability insurance. However, the employers' liability insurers (the "EL insurers") denied coverage. This issue was litigated and ultimately resolved through the establishment of a multi-million pound fund against which the employees and their dependants (the "EL claimants") would assert their claims. In return, T&N's former employees and dependants (the "EL claimants") agreed to forego any further claims against the EL insurers. This settlement was incorporated into the plan of compromise and arrangement between the T&N companies and the EL claimants that was voted on and put forward for court sanction.

66 Certain creditors argued that the court could not sanction the plan because it did not constitute a "compromise or arrangement" between T&N and the EL claimants since it did not purport to affect rights as between them but only the EL claimants' rights against the EL insurers. The Court rejected this argument. Richards J. adopted previous jurisprudence -- cited earlier in these reasons -- to the effect that the word "arrangement" has a very broad meaning and that, while both a compromise and an arrangement involve some "give and take", an arrangement need not involve a compromise or be confined to a case of dispute or difficulty (paras. 46-51). He referred to what would be the equivalent of a solvent arrangement under Canadian corporate legislation as an example.[5] Finally, he pointed out that the compromised rights of the EL claimants against the EL insurers were not unconnected with the EL claimants' rights against the T&N companies; the scheme of arrangement involving the EL insurers was "an integral part of a single proposal affecting all the parties" (para. 52). He concluded his reasoning with these observations (para. 53):

> In my judgment it is not a necessary element of an arrangement for the purposes of s. 425 of the 1985 Act that it should alter the rights existing between the company and the creditors or members with whom it is made. No doubt in most cases it will alter those rights. But, provided that the context and content of the scheme are such as properly to constitute an arrangement between the company and the members or creditors concerned, it will fall within s. 425. It is ... neither necessary nor desirable to attempt a definition of arrangement. The legislature has not done so. To insist on an alteration of rights, or a termination of rights as in the case of schemes to effect takeovers or mergers, is to impose a restriction which is neither warranted by the statutory language nor justified by the courts' approach

> over many years to give the term its widest meaning. *Nor is an arrangement necessarily outside the section, because its effect is to alter the rights of creditors against another party or because such alteration could be achieved by a scheme of arrangement with that party*. [Emphasis added.]

67 I find Richard J.'s analysis helpful and persuasive. In effect, the claimants in *T&N* were being asked to release their claims against the EL insurers in exchange for a call on the fund. Here, the appellants are being required to release their claims against certain financial third parties in exchange for what is anticipated to be an improved position for all ABCP Noteholders, stemming from the contributions the financial third parties are making to the ABCP restructuring. The situations are quite comparable.

The Binding Mechanism

68 Parliament's reliance on the expansive terms "compromise" or "arrangement" does not stand alone, however. Effective insolvency restructurings would not be possible without a statutory mechanism to bind an unwilling minority of creditors. Unanimity is frequently impossible in such situations. But the minority must be protected too. Parliament's solution to this quandary was to permit a wide range of proposals to be negotiated and put forward (the compromise or arrangement) and to bind <u>all</u> creditors by class to the terms of the plan, but to do so only where the proposal can gain the support of the requisite "double majority" of votes[6] <u>and</u> obtain the sanction of the court on the basis that it is fair and reasonable. In this way, the scheme of the CCAA supports the intention of Parliament to encourage a wide variety of solutions to corporate insolvencies without unjustifiably overriding the rights of dissenting creditors.

The Required Nexus

69 In keeping with this scheme and purpose, I do not suggest that any and all releases between creditors of the debtor company seeking to restructure and third parties may be made the subject of a compromise or arrangement between the debtor and its creditors. Nor do I think the fact that the releases may be "necessary" in the sense that the third parties or the debtor may refuse to proceed without them, of itself, advances the argument in favour of finding jurisdiction (although it may well be relevant in terms of the fairness and reasonableness analysis).

70 The release of the claim in question must be justified as part of the compromise or arrangement between the debtor and its creditors. In short, there must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan. This nexus exists here, in my view.

71 In the course of his reasons, the application judge made the following findings, all of which are amply supported on the record:

> a) The parties to be released are necessary and essential to the restructuring of the debtor;
> b) *The claims to be released are rationally related to the purpose of the Plan and necessary for it*;
> c) The Plan cannot succeed without the releases;
> d) *The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan*; and

e) The Plan will benefit not only the debtor companies but creditor Noteholders generally.

72 Here, then -- as was the case in *T&N* -- there is a close connection between the claims being released and the restructuring proposal. The tort claims arise out of the sale and distribution of the ABCP Notes and their collapse in value, just as do the contractual claims of the creditors against the debtor companies. The purpose of the restructuring is to stabilize and shore up the value of those notes in the long run. The third parties being released are making separate contributions to enable those results to materialize. Those contributions are identified earlier, at para. 31 of these reasons. The application judge found that the claims being released are not independent of or unrelated to the claims that the Noteholders have against the debtor companies; they are closely connected to the value of the ABCP Notes and are required for the Plan to succeed. At paras. 76-77 he said:

> [76] I do not consider that the Plan in this case involves a change in relationship among creditors "that does not directly involve the Company." Those who support the Plan and are to be released are "directly involved in the Company" in the sense that many are foregoing immediate rights to assets and are providing real and tangible input for the preservation and enhancement of the Notes. It would be unduly restrictive to suggest that the moving parties' claims against released parties do not involve the Company, since the claims are directly related to the value of the Notes. The value of the Notes is in this case the value of the Company.
>
> [77] This Plan, as it deals with releases, doesn't change the relationship of the creditors apart from involving the Company and its Notes.

73 I am satisfied that the wording of the CCAA -- construed in light of the purpose, objects and scheme of the Act and in accordance with the modern principles of statutory interpretation -- supports the court's jurisdiction and authority to sanction the Plan proposed here, including the contested third-party releases contained in it.

The Jurisprudence

74 Third party releases have become a frequent feature in Canadian restructurings since the decision of the Alberta Court of Queen's Bench in *Re Canadian Airlines Corp.* (2000), 265 A.R. 201, leave to appeal refused by *Resurgence Asset Management LLC v. Canadian Airlines Corp.* (2000), 266 A.R. 131 (C.A.), and [2001] S.C.C.A. No. 60, (2001) 293 A.R. 351 (S.C.C.). In *Re Muscle Tech Research and Development Inc.* (2006), 25 C.B.R (5th) 231 (Ont. S.C.J.) Justice Ground remarked (para. 8):

> [It] is not uncommon in CCAA proceedings, in the context of a plan of compromise and arrangement, to compromise claims against the Applicants and other parties against whom such claims or related claims are made.

75 We were referred to at least a dozen court-approved CCAA plans from across the country that included broad third-party releases. With the exception of *Re Canadian Airlines*, however, the releases in those restructurings -- including *Muscle Tech* -- were not opposed. The appellants argue that those cases are wrongly decided, because the court simply does not have the authority to approve such releases.

76 In *Re Canadian Airlines* the releases in question were opposed, however. Paperny J. (as she then was) concluded the court had jurisdiction to approve them and her decision is said to be the well-spring of the trend towards third-party releases referred to above. Based on the foregoing analysis, I agree with her conclusion although for reasons that differ from those cited by her.

77 Justice Paperny began her analysis of the release issue with the observation at para. 87 that "[p]rior to 1997, the CCAA did not provide for compromises of claims against anyone other than the petitioning company." It will be apparent from the analysis in these reasons that I do not accept that premise, notwithstanding the decision of the Quebec Court of Appeal in *Michaud v. Steinberg,*[7] of which her comment may have been reflective. Paperny J.'s reference to 1997 was a reference to the amendments of that year adding s. 5.1 to the CCAA, which provides for limited releases in favour of directors. Given the limited scope of s. 5.1, Justice Paperny was thus faced with the argument -- dealt with later in these reasons -- that Parliament must not have intended to extend the authority to approve third-party releases beyond the scope of this section. She chose to address this contention by concluding that, although the amendments "[did] not authorize a release of claims against third parties other than directors, [they did] not prohibit such releases either" (para. 92).

78 Respectfully, I would not adopt the interpretive principle that the CCAA permits releases because it does not expressly prohibit them. Rather, as I explain in these reasons, I believe the open-ended CCAA permits third-party releases that are reasonably related to the restructuring at issue because they are encompassed in the comprehensive terms "compromise" and "arrangement" and because of the double-voting majority and court sanctioning statutory mechanism that makes them binding on unwilling creditors.

79 The appellants rely on a number of authorities, which they submit support the proposition that the CCAA may not be used to compromise claims as between anyone other than the debtor company and its creditors. Principal amongst these are *Michaud v. Steinberg, supra*; *NBD Bank, Canada v. Dofasco Inc.*, (1999), 46 O.R. (3d) 514 (C.A.); *Pacific Coastal Airlines Ltd. v. Air Canada* (2001), 19 B.L.R. (3d) 286 (B.C.S.C.); and *Re Stelco Inc.* (2005), 78 O.R. (3d) 241 (C.A.) ("*Stelco I*"). I do not think these cases assist the appellants, however. With the exception of *Steinberg*, they do not involve third party claims that were reasonably connected to the restructuring. As I shall explain, it is my opinion that *Steinberg* does not express a correct view of the law, and I decline to follow it.

80 In *Pacific Coastal Airlines*, Tysoe J. made the following comment at para. 24:

> [The purpose of the CCAA proceeding] is not to deal with disputes between a creditor of a company and a third party, even if the company was also involved in the subject matter of the dispute. While issues between the debtor company and non-creditors are sometimes dealt with in CCAA proceedings, it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company.

81 This statement must be understood in its context, however. Pacific Coastal Airlines had been a regional carrier for Canadian Airlines prior to the CCAA reorganization of the latter in 2000. In the action in question it was seeking to assert separate tort claims against Air Canada for contractual interference and inducing breach of contract in relation to certain rights it had to the use of Canadian's flight designator code prior to the CCAA proceeding. Air Canada sought to have the action

dismissed on grounds of *res judicata* or issue estoppel because of the CCAA proceeding. Tysoe J. rejected the argument.

82 The facts in *Pacific Coastal* are not analogous to the circumstances of this case, however. There is no suggestion that a resolution of Pacific Coastal's separate tort claim against Air Canada was in any way connected to the Canadian Airlines restructuring, even though Canadian -- at a contractual level -- may have had some involvement with the particular dispute. Here, however, the disputes that are the subject-matter of the impugned releases are not simply "disputes between parties other than the debtor company". They are closely connected to the disputes being resolved between the debtor companies and their creditors and to the restructuring itself.

83 Nor is the decision of this Court in the *NBD Bank* case dispositive. It arose out of the financial collapse of Algoma Steel, a wholly-owned subsidiary of Dofasco. The Bank had advanced funds to Algoma allegedly on the strength of misrepresentations by Algoma's Vice-President, James Melville. The plan of compromise and arrangement that was sanctioned by Farley J. in the Algoma CCAA restructuring contained a clause releasing Algoma from all claims creditors "may have had against Algoma or its directors, officers, employees and advisors." Mr. Melville was found liable for negligent misrepresentation in a subsequent action by the Bank. On appeal, he argued that since the Bank was barred from suing Algoma for misrepresentation by its officers, permitting it to pursue the same cause of action against him personally would subvert the CCAA process -- in short, he was personally protected by the CCAA release.

84 Rosenberg J.A., writing for this Court, rejected this argument. The appellants here rely particularly upon his following observations at paras. 53-54:

> 53 In my view, the appellant has not demonstrated that allowing the respondent to pursue its claim against him would undermine or subvert the purposes of the Act. As this court noted in *Elan Corp. v. Comiskey* (1990), 1 O.R. (3d) 289 at 297, the *CCAA* is remedial legislation "intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both". It is a means of avoiding a liquidation that may yield little for the creditors, especially unsecured creditors like the respondent, and the debtor company shareholders. However, the appellant has not shown that allowing a creditor to continue an action against an officer for negligent misrepresentation would erode the effectiveness of the Act.
>
> 54 In fact, to refuse on policy grounds to impose liability on an officer of the corporation for negligent misrepresentation would contradict the policy of Parliament as demonstrated in recent amendments to the *CCAA* and the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3. Those Acts now contemplate that an arrangement or proposal may include a term for compromise of certain types of claims against directors of the company except claims that "are based on allegations of misrepresentations made by directors". L.W. Houlden and C.H. Morawetz, the editors of *The 2000 Annotated Bankruptcy and Insolvency Act* (Toronto: Carswell, 1999) at p. 192 are of the view that the policy behind the provision is to encourage directors of an insolvent corporation to remain in office so that the affairs of the corporation can be reorganized. I can see no similar policy interest in barring an action against an officer of the company who, prior to

> the insolvency, has misrepresented the financial affairs of the corporation to its creditors. It may be necessary to permit the compromise of claims against the debtor corporation, otherwise it may not be possible to successfully reorganize the corporation. The same considerations do not apply to individual officers. Rather, it would seem to me that it would be contrary to good policy to immunize officers from the consequences of their negligent statements which might otherwise be made in anticipation of being forgiven under a subsequent corporate proposal or arrangement. [Footnote omitted.]

