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 UNDERWRITERS NAMED IN CLASS ACTIONS

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LIST OF AUTHORITIES

1. *Re Campeau Corp.* (1992), 10 C.B.R. (3d) 104 (Ont. C.J. (Gen. Div.))

2. *Re First Marathon Inc.*, [1999] O.J. No. 2805 (Ont. S.C.J.)

3. *Re Armbro Enterprises Inc.* (1993), 22 C.B.R. (3d) 80 (Ont. C.J. (Gen. Div.))

4. *Re Canadian Airlines Corp.* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B)

5. *Re Woodward's Ltd.* (1993), 20 C.B.R. (3d) 74 (B.C.S.C.)

6. *Re 229531 B.C. Ltd.* (1989), 72 C.B.R. (N.S.) 310 (B.C. S.C.)

7. *Re San Francisco Gifts Ltd.* (2004), 5 C.B.R. (5th) 92 (Alta. Q.B.)

8. *Re NsC Diesel Power Incorporated* (1990), 79 C.B.R. (N.S.) 1 (N.S. S.C.)

TAB 1

C

1992 CarswellOnt 161, 10 C.B.R. (3d) 104

Campeau Corp., Re

Re PROPOSED PLAN OF ARRANGEMENT FOR CREDITORS AND SHAREHOLDERS OF CAMPEAU CORPORATION; Re CAMPEAU CORPORATION (Applicant)

Ontario Court of Justice (General Division)

Farley J.

Heard: February 6, 1992
Judgment: February 10, 1992
Docket: Doc. B298/91

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Counsel: *K.P. McElcheran* and *P. Slayton*, for Campeau Corporation.

H. Fogul, for Mondev International Ltd.

J. Gilbert Van Allen and John Andrachuk, in person.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Approval by Court — "Fair and reasonable".

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Criteria to be considered by court in exercising discretion to approve proposed plan set out — Court sanctioning plan of creditors and shareholders — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

In exercising its discretion to approve a proposed plan of arrangement for the shareholders of a corporation, the court should consider three criteria: "(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*; and (3) the Plan must be fair and reasonable."

Cases considered:

Campeau Corp., Re (1990), 10 C.B.R. (3d) 100, 86 D.L.R. (4th) 570 (Ont. Gen. Div.), leave to appeal to Ont. C.A. refused (1992), 10 C.B.R. (3d) 100n, 86 D.L.R. (4th) 570n, leave to appeal to S.C.C. refused (1992), 10 C.B.R. (3d) 100n, 86 D.L.R. (4th) 570n — *referred to*

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Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd. (1988), 71 C.B.R. (N.S.) 20, 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566 (Q.B.) — *considered*

Northland Properties Ltd., Re (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.) — *applied*

Quintette Coal Ltd., Re (1991), 7 C.B.R. (3d) 165, (sub nom. *Quintette Coal Ltd. v. Nippon Steel Corp.*) 56 B.C.L.R. (2d) 80 (S.C.) — *referred to*

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

Statutes considered:

Bankruptcy Code of 1978 —

11 U.S.C. 1129

Business Corporations Act, 1982, S.O. 1982, c. 4 [now R.S.O. 1990, c. B.16].

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

Motion for approval of proposed plan of arrangement.

***Farley J.*:**

1 This matter was heard by me on Thursday, February 6, 1992, on the understanding that I would not release my decision pending the determination of a proceedings brought by Mondev International Ltd. re stay and leave to appeal in the Supreme Court of Canada. I now have been advised that these proceedings have been dismissed on Friday.

2 Approvals of plans under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 ("C.C.A.A.") and the *Business Corporations Act, 1982*, S.O. 1982, c. 4 involve compliance with various procedural requirements either directly under that legislation or flowing from directions received from the court pursuant to those Acts. In this regard I am satisfied that appropriate notices were given pursuant to the various orders that I gave both as to material by mail and advice by newspaper publication. The information circular and related materials were in the general form approved.

3 I am also satisfied that the meetings of the various groups of creditors and shareholders (as categorized under the original order and not successfully challenged) were regularly called in accordance with the requirements. In all categories a quorum as required was present. The vote by category was also substantially in favour of the plan. This may be summarized as follows:

Category	$(1000s)	Present % by $ for debt & by No. of shares for share-holders	Affirmative vote of those present % by $ by debt and by No. of shares for shareholders
Secured Debt	488,170	99.6%	100%
Senior Unsecured Debt	190,735	100%	93.94%<*>

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7 1/2% Debentures	174,550	81%	98.7%
7% Debentures	382,822	100%	100%
Preferred Shares	N/A	64.3%	98%<**>
Common Shares	N/A	63.6%	88%

<*> Mondev International Ltd. abstaining
<**> 95% of series B, C and D Preferred Shares

4 I am further advised that orders of the United States Bankruptcy Court, Southern District of Ohio, Western Division, under s. 1129 of the *Bankruptcy Code* of the United States confirming the Federated Stores Inc., etc., plan and the Allied Stores Corporation — Federated Department Stores Inc., etc., plan (a prerequisite to this plan) have now issued and further that all necessary and contemplated regulatory reviews, consents and approvals (and specifically stock exchange conditional approval for listing) have been obtained or completed to the extent feasible. Notices of the hearing for a final order sanctioning the plan were published in the national edition of *The Globe and Mail* and the *Wall Street Journal* on January 27, 1992.

5 I am therefore satisfied that all procedural requirements under the legislation and orders have been satisfied.

6 It then comes down to the question of whether I come to the conclusion that the plan is fair and reasonable in respect of each of the categories of creditors and shareholders. It was opposed on that basis by Mondev, J. Gilbert Van Allen and John Andrachuk. I am mindful of the applicant's financial difficulties. It is obvious that with its condition of insolvency as demonstrated there would be nothing for the shareholders on a liquidation; the same holds true for the debentureholders. A result that the plan gives them something rather than nothing in a looming liquidation is axiomatically one that is fair and reasonable for those categories if their interest alone is looked at.

7 I note that the applicant's board (with the exception of Robert Campeau who voted against and one of his nominees, Patrick Kelly, who abstained) voted in favour of the plan after a year-and-a-half of the applicant's management, board and professional advisors trying to find a solution to the applicant's financial dilemma. This vote included all of the independent directors on the board (independent of the Olympia & York group and of Robert Campeau) who were involved in reviewing the RBC Dominion's Securities Inc. fairness (fair from a financial point of view to holders of public securities) opinion. This committee of independent directors also had the advantage of Richardson Greenshields of Canada Limited's advice as to the RBC Dominion's employing standard procedures, criteria and analysis. I am further satisfied that the information circular provided information in the detail necessary as to all material matters to allow those eligible to vote to make informed decisions. I note specifically that the opinion of Messrs. Blake, Cassels & Graydon referred to in the summary to directors dated March 14, 1991 (which summary was contemporaneously given to the applicant's directors for analysis and discussion and was a fair synopsis) recommended that any claim against the Olympia & York group be used as a "shield" rather than a "sword" in effect. The opinion was of the conclusion that a successful "sword" approach was extremely unlikely given the nature of the relief to be claimed and the fact circumstances (including a conflict of testimony on material points by potential witnesses for the applicant). I am therefore satisfied that there was no practical necessity to highlight in the information circular this question and the standard mutual release between the applicant and the Olympia & York group. It is perhaps unfortunate in the circumstances that notwithstanding the immateriality this was not disclosed, as this might have avoided the raising of false hopes in those who opposed the plan. This aspect may be particularly so when the information circular, apparently for securities legislation and policy purposes, includes so much disclosure of what might similarly be considered immaterial matters in the overall context of the subject-matter.

8 Mondev was said to have abstained from voting in the plans since it did not think that the information in the information circular was complete. It objected to the general thrust of the disclosure which was best exemplified by the summary in the information circular which indicated in part:

> The Arrangement is an integral part of the restructuring plan. In the opinion of management of the Corporation, the alternative to the Arrangement is liquidation of the Corporation. In the event of a liquidation, the Shareholders and Creditors, other than holders of Secured Debt, would be unlikely to receive any recovery.

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Mondev then suggested various arithmetical exercises by which it claimed that it would in fact receive in liquidation more than the estimated value of new shares that it would receive under the plan. Mondev's analysis was simplistic and would appear to ignore a number of factors. These include: it focused on one part of the equation without seemingly appreciating that the equation was in other respects influenced by the arrangement including concessions by the secured debt holders; it did not take into account the costs of liquidation and its uncertain results in a recessionary market; it ignored the recovery Mondev would receive out of the U.S. reorganizations; and it did not consider that all other members of the senior unsecured debt class of which it was a member and who were sophisticated institutions and investor corporations (including Marine Midland which Mondev unsuccessfully attempted to include with itself in another voting category) voted in favour of the plan. Mondev should be content to take the bad with the good. I do not see the plan as being unfair to senior unsecured debt-holders generally nor Mondev specifically.

9 Messrs. Van Allen (a preferred shareholder and investment advisor) and Andrachuk (a preferred shareholder, debenture holder and accountant) were both concerned with the categories which were established. They did not bring any proceedings to dispute that classification as Mondev unsuccessfully did before three levels of court (see *Re Campeau Corp.*, [1991] O.J. No. 2338 (Montgomery J.) [reported ante at p. 100, 86 D.L.R. (4th) 570] which the Supreme Court of Canada ruled on February 7, 1992). Apparently they did not become concerned, notwithstanding timely disclosure, until they saw the information circular. However, there should be an appreciation that the categorization should take into account *general* similarities of interest. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20, 64 Alta. L.R. (2d) 139, [1989] 2 W.W.R. 566 (Q.B.) at pp. 26-28 [C.B.R.], particularly at p. 28 where Forsyth J. states:

> 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.

See also *Re Quintette Coal Ltd.* (1991), 7 C.B.R. (3d) 165, (sub nom. *Quintette Coal Ltd. v. Nippon Steel Corp.*) 56 B.C.L.R. (2d) 80 (S.C.) at pp. 90-91 [B.C.L.R.] and *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*, [1991] O.J. No. 2288 (Borins J.) at pp. 14-15 [now reported at 8 C.B.R. (3d) 312, 86 D.L.R. (4th) 621 (Ont. Gen. Div.)].

10 Mr. Andrachuk also complained that the public security holders were not involved directly in the negotiation process. I would echo in spades what Forsyth J. said about making a reorganization impossible to achieve. It is of course to the management and directors of a corporation that security holders must look to be responsible for doing what is in the best interests of the corporation (and indirectly of the security holders). Further, he was concerned that the senior unsecureds were too richly rewarded with new shares in the plan. Evidently he was not common in interest to that group including Mondev. Finally, he was concerned that the approval process of the plan did not involve a majority of the minority test which he suggested should exclude the Olympia & York group and the National Bank. However, this type of voting is not contemplated by the voting procedures set forth in the C.C.A.A.

11 I have also examined the materials filed and procedures carried out in connection with this plan and the application to approve it. I am satisfied that such is in accordance with and has been carried out as authorized pursuant to the C.C.A.A.

12 In *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.), Trainor J. stated at pp. 182-183:

> In the exercise of its discretion, the court should consider three criteria, which are:
>
> 1. There must be strict compliance with all statutory requirements.

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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.

13 I am of the view that all three criteria have been satisfied in this matter. The plan is fair and reasonable to all participants generally and the objectors specifically; there has been nothing in the nature of a confiscation of their rights but rather a reasonable balancing of interest. An order is to issue in the form submitted with the return of application adjusting the date of such order to today's date. I have endorsed the record as follows:

Monday, Feb. 10/92

I have been advised that the Supreme Court of Canada has dismissed Mondev's proceedings before it. It is therefore appropriate to release my decision concerning the sanctioning of the Campeau plan. For written reasons I have sanctioned the plan and an order is to issue in the form requested.

Approval granted.

END OF DOCUMENT

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TAB 2

Indexed as:
First Marathon Inc. (Re)

**IN THE MATTER OF First Marathon Inc.
AND IN THE MATTER OF an application by First Marathon Inc. under the provisions of Section 182 of the Business Corporations Act (Ontario), R.S.O. 1990, c. B.16, as amended, for an arrangement involving First Marathon Inc. and its shareholders.
APPLICATION UNDER the Business Corporations Act (Ontario), R.S.O. 1990, c. B.16, as amended.**

[1999] O.J. No. 2805

File No. 99-CL-003444

Ontario Superior Court of Justice
Commercial List

Blair J.

July 30, 1999.

(15 pp.)

Creditors and debtors -- Companies' creditors arrangement legislation -- Arrangement, participation -- Notice to creditors -- Setting aside or varying order.