85 Once again, this statement must be assessed in context. Whether Justice Farley had the authority in the earlier Algoma CCAA proceedings to sanction a plan that included third party releases was not under consideration at all. What the Court was determining in *NBD Bank* was whether the release extended by its terms to protect a third party. In fact, on its face, it does not appear to do so. Justice Rosenberg concluded only that not allowing Mr. Melville to rely upon the release did not subvert the purpose of the CCAA. As the application judge here observed, "there is little factual similarity in *NBD* to the facts now before the Court" (para. 71). Contrary to the facts of this case, in *NBD Bank* the creditors had not agreed to grant a release to officers; they had not voted on such a release and the court had not assessed the fairness and reasonableness of such a release as a term of a complex arrangement involving significant contributions by the beneficiaries of the release -- as is the situation here. Thus, *NBD Bank* is of little assistance in determining whether the court has authority to sanction a plan that calls for third party releases.

86 The appellants also rely upon the decision of this Court in *Stelco I*. There, the Court was dealing with the scope of the CCAA in connection with a dispute over what were called the "Turnover Payments". Under an inter-creditor agreement one group of creditors had subordinated their rights to another group and agreed to hold in trust and "turn over" any proceeds received from Stelco until the senior group was paid in full. On a disputed classification motion, the Subordinated Debt Holders argued that they should be in a separate class from the Senior Debt Holders. Farley J. refused to make such an order in the court below, stating:

> [Sections] 4, 5 and 6 [of the CCAA] talk of compromises or arrangements between a company and its creditors. There is no mention of this extending by statute to encompass a change of relationship among the creditors vis-à-vis the creditors themselves *and not directly involving the company*. [Citations omitted; emphasis added.]
>
> See *Re Stelco Inc.* (2005), 15 C.B.R. (5th) 297 (Ont. S.C.J.) at para. 7.

87 This Court upheld that decision. The legal relationship between each group of creditors and Stelco was the same, albeit there were inter-creditor differences, and creditors were to be classified in accordance with their legal rights. In addition, the need for timely classification and voting decisions in the CCAA process militated against enmeshing the classification process in the vagaries of inter-corporate disputes. In short, the issues before the Court were quite different from those raised on this appeal.

88 Indeed, the Stelco plan, as sanctioned, included third party releases (albeit uncontested ones). This Court subsequently dealt with the same inter-creditor agreement on an appeal where the Subordinated Debt Holders argued that the inter-creditor subordination provisions were beyond the

reach of the CCAA and therefore that they were entitled to a separate civil action to determine their rights under the agreement: *Re Stelco Inc.*, (2006), 21 C.B.R. (5th) 157 (Ont. C.A.) ("*Stelco II*"). The Court rejected that argument and held that where the creditors' rights amongst themselves were sufficiently related to the debtor and its plan, they were properly brought within the scope of the CCAA plan. The Court said (para. 11):

> In [*Stelco I*] -- the classification case -- the court observed that it is not a proper use of a CCAA proceeding to determine disputes between parties other than the debtor company ... *[H]owever, the present case is not simply an inter-creditor dispute that does not involve the debtor company; it is a dispute that is inextricably connected to the restructuring process.* [Emphasis added.]

89 The approach I would take to the disposition of this appeal is consistent with that view. As I have noted, the third party releases here are very closely connected to the ABCP restructuring process.

90 Some of the appellants -- particularly those represented by Mr. Woods -- rely heavily upon the decision of the Quebec Court of Appeal in *Michaud v. Steinberg, supra*. They say that it is determinative of the release issue. In *Steinberg*, the Court held that the CCAA, as worded at the time, did not permit the release of directors of the debtor corporation and that third-party releases were not within the purview of the Act. Deschamps J.A. (as she then was) said (paras. 42, 54 and 58 -- English translation):

> [42] Even if one can understand the extreme pressure weighing on the creditors and the respondent at the time of the sanctioning, a plan of arrangement is not the appropriate forum to settle disputes other than the claims that are the subject of the arrangement. In other words, one cannot, under the pretext of an absence of formal directives in the Act, transform an arrangement into a potpourri.
>
> ...
>
> [54] The Act offers the respondent a way to arrive at a compromise with is creditors. It does not go so far as to offer an umbrella to all the persons within its orbit by permitting them to shelter themselves from any recourse.
>
> ...
>
> [58] The [CCAA] and the case law clearly do not permit extending the application of an arrangement to persons other than the respondent and its creditors and, consequently, the plan should not have been sanctioned as is [that is, including the releases of the directors].

91 Justices Vallerand and Delisle, in separate judgments, agreed. Justice Vallerand summarized his view of the consequences of extending the scope of the CCAA to third party releases in this fashion (para. 7):

> In short, the Act will have become the Companies' *and Their Officers and Employees* Creditors Arrangement Act -- an awful mess -- and likely not attain its purpose, which is to enable the company to survive in the face of *its* creditors and

> through their will, and not in the face of the creditors of its officers. This is why I feel, just like my colleague, that such a clause is contrary to the Act's mode of operation, contrary to its purposes and, for this reason, is to be banned.

92 Justice Delisle, on the other hand, appears to have rejected the releases because of their broad nature -- they released directors from all claims, including those that were altogether unrelated to their corporate duties with the debtor company -- rather than because of a lack of authority to sanction under the Act. Indeed, he seems to have recognized the wide range of circumstances that could be included within the term "compromise or arrangement". He is the only one who addressed that term. At para. 90 he said:

> The CCAA is drafted in general terms. It does not specify, among other things, what must be understood by "compromise or arrangement". However, it may be inferred from the purpose of this [A]ct that these terms *encompass all that should enable the person who has recourse to it to fully dispose of his debts*, both those that exist on the date when he has recourse to the statute and *those contingent on the insolvency in which he finds himself* ... [Emphasis added.]

93 The decision of the Court did not reflect a view that the terms of a compromise or arrangement should "encompass all that should enable the person who has recourse to [the Act] to dispose of his debts ... and those contingent on the insolvency in which he finds himself," however. On occasion such an outlook might embrace third parties other than the debtor and its creditors in order to make the arrangement work. Nor would it be surprising that, in such circumstances, the third parties might seek the protection of releases, or that the debtor might do so on their behalf. Thus, the perspective adopted by the majority in *Steinberg*, in my view, is too narrow, having regard to the language, purpose and objects of the CCAA and the intention of Parliament. They made no attempt to consider and explain why a compromise or arrangement could not include third-party releases. In addition, the decision appears to have been based, at least partly, on a rejection of the use of contract-law concepts in analysing the Act -- an approach inconsistent with the jurisprudence referred to above.

94 Finally, the majority in *Steinberg* seems to have proceeded on the basis that the CCAA cannot interfere with civil or property rights under Quebec law. Mr. Woods advanced this argument before this Court in his factum, but did not press it in oral argument. Indeed, he conceded that if the Act encompasses the authority to sanction a plan containing third-party releases -- as I have concluded it does -- the provisions of the CCAA, as valid federal insolvency legislation, are paramount over provincial legislation. I shall return to the constitutional issues raised by the appellants later in these reasons.

95 Accordingly, to the extent *Steinberg* stands for the proposition that the court does not have authority under the CCAA to sanction a plan that incorporates third-party releases, I do not believe it to be a correct statement of the law and I respectfully decline to follow it. The modern approach to interpretation of the Act in accordance with its nature and purpose militates against a narrow interpretation and towards one that facilitates and encourages compromises and arrangements. Had the majority in *Steinberg* considered the broad nature of the terms "compromise" and "arrangement" and the jurisprudence I have referred to above, they might well have come to a different conclusion.

<u>The 1997 Amendments</u>

96 *Steinberg* led to amendments to the CCAA, however. In 1997, s. 5.1 was added, dealing specifically with releases pertaining to directors of the debtor company. It states:

> 5.1 (1) A compromise or arrangement made in respect of a debtor company may include in its terms provision for the compromise of claims against directors of the company that arose before the commencement of proceedings under this Act and that relate to the obligations of the company where the directors are by law liable in their capacity as directors for the payment of such obligations.
>
> Exception
>
> (2) A provision for the compromise of claims against directors may not include claims that
>
> (*a*) relate to contractual rights of one or more creditors; or
>
> (*b*) are based on allegations of misrepresentations made by directors to creditors or of wrongful or oppressive conduct by directors.
>
> Powers of court
>
> (3) The court may declare that a claim against directors shall not be compromised if it is satisfied that the compromise would not be fair and reasonable in the circumstances.
>
> Resignation or removal of directors
>
> (4) Where all of the directors have resigned or have been removed by the shareholders without replacement, any person who manages or supervises the management of the business and affairs of the debtor company shall be deemed to be a director for the purposes of this section.

1997, c. 12, s. 122.

97 Perhaps the appellants' strongest argument is that these amendments confirm a prior lack of authority in the court to sanction a plan including third party releases. If the power existed, why would Parliament feel it necessary to add an amendment specifically permitting such releases (subject to the exceptions indicated) in favour of directors? *Expressio unius est exclusio alterius*, is the Latin maxim sometimes relied on to articulate the principle of interpretation implied in that question: to express or include one thing implies the exclusion of the other.

98 The maxim is not helpful in these circumstances, however. The reality is that there *may* be another explanation why Parliament acted as it did. As one commentator has noted:[8]

> Far from being a rule, [the maxim *expressio unius*] is not even lexicographically accurate, because it is simply not true, generally, that the mere express conferral of a right or privilege in one kind of situation implies the denial of the equivalent right or privilege in other kinds. Sometimes it does and sometimes its does not,

> and whether it does or does not depends on the particular circumstances of context. Without contextual support, therefore there is not even a mild presumption here. Accordingly, the maxim is at best a description, after the fact, of what the court has discovered from context.

99 As I have said, the 1997 amendments to the CCAA providing for releases in favour of directors of debtor companies in limited circumstances were a response to the decision of the Quebec Court of Appeal in *Steinberg*. A similar amendment was made with respect to proposals in the BIA at the same time. The rationale behind these amendments was to encourage directors of an insolvent company to remain in office during a restructuring, rather than resign. The assumption was that by remaining in office the directors would provide some stability while the affairs of the company were being reorganized: see Houlden and Morawetz, vol. 1, *supra*, at 2-144, Es.11A; *Le Royal Penfield Inc. (Syndic de)*, [2003] R.J.Q. 2157 at paras. 44-46 (C.S.).

100 Parliament thus had a particular focus and a particular purpose in enacting the 1997 amendments to the CCAA and the BIA. While there is some merit in the appellants' argument on this point, at the end of the day I do not accept that Parliament intended to signal by its enactment of s. 5.1 that it was depriving the court of authority to sanction plans of compromise or arrangement in all circumstances where they incorporate third party releases in favour of anyone other than the debtor's directors. For the reasons articulated above, I am satisfied that the court does have the authority to do so. Whether it sanctions the plan is a matter for the fairness hearing.

The Deprivation of Proprietary Rights

101 Mr. Shapray very effectively led the appellants' argument that legislation must not be construed so as to interfere with or prejudice established contractual or proprietary rights -- including the right to bring an action -- in the absence of a clear indication of legislative intention to that effect: *Halsbury's Laws of England*, 4th ed. reissue, vol. 44 (1) (London: Butterworths, 1995) at paras. 1438, 1464 and 1467; Driedger, 2nd ed., *supra,* at 183; Ruth Sullivan, *Sullivan and Driedger on the Construction of Statutes*, 4th ed., (Markham: Butterworths, 2002) at 399. I accept the importance of this principle. For the reasons I have explained, however, I am satisfied that Parliament's intention to clothe the court with authority to consider and sanction a plan that contains third party releases is expressed with sufficient clarity in the "compromise or arrangement" language of the CCAA coupled with the statutory voting and sanctioning mechanism making the provisions of the plan binding on all creditors. This is not a situation of impermissible "gap-filling" in the case of legislation severely affecting property rights; it is a question of finding meaning in the language of the Act itself. I would therefore not give effect to the appellants' submissions in this regard.

The Division of Powers and Paramountcy

102 Mr. Woods and Mr. Sternberg submit that extending the reach of the CCAA process to the compromise of claims as between solvent creditors of the debtor company and solvent third parties to the proceeding is constitutionally impermissible. They say that under the guise of the federal insolvency power pursuant to s. 91(21) of the *Constitution Act, 1867*, this approach would improperly affect the rights of civil claimants to assert their causes of action, a provincial matter falling within s. 92(13), and contravene the rules of public order pursuant to the *Civil Code of Quebec*.