These were motions by a shareholder, Epstein, to set aside an interim order permitting a proposed merger between First Marathon and the National Bank, and for an order appointing his solicitors as representative counsel for all dissenting shareholders who disputed the proposed merger. National Bank proposed purchasing all of certain classes of shares of First Marathon and then merging First Marathon with its wholly owned subsidiary, Levesque Beaubien. The merger was to be accomplished by way of an arrangement under section 182 of the Ontario Business Corporations Act. To initiate the arrangement proceedings, First Marathon obtained an interim order on an ex parte basis which provided for the calling and holding of a shareholders' meeting for possible approval of the merger. The order further prescribed the procedure for giving notice to shareholders, required the necessary notice, and it accorded dissenting rights to shareholders. Epstein claimed that the order was flawed in that it was granted without notice to shareholders, and because it purported to authorize an information circular that provided inadequate

disclosure regarding the merger. Epstein relied upon the evidence of a US business valuator who pointed out several alleged gaps in the information provided. First Marathon relied upon expert evidence affirming that the level of disclosure was similar to that customarily provided in similar transactions. Epstein provided no evidence of any other shareholders who had objections to the proposed merger in support of his request for representation status.

HELD: Motions dismissed. Section 182 created a specific procedure for dealing with arrangement transactions. Because of the very nature of such transactions, there was often a necessity to respect tight timing requirements and it was unrealistic to require notice to be provided. In this case, moreover, there was no indication beforehand of any shareholder dissatisfaction. The Business Corporations Act was to be construed and applied in a fashion which facilitated the fair and effective processing of the application in light of the realities of business transactions. The purpose of the interim order was simply to set the wheels in motion. It was always open to shareholders to take appropriate action in the application procedure itself. There was no evidence that the level of disclosure provided in the information circular was inadequate. In any event, the court in making the interim order was not approving or authorizing the circular. It set out the substance of the transaction with sufficient particularity to permit shareholders to form a reasoned judgment. There was no evidence that the appointment of counsel to represent shareholders was necessary or appropriate. The statutory scheme for approval of arrangements was not designed to enable classes of claimants to pursue damages or other heads of relief common to class actions.

Statutes, Regulations and Rules Cited:

Business Corporations Act (Ontario), R.S.O. 1990, c. B.16, s. 182, 182(5)(d).

Counsel:

David Klein, for Stephen Epstein the moving party.
Dale Denis, Anthony Caldwell and Laura Paglia, for First Marathon Inc.
James C. Tory, for National Bank.

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1 **BLAIR J.**:-- On June 17, 1999, First Marathon Inc. - a publicly traded financial services corporation - and National Bank announced a merger agreement whereby National Bank would purchase all of the outstanding Class A non-voting shares and the Class C voting shares of First Marathon, and then merge First Marathon with National Bank's wholly owned subsidiary, Levesque Beaubien Geoffrion Inc. The proposed acquisition of shares is to be accomplished through an exchange of securities and cash, and is being structured as an "arrangement" under section 182 of the Business Corporations Act (Ontario), R.S.O. 1990, c. B.16 as amended (the "OBCA").

2 This Motion arises in the context of the "arrangement" proceedings, and raises questions concerning,

1) the circumstances in which the initial Interim Order in such proceedings should be obtained on an ex parte, or without notice, basis (as is generally the practice);
2) the adequacy of the level of disclosure in the First Marathon Management Information Circular distributed, with other materials, in accordance with the terms of that Order;
3) the circumstances in which counsel should be appointed to represent the interests of shareholders in section 182 arrangement proceedings; and, at least indirectly,
4) the appropriateness of importing class action proceedings notions and practices into statutory procedures designed to deal with the approval (both by shareholders and the Court) of complex, and often time-sensitive, corporate transactions.

3 To initiate the "arrangement" proceedings, First Marathon sought and obtained an Interim Order from the Honourable Mr. Justice Cumming, on an ex parte basis, on July 9, 1999. The Motion seeks to have the Interim Order set aside or varied. Also requested is an order appointing the Moving Parties firm of solicitors, Klein Lyons, as counsel to represent the interest of shareholders - at the expense of First Marathon - pursuant to paragraph 182(5)(d) of the OBCA.

4 First Marathon's currently outstanding capital consists of 23,706,713 Class A non-voting shares and 2,325,750 Class C voting shares, Mr. Epstein is the holder of 400 of the Class A shares.

The Attack on the Interim Order

5 The Interim Order,

a) provides for the calling and holding of shareholders' meetings to consider, and thought advisable, to approve the arrangement;
b) prescribes the notice to be given to shareholders, and the procedures to be followed at the meetings including matters relating to quorums, voting thresholds, and who is entitled to attend;
c) orders that the Notice of Application (respecting the arrangement and its approval hearing), the Notice of Special Meeting, and the Management Information Circular of First Marathon be distributed to the shareholders and others at least 25 days prior to the date of the meeting;
d) accords dissenting rights to shareholders; and,
e) provides that upon approval by the shareholders of the arrangement, First Marathon may apply to the Court for approval of the arrangement.

6 How it is sought to have the Order varied is not clear. The thrust of Mr. Klein's argument in relation to the Interim Order, as I apprehend it, is that the Order should be set aside altogether because it should not have been sought or granted on an ex parte basis, but rather - for reasons of "procedural fairness" - on notice to all shareholders, and in any event that it is fundamentally flawed because it "authorized" an Information Circular which provides inadequate disclosure to shareholders regarding the proposed transaction.

7 In my view there is simply no basis, on the materials before the Court, upon which the relief sought in this respect can be granted, and the attack on the Interim Order must fail.

8 I do not accept the submission that Interim Orders of the sort in question here should not be made on a without notice basis - at least where, as here, there has been no indication of shareholder opposition to the proposed transaction prior to the seeking of the Order and there has been a public announcement in the media regarding the transaction. Each case will require its own consideration, of course. In section 182 of the OBCA, however, the Legislature has created a specific procedure for dealing with arrangement transactions[1]. Because of the very nature of such transactions - particularly in relation to publicly traded companies - there is often a tight timing dynamic to them. The provisions of the Act should be construed and applied in a fashion which facilitates the fair and effective processing of the application in a manner that is consistent with their "real time" nature as business transactions. To require the corporation to serve notice on all shareholders before taking any steps seems to me to introduce unnecessary expense, duplication, and delay into the procedure.

9 The purpose of such Orders is simply to set the wheels in motion for the application process relating to the arrangement and to establish the parameters for the holding of shareholder meetings to consider approval of the arrangement in accordance with the statute. This does not mean, of course, that shareholders and other interested parties are without recourse to have legitimate concerns and disputes regarding the procedure determined. It is always open to them, if so advised, to move in the application procedure for appropriate relief. I do not think, however, that in most cases - and this is not one of the exceptions - the appropriate attack is on the ex parte nature of the Interim Order. If the Applicant is aware of shareholder opposition to the transaction in advance of the motion for the Interim Order, it may be wise, of course, for notice to be given to such dissidents or at least to ensure that the Interim Order contains provisions which permits them to "come back" to the Court should they have issues of a preliminary nature in the application they wish to have addressed.

10 In this case, the main force of the complaint made is that the Information Circular distributed in accordance with paragraph 3 of the Interim Order is insufficient in its detail. There are significant "gaps" in the information disclosed "which the shareholders should have", it is alleged. A number of observations may be made in this regard.

11 First, for the reasons I have articulated above, I do not think it is incumbent upon the judge being asked to grant the Interim Order to carry out a detailed examination of the Information Circular, which is to be distributed to the shareholders, for its sufficiency. Unless the Circular is obviously bereft of substance and detail, such considerations are

better left to a later occasion where that issue can be determined - either by the Court, or perhaps more appropriately by the Securities Commission (the tribunal with particular expertise in such matters) - with the benefit of the input of those who have concerns. The Court does not "approve" or "authorize" the Circular. The Interim Order simply directs that the Circular prepared by management be distributed to the shareholders. Undoubtedly, if the Information Circular is clearly inadequate, that will be a factor bearing considerable weight at the time of the "fairness hearing" by the Court to determine whether the arrangement will be sanctioned and approved: see, for example, Imperial Trust Company and Taylor Assets (Dominion) Limited v. Canbra Foods Ltd. (1987), 50 Alta. L.R. (2d) 375 (Moore C.J.Q.B.).

12 Secondly, and leaving aside the technical argument about whether an attack on the Information Circular should be made in the present context or at some other stage of the proceeding - and dealing with it here, because the argument has been made - I am not persuaded on the materials before the Court that there is any basis for Court interference founded upon the adequacy of the level of disclosure in the Circular. I can only assume, since the argument was not put directly, that it is in this area that a variation of the Interim Order might be sought, perhaps in the form of a direction that a further and better Information Circular should be required and distributed to shareholders.

13 I note at the outset that there is no evidence from any shareholder stating that the shareholder finds the disclosure provided inadequate. This includes the Moving Party, Mr. Epstein, who did not file any affidavit at all. Indeed, the only evidence from shareholders is to the opposite effect. Affidavits were filed from 11 arm's length shareholders holding a total of 9,234,980 Class A shares, and representing 35.5% of the Class A shares - and 46.5% of the Class A and Class C shares after excluding those shares held by persons connected with First Marathon. Those affidavits are all to the effect that the level of disclosure is satisfactory to those shareholders and that they want to proceed with the shareholders' meetings scheduled for August 10th. I observe again that Mr. Epstein, who did not depose to any confusion or lack of information himself, is the holder of 400 shares.

14 Instead, what is put forward by Mr. Klein on behalf of his client, is a letter of opinion from Mark L. Mitchell of Business Valuation Services Inc. in Dallas, Texas. Mr. Mitchell appears to be an active business valuation expert in various U.S. jurisdictions, but he has no experience or expertise with respect to corporate arrangements or securities transactions in Canada or Ontario. He does not indicate even that he has reviewed the various provisions of the OBCA, the OBCA Regulations, the Ontario Securities Act Regulation and Forms, or the national and provincial policy statements prescribed by the Canadian Securities Administrators and the Ontario Securities Commission - all of which pertain to the requisite form and content of information circulars in Canada and Ontario.

15 Nonetheless, Mr. Mitchell lists a series of gaps said to exist in the disclosure made in First Marathon's Information Circular here. These alleged deficiencies fall essentially into the following categories:

(1) lack of detail regarding comparable transactions (particularly an earlier transaction between Merrill Lynch and Midland Walwyn,

which is alleged to have resulted in a much higher ratio of share price to assets);

(2) lack of details regarding the issues between the parties as of May 21, 1999 (when negotiations between the First Marathon and National Bank broke off) and how they were resolved prior to June 9, 1999 (when negotiations resumed);

(3) failure to provide all of the back-up information used by Deutsche Bank for purposes of its fairness opinion;

(4) lack of clarity "as to whether all of the conflicts of interest [referred to in the Circular] are described in the Circular";

(5) lack of details concerning the employment agreements and retention packages; and

(6) lack of details concerning the right of first refusal arrangement.

16 First Marathon, for its part, has filed the affidavit of Jean-Paul Bisnaire, a lawyer with considerable experience and expertise in the area of mergers and acquisitions - including plans of arrangement and advising on questions relating to matters of disclosure in Information Circulars - in Ontario and Canada. Mr. Bisnaire responds to each of the Mitchell allegations as to discrepancies in the First Marathon Information Circular. Without reviewing these items in detail - on either side - suffice it to say that in Mr. Mitchell's view there are inadequacies in the Circular, whereas it is Mr. Bisnaire's opinion that "the level and detail of disclosure in the Circular is consistent with the level and detail of the disclosure customarily provided in information circulars prepared for other transactions of a similar nature to this one".

17 Given this evidence, and having regard to the fact that there are no complaints from shareholders themselves as to the adequacy of disclosure (and, as I have pointed out, all of the existing shareholder evidence is to the contrary) I am not prepared to find that the Information Circular is deficient. The question is not whether the Information Circular contains information answering every conceivable query, and follow-up query, that an inquisitive minded shareholder (or shareholder's advisor) can pose. The requirement is that the substance of the pertinent matter be set out "in sufficient detail to permit shareholders to form a reasoned judgement concerning the matter": OBCA Regulation, s. 30, item 31. This standard, it seems to me, is not dissimilar to the frequent declaration that shareholders are entitled to "full, fair and plain disclosure": see, for example, Imperial Trust Company, supra, at p. 393.

18 Those preparing Information Circulars in complex transactions have a difficult task. They must weigh an often uneasy balance between providing insufficient detail (which does not convey the substance and the material information to shareholders) and "[burying] the shareholder in an avalanche of trivial information", which creates its own kind of risks for intelligent and informed decisions making: Re Universal Explorations Ltd. and Petrol Oil and Gas Co. Ltd. (1982), 37 A.R. 35, at p. 37 (Alta. C.A.). The exercise requires business skill, expertise and acumen. Reasonable people can differ on what may be required. The courts should not be quick to interfere with such decisions, unless it is plain that there are good reasons to be concerned about the adequacy of the disclosure (as

there were, for instance, in Imperial Trust Company, supra).

19 Such is not the case here.

20 Mr. Klein also argued that the Interim Order reduced the standard notice period for mailing the Information Circular from 25 days to 40 without there having been any demonstrated basis for doing so. The Ontario Securities Commission - the regulatory body governing the transaction - had already granted such an exemption before the Interim Order was made, however, and the materials before Justice Cumming revealed that such an exemption had been granted. I see nothing wrong with the Court accepting the Commission's prior consideration of this issue, and harmonizing the timing of the arrangement proceeding to that already approved by the other regulatory body.

21 A French language version of the Information Circular was distributed. Mr. Klein submitted it was not disclosed to Cumming J. that this would be so, and pointed out further that, although the English version of the Circular was circulated within the required 25 days before the Meeting, the French language version was not mailed until 21 days in advance. He argued that the nondisclosure was material and that the late mailing was a failure to comply with the requirements of the arrangement, and that each of these factors justifies the setting aside of the ex parte order. I am not prepared to set aside the Order on either basis. To the extent that it turns out the late mailing of the French language version is a material failure to comply with one of the requirements of the arrangement proceeding, that failure will be a matter for consideration and determination at the time of the approval hearing.

22 The Motion to set aside or vary the Interim Order of Cumming J., dated July 9, 1999, is therefore dismissed.

Representative Counsel

23 Paragraph 182(5)(d) of the OBCA provides that in an arrangement application the Court may make "an order appointing counsel, at the expense of the corporation, to represent the interests of shareholders". Klein Lyons has applied for such an Order here.

24 In my view it would be quite inappropriate to accede to such a request in the circumstances of this case.

25 Mr. Klein submits that his firm has extensive experience, as class action lawyers, in the representation of classes of persons in complex litigation including shareholder rights litigation. His experience and that of his firm are not questioned. But that experience and expertise are not the issue, and there is not a single piece of evidence suggesting that the appointment of counsel to represent shareholders is either necessary or fitting in this case.

26 Indeed, the evidence of the 46.5% of the non-First Marathon related shareholders, to which I have referred above, is clear that they do not wish to be represented by Klein Lyons, that they do not intend to join or in any way participate in any class proceedings commenced by that firm with regard to the Arrangement, and that they do not support

either this Motion or any proceeding designed to allege a lack of fair value in the First Marathon/National Bank transaction. Although Mr. Klein's representation of Mr. Epstein is well known in the public domain and has received high profile media attention - along with the fact that he has commenced a separate class action proceeding asserting that the price offered is insufficient -- he is not able to say that a single shareholder in addition to Mr. Epstein has approached him registering any concern about or objection to the proposed transaction or to request that he represent them.

27 A representation order under paragraph 182(5)(d) of the OBCA, in my opinion, is not necessarily analogous to the appointment of counsel in a class action proceeding to represent a certain class for the purposes of such a proceeding. Class action proceedings and the statutory procedure created for dealing with and approving corporate arrangements are two quite different procedures with two quite different purposes. While this is not the case where it is necessary to determine the inter-relationship, if any, between class action proceedings and complex corporate transactions involving publicly traded companies and statutory of securities-regulated schemes requiring the approval of such transactions, I am inclined to think that the importation of class action principles and proceedings into the latter situations should be approached with caution and will rarely be required.

28 The statutory scheme for the approval of arrangements is not designed to enable classes of claimants to pursue damages or other types of relief common to class action proceedings. The processing of such matters is strengthened by the longer timing parameters and other procedural characteristics of normal litigation. The scheme arrangement approval scheme, on the other hand, is designed to provide a governing and court-supervised framework within which shareholder approval of a proposed transaction can be sought and obtained, and the Court's sanction provided if appropriate, in a timely fashion and in a manner which is open and fair to all interested parties but which enables the transaction to be processed with regard to matters of business efficacy.

29 Shareholders are able to think for themselves and to seek advice. They are identifiable. They receive notice and disclosure relating to the proposed transaction, and they have the opportunity to respond. It should not be presumed, without some basis for concluding, that they either need or desire that a further litigious layer be imposed on the process on their behalf. More is necessary, in my view, than a skilful professional being able to come forward and say that he or she may be able to make some good "objective" points - as Mr. Klein put it - on behalf of the shareholders as a whole, if let loose (at the corporation's expense) to do so. In my opinion, for a representation order to be made under the arrangement provisions of the OBCA, there must be some clear need demonstrated in the evidence for the establishment of a representative counsel regime to assist the Court and/or to protect the rights of the shareholders as a whole, and generally there should be some evidence of a reasonable level of shareholder support for the appointment of such representation and of the lawyers in question.

30 Without impugning for a moment the credentials and expertise of Mr. Klein or his firm in class action matters, none of the factors which would lead to the appointment of representative counsel is present here.

31 The Motion for the appointment of representative counsel is therefore dismissed, as well. In the circumstances, it is unnecessary to deal with the question of funding.

Costs

32 Counsel made submissions as to costs at the conclusion of argument, taking into account the differing outcome possibilities.

33 I see no reason why costs should not follow the event, as is the normal rule. Moreover, I intend to fix the costs, as is the customary practice in proceedings such as this on the Commercial List at Toronto.

34 Mr. Epstein has chosen to litigate in the circumstances described. He is exposed to the payment of costs to his successful opponents if he loses, like any other litigant. The First Marathon/National Bank transaction is a very substantial one, and it is not surprising that litigation in respect of it is comparably complex, requiring significant preparation, voluminous materials and expense.

35 Mr. Denis has asked for costs on a party and party basis fixed at $5,000 on behalf of First Marathon, and Mr. Tory has requested a lesser amount of $2,500 on behalf of National Bank. In my view, these requests are quite modest in the circumstances, and I have no hesitation in awarding costs in those amounts, and do so. Party and party costs are intended to provide partial indemnity to the successful party for their legal expenses, and they must therefore bear some reasonable relationship to those expenses or their purpose is rendered nugatory. Mr. Klein's suggestion that costs should be fixed in the amount of $500 is not realistic.

Summary of Disposition

36 In summary, then, the Motion to set aside or vary the Interim Order and the Motion for the appointment of representative counsel are both dismissed. Mr. Epstein is to pay costs in the amount of $5,000 to First Marathon and in the amount of $2,500 to National Bank. The costs are payable forthwith.

37 I would like to thank counsel for their assistance and for the excellent quality of their submissions.

BLAIR J.

qp/s/bbd

1 Parliament has created a similar procedure, as well. There are comparable provisions to those of the OBCA in the Canada Business Corporations Act, R.S.C.

1985, c. C-44, as amended (section 192). Other Provinces have like provisions.

TAB 3

1993 CarswellOnt 241, 22 C.B.R. (3d) 80

Armbro Enterprises Inc., Re

Re ARMBRO ENTERPRISES INC.

Ontario Court of Justice (General Division), In Bankruptcy

R.A. Blair J.

Judgment: November 1, 1993

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Counsel: *Geoffrey B. Morawetz* and *Craig J. Hill*, for applicants.

Irving Marks, for opposing creditor.

Michael S.F. Watson and *Lilly A. Wong*, for Royal Bank of Canada.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Approval by Court.

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Plan of arrangement — Court approval of plan — Landlord opposing sanctioning of plan — Landlord not taking advantage of opportunities to make its opposition to classification of creditors known and waiting until sanctioning hearing to oppose — Landlord's opposition being unwarranted and too late — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Plan of arrangement — Court approval of plan — Landlord opposing sanctioning of plan and arguing that court not having power to sanction plan terminating lease — Nothing under CCAA precluding court from sanctioning such a plan — Plan sanctioned — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

A company applied for the sanction and approval of its plan of arrangement and compromise. The creditors had voted on the plan and, after requiring certain amendments, approved it. One creditor, a landlord, opposed the sanctioning of the plan.

The landlord argued that: (1) it should have been placed in a separate class of creditors instead of being grouped with the unsecured creditors, and (2) the plan purported to terminate the tenancy, and that the court had no power to sanction a plan that purported to do so.

Held:

The plan was sanctioned and approved.

The landlord's claim was based on a default judgment for arrears of rent and on a contingent claim for unliquidated damages arising out of the termination of the lease. Therefore, the landlord was not in a different position than that of other unsecured creditors. There was a sufficient community of interest and rights among the landlord and the other unsecured creditors to warrant their being placed in the same class. Further, the creation of one class of unsecured creditors would avoid the unnecessary fragmentation of creditors. While the landlord's claim was large, it was relatively insignificant with respect to the overall indebtedness.

The landlord had been given notice of the application for a stay of proceedings and of the order sought. It did not attend or make submissions regarding its classification with the other unsecured creditors. It did not avail itself of the "come back" clause in the stay order, nor did it appeal. As there was no "substantial injustice", it was too late to oppose at the sanctioning hearing.

With respect to the termination of the tenancy, the landlord's argument was unacceptable. Under the *Companies' Creditors Arrangement Act*, there is nothing that precludes a court from interfering with the rights of a landlord under a lease, any more than the Act precludes a court from interfering with the rights of a secured creditor under a security document. Such interferences may be justified by the circumstances of a reorganization.

Cases considered:

Ayer's Ltd., Re (December 9, 1991), (Nfld. T.D.) [unreported] — *referred to*

Dairy Corp. of Canada Ltd., Re, [1934] O.R. 436, [1934] 3 D.L.R. 347 (S.C.) — *referred to*

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

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

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

Keddy Motor Inns Ltd., Re (1992), 13 C.B.R. (3d) 245, 90 D.L.R. (4th) 175, 6 B.L.R. (2d) 116, 110 N.S.R. (2d) 246, 299 A.P.R. 246 (C.A.) — *referred to*

Northland Properties Ltd., Re, (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363, 34 B.C.L.R. (2d) 122 (C.A.) — *referred to*

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

Quintette Coal Ltd., Re (1992), 13 C.B.R. (3d) 146, 68 B.C.L.R. (2d) 219 (S.C.) — *referred to*

Silcorp Ltd. v. Canadian Imperial Bank of Commerce (June 26, 1992), Doc. B152/92 (Ont. Gen. Div.) — *referred to*

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

Woodward's Ltd., Re (1993), 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206 (S.C.) — *referred to*

Statutes considered:

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

s. 6

Motion for order sanctioning and approving plan of compromise and arrangement.

***R.A. Blair J.* (Endorsement):**

1 This is a motion by the Applicants for an Order pursuant to s. 6 of the CCAA for sanction and approval of the plan of compromise and arrangement filed by the Applicants on September 24, 1993, as amended. On that date, I made an Order granting the Applicants the protection of a stay of proceedings under the Act, in order to permit them to restructure their operations and develop a plan of compromise or arrangement for presentation to their Creditors.

2 The Plan has now been negotiated and put to meetings of the classes of creditors established under the Sept. 24th Order. With certain amendments it has been voted on and approved by creditors of sufficient numbers and in sufficient value amounts in each class to meet the requirements of s. 6 of the Act. One creditor, a landlord — 803774 Ontario Limited — opposes the sanctioning and approval of the Plan.

3 In considering whether to sanction a Plan of this sort, the Court must have regard to the following criteria, namely:

1) whether there has been complete compliance with all statutory requirements;

2) whether any material filings or procedures have been done or are purported to have been done otherwise than as authorized by the CCAA; and,

3) whether the proposed Plan is fair and reasonable.

See: *Re Dairy Corp. of Canada*, [1934] O.R. 436 (S.C.); *Re Quintette Coal Ltd.* (1992), 13 C.B.R. (3d) 146 (B.C. S.C.).

4 I am satisfied that this Plan meets the foregoing criteria. The position put forward on behalf of the opposing creditor needs to be addressed, however.

5 As I apprehend the Landlord's position, it is essentially twofold, namely

a) that the landlord ought to have been placed in a separate class of creditors, and ought not to have been grouped with the unsecured creditors, generally; and,

b) that the Plan purports to terminate the tenancy, and there is no power in the Court under the CCAA to sanction

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a Plan which purports to do so.

6 Counsel for the opposing creditor advanced an additional argument under the "fairness" criterion to the effect that the "new common shares" to be issued under the Plan were not evenly allocated amongst the unsecured creditors, and that Royal Bank of Canada ("RBC") — the major creditor, and also a secured creditor for part of its claim — was being favoured. 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 classes in approving the proposed Plan, as they have done. RBC's co-operation 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. It does not seem unfair or unreasonable to me that it should receive some additional incentive to support the Plan.