103 I do not accept these submissions. It has long been established that the CCAA is valid federal legislation under the federal insolvency power: *Reference re: Companies' Creditors Arrangement Act (Canada)*, [1934] S.C.R. 659. As the Supreme Court confirmed in that case (p. 661), citing

Viscount Cave L.C. in *Royal Bank of Canada v. Larue* [1928] A.C. 187, "the exclusive legislative authority to deal with all matters within the domain of bankruptcy and insolvency is vested in Parliament." Chief Justice Duff elaborated:

> Matters normally constituting part of a bankruptcy scheme but not in their essence matters of bankruptcy and insolvency may, of course, from another point of view and in another aspect be dealt with by a provincial legislature; but, when treated as matters pertaining to bankruptcy and insolvency, they clearly fall within the legislative authority of the Dominion.

104 That is exactly the case here. The power to sanction a plan of compromise or arrangement that contains third-party releases of the type opposed by the appellants is embedded in the wording of the CCAA. The fact that this may interfere with a claimant's right to pursue a civil action -- normally a matter of provincial concern -- or trump Quebec rules of public order is constitutionally immaterial. The CCAA is a valid exercise of federal power. Provided the matter in question falls within the legislation directly or as necessarily incidental to the exercise of that power, the CCAA governs. To the extent that its provisions are inconsistent with provincial legislation, the federal legislation is paramount. Mr. Woods properly conceded this during argument.

Conclusion With Respect to Legal Authority

105 For all of the foregoing reasons, then, I conclude that the application judge had the jurisdiction and legal authority to sanction the Plan as put forward.

(2) The Plan is "Fair and Reasonable"

106 The second major attack on the application judge's decision is that he erred in finding that the Plan is "fair and reasonable" and in sanctioning it on that basis. This attack is centred on the nature of the third-party releases contemplated and, in particular, on the fact that they will permit the release of some claims based in fraud.

107 Whether a plan of compromise or arrangement is fair and reasonable is a matter of mixed fact and law, and one on which the application judge exercises a large measure of discretion. The standard of review on this issue is therefore one of deference. In the absence of a demonstrable error an appellate court will not interfere: see *Re Ravelston Corp. Ltd.* (2007), 31 C.B.R. (5th) 233 (Ont. C.A.).

108 I would not interfere with the application judge's decision in this regard. While the notion of releases in favour of third parties -- including leading Canadian financial institutions -- that extend to claims of fraud is distasteful, there is no legal impediment to the inclusion of a release for claims based in fraud in a plan of compromise or arrangement. The application judge had been living with and supervising the ABCP restructuring from its outset. He was intimately attuned to its dynamics. In the end he concluded that the benefits of the Plan to the creditors as a whole, and to the debtor companies, outweighed the negative aspects of compelling the unwilling appellants to execute the releases as finally put forward.

109 The application judge was concerned about the inclusion of fraud in the contemplated releases and at the May hearing adjourned the final disposition of the sanctioning hearing in an effort to encourage the parties to negotiate a resolution. The result was the "fraud carve-out" referred to earlier in these reasons.

110 The appellants argue that the fraud carve-out is inadequate because of its narrow scope. It (i) applies only to ABCP Dealers, (ii) limits the type of damages that may be claimed (no punitive damages, for example), (iii) defines "fraud" narrowly, excluding many rights that would be protected by common law, equity and the Quebec concept of public order, and (iv) limits claims to representations made directly to Noteholders. The appellants submit it is contrary to public policy to sanction a plan containing such a limited restriction on the type of fraud claims that may be pursued against the third parties.

111 The law does not condone fraud. It is the most serious kind of civil claim. There is therefore some force to the appellants' submission. On the other hand, as noted, there is no legal impediment to granting the release of an antecedent claim in fraud, provided the claim is in the contemplation of the parties to the release at the time it is given: *Fotinis Restaurant Corp. v. White Spot Ltd.* (1998), 38 B.L.R. (2d) 251 at paras. 9 and 18 (B.C.S.C.). There may be disputes about the scope or extent of what is released, but parties are entitled to settle allegations of fraud in civil proceedings -- the claims here all being untested allegations of fraud -- and to include releases of such claims as part of that settlement.

112 The application judge was alive to the merits of the appellants' submissions. He was satisfied in the end, however, that the need "to avoid the potential cascade of litigation that ... would result if a broader 'carve out' were to be allowed" (para. 113) outweighed the negative aspects of approving releases with the narrower carve-out provision. Implementation of the Plan, in his view, would work to the overall greater benefit of the Noteholders as a whole. I can find no error in principle in the exercise of his discretion in arriving at this decision. It was his call to make.

113 At para. 71 above I recited a number of factual findings the application judge made in concluding that approval of the Plan was within his jurisdiction under the CCAA and that it was fair and reasonable. For convenience, I reiterate them here -- with two additional findings -- because they provide an important foundation for his analysis concerning the fairness and reasonableness of the Plan. The application judge found that:

a) The parties to be released are necessary and essential to the restructuring of the debtor;
b) The claims to be released are rationally related to the purpose of the Plan and necessary for it;
c) The Plan cannot succeed without the releases;
d) The parties who are to have claims against them released are contributing in a tangible and realistic way to the Plan;
e) The Plan will benefit not only the debtor companies but creditor Noteholders generally;
f) The voting creditors who have approved the Plan did so with knowledge of the nature and effect of the releases; and that,
g) The releases are fair and reasonable and not overly broad or offensive to public policy.

114 These findings are all supported on the record. Contrary to the submission of some of the appellants, they do not constitute a new and hitherto untried "test" for the sanctioning of a plan under the CCAA. They simply represent findings of fact and inferences on the part of the application judge that underpin his conclusions on jurisdiction and fairness.

115 The appellants all contend that the obligation to release the third parties from claims in fraud, tort, breach of fiduciary duty, etc. is confiscatory and amounts to a requirement that they -- as individual creditors -- make the equivalent of a greater financial contribution to the Plan. In his usual lively fashion, Mr. Sternberg asked us the same rhetorical question he posed to the application judge. As he put it, how could the court countenance the compromise of what in the future might turn out to be fraud perpetrated at the highest levels of Canadian and foreign banks? Several appellants complain that the proposed Plan is unfair to them because they will make very little additional recovery if the Plan goes forward, but will be required to forfeit a cause of action against third-party financial institutions that may yield them significant recovery. Others protest that they are being treated unequally because they are ineligible for relief programs that Liquidity Providers such as Canaccord have made available to other smaller investors.

116 All of these arguments are persuasive to varying degrees when considered in isolation. The application judge did not have that luxury, however. He was required to consider the circumstances of the restructuring as a whole, including the reality that many of the financial institutions were not only acting as Dealers or brokers of the ABCP Notes (with the impugned releases relating to the financial institutions in these capacities, for the most part) but also as Asset and Liquidity Providers (with the financial institutions making significant contributions to the restructuring in these capacities).

117 In insolvency restructuring proceedings almost everyone loses something. To the extent that creditors are required to compromise their claims, it can always be proclaimed that their rights are being unfairly confiscated and that they are being called upon to make the equivalent of a further financial contribution to the compromise or arrangement. Judges have observed on a number of occasions that CCAA proceedings involve "a balancing of prejudices," inasmuch as everyone is adversely affected in some fashion.

118 Here, the debtor corporations being restructured represent the issuers of the more than $32 billion in non-bank sponsored ABCP Notes. The proposed compromise and arrangement affects that entire segment of the ABCP market and the financial markets as a whole. In that respect, the application judge was correct in adverting to the importance of the restructuring to the resolution of the ABCP liquidity crisis and to the need to restore confidence in the financial system in Canada. He was required to consider and balance the interests of <u>all</u> Noteholders, not just the interests of the appellants, whose notes represent only about 3% of that total. That is what he did.

119 The application judge noted at para. 126 that the Plan represented "a reasonable balance between benefit to all Noteholders and enhanced recovery for those who can make out specific claims in fraud" within the fraud carve-out provisions of the releases. He also recognized at para. 134 that:

> No Plan of this size and complexity could be expected to satisfy all affected by it. The size of the majority who have approved it is testament to its overall fairness. No plan to address a crisis of this magnitude can work perfect equity among all stakeholders.

120 In my view we ought not to interfere with his decision that the Plan is fair and reasonable in all the circumstances.

D. DISPOSITION

121 For the foregoing reasons, I would grant leave to appeal from the decision of Justice Campbell, but dismiss the appeal.

R.A. BLAIR J.A.
J.I. LASKIN J.A.:-- I agree.
E.A. CRONK J.A.:-- I agree.

* * * * *

SCHEDULE "A" - CONDUITS

Apollo Trust

Apsley Trust

Aria Trust

Aurora Trust

Comet Trust

Encore Trust

Gemini Trust

Ironstone Trust

MMAI-I Trust

Newshore Canadian Trust

Opus Trust

Planet Trust

Rocket Trust

Selkirk Funding Trust

Silverstone Trust

Slate Trust

Structured Asset Trust

Structured Investment Trust III

Symphony Trust

Whitehall Trust

* * * * *

SCHEDULE "B" - APPLICANTS

ATB Financial

Caisse de Dépôt et Placement du Québec

Canaccord Capital Corporation

Canada Post Corporation

Credit Union Central of Alberta Limited

Credit Union Central of British Columbia

Credit Union Central of Canada

Credit Union Central of Ontario

Credit Union Central of Saskatchewan

Desjardins Group

Magna International Inc.

National Bank Financial Inc./National Bank of Canada

NAV Canada

Northwater Capital Management Inc.

Public Sector Pension Investment Board

The Governors of the University of Alberta

* * * * *

SCHEDULE "A" - COUNSEL

1) Benjamin Zarnett and Frederick L. Myers for the Pan-Canadian Investors Committee.
2) Aubrey E. Kauffman and Stuart Brotman for 4446372 Canada Inc. and 6932819 Canada Inc.
3) Peter F.C. Howard and Samaneh Hosseini for Bank of America N.A.; Citibank N.A.; Citibank Canada, in its capacity as Credit Derivative Swap Counterparty and not in any other capacity; Deutsche Bank AG; HSBC Bank Canada; HSBC Bank USA, National Association; Merrill Lynch International; Merill Lynch Capital Services, Inc.; Swiss Re Financial Products Corporation; and UBS AG.
4) Kenneth T. Rosenberg, Lily Harmer and Max Starnino for Jura Energy Corporation and Redcorp Ventures Ltd.
5) Craig J. Hill and Sam P. Rappos for the Monitors (ABCP Appeals).
6) Jeffrey C. Carhart and Joseph Marin for Ad Hoc Committee and Pricewaterhouse Coopers Inc., in its capacity as Financial Advisor.
7) Mario J. Forte for Caisse de Dépôt et Placement du Québec.
8) John B. Laskin for National Bank Financial Inc. and National Bank of Canada.
9) Thomas McRae and Arthur O. Jacques for Ad Hoc Retail Creditors Committee (Brian Hunter, et al).
10) Howard Shapray, Q.C. and Stephen Fitterman for Ivanhoe Mines Ltd.
11) Kevin P. McElcheran and Heather L. Meredith for Canadian Banks, BMO, CIBC RBC, Bank of Nova Scotia and T.D. Bank.

12) Jeffrey S. Leon for CIBC Mellon Trust Company, Computershare Trust Company of Canada and BNY Trust Company of Canada, as Indenture Trustees.
13) Usman Sheikh for Coventree Capital Inc.
14) Allan Sternberg and Sam R. Sasso for Brookfield Asset Management and Partners Ltd. and Hy Bloom Inc. and Cardacian Mortgage Services Inc.
15) Neil C. Saxe for Dominion Bond Rating Service.
16) James A. Woods, Sebastien Richemont and Marie-Anne Paquette for Air Transat A.T. Inc., Transat Tours Canada Inc., The Jean Coutu Group (PJC) Inc., Aéroports de Montréal, Aéroports de Montréal Capital Inc., Pomerleau Ontario Inc., Pomerleau Inc., Labopharm Inc., Agence Métropolitaine de Transport (AMT), Giro Inc., Vêtements de sports RGR Inc., 131519 Canada Inc., Tecsys Inc., New Gold Inc. and Jazz Air LP.
17) Scott A. Turner for Webtech Wireless Inc., Wynn Capital Corporation Inc., West Energy Ltd., Sabre Energy Ltd., Petrolifera Petroleum Ltd., Vaquero Resources Ltd., and Standard Energy Ltd.
18) R. Graham Phoenix for Metcalfe & Mansfield Alternative Investments II Corp., Metcalfe & Mansfield Alternative Investments III Corp., Metcalfe & Mansfield Alternative Investments V Corp., Metcalfe & Mansfield Alternative Investments XI Corp., Metcalfe & Mansfield Alternative Investments XII Corp., Quanto Financial Corporation and Metcalfe & Mansfield Capital Corp.

cp/e/ln/qlkxl/qllkb/qlltl/qlrxg/qlhcs/qlcas/qlhcs/qlhcs

1 Section 5.1 of the CCAA specifically authorizes the granting of releases to directors in certain circumstances.

2 Justice Georgina R. Jackson and Dr. Janis P. Sarra, "Selecting the Judicial Tool to get the Job Done: An Examination of Statutory Interpretation, Discretionary Power and Inherent Jurisdiction in Insolvency Matters" in Sarra, ed., *Annual Review of Insolvency Law, 2007* (Vancouver: Thomson Carswell, 2007).