Classification

7 In the circumstances of this case, it is not, in my view, inappropriate to have classified the landlord in the same class of creditors as the unsecured creditors. The landlord's claim has two bases: it is a judgment creditor for approximately $1 million as a result of a default judgment obtained against Armbro Inc. for arrears of rent; and it has a contingent claim for unliquidated damages arising out of the termination of the lease. A landlord has a right of distraint under a lease, but I am told that this right is academic for present purposes. Thus, it seems to me that 803774 Ontario Limited is not in a materially different position than other unsecured creditors who have either a claim for liquidated damages or an unliquidated claim for damages which is contingent or which has crystallized.

8 There is, in my view, a sufficient community of interest and rights between the Landlord here objecting and the other unsecured creditors to warrant their inclusion in the same class of creditors and to avoid an unnecessary fragmentation of creditors into an unwieldy patchwork or into a patchwork which may — as it would here — give one creditor an undue advantage and influence over the negotiations. The Landlord's claim is sizeable — between $3.5 million and $4.5 million, depending on whose version prevails — but it is nonetheless relatively insignificant in an overall blanket of approximately $130 million in indebtedness. See: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.); *Re Northland Properties Ltd.* (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.); *Re Woodward's Ltd.* (1993), 20 C.B.R. (3d) 74 (B.C. S.C.).

9 There is another factor to be considered at this juncture, as well. The Applicants have been assiduous in their efforts to negotiate in good faith and in advance of their Application with all of their creditors — and the opposing creditor falls within this category. The Landlord had notice of the Application which was returnable on Sept. 24 and of the Order which was sought, including the classification of creditors into three groups: Secured, Unsecured, and RBC. It did not attend and oppose or make submissions at that time regarding its classification with the unsecured creditors. It did not avail itself of the "come back" clause within the Sept. 24th Order, to raise the issue be fore the creditor's meetings. It did not appeal. In my opinion, one of those avenues should have been followed. To await the sanctioning hearing is too late, unless it can be said — which it cannot, in this case — that the classification has given rise to a "substantial injustice": *Re Keddy Motor Inns Ltd.* (1992), 13 C.B.R. (3d) 245 (N.S. C.A.).

Termination of Leases within CCAA Proceedings

10 This brings me to the second major issue raised on behalf of the objecting creditor, namely that the Court does not have the power under the CCAA to sanction or approve a Plan which terminates leases as part of its arrangement.

11 I do not accept this submission.

12 The CCAA is broad, remedial legislation, designed to facilitate a re-organization of a debtor company's affairs in a way that is in the interests of the company, its creditors and the public. It is to be liberally construed. See: *Nova*

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Metal Products Inc. v. Comiskey (Trustee of) (sub nom. *Elan Corp. v. Comiskey*) (1990), 1 O.R. (3d) 289 (C.A.); *Hongkong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 51 B.C.L.R. (2d) 84 (C.A.).

13 It is true that there is no specific provision in the CCAA which states openly that the Court has the power to sanction the termination of leases. This, I think, is what Houlden J.A. must have been contemplating when he noted, in *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285 (Ont. Gen. Div.) [at p. 287], that "[i]t is difficult to make a plan of compromise for such a company (a chain of retail clothing stores in rented premises) under the C.C.A.A., because there is no way ... to terminate leases and to limit the amount of the claims of landlords." Section 6 of the Act is discretionary, however, and provides that "the compromise or arrangement *may be sanctioned* by the court" — assuming the statutory requirements respecting voting have been met, as they have here. There are a number of examples where the Courts have granted their approval to arrangements which involve the repudiation, surrender and ultimate termination of leases — including, incidentally, *Re Grafton-Fraser* itself in its ultimate disposition. See also: *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia, supra; Re Ayer's Ltd.* (unreported, December 9, 1991, Nfld. T.D.); *Re Inducon Development Corp.* (1992), 8 C.B.R. (3d) 306 (Ont. Gen. Div.); *Silcorp Ltd. v. Canadian Imperial Bank of Commerce* (June 26, 1992), Doc. B152/92 (Ont. Gen. Div.) (unreported). I see nothing in principle which precludes a Court from interfering with the rights of a landlord under a lease, in the CCAA context, any more than from interfering with the rights of a secured creditor under a security document. Both may be sanctioned when the exigencies of the particular re-organization justify such balancing of the prejudices.

14 In this case the sanction and approval of the Court is warranted, for the reasons I have articulated, and an Order will issue to that effect in terms of the draft Order filed on which I have placed my fiat.

15 In addition, an Order will go directing the Registrar of Deeds to discharge and vacate the registration of certain Instruments described in a companion draft Order on which I have placed my fiat, and directing the Sheriff to withdraw certain Writs of Seizure and Sale also described therein. This Order is to issue immediately upon the filing of an Affidavit on behalf of the Applicants deposing that the conditions to implementation referred to in Article 5.3 of the Plan have been satisfied and that the Applicants are proceeding to implement the Plan. The Court office shall issue, enter and return this Order to the Applicants on the day on which the Order is presented for signing and entry.

Motion allowed.

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TAB 4

2000 CarswellAlta 623, 19 C.B.R. (4th) 12

Canadian Airlines Corp., Re

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

In the Matter of the Business Corporations Act (Alberta) S.A. 1981, c. B-15, As Amended, Section 185

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

Alberta Court of Queen's Bench

Paperny J.

Judgment: May 12, 2000[FN*]
Docket: Calgary 0001-05071

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Proceedings: refused leave to appeal *Canadian Airlines Corp., Re*, 2000 ABCA 149, 80 Alta. L.R. (3d) 213 (Alta. C.A. [In Chambers])

Counsel: *A.L. Friend, Q.C.*, *H.M. Kay, Q.C.*, and *R.B. Low, Q.C.*, for Canadian Airlines.

V.P. Lalonde and *Ms M. Lalonde*, for AMR Corporation.

S. Dunphy, for Air Canada.

P.T. McCarthy, Q.C., for PricewaterhouseCoopers.

D. Nishimura, for Resurgence Asset Management LLC.

E. Halt, for Claims Officer.

A.J. McConnell, for Bank of Nova Scotia Trust Company of New York and Montreal Trust Co. of Canada.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Miscellaneous issues

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Creditors of corporation gave corporation concessions worth $200 million in exchange for assurance from airline that creditors would cease to be affected by CCAA proceedings — Concessions were reflected in promissory notes assigned to airline in exchange for its guarantee of aircraft leases — Representative of 60 per cent of unsecured noteholders in corporation brought application for order that all unsecured claims held or controlled by airline be placed in separate class from other unsecured claims for voting purposes, and for order striking portion of reorganization plan — Application dismissed — Class of creditors should include all those with commonality of interest — Commonality of interest refers to rights creditor has vis-à-vis debtor — "Interest" does not include personality or identity of creditor, and absent bad faith, motivation of creditor for supporting plan is not classification issue — Proper point at which to consider effect of airline's status as assignee of unsecured debt was at fairness hearing — Legal rights of unsecured noteholders and airline were essentially same — Votes cast by airline should be tabulated separately to provide evidentiary record for fairness hearing — Propriety of airline voting to share in pool of cash funded by it for benefit of unsecured creditors was also issue best considered at fairness hearing — Provision of plan that released directors, officers and others should not be struck at classification stage as fairness of proposed compromises or claims was issue for fairness hearing — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

Cases considered by *Paperny J.*:

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

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

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

Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada, 34 B.C.L.R. (2d) 122, 73 C.B.R. (N.S.) 195, [1989] 3 W.W.R. 363 (B.C. C.A.) — considered

NsC Diesel Power Inc., Re (1990), 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295 (N.S. T.D.) — considered

Savage v. Amoco Acquisition Co. (1988), 59 Alta. L.R. (2d) 260, 68 C.B.R. (N.S.) 154, 40 B.L.R. 188, (sub nom. *Amoco Acquisition Co. v. Savage*) 87 A.R. 321 (Alta. C.A.) — considered

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

Sovereign Life Assurance Co. v. Dodd (1891), [1891-4] All E.R. Rep. 246, [1892] 2 Q.B. 573 (Eng. C.A.) — applied

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

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

Statutes considered:

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

Generally — referred to

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

Generally — considered

s. 5.1 [en. 1997, c. 12, s. 122] — referred to

s. 5.1(3) [en. 1997, c. 12, s. 122] — considered

APPLICATION by unsecured creditors of corporation for order that unsecured claims held by Air Canada should be placed in separate class from other unsecured creditors, and for order striking portion of reorganization plan.

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

1 Resurgence Asset Management LLC "Resurgence" appeared on behalf of holders of approximately 60 percent of the unsecured notes issued by Canadian Airlines Corporation in the total amount of $100 million U.S. These unsecured note holders are proposed to be classified as unsecured creditors in the plan that is the subject of these proceedings.

2 Resurgence applied for the following relief:

1. An order lifting the stay of proceedings against Canadian Airlines Corporation and Canadian Airlines International Ltd. (respectively "CAC" and "CAIL" and collectively called "Canadian") to permit Resurgence to commence and proceed with an oppression action against Canadian, Air Canada and others.

2. Further, and in the alternative, Resurgence sought the same relief described in item one above in the context of the C.C.A.A. proceedings.

3. An order that any and all unsecured claims held or controlled, directly or indirectly by Air Canada shall be placed in a separate class and either not allowed to be voted at all, or, alternatively, allowed to be voted in separate class from all other affected unsecured claims.

4. An order that there be a separation in class between creditors of CAC and CAIL

5. An order striking Section 6.2(2)(ii) of the plan on the basis that it is contrary to the C.C.A.A.

3 Resurgence abandoned the application described in item 1 above, and the application in item 2 was addressed in my ruling given May 8, 2000, in these proceedings.

Standing

4 Prior to dealing with the remaining issues of classification, voting and Section 6.2(2)(ii) of the plan, the issue of standing needs to be addressed. This was a matter of some debate, largely in the context of the first two applications. Canadian argued that Resurgence was only a fund manager and did not hold the unsecured notes, beneficially or otherwise, and, accordingly, did not have standing to make any of the applications. The evidence establishes that Resurgence is not the legal owner and the evidence of beneficial ownership is equivocal.

5 Canadian has not raised this issue on any of the previous occasions on which Resurgence has been before the

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court in these proceedings. There has been a consent order involving Resurgence and Canadian.

6 In my view, it is not appropriate now for Canadian to suggest that Resurgence does not represent the interests of the holders of 60 percent of the unsecured notes and essentially seek a declaration that Resurgence is a stranger to these proceedings.

7 I am not prepared to dismiss the applications of Resurgence on classification, voting and amending the plan out of hand on the basis of standing.

8 Resurgence was also supported in these applications by the senior secured note holders. For the purposes of these applications, I accept that Resurgence is representing the interests of 60 percent of the unsecured note holders.

Classification of Air Canada's Unsecured Claim

9 By my April 14, 2000 order in these proceedings, I approved transactions involving CAIL, a large number of aircraft lessors and Air Canada, which achieved approximately $200 million worth of concessions for CAIL. In exchange for granting the concession, each creditor received a guarantee from Air Canada and the assurance that the creditor would immediately cease to be affected by the C.C.A.A. proceedings.

10 These concessions or deficiency claims were quantified and reflected in promissory notes which were assigned to Air Canada in exchange for its guarantee of the aircraft leases. The monitor approved the method of quantifying these claims and recognized the value of the concessions to Canadian. In that order I reserved the issue of classification and voting to be determined at some later date. The plan provides for two classes of creditors, secured and unsecured.

11 The unsecured class is composed of a number of types of unsecured claims, including aircraft financings, executory contracts, unsecured notes, litigation claims, real estate leases and the deficiencies, if any, of the senior secured note holders.

12 In one portion of the application, Resurgence seeks to have Air Canada vote the promissory notes in separate class and relied on several factors to distinguish the claims of other Affected, Unsecured Creditors from Air Canada's unsecured claim, including the following:

1. The Air Canada appointed board caused Canadian to enter into these C.C.A.A. proceedings under which Air Canada stands to gain substantial benefits in its own operations and in the merged operations and ownership contemplated after the compromise of debts under the plan.

2. Air Canada is providing the fund of money to be distributed to the Affected Unsecured Creditors and will, therefore, end up paying itself a portion of that money if it is included in the Affected Unsecured Creditors' class and permitted to vote.

3. Air Canada gave no real consideration in acquiring the deficiency claims and manufactured them only to secure a 'yes' vote.

13 Air Canada and Canadian argue that the legal right associated with Air Canada's unsecured promissory notes and with the other Affected, Unsecured Claims, are the same and that the matters raised by Resurgence, as relating to classification, are really matters of fairness, more appropriately dealt with at the fairness hearing. Air Canada and Canadian emphasized that classification must be determined according to the rights of the creditors, not their personalities.

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14 The starting point in determining classification is the statute under which the parties are operating and from which the court obtains its jurisdiction. The primary purpose of the C.C.A.A. is to facilitate the re-organization of insolvent companies, and this goal must be given proper consideration at every stage of the C.C.A.A. process, including classification of claims; see, for example, *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.)

15 Beyond identifying secured and unsecured classes, the C.C.A.A. does not offer any guidance to the classification of claims. The process, instead, has developed in the case law.

16 A frequently cited description of the method of classification of creditors for the purposes of voting on a plan, under the C.C.A.A., is *Sovereign Life Assurance Co. v Dodd* (1891), [1892] 2 Q.B. 573 (Eng. C.A.).

17 At page 583 (Q.B.), Bowen, L.J. stated:

> The word 'class' is vague and to find out what is meant by it, we must look at the scope of the section which is a section enabling the court to order a meeting of a class of creditors to be called. It seems plain that we must give such a meaning to the term 'class' as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with the view to their common interest.

This test has been described as the "commonality of interest" test. All counsel agree that this is the test to apply in classification of claims under the C.C.A.A. However, there is a dispute on the types of interests that are to be considered in determining commonality.

18 Generally, the cases hold that classification is a fact-driven determination unique to the circumstances of every case, upon which the court should be loathe to impose rules for universal application, particularly in light of the flexible and remedial jurisdiction involved; see, for example, *Re Fairview Industries Ltd.* (1991), 11 C.B.R. (3d) 71 (N.S. T.D.)

19 The majority of the cases presented to me, held that commonality of the interest is to be determined by the rights the creditor has vis-a-vis the debtor. Courts have also found it helpful to consider the context of the proposed plan and treatment of creditors under a liquidation scenario. In the absence of bad faith, motivation for supporting or rejecting a plan is not a classification issue in the authorities.

20 In considering what interests are included in the commonality of interest test, Forsyth J., in *Norcen Energy Resources Ltd.* (Supra) had to determine whether all the secured creditors of the company ought to be included in one class. The creditors all had first-charge security and the same method of valuation was applied to each secured claim in order to determine security value under the plan. The distinguishing features were submitted to be based on the difference in the security held, including ease of marketability and realization potential. In holding that a separate class was not necessary, Forsyth J., said at page 29:

> Different security positioning and changing security values are a fact of life in the world of secured financing. To accept this argument would again result in a different class of creditor for each secured lender.

In doing so, Forsyth J. rejected the "identity of the interest" approach in which creditors in a class must have identical interests.

21 It was also submitted in *Norcen Energy Resources Ltd.* that since the purchaser under the plan had made

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financing arrangements with the Royal Bank, the bank had an interest not shared by the other secured creditors. Forsyth J., held that in the absence of any allegation that the Royal Bank was not acting bona fide in considering the benefit of the plan, the secured creditors could not be heard to criticize the presence of the Royal Bank in their class.

22 Forsyth J., also emphasized in *Norcen Energy Resources Ltd.* that the commonality test cannot be considered without also considering the underlying purpose of the C.C.A.A., which is to facilitate reorganizations of insolvent companies. To that end, the court should not approve a classification scheme which would make a reorganization difficult, if not impossible, to achieve. At the same time, while the C.C.A.A. grants the court the authority to alter the legal rights of parties other than the debtor company without their consent, the court will not permit a confiscation of rights or an injustice to occur.

23 The *Norcen Energy Resources Ltd.* approach was specifically adopted in British Columbia in *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada* (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.), where it was held that various mortgagees with different mortgages against different properties were included in the same class.

24 In *Savage v. Amoco Acquisition Co.* (1988), 68 C.B.R. (N.S.) 154 (Alta. C.A.) the Alberta Court of Appeal rejected the argument that shareholders who have private arrangements with the applicant or who are brokers or officers or otherwise in a special position vis-a-vis the debtor company, should be put in a special category.

25 At page 158 the court stated in regard to the test applied to classification:

> We do not think that this rule justifies the division of shareholders into separate classes on the basis of their presumed prior commitment to a point of view. The state of facts, common to all, is that they are all offered this proposal, face as an alternative the break-up of this apparently insolvent company and hold shares that appear to be worthless on break-up. In any event, any attempt to divide them on the basis suggested, would be futile. One would have as many groups as there are shareholders.

The commonality of interest test was addressed by the British Columbia Supreme Court in *Re Woodward's Ltd.* (1993), 84 B.C.L.R. (2d) 206 (B.C. S.C.). Tysoe J. rejected the identity of interest approach and held that it was permissible to include creditors with different legal rights in the same class, so long as their legal rights were not so dissimilar that it was still possible for them to vote with a common interest.

26 Tysoe J. went on to find that legal interests should be considered in the context of the proposed plan and that it was also necessary to examine the legal rights of creditors in the context of the possible failure of the plan.

27 In other words, "interest" for the purpose of classification does not include the personality or identity of the creditor, and the interests it may have in the broader commercial sphere that might influence its decision or predispose it to vote in a particular way; rather, "interest" involves the entitlement of the debt holder viewed within the context of the provisions of the proposed plan. In that regard, see *Woodward's Ltd.* at page 212.

28 In *Fairview Industries Ltd.* , the court held that in classification there need not be a commonality of interest of debts involved, so long as the legal interests were the same. Justice Glube (as she then was) stated that it did not automatically follow that those with different commercial interests, for example, those with security on "quick" assets, are necessarily in conflict with those with security on "fixed" assets. She stated that just saying there is a conflict is insufficient to warrant separation.

29 In *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.) at 626 like *Norcen Energy Resources Ltd.*, the "identity of interests" approach was rejected. The court preserved a class of creditors which included debenture holders, terminated employees, realty lessors and equipment lessors.

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30 Borins J. held that not every difference in the nature of the debt warrants a separate class and that in placing a broad and purposive interpretation on the C.C.A.A., the court should "take care to resist approaches which would potentially jeopardize a potentially viable plan." He observed that "excessive fragmentation is counterproductive to the legislative intent to facilitate corporate reorganization" and that it would be "improper to create a special class simply for the benefit of an opposing creditor which would give that creditor the potential to exercise an unwarranted degree of power." (p. 627).

31 In summary, the cases establish the following principles applicable to assessing commonality of interest:

1. Commonality of interest should be viewed on the basis of the non-fragmentation test, not on an identity of interest test;

2. The interests to be considered are the legal interests the creditor holds qua creditor in relationship to the debtor company, prior to and under the plan as well as on liquidation;

3. The commonality of these interests are to be viewed purposively, bearing in mind the object of the C.C.A.A., namely to facilitate reorganizations if at all possible;

4. In placing a broad and purposive interpretation on the C.C.A.A., the court should be careful to resist classification approaches which would potentially jeopardize potentially viable plans.

5. Absent bad faith, the motivations of the creditors to approve or disapprove are irrelevant.

6. The requirement of creditors being able to consult together means being able to assess their legal entitlement *as creditors* before or after the plan in a similar manner.

32 With this background, I will make several observations relating to the reasons asserted by Resurgence that distinguish Air Canada from the rest of the Affected Unsecured Creditors.

33 The first two reasons given relate to interests of Air Canada extraneous to its legal rights as a unsecured creditor. The third reason relates largely to the further assertion that Air Canada should not be allowed to vote at all. The matter of voting is addressed more specifically later in these reasons.

34 The factors described by Resurgence distinguish between Air Canada and other unsecured creditors relate largely to the fact that Air Canada is the assignee of the unsecured debt. In my view, that approach is to be discouraged at the classification stage. To require the court to consider who holds the claim, as distinct from what they hold, at that point would be untenable. I note that Mr. Edwards recognizes in 1947 in his article, "*Reorganizations under the Companies Creditors Arrangement Act*", (1947), 25 Cdn. Bar Rev. 587, and observe this concern is heightened in the current commercial reality of debt trading.

35 Resurgence also asserted that a court should avoid placing creditors with a potential conflict of interest in the same class and relies on *Re NsC Diesel Power Inc.* (1990), 79 C.B.R. (N.S.) 1 (N.S. T.D.), a case in which the court considered a potential conflict of interest between subcontractors and direct contractors. To the extent this case can be seen as decided on the basis of the distinct legal rights of the creditors, I agree with the result. To the extent that the case determined that a class could be separated based on a conflict of interest not based on legal right, I disagree. In my view, this would be the sort of issue the court should consider at the fairness hearing.

36 Resurgence also relied on the decisions of the British Columbia Supreme Court in *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.), a case decided prior to *Norcen Energy Resources Ltd.*. In that case the

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court held that a subsidiary wholly owned by Northland Bank was incorporated to purchase certain bonds from Northland in exchange for preferred shares and was not entitled to vote. The court found that would be tantamount to Northland Bank voting in its own reorganization and relied on *Re Wellington Building Corp.*, [1934] O.R. 653, 16 C.B.R. 48 (Ont. S.C.) In this regard. I would note that the passage relied upon at page 5 in that case, in *Wellington Building Corp* (Supra) dealt with whether the scheme, as proposed, was unfair.

37 All creditors proposed to be included in the class of Affected, Unsecured Creditors, are all unsecured and are treated the same under the plan. All would be treat similarly under the BIA. The plan provides that they will receive 12 cents on the dollar. The Monitor opined that in liquidation unsecured creditors would realize a maximum of 3 cents on the dollar. Their legal interests are essentially the same. Issue is taken with the presence of Air Canada, supporter and funder of the plan, also having taken an assignment of a substantial, unsecured claim. However, absent bad faith, who creditors are is not relevant. Air Canada's mere presence in the class does not in and of itself constitute bad faith.

38 Further, all of these methods of distinguishing Air Canada's unsecured claim at their core are fundamentally issues of fairness which will be addressed by the Court at the fairness hearing on June 5, 2000. I am prepared to give serious consideration to these matters at that time and direct that there be a separate tabulation of the votes cast by Air Canada arising from any assignments of promissory notes they have taken, so that there is an evidentiary record to assist me in assessing the fairness of the vote when and if I am called upon to sanction the plan. This approach was taken by Justice Forsyth in *Norcen Energy Resources Ltd.*, and in my view is consistent with the underlying purpose of the C.C.A.A. I wish to emphasize that the concerns raised by Resurgence will form part of the assessment of the overall fairness of the plan.

39 Permitting the classification to remain intact for voting purposes will not result in a confiscation of rights of or injustice to the unsecured note holders. Their treatment does not at this point depart from any other Affected Unsecured Creditors and recognizes the similarity of legal rights. Although based on different legal instruments, the legal rights of the unsecured note holders and Air Canada are essentially the same. Neither has security, nor specific entitlement to assets. Further, the ability of all of the Affected Unsecured Creditors to realize their claims against the debtor companies, depend in significant part, on the company's ability to continue as a going concern.

40 The separate tabulation of votes will allow the "voice" of unsecured creditors to be heard, while at the same time, permit rather than rule out the possibility that a plan might proceed.

41 It is important to preserve this possibility in the interests of facilitating the aim of the C.C.A.A. and protecting interests of all constituents. To fracture the class prior to the vote, may have the effect of denying the court jurisdiction to consider sanctioning a plan which may pass the fairness test but which has been rejected by one creditor. This would be contrary to the purpose of the C.C.A.A.

Separating the Claims Against CAC and CAIL

42 Resurgence briefly argued that since Air Canada's debt is owed by CAIL only, it could only look to CAIL's assets in a bankruptcy and would not be able to look to any CAC assets. In contrast, Resurgence suggested that the unsecured note holders are creditors of both CAIL under a guarantee, and CAC under the notes. Resurgence submitted that the resulting difference in legal rights destroys the commonality of interests.

43 There is insufficient evidence to suggest that the unsecured note holders are also creditors of CAIL. Counsel referred only to a statement made by Mr. Carty on cross-examination that there was an "unsecured guarantee". However, no documents have been brought to my attention that would support this statement and, in of itself, the statement is not determinative. In any case, I do not have sufficient evidence before me to conclude that there would be a meaningful difference in recoveries for unsecured creditors of CAC and CAIL in the event of bankruptcy. I, therefore, cannot conclude on this basis that rights are being confiscated, unlike Tysoe J.'s ability to do so in *Re*

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Woodward's Ltd. Simply looking to different assets or pools of assets will not alone fracture a class; some unique additional legal right of value in liquidation going unrecognized in a plan and not balanced by others losing rights as well is needed on the analysis of Tysoe J.

44 I recognize the struggle between the unsecured note holders, represented by Resurgence on one side, and Air Canada and Canadian on the other. Resurgence fears the inclusion of Air Canada and the Affected Unsecured Creditors' class will swamp the vote. Air Canada and Canadian fear that exclusion of Air Canada will result in the voting down of a plan which, in their view, otherwise stands a realistic chance of approval. As unsecured creditors, they do share similar legal rights. As supporters or opponents of the plan, they may well have distinctly different financial or strategic interests. I believe that in the circumstances of this case, these other interests and their impact on the plan, are best addressed as matters of fairness at the June 5, 2000 hearing, and in this way, the concerns will be heard by the court without necessarily putting an end to the entire process.