3 Citing Gibbs J.A. in *Chef Ready Foods, supra,* at pp. 319-320.

4 The Legislative Debates at the time the CCAA was introduced in Parliament in April 1933 make it clear that the CCAA is patterned after the predecessor provisions of s. 425 of the *Companies Act 1985* (U.K.): see *House of Commons Debates (Hansard), supra.*

5 See *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, s. 192; *Ontario Business Corporations Act,* R.S.O. 1990, c. B.16, s. 182.

6 A majority in number representing two-thirds in value of the creditors (s. 6).

7 *Steinberg* was originally reported in French: [1993] R.J.Q. 1684 (C.A.). All paragraph references to *Steinberg* in this judgment are from the unofficial English translation available at 1993 CarswellQue 2055.

8 Reed Dickerson, *The Interpretation and Application of Statutes* (1975) at pp. 234-235, cited in Bryan A. Garner, ed., Black's Law Dictionary, 8th ed. (West Group, St. Paul, Minn., 2004) at 621.

Tab 23

Case Name:

Canwest Global Communications (Re)

IN THE MATTER OF Section 11 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 and the other applicants

[2010] O.J. No. 3233

2010 ONSC 4209

70 C.B.R. (5th) 1

2010 CarswellOnt 5510

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

Ontario Superior Court of Justice
Commercial List

S.E. Pepall J.

Oral judgment: July 28, 2010.

(39 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Sanction by court -- Application by CMI Entities for approval of plan allowed -- Plan contemplated acquisition of Canwest television interests by Shaw subsidiary with proceeds used to satisfy claims of senior subordinated noteholders and additional payment to Monitor to satisfy claims of other affected creditors -- Plan contemplated delisting and extinguishment of equity compensation plans and related options or equity-based awards -- Creditor support for plan was overwhelming -- Plan reflected settlement with existing shareholders -- Plan was fair and reasonable, met statutory requirements and was in public interest -- Plan emergence agreement outlining implementation was also approved -- Companies' Creditors Arrangement Act, s. 6.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act, R.S.C. 1985, c. C-44, s. 173, s. 173(1)(e), s. 173(1)(h), s. 191, s. 191(1)(c), s. 191(2)

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 2, s. 6, s. 6(1), s. 6(2), s. 6(3), s. 6(5), s. 6(6), s. 6(8), s. 11, s. 36

Counsel:

Lyndon Barnes, Jeremy Dacks and Shawn Irving, for the CMI Entities.

David Byers and Marie Konyukhova, for the Monitor.

Robin B. Schwill and Vince Mercier, for Shaw Communications Inc.

Derek Bell, for the Canwest Shareholders Group (the "Existing Shareholders").

Mario Forte, for the Special Committee of the Board of Directors.

Robert Chadwick and Logan Willis, for the Ad Hoc Committee of Noteholders.

Amanda Darrach, for Canwest Retirees.

Peter Osborne, for Management Directors.

Steven Weisz, for CIBC Asset-Based Lending Inc.

REASONS FOR DECISION

1 **S.E. PEPALL J.** (orally):-- This is the culmination of the *Companies' Creditors Arrangement Act*[1] restructuring of the CMI Entities. The proceeding started in court on October 6, 2009, experienced numerous peaks and valleys, and now has resulted in a request for an order sanctioning a plan of compromise, arrangement and reorganization (the "Plan"). It has been a short road in relative terms but not without its challenges and idiosyncrasies. To complicate matters, this restructuring was hot on the heels of the amendments to the CCAA that were introduced on September 18, 2009. Nonetheless, the CMI Entities have now successfully concluded a Plan for which they seek a sanction order. They also request an order approving the Plan Emergence Agreement, and other related relief. Lastly, they seek a post-filing claims procedure order.

2 The details of this restructuring have been outlined in numerous previous decisions rendered by me and I do not propose to repeat all of them.

The Plan and its Implementation

3 The basis for the Plan is the amended Shaw transaction. It will see a wholly owned subsidiary of Shaw Communications Inc. ("Shaw") acquire all of the interests in the free-to-air television stations and subscription-based specialty television channels currently owned by Canwest Television Limited Partnership ("CTLP") and its subsidiaries and all of the interests in the specialty television stations currently owned by CW Investments and its subsidiaries, as well as certain other assets of the CMI Entities. Shaw will pay to CMI US $440 million in cash to be used by CMI to satisfy the claims of the 8% Senior Subordinated Noteholders (the "Noteholders") against the CMI Entities. In the event that the implementation of the Plan occurs after September 30, 2010, an additional cash amount of US $2.9 million per month will be paid to CMI by Shaw and allocated by CMI to the Noteholders. An additional $38 million will be paid by Shaw to the Monitor at the direction of CMI

to be used to satisfy the claims of the Affected Creditors (as that term is defined in the Plan) other than the Noteholders, subject to a pro rata increase in that cash amount for certain restructuring period claims in certain circumstances.

4 In accordance with the Meeting Order, the Plan separates Affected Creditors into two classes for voting purposes:

(a) the Noteholders; and
(b) the Ordinary Creditors. Convenience Class Creditors are deemed to be in, and to vote as, members of the Ordinary Creditors' Class.

5 The Plan divides the Ordinary Creditors' pool into two sub-pools, namely the Ordinary CTLP Creditors' Sub-pool and the Ordinary CMI Creditors' Sub-pool. The former comprises two-thirds of the value and is for claims against the CTLP Plan Entities and the latter reflects one-third of the value and is used to satisfy claims against Plan Entities other than the CTLP Plan Entities. In its 16th Report, the Monitor performed an analysis of the relative value of the assets of the CMI Plan Entities and the CTLP Plan Entities and the possible recoveries on a going concern liquidation and based on that analysis, concluded that it was fair and reasonable that Affected Creditors of the CTLP Plan Entities share pro rata in two-thirds of the Ordinary Creditors' pool and Affected Creditors of the Plan Entities other than the CTLP Plan Entities share pro rata in one-third of the Ordinary Creditors' pool.

6 It is contemplated that the Plan will be implemented by no later than September 30, 2010.

7 The Existing Shareholders will not be entitled to any distributions under the Plan or other compensation from the CMI Entities on account of their equity interests in Canwest Global. All equity compensation plans of Canwest Global will be extinguished and any outstanding options, restricted share units and other equity-based awards outstanding thereunder will be terminated and cancelled and the participants therein shall not be entitled to any distributions under the Plan.

8 On a distribution date to be determined by the Monitor following the Plan implementation date, all Affected Creditors with proven distribution claims against the Plan Entities will receive distributions from cash received by CMI (or the Monitor at CMI's direction) from Shaw, the Plan Sponsor, in accordance with the Plan. The directors and officers of the remaining CMI Entities and other subsidiaries of Canwest Global will resign on or about the Plan implementation date.

9 Following the implementation of the Plan, CTLP and CW Investments will be indirect, wholly-owned subsidiaries of Shaw, and the multiple voting shares, subordinate voting shares and non-voting shares of Canwest Global will be delisted from the TSX Venture Exchange. It is anticipated that the remaining CMI Entities and certain other subsidiaries of Canwest Global will be liquidated, wound-up, dissolved, placed into bankruptcy or otherwise abandoned.

10 In furtherance of the Minutes of Settlement that were entered into with the Existing Shareholders, the articles of Canwest Global will be amended under section 191 of the CBCA to facilitate the settlement. In particular, Canwest Global will reorganize the authorized capital of Canwest Global into (a) an unlimited number of new multiple voting shares, new subordinated voting shares and new non-voting shares; and (b) an unlimited number of new non-voting preferred shares. The terms of the new non-voting preferred shares will provide for the mandatory transfer of the new preferred shares held by the Existing Shareholders to a designated entity affiliated with Shaw for an aggregate amount of $11 million to be paid upon delivery by Canwest Global of the transfer notice

to the transfer agent. Following delivery of the transfer notice, the Shaw designated entity will donate and surrender the new preferred shares acquired by it to Canwest Global for cancellation.

11 Canwest Global, CMI, CTLP, New Canwest, Shaw, 7316712 and the Monitor entered into the Plan Emergence Agreement dated June 25, 2010 detailing certain steps that will be taken before, upon and after the implementation of the plan. These steps primarily relate to the funding of various costs that are payable by the CMI Entities on emergence from the CCAA proceeding. This includes payments that will be made or may be made by the Monitor to satisfy post-filing amounts owing by the CMI Entities. The schedule of costs has not yet been finalized.

Creditor Meetings

12 Creditor meetings were held on July 19, 2010 in Toronto, Ontario. Support for the Plan was overwhelming. 100% in number representing 100% in value of the beneficial owners of the 8% senior subordinated notes who provided instructions for voting at the Noteholder meeting approved the resolution. Beneficial Noteholders holding approximately 95% of the principal amount of the outstanding notes validly voted at the Noteholder meeting.

13 The Ordinary Creditors with proven voting claims who submitted voting instructions in person or by proxy represented approximately 83% of their number and 92% of the value of such claims. In excess of 99% in number representing in excess of 99% in value of the Ordinary Creditors holding proven voting claims that were present in person or by proxy at the meeting voted or were deemed to vote in favour of the resolution.

Sanction Test

14 Section 6(1) of the CCAA provides that the court has discretion to sanction a plan of compromise or arrangement if it has achieved the requisite double majority vote. The criteria that a debtor company must satisfy in seeking the court's approval are:

(a) there must be strict compliance with all statutory requirements;
(b) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and
(c) the Plan must be fair and reasonable.

See *Re: Canadian Airlines Corp.*[2]

(a) Statutory Requirements

15 I am satisfied that all statutory requirements have been met. I already determined that the Applicants qualified as debtor companies under section 2 of the CCAA and that they had total claims against them exceeding $5 million. The notice of meeting was sent in accordance with the Meeting Order. Similarly, the classification of Affected Creditors for voting purposes was addressed in the Meeting Order which was unopposed and not appealed. The meetings were both properly constituted and voting in each was properly carried out. Clearly the Plan was approved by the requisite majorities.

16 Section 6(3), 6(5) and 6(6) of the CCAA provide that the court may not sanction a plan unless the plan contains certain specified provisions concerning crown claims, employee claims and pension claims. Section 4.6 of Plan provides that the claims listed in paragraph (l) of the definition

of "Unaffected Claims" shall be paid in full from a fund known as the Plan Implementation Fund within six months of the sanction order. The Fund consists of cash, certain other assets and further contributions from Shaw. Paragraph (1) of the definition of "Unaffected Claims" includes any Claims in respect of any payments referred to in section 6(3), 6(5) and 6(6) of the CCAA. I am satisfied that these provisions of section 6 of the CCAA have been satisfied.

(b) Unauthorized Steps

17 In considering whether any unauthorized steps have been taken by a debtor company, it has been held that in making such a determination, the court should rely on the parties and their stakeholders and the reports of the Monitor: *Re Canadian Airlines*[3].

18 The CMI Entities have regularly filed affidavits addressing key developments in this restructuring. In addition, the Monitor has provided regular reports (17 at last count) and has opined that the CMI Entities have acted and continue to act in good faith and with due diligence and have not breached any requirements under the CCAA or any order of this court. If it was not obvious from the hearing on June 23, 2010, it should be stressed that there is no payment of any equity claim pursuant to section 6(8) of the CCAA. As noted by the Monitor in its 16th Report, settlement with the Existing Shareholders did not and does not in any way impact the anticipated recovery to the Affected Creditors of the CMI Entities. Indeed I referenced the inapplicability of section 6(8) of the CCAA in my Reasons of June 23, 2010. The second criterion relating to unauthorized steps has been met.

(c) Fair and Reasonable

19 The third criterion to consider is the requirement to demonstrate that a plan is fair and reasonable. As Paperny J. (as she then was) stated in *Re Canadian Airlines*:

> The court's role on a sanction hearing is to consider whether the plan fairly balances the interests of all stakeholders. Faced with an insolvent organization, its role is to look forward and ask: does this plan represent a fair and reasonable compromise that will permit a viable commercial entity to emerge? It is also an exercise in assessing current reality by comparing available commercial alternatives to what is offered in the proposed plan.[4]

20 My discretion should be informed by the objectives of the CCAA, namely to facilitate the reorganization of a debtor company for the benefit of the company, its creditors, shareholders, employees and in many instances, a much broader constituency of affected persons.

21 In assessing whether a proposed plan is fair and reasonable, considerations include the following:

(a) whether the claims were properly classified and whether the requisite majority of creditors approved the plan;
(b) what creditors would have received on bankruptcy or liquidation as compared to the plan;
(c) alternatives available to the plan and bankruptcy;
(d) oppression of the rights of creditors;
(e) unfairness to shareholders; and

(f) the public interest.

22 I have already addressed the issue of classification and the vote. Obviously there is an unequal distribution amongst the creditors of the CMI Entities. Distribution to the Noteholders is expected to result in recovery of principal, pre-filing interest and a portion of post-filing accrued and default interest. The range of recoveries for Ordinary Creditors is much less. The recovery of the Noteholders is substantially more attractive than that of Ordinary Creditors. This is not unheard of. In *Re Armbro Enterprises Inc.*[5] Blair J. (as he then was) approved a plan which included an uneven allocation in favour of a single major creditor, the Royal Bank, over the objection of other creditors. Blair J. wrote:

> "I am not persuaded that there is a sufficient tilt in the allocation of these new common shares in favour of RBC to justify the court in interfering with the business decision made by the creditor class in approving the proposed Plan, as they have done. RBC's cooperation is a sine qua non for the Plan, or any Plan, to work and it is the only creditor continuing to advance funds to the applicants to finance the proposed re-organization."[6]

23 Similarly, in *Re: Uniforêt Inc.*[7] a plan provided for payment in full to an unsecured creditor. This treatment was much more generous than that received by other creditors. There, the Québec Superior Court sanctioned the plan and noted that a plan can be more generous to some creditors and still fair to all creditors. The creditor in question had stepped into the breach on several occasions to keep the company afloat in the four years preceding the filing of the plan and the court was of the view that the conduct merited special treatment. See also Romaine J.'s orders dated October 26, 2009 in *SemCanada Crude Company et al.*

24 I am prepared to accept that the recovery for the Noteholders is fair and reasonable in the circumstances. The size of the Noteholder debt was substantial. CMI's obligations under the notes were guaranteed by several of the CMI Entities. No issue has been taken with the guarantees. As stated before and as observed by the Monitor, the Noteholders held a blocking position in any restructuring. Furthermore, the liquidity and continued support provided by the Ad Hoc Committee both prior to and during these proceedings gave the CMI Entities the opportunity to pursue a going concern restructuring of their businesses. A description of the role of the Noteholders is found in Mr. Strike's affidavit sworn July 20, 2010, filed on this motion.

25 Turning to alternatives, the CMI Entities have been exploring strategic alternatives since February, 2009. Between November, 2009 and February, 2010, RBC Capital Markets conducted the equity investment solicitation process of which I have already commented. While there is always a theoretical possibility that a more advantageous plan could be developed than the Plan proposed, the Monitor has concluded that there is no reason to believe that restarting the equity investment solicitation process or marketing 100% of the CMI Entities assets would result in a better or equally desirable outcome. Furthermore, restarting the process could lead to operational difficulties including issues relating to the CMI Entities' large studio suppliers and advertisers. The Monitor has also confirmed that it is unlikely that the recovery for a going concern liquidation sale of the assets of the CMI Entities would result in greater recovery to the creditors of the CMI Entities. I am not satisfied that there is any other alternative transaction that would provide greater recovery than the recoveries contemplated in the Plan. Additionally, I am not persuaded that there is any oppression of creditor rights or unfairness to shareholders.

26 The last consideration I wish to address is the public interest. If the Plan is implemented, the CMI Entities will have achieved a going concern outcome for the business of the CTLP Plan Entities that fully and finally deals with the Goldman Sachs Parties, the Shareholders Agreement and the defaulted 8% senior subordinated notes. It will ensure the continuation of employment for substantially all of the employees of the Plan Entities and will provide stability for the CMI Entities, pensioners, suppliers, customers and other stakeholders. In addition, the Plan will maintain for the general public broad access to and choice of news, public and other information and entertainment programming. Broadcasting of news, public and entertainment programming is an important public service, and the bankruptcy and liquidation of the CMI Entities would have a negative impact on the Canadian public.

27 I should also mention section 36 of the CCAA which was added by the recent amendments to the Act which came into force on September 18, 2009. This section provides that a debtor company may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. The section goes on to address factors a court is to consider. In my view, section 36 does not apply to transfers contemplated by a Plan. These transfers are merely steps that are required to implement the Plan and to facilitate the restructuring of the Plan Entities' businesses. Furthermore, as the CMI Entities are seeking approval of the Plan itself, there is no risk of any abuse. There is a further safeguard in that the Plan including the asset transfers contemplated therein has been voted on and approved by Affected Creditors.

28 The Plan does include broad releases including some third party releases. In *Metcalfe v. Mansfield Alternative Investments II Corp.*[8], the Ontario Court of Appeal held that the CCAA court has jurisdiction to approve a plan of compromise or arrangement that includes third party releases. The *Metcalfe* case was extraordinary and exceptional in nature. It responded to dire circumstances and had a plan that included releases that were fundamental to the restructuring. The Court held that the releases in question had to be justified as part of the compromise or arrangement between the debtor and its creditors. There must be a reasonable connection between the third party claim being compromised in the plan and the restructuring achieved by the plan to warrant inclusion of the third party release in the plan.

29 In the *Metcalfe* decision, Blair J.A. discussed in detail the issue of releases of third parties. I do not propose to revisit this issue, save and except to stress that in my view, third party releases should be the exception and should not be requested or granted as a matter of course.

30 In this case, the releases are broad and extend to include the Noteholders, the Ad Hoc Committee and others. Fraud, wilful misconduct and gross negligence are excluded. I have already addressed, on numerous occasions, the role of the Noteholders and the Ad Hoc Committee. I am satisfied that the CMI Entities would not have been able to restructure without materially addressing the notes and developing a plan satisfactory to the Ad Hoc Committee and the Noteholders. The release of claims is rationally connected to the overall purpose of the Plan and full disclosure of the releases was made in the Plan, the information circular, the motion material served in connection with the Meeting Order and on this motion. No one has appeared to oppose the sanction of the Plan that contains these releases and they are considered by the Monitor to be fair and reasonable. Under the circumstances, I am prepared to sanction the Plan containing these releases.

31 Lastly, the Monitor is of the view that the Plan is advantageous to Affected Creditors, is fair and reasonable and recommends its sanction. The board, the senior management of the CMI Enti-

ties, the Ad Hoc Committee, and the CMI CRA all support sanction of the Plan as do all those appearing today.

32 In my view, the Plan is fair and reasonable and I am granting the sanction order requested.[9]

33 The Applicants also seek approval of the Plan Emergence Agreement. The Plan Emergence Agreement outlines steps that will be taken prior to, upon, or following implementation of the Plan and is a necessary corollary of the Plan. It does not confiscate the rights of any creditors and is necessarily incidental to the Plan. I have the jurisdiction to approve such an agreement: *Re Air Canada*[10] and *Re Calpine Canada Energy Ltd.*[11] I am satisfied that the agreement is fair and reasonable and should be approved.

34 It is proposed that on the Plan implementation date the articles of Canwest Global will be amended to facilitate the settlement reached with the Existing Shareholders. Section 191 of the CBCA permits the court to order necessary amendments to the articles of a corporation without shareholder approval or a dissent right. In particular, section 191(1)(c) provides that reorganization means a court order made under any other Act of Parliament that affects the rights among the corporation, its shareholders and creditors. The CCAA is such an Act: *Beatrice Foods v. Merrill Lynch Capital Partners Inc.*[12] and *Re Laidlaw Inc*[13]. Pursuant to section 191(2), if a corporation is subject to a subsection (1) order, its articles may be amended to effect any change that might lawfully be made by an amendment under section 173. Section 173(1)(e) and (h) of the CBCA provides that:

> (1) Subject to sections 176 and 177, the articles of a corporation may by special resolution be amended to
>
> (e) create new classes of shares;
> (h) change the shares of any class or series, whether issued or unissued, into a different number of shares of the same class or series or into the same or a different number of shares of other classes or series.

35 Section 6(2) of the CCAA provides that if a court sanctions a compromise or arrangement, it may order that the debtor's constating instrument be amended in accordance with the compromise or arrangement to reflect any change that may lawfully be made under federal or provincial law.

36 In exercising its discretion to approve a reorganization under section 191 of the CBCA, the court must be satisfied that: (a) there has been compliance with all statutory requirements; (b) the debtor company is acting in good faith; and (c) the capital restructuring is fair and reasonable: *Re: A & M Cookie Co. Canada*[14] and *Mei Computer Technology Group Inc.*[15]

37 I am satisfied that the statutory requirements have been met as the contemplated reorganization falls within the conditions provided for in sections 191 and 173 of the CBCA. I am also satisfied that Canwest Global and the other CMI Entities were acting in good faith in attempting to resolve the Existing Shareholder dispute. Furthermore, the reorganization is a necessary step in the implementation of the Plan in that it facilitates agreement reached on June 23, 2010 with the Existing Shareholders. In my view, the reorganization is fair and reasonable and was a vital step in addressing a significant impediment to a satisfactory resolution of outstanding issues.

38 A post-filing claims procedure order is also sought. The procedure is designed to solicit, identify and quantify post-filing claims. The Monitor who participated in the negotiation of the proposed order is satisfied that its terms are fair and reasonable as am I.

39 In closing, I would like to say that generally speaking, the quality of oral argument and the materials filed in this CCAA proceeding has been very high throughout. I would like to express my appreciation to all counsel and the Monitor in that regard. The sanction order and the post-filing claims procedure order are granted.

S.E. PEPALL J.

cp/e/qlafr/qlmxj/qljxr/qlcas/qljyw

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

2 2000 ABQB 442 at para. 60, leave to appeal denied 2000 ABCA 238, aff'd 2001 ABCA 9, leave to appeal to S.C.C. refused July 12, 2001, [2001] S.C.C.A. No 60.

3 Ibid,at para. 64 citing *Olympia and York Developments Ltd. v. Royal Trust Co.* [1993] O.J. No. 545 (Gen. Div.) and *Re: Cadillac Fairview Inc.* [1995] O.J. No. 274 (Gen. Div.).

4 Ibid, at para. 3.

5 (1993), 22 C.B.R. (3rd) 80 (Ont. Gen. Div.).

6 *Ibid*, at para. 6.

7 (2003), 43 C.B.R. (4th) 254 (QUE. S.C.).

8 (2008), 92 O.R. (3rd) 513 (C.A.).

9 The Sanction Order is extraordinarily long and in large measure repeats the Plan provisions. In future, counsel should attempt to simplify and shorten these sorts of orders.

10 (2004), 47 C.B.R. (4th) 169 (Ont. S.C.J.).

11 (2007), 35 C.B.R. (5th) 1.

12 (1996), 43 CBR (4th) 10.

13 (2003), 39 CBR (4th) 239.

14 [2009] O.J. No. 2427 (S.C.J.) at para. 8/

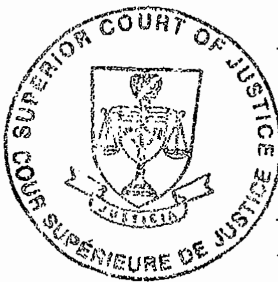
15 [2005] Q.J. No. 22993 at para. 9.

Tab 24

Court File No.: CV-09-00008502-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

THE HONOURABLE MR.	)	WEDNESDAY, THE 16TH DAY
	)	
JUSTICE CAMPBELL	)	OF DECEMBER, 2009



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 ARRANGEMENT AND REORGANIZATION OF ALLEN-VANGUARD CORPORATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND SECTION 186 OF THE ONTARIO *BUSINESS CORPORATIONS ACT*, R.S.O. 1990, c. B.16, AS AMENDED

SANCTION ORDER

THIS MOTION made by Allen-Vanguard Corporation (the "**Applicant**") for an Order pursuant to section 6 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") sanctioning the Applicant's Plan of Arrangement and Reorganization dated December 9, 2009, as amended, and as it may be further amended from time-to-time in accordance with its terms (the "**Plan**") and for ancillary relief associated with the implementation of the Plan, was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Notice of Motion dated December 10, 2009, the affidavit of David E. Luxton sworn December 8, 2009 and the Exhibits thereto, the affidavit of Barry Goldberg, Genuity Capital Markets, sworn December 8, 2009, the affidavit of Glenn Sauntry, BMO Capital Markets, sworn December 8, 2009 and the Exhibit thereto, all filed, and the First and Second Reports of Deloitte & Touche Inc. (the "**Monitor**") in its capacity as Monitor dated December 8, 2009, and December 10, 2009 and the Appendices thereto (the "**Reports**"), all filed, and on being advised by counsel present that the Monitor, the Affected Creditors and the Sponsor (as

defined in the Plan) consent to the relief sought on this motion, and on hearing the submissions of counsel for the Applicant, the Monitor, the Affected Creditors, the Sponsor, Export Development Canada, the directors of the Applicant and for the Plaintiff in the Action (as defined below), no one else appearing although notice and service of this motion was duly and properly given in accordance with the requirements of this Honourable Court's Plan Filing and Meeting Order dated December 9, 2009 (the "**Meeting Order**"), as appears from the Affidavit of Service of David E. Luxton sworn December 14, 2009 (the "**Luxton Affidavit of Service**"):

SERVICE

1. **THIS COURT ORDERS AND DECLARES** that in accordance with the Meeting Order this Motion is properly returnable today and hereby dispenses with further service hereof.