Voting

45 Although my decision on classification makes it clear that I will permit Air Canada to vote on the plan, I wish to comment further on this issue. Air Canada submitted that it should be entitled to vote the face value of the promissory notes which represent deficiency claims assigned to it from aircraft lessors in the same fashion as any other creditor who has acquired the claims by assignment. All parties accept that deficiency claims such as these would normally be included and voted upon in an unsecured claims class. The request by Resurgence to deny them a vote would have the effect of varying rights associated with those notes.

46 The concessions achieved in the re-negotiation of the aircraft leases, represent value to CAIL. The methodology of calculation of the claims and their valuation was reviewed by the Monitor and this is not being challenged. Rather, it is because it is Air Canada that now holds them, that it is objectionable to Resurgence. Resurgence asserts that Air Canada manufactured the assignment so it could preserve a 'yes' vote. This, in my view, is a matter going to fairness. Is it fair for Air Canada to vote to share in the pool of cash funded by it for the benefit of unsecured creditors? That matter is best resolved at the fairness hearing.

47 Resurgence relied on Northland Properties Ltd. in which a wholly owned subsidiary of the debtor company was not allowed to vote because to do so would amount to the debtor company voting in its own reorganization. The corporate relationship between Air Canada and CAIL can be distinguished from the parent and wholly owned subsidiary in Northland Properties Ltd.. Air Canada is not CAIL's parent and owns 10 percent of a numbered company which owns 82 percent of CAIL. Further, as noted above, the court in Northland Properties Ltd. apparently relied on the passage from Wellington Building Corp which indicated in that case the court was being asked to approve a plan as fair. Again, the basis on which Resurgence seeks to deprive Air Canada of its vote is really an issue of fairness.

Section 6(2)(2) of the Plan

48 Resurgence wishes me to strike out Section 6(2)(2) of the plan, which essentially purports to provide a release by affected creditors of all claims based in whole or in part on any act, omission transaction, event or occurrence that took place prior to the effective date in any way relating to the debtor companies and subsidiaries, the C.C.A.A. proceeding or the plan against:

1. The debtor companies and its subsidiaries;

2. The directors, officers and employees;

3. The former directors, officers and employees of the debtor companies and its subsidiaries; or

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> 4. The respective current and former professionals of the entities, including the Monitor, its counsel and its current officers and directors, et cetera. Resurgence submits that this provision constitutes a wholesale release of directors and others which is beyond that permitted by Section 5.1 of the C.C.A.A. CAIL and CAC submit that the proposed release was not intended to preclude rights expressly preserved by the statute and are prepared to amend the plan to state this.

49 Section 5.1(3) of the C.C.A.A. provides that 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.

50 In this application of Resurgence, the court must deal with two issues: One, what releases are permitted under the statute; and, two, what releases ought to be permitted, if any, under the plan.

51 In my view, I will be in a better position to assess the fairness of the proposed compromise of claims which is drafted in extremely broad terms, when I consider the other issues of fairness raised by Resurgence. Accordingly, I leave that matter to the fairness hearing as well.

52 In summary, the application contained in paragraph (d) of the Resurgence Notice of Motion is dismissed. The application in paragraph (e) is adjourned to June 5, 2000.

Application dismissed.

FN* Leave to appeal refused 2000 ABCA 149, 80 Alta L.R. (3d) 213, 19 C.B.R. (4th) 33 (Alta C.A. [In Chambers]).

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TAB 5

1993 CarswellBC 555, 20 C.B.R. (3d) 74, 84 B.C.L.R. (2d) 206

Woodward's Ltd., Re

Re COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36; Re COMPANY ACT, R.S.B.C. 1979, c. 59; Re WOODWARD'S LIMITED, WOODWARD STORES LIMITED and ABERCROMBIE & FITCH CO. (CANADA) LTD.

British Columbia Supreme Court

Tysoe J. [in Chambers]

Heard: April 13, 14 and 15, 1993
Judgment: April 20, 1993
Docket: Doc. Vancouver A924791

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Counsel: *Michael A. Fitch, Susan M. Eyre* and *D. Geoffrey Cowper*, for Woodward's Ltd., Woodward Stores Ltd. and Abercrombie & Fitch Co. (Canada) Ltd.

Paul J. Pearlman, for Hans Andriessen and certain other terminated employees.

James E. Howell, for R. Longine and certain other terminated employees.

Vincent Morgan, for Royal Trust Corp. of Canada.

Digby R. Leigh, for National Bank Leasing.

Douglas B. Hyndman, for North American Trust Co.

B.A.R. Smith, Q.C., for Triple Five Corp. Ltd.

William E.J. Skelly, for Bucci Investment Corp. and Prospero International Realty Inc.

Douglas I. Knowles and *Clayton W. Caverly*, for Cambridge Shopping Centres Ltd.

Sean Donovan, for Neptune Foods.

Robert G. Kuhn and *Nicolas A. Blom*, for Park Royal Shopping Centre Ltd. and others.

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Robert P. Sloman, for Laing Properties.

Gordon K. Mitchell and *L.M. Candido*, for Oakbridge Centre Holdings Inc. and others.

Alan H. Brown, for General Electric Capital Canada Inc.

James P. Taylor, Q.C., Scott A. Turner and *Michael Harquail*, for Zellers Inc.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act — Arrangements — Approval by Court.

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Plan of arrangement — Approval of classes of creditors in plan — Creditors with commonality of interest being appropriate members of one class — Creditors forming minority within class requiring protection of own class — Proposed classes of creditors approved with addition of one class — Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36.

The petitioning company applied for an order approving the classes of creditors designated in its plan of arrangement under the *Companies' Creditors Arrangement Act*. The proposed classes of creditors were: secured creditors, note-holders, landlords and general creditors. There was no issue as to the appropriateness of the designated classes; the only issue was whether or not there should be additional classes. The terminated employees, a bank with a fixed charge on certain equipment, other equipment financiers, creditors holding the guarantee or joint covenant of the company's holding company, and landlords whose leases were being repudiated each proposed that they should constitute a separate class.

Held:

The plan of arrangement was approved with the addition of one class.

The "identity of interest" approach to creditor classification was rejected in favour of the "non-fragmentation" approach. In the former, all the members of a class have identical interests. In the latter, the interests of those in a given class may not be identical, but the legal interests are sufficiently similar to allow the members of the class to vote with a common interest. The "non-fragmentation" approach avoids creating a multiplicity of classes.

In determining whether classes of creditors are appropriate, the legal rights of those creditors must be considered. These rights should not be considered in isolation; they must be considered in light of the provisions of the proposed plan of reorganization. Creditors with similar legal rights might be appropriately separated into two classes if the plan treats them differently. Conversely, creditors with different legal rights might be properly included in the same class if the plan treats them in such a way as to give them a commonality of interest, despite their different legal rights.

The creditors holding the guarantee or joint covenant of the petitioning company's holding company were found to require the protection of a separate class. As a minority in the class of general creditors, these creditors could have their guarantees confiscated by a vote of the majority of the class who did not hold the same rights. In this way, they could be forced to accept the same proportionate amount as the other members of the class and to receive no value for their unique legal rights.

Cases considered:

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

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

Northland Properties Ltd., Re, 73 C.B.R. (N.S.) 195, (sub nom *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) 34 B.C.L.R. (2d) 122, [1989] 3 W.W.R. 363 (B.C. C.A.) —*followed*

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

Sovereign Life Assurance Co. v. Dodd, [1892] 2 Q.B. 573 (C.A.) — *considered*

Wellington Building Corp., Re, 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (S.C.) — *considered*

229531 B.C. Ltd., Re (1989), 72 C.B.R. (N.S.) 310 (B.C. S.C.) — *considered*

Statutes considered:

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

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

Joint Stock Companies Arrangement Act, 1870 (U.K.), 33 & 34 Vict., c. 104.

Application for order approving classes of creditors designated in plan of arrangement under *Companies' Creditors Arrangement Act*.

***Tysoe J.* [In Chambers]:**

Introduction

1 The Petitioners ("Woodward's") apply for an order approving the classes of creditors designated in their plan of arrangement under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA") filed on April 7, 1993 (the "Reorganization Plan"). Woodward's proposes to hold meetings of these classes of creditors during the first part of May 1993 for the purpose of voting on the Reorganization Plan.

2 The classes of creditors designated by the Reorganization Plan are Secured Creditors, Noteholders, Landlords and General Creditors. Each of these terms is defined in the Reorganization Plan. There is no issue as to the appropriateness of classes of secured creditors, noteholders, landlords and general creditors. The question is whether or not there should be additional classes.

3 The definitions in the Reorganization Plan of the classes of creditors are as follows:

"*Secured Creditors*" means the Secured Trustee as holder of the Secured Notes;

"*Noteholders*" means the A & F Debentureholders, the Stores Debentureholders, the 9% Noteholders and the 10%

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Noteholders;

"*Landlord*" means any landlord, head lessor, sublessor or owner of premises which has entered into any Lease with any member of the Woodward's Group and includes any mortgagee or successor in title of such premises who has taken possession of such premises or is collecting rent in respect of such premises as well as any party who has taken an assignment of rents or assignment of lease in respect of such premises, whether as security or otherwise; provided, however, that if more than one person would otherwise come within this definition of Landlord in respect of any particular Lease, the rights and claims of all such persons in respect of such Lease will be dealt with collectively under this Plan and each reference herein to such Landlord shall be construed as a collective reference to all such persons;

"*General Creditors*" means all persons with unsecured claims for any Indebtedness against Woodward's Group as at the General Creditor Meeting Date, including the Pre-Filing Trade Creditors, Employee Creditors, the Landlords and the Equipment Financiers but, for the Landlords and the Equipment Financiers, only to the extent of their claims to be dealt with in the General Creditor class as provided herein, and specifically excluding Post-Filing Trade Creditors, the Noteholders and the holders of the Unaffected Obligations.

4 The additional classes that have been proposed are as follows:

(a) employees of Woodward's that have been terminated since the commencement of these proceedings on December 11, 1992 (these employees made a formal application for separate classification);

(b) Royal Trust Corporation of Canada which holds a debenture creating a fixed charge against certain equipment purchased by Woodward's with the financing provided by Royal Trust;

(c) equipment financiers (which could include Royal Trust);

(d) creditors of Woodward Stores Limited (the "Operating Company") that hold the guarantee or joint covenant of its holding company, Woodward's Limited (the "Holding Company");

(e) one of more classes of landlords whose leases are being repudiated.

5 There is the potential that two parties having agreements to lease with Woodward's will want to make submissions that they should be in a separate or different class. These parties were only served with the Petition in this proceeding recently and it was agreed that my ruling would not affect their ability to make submissions at a subsequent time. It was also agreed that General Electric Capital Canada Inc. would not be bound by my ruling and could make submissions that it should be in a separate or different class or that it should be considered to be a holder of an Unaffected Obligation.

6 I will return to the positions of the various parties but I think it will be useful to first review the authorities setting forth the general principles applicable to the issue of creditor classification.

General Principles

7 The starting point of the case authorities is the decision of the English Court of Appeal in *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (C.A.) where Lord Esher said the following at pp. 579-80 in relation to the meeting of creditors to consider a plan of arrangement under the *Joint Stock Companies Arrangement Act*:

The Act says that the persons to be summoned to the meeting (all of whom, be it said in passing, are creditors) are

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> 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.

Bowen L.J. made the following comments at p. 583:

> The word "class" is vague, and to find out what is meant by it we must look at the scope of the section, which is a section enabling the Court to order a meeting of a class or classes to be called. It seems plain that we must give such a meaning to the term "class" as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.

8 There has been some jurisprudence over the years regarding creditor classification but, like the jurisprudence on other issues under the CCAA, it has intensified over the past five to ten years. One of the earlier cases of the present wave of jurisprudence dealing with creditor classification is *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. 20 (Alta. Q.B.). In that case Forsyth J. rejected the argument that different secured creditors should be placed in separate classes because they held separate security over different assets or because the relative values of their security were different. The Court rejected the "identity of interest" approach, which involves each class only containing creditors with identical interests. Instead, the Court followed the approach which I will call the "non-fragmentation" approach. This approach avoids the creation of a multiplicity of classes by including creditors with different legal rights in the same class as long as their legal rights are not so dissimilar that it is not possible for them to vote with a common interest. This is essentially the approach that was suggested by Bowen L.J. in the passage from the *Sovereign Life* quoted above (although his words have been incorrectly attributed to Lord Esher in at least one case authority and one article).