DEFINITIONS

2. **THIS COURT ORDERS** that any capitalized terms not otherwise defined in this Order shall have the meanings ascribed to such terms in the Plan.

SERVICE AND MEETING OF CREDITORS

3. **THIS COURT ORDERS AND DECLARES THAT** the Meeting Order remains in full force and effect, unvaried and unamended.

4. **THIS COURT ORDERS AND DECLARES** that there has been good and sufficient notice of the Meeting (as defined in the Meeting Order) and that the Meeting called pursuant to paragraph 6 of the Meeting Order was duly convened, held and conducted, in conformity with the CCAA and the Meeting Order.

AMENDMENT OF PLAN

5. **THIS COURT ORDERS AND DECLARES** that the amendments to the Plan described in Schedule "B" to this Order (the "**Amendments**") are hereby approved and the Applicant is hereby (a) authorized and directed to forthwith deliver to the Monitor, for posting on the website, an amended version of the Plan adopting and reflecting the Amendments and dated as of the date hereof and (b) deemed to have complied with the requirements of section 9.1 of the Plan and

paragraph 4 of the Plan Filing and Meeting Order concerning amendments to the Plan. (A blackline reflecting the Amendments made to the Plan is enclosed as Schedule "C" to this Order.)

SANCTION OF PLAN

6. **THIS COURT ORDERS AND DECLARES** that:

(a) the Plan has been approved by the requisite majorities of the Affected Creditors present and voting, either in person or by proxy, at the Meeting, all in conformity with the CCAA and the terms of the Initial Order and the Meeting Order;

(b) the Applicant has acted in good faith and with due diligence, has complied with the provisions of the CCAA, and has not done or purported to do (nor does the Plan do or purport to do) anything that is not authorized by the CCAA;

(c) the Applicant has adhered to, and acted in accordance with, all Orders of this Court in the CCAA Proceedings; and

(d) the Plan, together with all of the compromises, arrangements, reorganization, recapitalization, transfers, transactions, corporate transactions, releases and results provided for therein and effected or contemplated thereby are fair, reasonable and in the best interests of the Applicant, the Affected Creditors and the other stakeholders of the Applicant, and does not unfairly disregard the interests of any Person (whether an Affected Creditor or otherwise).

7. **THIS COURT ORDERS** that the Plan, including the compromises, arrangements, reorganization, recapitalization, transfers, transactions, corporate transactions, releases and results provided for therein and effected or contemplated thereby, including the Articles of Reorganization and the Restructuring Documents and the transactions contemplated thereby, be and are hereby sanctioned and approved pursuant to section 6 of the CCAA and, at the Effective Time, will enure to the benefit of, become effective and be binding upon the Applicant, the Affected Creditors, the Sponsor and all other Persons affected thereby, and on their respective heirs, administrators, executors, legal personal representatives, successors and assigns, in the order stipulated in the Plan.

PLAN IMPLEMENTATION

8. **THIS COURT ORDERS** that the Applicant, the Monitor and the Transfer Agent, as the case may be, are authorized and directed to take all steps and actions, and to do all things, necessary or appropriate to enter into or implement the Plan in accordance with its terms, including making the distributions and implementing the transactions contemplated by the Plan, and to enter into, execute, deliver, implement and consummate all of the steps, transactions and agreements contemplated under and pursuant to the Plan, including the Articles of Reorganization and the Restructuring Documents and the transactions contemplated thereby, in accordance with their respective terms.

9. **THIS COURT ORDERS** that in completing the Plan, the Applicant, the Monitor and the Transfer Agent, as the case may be, be and are hereby authorized and directed:

(a) to execute and deliver such additional, related and ancillary documents and assurances governing or giving effect to the Plan, including as set out in or contemplated by the Transaction Agreement, the Restructuring Documents and the Articles of Reorganization, which are reasonably necessary or advisable to conclude the Plan and the transactions contemplated thereby, including the execution of such powers of attorney, conveyances, deeds, releases, bills of sale, transfers, instruments and such other documents, in the name and on behalf of the Applicant or otherwise, as may be reasonably necessary or advisable to effect the Plan and transactions contemplated thereby; and

(b) to take any such steps, actions and proceedings that are reasonably necessary or incidental to conclude the Plan and the transactions contemplated thereby.

10. **THIS COURT ORDERS** that the *Bulk Sales Act*, R.S.O. 1990, c. B-14, as amended, and any other legislation affecting sales in bulk in all jurisdictions in which the Applicant's assets are located do not apply to the Plan, and the Plan may be completed without compliance with any notice, statutory or otherwise, which a creditor or other party may be required to issue in any jurisdiction within which any of the Applicant's assets are located.

11. **THIS COURT ORDERS AND DECLARES** that the reorganization of the capital of the Applicant under section 186 of the *Business Corporations Act* (Ontario), R.S.O. 1990, c. B.16, as amended (the "**OBCA**"), by the (i) cancellation and extinguishment, without a return of capital or any other consideration, of all issued and outstanding Securities; (ii) amendment of the Applicant's Articles of Amalgamation by way of the Articles of Reorganization; and (iii) the issuance of the New Shares to the Sponsor Subsidiary, in the manner set forth in section 8.2(2) of the Plan and the Articles of Reorganization, be and is hereby approved, authorized and directed.

12. **THIS COURT ORDERS** that the Applicant is hereby authorized and directed to file the Articles of Reorganization in the form attached hereto as Schedule "A" with the Director appointed under the OBCA pursuant to section 186(4) of the OBCA prior to closing to reflect the reorganization approved in paragraph 11 above.

13. **THIS COURT ORDERS AND DECLARES** that at the Effective Time, all Securities shall and are hereby cancelled and extinguished without a return of capital or other consideration, compensation or relief of any kind to the holders thereof.

14. **THIS COURT ORDERS AND DECLARES** that at the Effective Time, all Claims against the Applicant (and any successor thereto or the Sponsor Subsidiary) in respect of the Securities (including, without limitation, any Claims against the Applicant resulting from the ownership, purchase or sale of the Securities by any current or former holder thereof, and any Claims for contribution or indemnity against the Applicant in respect of any such Claims) shall be and are hereby discharged and extinguished without a return of capital or other consideration, compensation or relief of any kind to the current or former holders thereof.

15. **THIS COURT ORDERS AND DIRECTS** the Applicant and the Transfer Agent to transfer the Common Shares and to issue the New Shares to the Sponsor Subsidiary pursuant to section 8.2(2) of the Plan and the Articles of Reorganization.

16. **THIS COURTS ORDERS AND DECLARES** that no meetings or votes of any holders of Securities or of Common Shares are required in connection with the Plan or the Reorganization.

17. **THIS COURT ORDERS AND DECLARES** that all New Shares issued to the Sponsor Subsidiary in connection with the Plan are validly issued and outstanding on and as of the Effective Time as fully-paid and non-assessable.

18. **THIS COURT ORDERS AND DECLARES** that at the Effective Time, all Claims against the Applicant (and any successor thereto or the Sponsor Subsidiary) in respect of the Common Shares (including, without limitation, any Claims against the Applicant resulting from the ownership, purchase or sale of the Common Shares by any current or former holder thereof, and any Claims for contribution or indemnity against the Applicant in respect of any such Claims) shall be and are hereby discharged and extinguished without a return of capital or other consideration, compensation or relief of any kind to the current or former holders thereof, and the Transfer Agent shall not be required to distribute the Transfer Price (CDN$ 1.00) to the holders of the Common Shares.

19. **THIS COURT ORDERS AND DECLARES** that, in accordance with the terms of the Plan, and the Articles of Reorganization, the legal and beneficial right, title and interest of the Sponsor Subsidiary in and to the Common Shares shall vest and hereby are vested as of the Effective Time in the Sponsor Subsidiary absolutely and forever, free and clear of and from any and all Claims.

20. **THIS COURT ORDERS** that upon implementation of the Plan in accordance with Section 8.2(2) thereof, the Applicant shall deliver to the Monitor and file with the Court a copy of a certificate stating that all conditions precedent set out in the Plan have been satisfied or waived, the Articles of Reorganization have been filed and have become effective as of the date set out in the Certificate of Amendment, the transactions set out in Section 8.2(2) of the Plan have occurred and become effective, and that the implementation of the Plan shall have occurred in accordance with the Plan at the Effective Time.

21. **THIS COURT ORDERS** that each Contract shall remain in full force and effect and no Person who is a party to any Contract shall, following the Plan Implementation Date, accelerate, terminate, rescind, refuse to perform or repudiate its obligations thereunder, or enforce or exercise any right (including any right of set-off, dilution or other remedy) or make any demand or declare any default, violation or breach under or in respect of any such Contract and no

automatic termination under or in respect of any such Contract will have any validity or effect, by reason:

(a) of the insolvency of the Applicant (or any of its subsidiaries on account of the insolvency of the Applicant) or the fact that the Applicant sought or obtained relief under the CCAA, that the CCAA Proceedings have been commenced or completed, or that the within restructuring or recapitalization has been implemented in respect of the Applicant; or

(b) of any compromises or arrangements effected pursuant to, or in connection with, the Plan or any action taken or transaction effected pursuant to the Plan, the Articles of Reorganization, any of the Restructuring Documents or this Sanction Order, including the change in control of the Applicant or any of its subsidiaries; provided, however, that nothing in this paragraph shall affect or otherwise limit any contractual right that an employee of the Applicant may have with respect to a change in control of the Applicant.

RELEASES, DISCHARGES AND INJUNCTIONS

22. **THIS COURT ORDERS AND DECLARES** that the compromises, arrangements, reorganizations, releases, discharges and other transactions contemplated in and by the Plan, including the Articles of Reorganization and the Restructuring Documents, including those granted by and for the benefit of the Released Parties, are integral components thereof and are necessary for, and vital to, the success of the Plan and that, effective on the Plan Implementation Date, all such releases, discharges and injunctions are hereby sanctioned, approved and given full force and effect in accordance with and subject to their respective terms.

23. **THIS COURT ORDERS** that, without limiting the generality of any provision of this Order or the Plan, immediately upon the Plan Implementation Date having occurred, every Person (regardless of whether or not such Persons are Affected Creditors) hereby fully, finally, irrevocably and unconditionally releases and discharges each of the Released Parties of and from any and all demands, claims, actions (including any class actions or proceedings before an administrative tribunal), causes of action, grievances, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other recoveries on

account of any liability, obligation, demand or cause of action of whatever nature that any such Person may be entitled to assert, including, without limitation, any and all claims for accounting, reconciliation, contribution or indemnity, restitution or otherwise, whether known or unknown, matured or unmatured, direct, indirect or derivative, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing, termination, disclaimer or repudiation of any contract, lease or other agreement, whether written or oral or other occurrence existing or taking place on or prior to the Effective Time relating to, arising out of or in connection with any Affected Claims, the Plan, the Articles of Reorganization, the cancellation of the Securities and the transfer of the Common Shares without consideration, compensation or relief of any kind, the Restructuring Documents, the CCAA Proceedings, the Reorganization or any of the transactions implemented in connection with any of the foregoing (collectively, the "**Released Claims**"); provided, however, that nothing herein shall release or discharge a Released Party: (i) from any of its obligations under the Plan, the Restructuring Documents, the Articles of Reorganization, the Transaction Agreement or any other agreement which the Plan Participants or some of them may have entered into in connection with any of the foregoing; (ii) if such Released Party is adjudged by the express terms of a judgment rendered on a final determination on the merits to have committed gross negligence, fraud or willful misconduct; or (iii) in the case of directors in respect of any claim of the kind referred to in subsection 5.1(2) of the CCAA or (iv) the EDC Claims.

24. **THIS COURT ORDERS** that, without limiting the generality of any provision of this Order or the Plan, immediately upon the Plan Implementation Date having occurred, every Person (regardless of whether or not such Persons are Affected Creditors) hereby fully, finally, irrevocably and unconditionally releases and discharges the Applicant (and any successor thereto or the Sponsor Subsidiary) and the current and former officers and directors thereof of and from any and all demands, claims, actions (including any class actions or proceedings before an administrative tribunal), causes of action, grievances, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature that any such Person may be entitled to assert, including, without limitation, any and all claims for accounting, reconciliation, contribution or indemnity, restitution or otherwise, whether known or unknown, matured or unmatured, direct, indirect or derivative, foreseen or unforeseen, existing or hereafter

arising, based in whole or in part on any act or omission, transaction, dealing, termination, disclaimer or repudiation of any contract or other agreement, whether written or oral or other occurrence existing or taking place on or prior to the Effective Time relating to, arising out of or in connection with any Equity Claims; provided, however, that nothing herein shall release or discharge a director or current or former officer in respect of any claim of the kind referred to in subsection 5.1(2) of the CCAA.