9 The approach taken in the *Oakwood Petroleums* case has been specifically adopted by the B.C. Court of Appeal in *Northland Properties Ltd., Re* (sub nom. *Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada*) (1989), 73 C.B.R. (N.S.) 195 (B.C. C.A.). In the lower court decision in that case the Court considered the similarities and dissimilarities of various mortgagees holding mortgages against different properties and concluded that they should be in the same class. Dealing with the points of dissimilarity, Trainor J. said as follows at p. 192 of (1988), 73 C.B.R. (N.S.) 175 (B.C. S.C.):

> The points of dissimilarity are that they are separate properties and that there are deficiencies in value of security for the loan, which vary accordingly for particular priority mortgagees. Specifically with respect to Guardian and Excelsior, they are both in a deficiency position.
>
> Now, either of the reasons for points of dissimilarity, if effect was given to them, could result in fragmentation to the extent that a plan would be a realistic impossibility. The distinction which is sought is based on property values, not on contractual rights or legal interests.

10 After the Court of Appeal in *Northland Properties* quoted the above passage, it said the following (at p. 203):

> I agree with that, but I wish to add that in any complicated plan under this Act, there will often be some secured creditors who appear to be oversecured, some who do not know if they are fully secured or not, and some who appear not to be fully secured. This is a variable cause arising not by any difference in legal interests, but rather as a consequence of bad lending, or market values, or both.

11 As the B.C. Court of Appeal has specifically adopted the reasoning in *Oakwood Petroleums*, the approach

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which I have called the "non-fragmentation" approach is the one to be followed in British Columbia. As will be seen shortly, the "non-fragmentation" approach has also been preferred over the "identity of interest" approach by the Ontario courts.

12 There have been two recent cases that are particularly relevant because they deal with employees, landlords and equipment lessors in circumstances that are similar to the situation at hand. The first of these cases is *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) where one of the proposed classes consisted of all creditors other than two secured creditors, including holders of unsecured debentures, terminated employees, landlords whose leases had been repudiated and equipment lessors whose leases were to be repudiated (although the report does not specifically say it, I assume that the proposed class also included the general trade creditors). The Court rejected the argument of one of the landlords that there should be a separate class of creditors consisting of the landlords and the equipment lessors. Borins J. utilized the "non-fragmentation" approach as illustrated by the following passage on pp. 317-318:

> 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 Corp.*, 16 C.B.R. 48, [1934] O.R. 653, [1934] 4 D.L.R. 626 (S.C.), 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 reorganization and that in the modern world of large and complicated 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.

13 The other recent decision is *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285 (Ont. Gen. Div.). In that case Houlden J.A. approved the classification of creditors into secured creditors, landlords and unsecured creditors. It appears from the report that the plan contemplated that some leases would be repudiated and there would be rent reductions in respect of certain of the continuing premises. I am told that the final plan of Grafton-Fraser Inc. did not include the landlords with continuing leases at reduced rental rates in the same class as the landlords whose leases were repudiated, but the decision of Houlden J.A. appears to be predicated on the fact that the two types of landlords would be in the same class. It had been argued that the landlords should be in the same class as the unsecured creditors. Houlden J.A. felt that it was appropriate to have the landlords in a separate class for two reasons; namely, there would be great difficulty in ascertaining the amounts of the claims of the landlords and the plan enjoined the landlords from exercising their contractual and statutory remedies.

14 Before I apply the general principles outlined above to the circumstances of this case, I wish to add some comments regarding the classification of creditors. The case authorities focus on the differences in the legal rights of the creditors in determining whether their interests are sufficiently similar or dissimilar to warrant creditors being placed in the same class or separate classes. I agree that it is the legal rights of the creditors that must be considered and that other external matters that could influence the interests of a creditor are not to be taken in account. However, it is my view that the legal rights should not be considered in isolation and that they must be considered within the context of the provisions of the reorganization plan. It would be appropriate to segregate two sets of creditors with similar legal interests into separate classes if the plan treats them differently. Conversely, it may be appropriate to include two sets of creditors with different legal rights in the same class if the plan treats them in a fashion that gives them a commonality of interest despite their different legal rights. In addition, when the Court is assessing whether there is a sufficient commonality of interest to include two sets of creditors in the same class, it is necessary in my view to examine their legal rights within the context of the potential failure of the reorganization plan. The treatment of the two sets of creditors under the plan should be compared to the rights they would have in the event of the failure of the

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plan (i.e., bankruptcy or other liquidation).

Terminated Employees

15 The first set of creditors that submitted that it should be in a separate class is the group of former employees of Woodward's who were terminated after December 11, 1992, the date of commencement of these CCAA proceedings. These former employees all have claims against Woodward's for damages as a result of Woodward's failure to give them reasonable notice of termination. The Reorganization Plan includes the terminated employees in the class of General Creditors which also includes the trade suppliers and other unsecured claims of the Operating Company. The Reorganization Plan proposes that the General Creditors receive 37% of the principal amounts of their proven claims.

16 The two counsel acting for former employees on this application submitted that their clients should comprise a separate class of creditors for several reasons. They say that the terminated employees are largely middle-aged, long service employees with limited education who have little prospect of finding alternate employment. They point to the fact that the courts recognize the difference between a contract of employment and an ordinary commercial contract. They further make reference to the fact that the trade suppliers will be selling merchandise to the reorganized company and that they will have a potentially continuing relationship which may influence the manner in which they vote on the plan. Finally, they say that the trade suppliers have the ability to "write off" their losses and that they will receive different income tax treatment in respect of their losses than the terminated employees.

17 In arguing that the terminated employees should form their own class, counsel relied on the article *Reorganizations under the Companies' Creditors Arrangement Act* (1947) 25 Can. Bar Rev. 587 by Stanley E. Edwards. This article has been relied upon extensively by the courts in interpreting the CCAA. However, the article has not been followed with respect to the classification of creditors. Mr. Edwards proposes the "identity of interest" approach which was not been adopted by the Alberta, British Columbia and Ontario courts. The preferred approach is the "non-fragmentation" approach.

18 The legal rights of the terminated employees are the same as the legal rights of the trade suppliers. They are both creditors with unsecured claims against the Operating Company (the secured and preferred amounts payable to employees under provincial legislation and the *Bankruptcy and Insolvency Act* have already been paid to the terminated employees). In a bankruptcy or other liquidation they would both receive the same pro rata amount of their claims. They are to receive the same pro rata amount of their claims under the Reorganization Plan.

19 The fact that there is a recognized difference between contracts of employment and ordinary commercial contracts is not relevant because the contracts of employment of the terminated employees have come to an end. The terminated employees have claims for damages against Woodward's for wrongful dismissal. Once the amount of damages for an employee has been agreed upon or determined by the Court, the difference between the two types of contracts becomes historical and the employee has the same rights as any other unsecured creditor. The differences between the two types of contracts may result in the employees receiving higher amounts of damages but the differences do not warrant the terminated employees being entitled to a higher distribution than the other unsecured creditors.

20 I am satisfied that there is a sufficient commonality of interest between the terminated employees and the other members of the General Creditors class that they should be included in the same class.

Equipment Financiers and Royal Trust Corporation of Canada

21 It is convenient to deal with the submissions of the equipment lessors and Royal Trust at the same time because if Royal Trust is not put in a class of its own, its alternate position was that it should be included in a class with the equipment lessors.

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22 The term "Equipment Financiers" is defined in the Reorganization Plan. In brief, the term means any person who has provided financing for the acquisition or installation of office equipment or trade fixtures and who has retained a security interest by way of a lease or a security instrument. Woodward's has notified or will be notifying certain equipment financiers that it no longer requires their equipment. These equipment financiers will then have a claim against Woodward's for damages resulting from the repudiation of their contractual arrangements. It is these equipment financiers who wish to be in a separate class. The Reorganization Plan proposes that the terminated equipment financiers be treated as General Creditors and that they receive 37% of the amounts of their claims. The amount of each claim would presumably be the discounted value of future payments owing by Woodward's to the equipment financier less the present value of the equipment.

23 Most of the equipment financiers are parties that bought the equipment and are leasing it to Woodward's on a normal type of term lease. The equipment financiers who are lessors include National Bank Leasing, North American Trust Company and Royal Bank Leasing. Royal Trust also falls within the definition of "Equipment Financier" but it is not a lessor. It financed the acquisition by Woodward's of certain equipment by way of a traditional financing arrangement. It loaned money to Woodward's on a term basis and it took security in the form of a debenture creating a fixed charge against the equipment that it financed.

24 In other contexts under the CCAA the treatment of equipment leases in relation to the treatment of security documents causes me considerable doubts. Should equipment leases be treated the same as security instruments in all or some cases? Does it make a difference whether the lease is classified as an operating lease or a capital lease? Should the extent of depreciation of the subject asset be taken into account? Fortunately these questions can be left for another time because they do not need to be resolved in order to deal with the classification issue.

25 Lessors and debentureholders do have different legal rights but the question to be answered is whether the different rights result in a lack of commonality of interest. In a bankruptcy a lessor is entitled to retake possession of the leased goods upon default and, if the lease is worded properly, the lessor is entitled to prove as an unsecured creditor for its damages. In the case of a debentureholder in a bankruptcy situation, the debentureholder has the right to cause the charged assets to be sold and it is entitled to prove as an unsecured creditor for the deficiency on its loan. In most cases the damages of the lessor and the deficiency on the debentureholder's loan will be equivalent; namely, the difference between the present value of the monies that are owed and the value of the leased goods or the charged assets. Hence, the rights of an equipment lessor and the rights of a debentureholder with a fixed charge on financed equipment in a bankruptcy situation are roughly the same. The equipment lessors and Royal Trust are being treated the same under the Reorganization Plan. Therefore, there is a sufficient commonality of interest for Royal Trust to be included in the same class as the equipment lessors.

26 Some submissions were made with respect to the priority between Royal Trust and The R-M Trust Company which is the sole Secured Creditor under the Reorganization Plan. I do not accept the contention that Royal Trust has priority over The R-M Trust Company on any of Woodward's assets other than the ones that are covered by the fixed charge in favour of Royal Trust.

27 The question then becomes whether the equipment financiers (including Royal Trust) belong in a separate class or in the class of General Creditors. This is an example of why the legal rights of the parties must be examined within the context of the Reorganization Plan. In isolation the rights of the equipment financiers and the rights of unsecured creditors are very different. But the treatment of the two groups in the Reorganization Plan could affect their interests.

28 If the Reorganization Plan provided that Woodward's was to retain the financed equipment and the equipment financiers were to be paid the same proportion of their indebtedness as the unsecured creditors, the equipment financiers would be entitled to be included in a different class from the unsecured creditors. They would be losing their

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proprietary or security rights in the equipment and they would be receiving the same pro rata distribution as unsecured creditors who do not have same rights. However, that is not what the Reorganization Plan is proposing.

29 The Reorganization Plan does not affect any of the proprietary or security rights of the equipment financiers. Woodward's is allowing the equipment financiers to fully exercise those rights outside of the Reorganization Plan. All the Reorganization Plan is purporting to affect are the claims of the equipment financiers for damages or the deficiencies on loans. These claims are unsecured claims and there is no reason why they should be treated any differently than the claims of unsecured creditors. There is a sufficient commonality of interest between the unsecured creditors and the equipment financiers with respect to their unsecured claims for damages or the deficiencies on loans. It is appropriate to include the equipment financiers in the class of General Creditors with respect to these claims.

30 This classification of the equipment financiers is consistent with the decision in *Sklar-Peppler, supra,* where the Ontario Court of Justice approved the grouping of equipment lessors in the same class as the unsecured creditors.

Holders of Guarantees or Joint Covenants

31 The class of General Creditors is comprised of creditors of the Operating Company. However, at least two of these creditors hold a guarantee or joint covenant of the Holding Company. National Bank Leasing holds a guarantee from the Holding Company and the debenture held by Royal Trust is a joint debenture from the Operating Company and the Holding Company. For ease of reference I will refer to a creditor holding a guarantee or joint covenant of the Holding Company as the holder of a guarantee and such reference shall also include the holder of a joint covenant.

32 The Holding Company does not own any tangible assets. Other than the shares in the Operating Company, the only asset owned by the Holding Company is an inter-company account owed to it by the Operating Company. This inter-company account means that upon the bankruptcy or other liquidation of the Operating Company, the Holding Company would be an unsecured creditor entitled to share on a pro rata basis in distributions to the unsecured creditors of the Operating Company. If the Holding Company was also to be liquidated, the money received on account of the inter-company receivable would be distributed to the creditors of the Holding Company, including creditors of the Operating Company with guarantees from the Holding Company and other unsecured creditors if sufficient monies were available to fully satisfy the secured and preferred creditors of the Holding Company. The result is that unsecured creditors of the Operating Company with guarantees from the Holding Company may receive more money than the other unsecured creditors of the Operating Company in the event of bankruptcies or other liquidations of the two companies.

33 On April 16, 1993 the Monitor appointed in these proceedings issued a report confirming that upon a liquidation of the two companies, the unsecured creditors of the Holding Company would receive a distribution. The Monitor estimates a liquidation distribution for the unsecured creditors of the Holding Company to be in the range from 2% to 12%.