25. **THIS COURT ORDERS** that, without limiting the generality of any provision of this Order or the Plan, immediately upon the Plan Implementation Date having occurred, all Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any and all Released Claims, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Released Parties; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Released Parties or their property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against one or more of the Released Parties; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Released Parties or their property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; provided, however, that the foregoing shall not apply to the enforcement of any obligations under Plan, the Restructuring Documents or the Transaction Agreement or any other agreement which the Plan Participants or some of them may have entered into in connection with any of the foregoing or in respect of any claim against a director of the kind referred to in subsection 5.1(2) of the CCAA.

26. **THIS COURT ORDERS** that, without limiting the generality of any provision of this Order or the Plan, immediately upon the Plan Implementation Date having occurred, all Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any and all Equity Claims, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Applicant (or any successor thereto or the Sponsor Subsidiary) or any current or former officer or director thereof; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Applicant (or any successor thereto or the Sponsor Subsidiary), any current or former officer or director thereof, or their property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against the Applicant (or any successor thereto or the Sponsor Subsidiary) or any current or former officer or director thereof; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Applicant (or any successor thereto or the Sponsor Subsidiary), any current or former officer or director thereof, or their property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; provided, however, that the foregoing shall not apply in respect of any claim against a director or current or former officer of the kind referred to in subsection 5.1(2) of the CCAA.

27. **THIS COURT ORDERS** that, without limiting the generality of any provision of this Order or the Plan, immediately upon the Plan Implementation Date having occurred, all Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any claim of the kind referred to in subsection 5.1(2) of the CCAA, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings

of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Applicant (or any successor thereto or the Sponsor Subsidiary), or its property; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Applicant (or any successor thereto or the Sponsor Subsidiary), or its property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against the Applicant (or any successor thereto or the Sponsor Subsidiary) or its property; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Applicant (or any successor thereto or the Sponsor Subsidiary), or its property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; and that the sole recourse for any such claims against a current or former director or officer of the Applicant as of the date hereof shall be, and is hereby, limited to any recoveries available from the Applicant's insurance policies in respect of its current or former directors or officers, and that the holder of any such valid and proven claim shall be subrogated to the rights of any such director or officer to any insurance coverage available in respect of such a claim.

28. **THIS COURT ORDERS** that, pursuant to paragraphs 14 and 24 of this Order, the action styled as *Laneville v. Allen-Vanguard Corporation*, et al., Court File No. 64170, commenced at London (the "**Action**") is hereby dismissed without costs as against the Applicant. Notwithstanding the dismissal of the Action as against the Applicant and the full release of the Applicant from the claims in the Action pursuant to the Plan and this Order, the Applicant shall preserve all documentation within its possession, power and control relevant to the Action, pending further Order of the Court. This Order is without prejudice to: (a) the Plaintiff in the Action requesting documentary discovery and oral discovery of a representative of the Applicant under the provisions of R. 30.10 and R. 31.10 of the *Rules of Civil Procedure*; (b) the Plaintiff in the Action serving a summons to witness on an employee of the Applicant under the provisions

of R. 39.03 of the *Rules of Civil Procedure*; and (c) the Applicant's rights in responding to any such actions.

DISCHARGE OF MONITOR

29. **THIS COURT ORDERS** that as of the Effective Time, the Monitor shall be discharged and released and shall have no further obligations and responsibilities, save and expect with respect to any remaining duties and responsibilities required to give effect to the terms of the Plan and this Order.

30. **THIS COURT ORDERS** that the completion of the Monitor's duties shall be evidenced, and its final discharge shall be effected by the Monitor filing a certificate of discharge with this Court.

31. **THIS COURT ORDERS AND DECLARES** that the actions and conduct of the Monitor in the CCAA Proceedings are hereby approved and that the Monitor has satisfied all of its obligations up to and including the date of this Sanction Order, and that in addition to the protections in favour of the Monitor as set out in the Initial Order, the Monitor shall not be liable for any act or omission on the part of the Monitor, including with respect to any reliance thereof, including without limitation, with respect to any information disclosed, any act or omission pertaining to the discharge of duties under the Plan or as requested by the Applicant or with respect to any other duties or obligations in respect of the implementation of the Plan, save and except for any claim or liability arising out of any gross negligence or willful misconduct on the part of the Monitor. Subject to the foregoing, and in addition to the protections in favour of the Monitor as set out in the Orders of this Court, any Claims against the Monitor in connection with the performance of its duties as Monitor are hereby released, stayed, extinguished and forever barred and the Monitor shall have no liability in respect thereof.

32. **THIS COURT ORDERS** that no action or other proceeding shall be commenced against the Monitor in any way arising from or related to its capacity or conduct as Monitor except with prior leave of this Court and on prior written notice to the Monitor and such further order securing, as security for costs, the solicitor and his own client costs of the Monitor in connection with any proposed action or proceeding as the Court hearing the motion for leave to proceed may deem just and appropriate.

33. **THIS COURT ORDERS** that the Reports of the Monitor and the activities of the Monitor referred to therein be and are hereby approved.

CCAA CHARGES

34. **THIS COURT ORDERS** that the Director's Charge (as such term is defined in the Initial Order) is hereby discharged and released and of no further force or effect as of the Effective Time.

35. **THIS COURT ORDERS** that on the Plan Implementation Date, or as soon as reasonably practicable thereafter, the Applicant shall pay all professional fees and disbursements incurred at their standard rates due to the Monitor, counsel for the Monitor and counsel for the Applicant in respect of these proceedings for the period up to and including the Plan Implementation Date, to the extent not already paid in accordance with the terms of the Initial Order, and upon such payments having been made by the Applicant, the Monitor shall file an acknowledgment confirming same with the Court (with a copy to the Sponsor) at which time the Administration Charge (as such term is defined in the Initial Order) shall hereby be discharged and released and of no further force or effect or, failing the filing of such acknowledgement by the Monitor, at such time as determined by this Honourable Court.

INITIAL ORDER AND OTHER ORDERS

36. **THIS COURT ORDERS** that:

(a) except to the extent that the Initial Order has been varied by or is inconsistent with this Order or any further Order, the provisions of the Initial Order shall remain in full force and effect until the Effective Time; provided that the protection granted in favour of the Monitor in the Initial Order shall continue in full force and effect after the Effective Time;

(b) the stay of proceedings set out in the Initial Order is hereby extended until the Effective Time without further order of this Court.

EFFECT, RECOGNITION, ASSISTANCE

37. **THIS COURT ORDERS** that this Order shall have full force and effect in all provinces and territories in Canada, outside Canada and against all Persons against whom it may otherwise be enforceable.

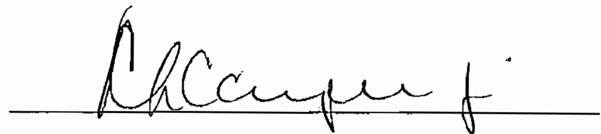
38. **THIS COURT REQUESTS** the aid, recognition and assistance of other courts in Canada in accordance with Section 17 of the CCAA and requests that the Federal Court of Canada and the courts and judicial, regulatory and administrative bodies of or by the provinces and territories of Canada, the Parliament of Canada, the United States of America, the states and other subdivisions of the United States of America including, without limitation, the U.S. District Court, the United Kingdom, Ireland, India and other nations and states act in aid, recognition and assistance of, and be complementary to, this Court in carrying out the terms of this Order and any other Order in this proceeding. Each of the Applicant, the Monitor and the Sponsor shall be at liberty, and is hereby authorized and empowered, to make such further applications, motions or proceedings to or before such other court and judicial, regulatory and administrative bodies, and take such other steps, in Canada, the United States of America, the United Kingdom, Ireland, India, and other nations as may be necessary or advisable to give effect to this Order.

39. **THIS COURT ORDERS** that, in the event that the Affected Creditors and the Sponsor cannot resolve the quantum of the equity injection to be made by the Sponsor pursuant to the Transaction Agreement prior to the Effective Time, such quantum shall be determined by this Honourable Court on an expedited basis (within thirty days or less, subject to Court availability) on a mutually agreed timetable and process between the Affected Creditors and the Sponsor. Prior to the Effective Time, the Affected Creditors, the Sponsor and the Allen-Vanguard Parties shall agree on amended terms to the Credit Agreement and any other agreements among them required to outline the mechanism to resolve the quantum of the equity injection and related matters.

ENTERED AT / INSCRIT À TORONTO
ON / BOOK NO:
LE / DANS LE REGISTRE NO.:

DEC 16 2009

PER / PAR: JSN Joanne Nicoara
Registrar, Superior Court of Justice



Schedule "A"

Articles of Reorganization

For Ministry Use Only
À l'usage exclusif du ministère

Ontario Corporation Number
Numéro de la société en Ontario

1633813

Form 9
Business Corporations Act

Formule 9
Loi sur les sociétés par actions

ARTICLES OF REORGANIZATION
STATUTS DE RÉORGANISATION

1. The name of the corporation is: (Set out in BLOCK CAPITAL LETTERS)
Dénomination sociale de la société : (Écrire en LETTRES MAJUSCULES SEULEMENT) :

ALLEN-VANGUARD CORPORATION

2. The new name of the corporation if changed by the reorganization: (Set out in BLOCK CAPITAL LETTERS)
Nouvelle dénomination sociale de la société si elle est modifiée par suite de la réorganisation : (Écrire en LETTRES MAJUSCULES SEULEMENT) :

3. Date of incorporation/amalgamation: / *Date de la constitution ou de la fusion :*

2005 February 10

Year, Month, Day / *année, mois, jour*

4. The reorganization was ordered by the court on / *La cour a ordonné la réorganisation le*

[DATE TO BE INSERTED PRIOR TO FILING]

Year, Month, Day / *année, mois, jour*

and a certified copy of the Order of the court is attached to these articles as Exhibit "A". / *une copie certifiée conforme de l'ordonnance de la cour constitue l'annexe «A».*

5. In accordance with the Order for reorganization the articles of the corporation are amended as follows:
Conformément à l'ordonnance de réorganisation, les statuts de la société sont modifiés de la façon suivante :

Amend the rights, privileges, restrictions and conditions attaching to the common shares by adding the provisions set out in Schedule 1 and Schedule 2 which are attached to these articles.

SCHEDULE 1
TO THE ARTICLES OF REORGANIZATION OF
ALLEN-VANGUARD CORPORATION

The additional rights, privileges, restrictions and conditions attaching to the common shares as a class shall be as follows:

1. Defined Terms

For the purposes of paragraphs 2 and 3 hereof:

(a) "**Corporation**" means Allen-Vanguard Corporation;

(b) "**Contego AV**" means Contego AV Luxembourg S.à r.l., a Luxembourg S.à r.l.;

(c) "**Transfer**" has the meaning ascribed to such term in paragraph 2(b) hereof;

(d) "**Transfer Agent**" means CIBC Mellon Trust Company;

(e) "**Transfer Date**" means the date upon which the Transfer Notice is delivered to the Transfer Agent in accordance with paragraph 2(a) hereof;

(f) "**Transfer Price**" means $1.00;

(g) "**Transfer Notice**" means the notice advising of the Transfer, substantially in the form attached hereto as Schedule 2; and

(h) "**Transfer Time**" means the time the Transfer Notice is delivered to the Transfer Agent on the Transfer Date in accordance with paragraph 2(a) hereof.

2. Transfer

(a) At any time, the Corporation may cause the Transfer through the delivery by the Corporation of the Transfer Notice to the Transfer Agent by hand delivery to an authorized signing officer of the Transfer Agent, which delivery shall be deemed to be delivery of the Transfer Notice to each holder of common shares of the Corporation, with a copy to Contego AV by delivery to an authorized signing officer of Contego AV.

(b) In the event the Transfer Notice is delivered by the Corporation in accordance with paragraph 2(a) hereof, at the Transfer Time, each holder of common shares shall be deemed to have transferred, to Contego AV all of such person's right, title and interest in and to its common shares and Contego AV shall acquire, and shall be deemed to have acquired, from each such holder of common shares all, but not less than all, of the common shares held by each such holder (which transfer and acquisitions are referred to herein as the "**Transfer**") and, at the Transfer Time, each holder of common shares shall not be entitled to exercise any of the rights of a holder of common shares in respect thereof other than the right to receive its pro rata share of the Transfer Price for the common shares.

(c) Contego AV shall, on the Transfer Date, deposit with, or otherwise cause to be deposited with, the Transfer Agent sufficient funds to pay the Transfer Price to the holders of the common shares and, in the event that the Transfer Notice is delivered by the Corporation in accordance with paragraph 2(a) hereof, such deposit shall constitute a full and complete discharge of Contego AV's obligation to pay the Transfer Price to the holders of the common shares. On and after the Transfer Time, any such money deposited with the Transfer Agent shall be held by the Transfer Agent as agent for the holders of the common shares, and receipt of payment by the Transfer Agent shall be deemed to constitute payment of the Transfer Price to the holders of the common shares for all of the common shares transferred pursuant to the Transfer. The holders of the common shares transferred pursuant to the Transfer shall be entitled to receive their pro rata share of the Transfer Price (rounded down to the nearest $0.01), without interest, for the common shares so transferred, (i) on presentation and surrender of the certificate or certificates representing all common shares held by such holder (or, in respect of any such certificate or certificates which have been lost, destroyed or wrongfully taken, an indemnity bond together with an affidavit confirming ownership, each in a form satisfactory to Contego AV, acting reasonably) or any other evidence of ownership with respect to the common shares which is satisfactory to Contego AV, acting reasonably, and (ii) on presentation of a fully completed and duly executed letter of transmittal in a form acceptable to Contego AV and the Transfer Agent, acting reasonably, provided that no holder shall be entitled to receive an amount less than $0.01. Should any holder of any common shares transferred pursuant to the Transfer fail to present and surrender the above mentioned documentation, Contego AV shall have the right, after four (4) years from the Transfer Date, to have all remaining funds deposited with the Transfer Agent returned to Contego AV and Contego AV shall thereafter be responsible for payment of the Transfer Price to any former holder of a common share upon presentation and surrender of such documentation as Contego AV may require.

3. If the Transfer Notice has not been delivered to the Transfer Agent in accordance with paragraph 2(a) hereof on or prior to 11:59 p.m. on the date that is two (2) business days after the date on which the certificate of amendment is received by the Corporation from the Ministry of Government Services, the provisions of paragraphs 1 and 2 hereof shall be of no force or effect.

SCHEDULE 2
TO THE ARTICLES OF REORGANIZATION OF
ALLEN-VANGUARD CORPORATION

TRANSFER NOTICE

TO: CIBC Mellon Trust Company

COPY TO: Contego AV Luxembourg S.à r.l.

FROM: Allen-Vanguard Corporation

DATE: **[insert date]**

All capitalized terms in this Transfer Notice that are not defined herein have the meaning ascribed to such terms in the share provisions attaching to the common shares of Allen-Vanguard Corporation.

In accordance with the share provisions attaching to the common shares, Allen-Vanguard Corporation hereby gives notice to the Transfer Agent and Contego AV Luxembourg S.à r.l. of the Transfer.

ALLEN-VANGUARD CORPORATION

Per: ______________________________
Name:
Title:

Date on which this Transfer Notice is delivered to the Transfer Agent: ________________

Time on the Transfer Date this Transfer Notice is delivered to the Transfer Agent: _________

6. The terms and conditions to which the reorganization is made subject by the Order have been complied with.
Les conditions que l'ordonnance impose à la réorganisation ont été respectées.

These articles are submitted under section 186 of the *Business Corporations Act* and are signed in duplicate.
Les présents statuts sont déposés en vertu de l'article 186 de la Loi sur les sociétés par actions. *Ils sont signés en double exemplaire.*

ALLEN-VANGUARD CORPORATION

Name of Corporation / *Dénomination sociale de la société*

By/
Par :

[TO BE COMPLETED]

Signature / *Signature*

Description of Office / *Fonction*

EXHIBIT A
TO THE ARTICLES OF REORGANIZATION OF
ALLEN-VANGUARD CORPORATION

CERTIFIED COPY OF THE ORDER OF THE COURT

Schedule "B"

Amendments

Section 8.6(i)

- **Delete current section 8.6(i) and replace with:**

(i) At the Effective Time, the Released Parties will be released and discharged or deemed to be released and discharged by each of the other Released Parties and all Affected Creditors and all other Persons from any and all demands, claims, actions (including any class actions or proceedings before an administrative tribunal), causes of action, grievances, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature that any such Person may be entitled to assert, including, without limitation, any and all claims for accounting, reconciliation, contribution or indemnity, restitution or otherwise, whether known or unknown, matured or unmatured, direct, indirect or derivative, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing, termination, disclaimer or repudiation of any contract, lease or other agreement, whether written or oral or other occurrence existing or taking place on or prior to the Effective Time relating to, arising out of or in connection with any Affected Claims, this Plan, the Articles of Reorganization, the cancellation of the Securities and the transfer of the Common Shares without consideration, compensation or relief of any kind, the Restructuring Documents, the CCAA Proceedings, the Reorganization or any of the transactions implemented in connection with any of the foregoing (collectively, the "**Released Claims**"); provided, however, that nothing herein shall release or discharge a Released Party: (i) from any of its obligations under the Plan, the Restructuring Documents, the Articles of Reorganization, the Transaction Agreement or any other agreement which the Plan Participants or some of them may have entered into in connection with any of the foregoing; (ii) if such Released Party is adjudged by the express terms of a judgment rendered on a final determination on the merits to have committed gross negligence, fraud or willful misconduct; or (iii) in the case of directors in respect of any claim of the kind referred to in subsection 5.1(2) of the CCAA or (iv) the EDC Claims.

Section 8.6(ii)

- **Delete current section 8.6(ii) and replace with:**

(ii) At the Effective Time, the Company and the current and former officers and directors thereof will be released and discharged or deemed to be released and discharged by each other and all Affected Creditors and all other Persons from any and all demands, claims, actions (including any class actions or proceedings before an administrative tribunal), causes of action, grievances, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other

recoveries on account of any liability, obligation, demand or cause of action of whatever nature that any such Person may be entitled to assert, including, without limitation, any and all claims for accounting, reconciliation, contribution or indemnity, restitution or otherwise, whether known or unknown, matured or unmatured, direct, indirect or derivative, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing, termination, disclaimer or repudiation of any contract, lease or other agreement, whether written or oral or other occurrence existing or taking place on or prior to the Effective Time relating to, arising out of or in connection with any Equity Claims; provided, however, that nothing herein shall release a director or current or former officer in respect of any claim of the kind referred to in subsection 5.1(2) of the CCAA.

Section 8.7(ii)

- **Delete current section 8.7(ii) and replace with:**

  (ii) All Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any and all Equity Claims, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Company (or any successor thereto or the Sponsor Subsidiary) or any current or former officer or director thereof; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Company (or any successor thereto or the Sponsor Subsidiary), any current or former officer or director thereof, or their property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against the Company (or any successor thereto or the Sponsor Subsidiary) or any current or former officer or director thereof; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Company (or any successor thereto or the Sponsor Subsidiary), any current or former officer or director thereof, or their property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; provided, however, that the foregoing shall not apply in respect of any claim against a director or current or former officer of the kind referred to in subsection 5.1(2) of the CCAA.

Section 8.7(iii)

- **Delete current section 8.7(iii) and replace with:**

(iii) All Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any claim of the kind referred to in subsection 5.1(2) of the CCAA, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Company (or any successor thereto or the Sponsor Subsidiary) or its property; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Company (or any successor thereto or the Sponsor Subsidiary) or its property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against the Company (or any successor thereto or the Sponsor Subsidiary) or its property; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Company (or any successor thereto or the Sponsor Subsidiary) or its property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; and the sole recourse for any such claims against a current or former director or officer of the Company as of the date hereof shall be, and is hereby, limited to any recoveries available from the Company's insurance policies in respect of its current or former directors or officers, and that the holder of any such valid and proven claim shall be subrogated to the rights of any such director or officer to any insurance coverage available in respect of such a claim.

Schedule "C"

Blackline of Amendments

Section 8.6(i):

(i) At the Effective Time, the Released Parties will be released and discharged or deemed to be released and discharged by each of the other Released Parties and all Affected Creditors and all other Persons from any and all demands, claims, actions (including any class actions or proceedings before an administrative tribunal), causes of action, grievances, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature that any such Person may be entitled to assert, including, without limitation, any and all claims for accounting, reconciliation, contribution or indemnity, restitution or otherwise, whether known or unknown, matured or unmatured, direct, indirect or derivative, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing, termination, disclaimer or repudiation of any contract, lease or other agreement, whether written or oral or other occurrence existing or taking place on or prior to the Effective Time relating to, arising out of or in connection with any Affected Claims, this Plan, the Articles of Reorganization, the cancellation of the Securities and the transfer of the Common Shares without consideration, compensation or relief of any kind, the Restructuring Documents, the CCAA Proceedings, the Reorganization or any of the transactions implemented in connection with any of the foregoing (collectively, the "**Released Claims**"); provided, however, that nothing herein shall release or discharge a Released Party: (i) from any of its obligations under the Plan, the Restructuring Documents, the Articles of Reorganization, the Transaction Agreement or any other agreement which the Plan Participants or some of them may have entered into in connection with any of the foregoing; (ii) if such Released Party is adjudged by the express terms of a judgment rendered on a final determination on the merits to have committed gross negligence, fraud or willful misconduct; or (iii) in the case of directors in respect of any claim of the kind referred to in subsection 5.1(2) of the CCAA or (iv) the EDC Claims.

Section 8.6(ii):

(ii) At the Effective Time, the Company and the current and former officers and directors thereof will be released and discharged or deemed to be released and discharged by each other and all Affected Creditors and all other Persons from any and all demands, claims, actions (including any class actions or proceedings before an administrative tribunal), causes of action, grievances, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, liens and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature that any such Person may be entitled to assert, including, without limitation, any and all claims for accounting, reconciliation, contribution or indemnity, restitution or otherwise, whether known or unknown, matured or unmatured, direct, indirect or

derivative, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing, termination, disclaimer or repudiation of any contract, lease or other agreement, whether written or oral or other occurrence existing or taking place on or prior to the Effective Time relating to, arising out of or in connection with any Equity Claims; provided, however, that nothing herein shall release a director or current or former officer in respect of any claim of the kind referred to in subsection 5.1(2) of the CCAA.

Section 8.7(ii):

(ii) All Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any and all Equity Claims, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Company (or any successor thereto or the Sponsor Subsidiary) or any current or former officer or director thereof; (ii) enforcing, levying, attaching, collecting or otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Company (or any successor thereto or the Sponsor Subsidiary), any current or former officer or director thereof, or their property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against the Company (or any successor thereto or the Sponsor Subsidiary) or any current or former officer or director thereof; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Company (or any successor thereto or the Sponsor Subsidiary), any current or former officer or director thereof, or their property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; provided, however, that the foregoing shall not apply in respect of any claim against a director or current or former officer of the kind referred to in subsection 5.1(2) of the CCAA.

Section 8.7(iii):

(iii) All Persons (regardless of whether or not such Persons are Affected Creditors) are permanently and forever barred, estopped, stayed and enjoined, on and after the Effective Time, with respect to any claim ~~against a current or former director of the Company as of the date hereof~~ of the kind referred to in subsection 5.1(2) of the CCAA, from (i) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits, demands or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against the Company (or any successor thereto or the Sponsor Subsidiary) or ~~any current or former officer thereof~~its property; (ii) enforcing, levying, attaching, collecting or

otherwise recovering or enforcing by any manner or means, directly or indirectly, any judgment, award, decree or order against the Company (or any successor thereto or the Sponsor Subsidiary)~~, any current or former officer thereof, or their~~ or its property; (iii) commencing, conducting or continuing in any manner, directly or indirectly, any action, suits or demands, including without limitation, by way of contribution or indemnity or other relief, in common law, or in equity, breach of trust or breach of fiduciary duty or under the provisions of any statute or regulation, or other proceedings of any nature or kind whatsoever (including, without limitation, any proceeding in a judicial, arbitral, administrative or other forum) against any Person who makes such a claim or might reasonably be expected to make such a claim, in any manner or forum, against the Company (or any successor thereto or the Sponsor Subsidiary) or ~~any current or former officer thereof~~its property; (iv) creating, perfecting, asserting or otherwise enforcing, directly or indirectly, any lien or encumbrance of any kind against the Company (or any successor thereto or the Sponsor Subsidiary)~~, any current or former officer thereof, or their~~ or its property; or (v) taking any actions to interfere with the implementation or consummation of this Plan; and the sole recourse for any such claims against a current or former director or officer of the Company as of the date hereof shall be, and is hereby, limited to any recoveries available from the Company's insurance policies in respect of its current or former directors or officers, and that the holder of any such valid and proven claim shall be subrogated to the rights of any such director or officer to any insurance coverage available in respect of such a claim.

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 ARRANGEMENT AND REORGANIZATION OF ALLEN-VANGUARD CORPORATION UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED AND SECTION 186 OF THE ONTARIO *BUSINESS CORPORATIONS ACT*, R.S.O. 1990, c. B.16, AS AMENDED

Court File No. CV-09-00008502-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

SANCTION ORDER

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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 OR COMPROMISE OR ARRANGEMENT OF SINO-FOREST CORPORATION

Court File No.

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceedings commenced in Toronto

BRIEF OF AUTHORITIES
OF THE APPLICANT,
SINO-FOREST CORPORATION
(Motion for Plan Filing and Meeting Order Returnable August 28, 2012)

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