34 The distinction between the interests of the unsecured creditors of the Operating Company and the interests of the unsecured creditors of the Holding Company is recognized in the classification of the creditors in the Reorganization Plan. The unsecured creditors of the Holding Company are included in the class of Noteholders which is a different class from the General Creditors, the class that includes the unsecured creditors of the Operating Company. It is proposed in the Reorganization Plan that the Noteholders receive 32% of their indebtedness.

35 The Reorganization Plan ignores the fact that the holders of guarantees are unsecured creditors of both companies. It proposes that they receive the same 37% proportion of their indebtedness as the other General Creditors and their status as creditors of the Holding Company is not reflected.

36 In view of the fact that the holders of guarantees do have different legal rights from the other members of the

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class of General Creditors, it is necessary to decide whether the rights are so dissimilar that they cannot vote on the Reorganization Plan with a common interest. It was submitted by counsel for Woodward's that there is a common interest because the holders of guarantees will still receive more under the Reorganization Plan that they will be paid upon a liquidation of the two companies. I do not think that this is sufficient to create a commonality of interest with the other members in the class of General Creditors who have lesser legal rights. To the contrary, I believe that this is an example of what Bowen L.J. had in mind in the *Sovereign Life* case, *supra*, when he used the term "confiscation". By being a minority in the class of General Creditors, the holders of guarantees can have their guarantees confiscated by a vote of the requisite majority of the class who do not have the same rights. The holders of guarantees could be forced to accept the same proportionate amount as the other members of the class and to receive no value in respect of legal rights that they uniquely enjoy and that would have value in a liquidation of the two companies.

37 The passage from *Sklar-Peppler* quoted above made reference to the decision in *Re Wellington Building Corp.*, *supra* [(1934), 16 C.B.R. 48 (Ont. S.C.)]. In that case the Court was asked to approve a scheme of arrangement under the CCAA that had one class of secured creditors which included boldholders, lienholders, third mortgagee and fourth mortgagees. The Court refused to approve the scheme on the basis that there should have been more than one class of secured creditors. Kingstone J. said the following at p. 54 of 16 C.B.R.:

> ... it was necessary under the Act that they should vote in classes and that three-fourths of the value of each class should be obtained in support of the scheme before the Court could or should approve of it. Particularly is this the case where the holders of the senior securities' (in this case the bondholders') rights are seriously affected by the proposal as they are deprived of the arrears of interest on their bonds if the proposal is carried through. It was never the intention under the Act, I am convinced, to deprive creditors in the position of the bondholders of their right to approve as a class by the necessary majority of a scheme propounded by the company which would permit the holders of junior securities to put through a scheme inimicable to this class and amounting to confiscation of the vested interest of the bondholders.

38 In *Re 229531 B.C. Ltd.* (1989), 72 C.B.R. (N.S.) 310 (B.C. S.C.) the Court refused to approve a plan of arrangement under the CCAA for numerous reasons. One of the reasons was that a guarantee held by one creditor was to be released as a result of the reorganization plan and the creditor was to receive the same proportionate distribution as all of the other unsecured creditors. In other words, the guarantee was being confiscated by the vote of other creditors who did not enjoy the same rights as the creditor which held the guarantee.

39 If it was clear that no monies would be available to unsecured creditors upon a liquidation of the Holding Company, the legal rights of the holders of the guarantees would have no practical value and there would then be no objection to their inclusion in the class of General Creditors. There is also a point where the prospects of the unsecured creditors of the Holding Company receiving any monies upon its liquidation would be so uncertain that the commonality of interest between the holders of the guarantees and the other members of the class of General Creditors would not be affected. However, I am not satisfied in this case that such prospects are so uncertain that the holders of guarantees should be forced to be in the same class as the other unsecured creditors of the Operating Company. In making this statement, I note that the unsecured creditors of the Holding Company are to receive 32% of their indebtedness under the Reorganization Plan.

40 I should stress that it is important in my view that there is only one difference between the rights of the holders of the guarantees and the rights of the other members of the class of General Creditors. It is clear that the one additional right enjoyed by the holders of the guarantees is not being given any value under the Reorganization Plan. The result could be different if the other members of the class of General Creditors had additional rights that were not enjoyed by the holders of the guarantees. There could be a trade-off between the rights that were not commonly shared and the groups could have a sufficient commonality of interest to be included in the same class. Here, there is no potential trade-off between the two groups and the one additional right of the holders of the guarantees is being confiscated without compensation.

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41 Counsel for Woodward's suggested that the issue of the guarantees be left to the fairness hearing (i.e., the hearing to consider the sanctioning of the Reorganization Plan). As I believe that the holders of guarantees have a sufficiently different legal right to warrant a separate classification, it follows that I would consider the Reorganization Plan to be unfair to them if they are included in the class of General Creditors. I should not order meetings for the creditors to vote on the Reorganization Plan when I know that those meetings would be fruitless because I would refuse to approve the outcome of the meetings.

Landlords

42 Counsel for Triple Five Corporation Limited submitted that there should be two classes of landlords, one class consisting of landlords with anchor tenants whose leases are being repudiated and the other class consisting of the remaining landlords. Counsel for Bucci Investment Corporation and Prospero International Realty Inc. submitted that there should be three classes of landlords, one class consisting of landlords with anchor tenants whose leases are being repudiated, a second class consisting of landlords without anchor tenants whose leases are being repudiated and the third class consisting of the remaining landlords.

43 Counsel for Triple Five Corporation Limited put forward three reasons in support of his position. A fourth reason was also put forward initially but it was withdrawn and reserved for the fairness hearing. The three reasons are as follows:

(a) a repudiation of a lease by an anchor tenant will cause the landlord to be in breach of other contractual obligations and the consequences of such a repudiation go beyond the liquidated damages that result from the repudiation of a lease by a tenant other than an anchor tenant;

(b) there is no precedent for the selective repudiation of leases under the CCAA and Woodward's has chosen not utilize the proposal provisions of the *Bankruptcy and Insolvency Act* that now has a procedure for the repudiation of leases;

(c) Zellers Inc. (and its parent, The Hudson's Bay Company) is a stranger to the relationship between Woodward's and its creditors and its involvement in Woodward's reorganization (by way of a merger with the reorganized company) requires a higher degree of fairness.

44 In my view, none of these reasons is a valid justification for the creation of a separate class of landlords:

(a) the additional consequences of a repudiation by an anchor tenant flow from external considerations and the different consequences to different landlords does not result from different legal rights existing between the landlords and Woodward's. As was held in *Northland Properties, supra*, separate creditor classification must be based on a difference in legal interests or rights;

(b) *Sklar-Peppler, supra*, and *Grafton-Fraser, supra*, are both examples of reorganizations involving repudiations of leases. The fact that the *Bankruptcy and Insolvency Act* now specifically provides for the repudiation of leases does not mean that a reorganization involving lease repudiation cannot be attempted under the CCAA and it certainly does not mean that there should be separate classes of landlords;

(c) the aspect of fairness is a matter to be considered on the application for the Court to sanction the Reorganization Plan. The application is commonly called the fairness hearing. There is nothing in the involvement of Zellers Inc. that requires the creation of separate classes for landlords.

45 Counsel for Bucci and Prospero did not put forward any independent grounds for the creation of separate landlord classes. His point was that if there was justification for the creation of a separate class for landlords with

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anchor tenants whose leases were being repudiated, there was equal justification for the creation of a separate class for the other landlords whose leases were being repudiated.

46 There was one point that bothered me about the grouping of all the landlords into a single class. In addition to including landlords whose leases were being repudiated, the class includes landlords who are having their leases partially repudiated by the unilateral reduction in the amount of leased space and landlords who are having the rent under their leases unilaterally reduced. Both of these two groups of landlords would be having a continuing relationship with Woodward's. Unlike the trade suppliers, the continuing relationship between these landlords and Woodward's is based on legal rights. I was concerned that the continuing legal relationship between these landlords and Woodward's may give them a different interest from interests of the landlords whose leases are being wholly repudiated. For example, the continuing landlords may be more willing to vote in favour of the Reorganization Plan because they will be able to recoup some of their losses from the profits generated out of the continuing relationship with Woodward's. The answer to my concern is that the rent under all of the continuing leases is to be adjusted to market rent. The landlords whose leases are being repudiated will also be leasing their premises to new tenants at market rent. Accordingly, the landlords with continuing leases will not have any advantage over the other landlords and there will be sufficient commonality of interest to include all of the landlords in one class.

47 During submissions I queried whether the landlords should be included in the class of General Creditors. At first blush a landlord whose lease is being repudiated is in the same position as the other unsecured creditors of the Operating Company. The reason why it is appropriate for the Landlords to be in a different class is that they receive different treatment under the Reorganization Plan. The General Creditors are to be paid 37% of their claims while the Landlords are to be paid an amount equal to six months' rent. One reason for the different treatment is the fact that it is very difficult to properly quantify the claims of the Landlords and the efforts of the Landlords to mitigate their damages will not be known prior to the implementation of the Reorganization Plan. This rationale was accepted in *Grafton-Fraser, supra*, where the Court approved a separate classification for the landlords. Another justification for the different treatment is the fact that the *Bankruptcy and Insolvency Act* provides that landlords whose leases are repudiated are entitled to compensation equal to six months' rent.

48 In the *Grafton-Fraser* case, *supra*, the Court approved a landlord class which, at least at the time of the decision, appeared to include both landlords with repudiated leases and landlords with continuing leases at reduced rental rates.

49 It is my view that there is sufficient commonality of interest among the landlords for all of them to be included in a single class. I am reinforced in my decision by the positions of the other landlords represented by counsel at the hearing. Mr. Kuhn, Mr. Knowles and Mr. Mitchell, who each represent landlords in each of the three proposed landlord classes, all supported the single class for the landlords and that position in itself demonstrates that the landlords do have a commonality of interest.

Conclusion

50 I approve the classes of creditors designated in the Reorganization Plan with the exception that the class of General Creditors should not include creditors of the Operating Company who hold guarantees or joint covenants from the Holding Company. I dismiss the application of the terminated employees for separate classification and I reject the other submissions for separate classifications.

Order accordingly.

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TAB 6

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1989 CarswellBC 330, 72 C.B.R. (N.S.) 310

229531 British Columbia Ltd., Re

Re 229531 B.C. Ltd.

British Columbia Supreme Court

Hinds J.

Heard: November 14, 15 and 17, 1988
Judgment: January 16, 1989
Docket: Vancouver No. A881623

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Counsel: *D.W. Donohoe*, for petitioner.

P.S. Hyndman, for Pontiac Holdings Ltd.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangement Act — Arrangements — Approval by Court — "Fair and reasonable".

Corporations — Arrangements and compromises — Companies' Creditors Arrangement Act — Debtor company applying for court approval of arrangement — Arrangement releasing debtor's principals from personal guarantees and improperly treating liquor licence as asset of debtor — Arrangement not fair and reasonable to creditor landlord, and not complying with legislation — Creditors not voting in classes — Original ex parte application not disclosing material information — Application dismissed.

The debtor company operated a cabaret in premises leased from P. Ltd. which had been renovated at the debtor's expense. It failed to pay for most of the renovations, and liens were filed against the premises. The major lien holder B. Corp. obtained judgment against both the debtor, who authorized the renovations, and P. Ltd. who owned the building. The combination of this judgment, the other liens, and rental arrears owing to P. Ltd. caused the debtor to become insolvent and to seek relief under the Companies' Creditors Arrangement Act. An ex parte order was granted authorizing the debtor to file a reorganization plan between it and its secured and unsecured creditors.

A meeting of creditors was held. P. Ltd. attended and, prior to the convening of the meeting, attempted to obtain changes to the plan. P. Ltd. was unsuccessful, and left prior to the formal commencement of the meeting. The plan was unanimously approved by the secured and unsecured creditors who voted. The debtor applied under s. 6 for court approval of the plan.

Held:

Application dismissed.

Before exercising discretion to approve a plan of arrangement, a judge should consider whether all statutory requirements which are in the nature of conditions precedent have been strictly complied with, whether anything not authorized by statute has been done and whether the plan of arrangement is fair and reasonable. In this case all statutory requirements which were conditions precedent under the Act had been strictly complied with, but the material sent out to the creditors did not comply with s. 277 of the Company Act. Furthermore, things had been done which were not authorized by statute. The debtor had not identified the various classes of creditors, as required by ss. 4, 5 and 6, but had simply taken a pool vote.

The arrangement was not fair and reasonable to P. Ltd., as the plan would release the principals of the debtor company from liability under their personal guarantees to P. Ltd. The plan relied upon the use of a liquor licence which was treated as an asset of the debtor but which belonged to the principals of the debtor and had been pledged to P. Ltd. as additional security for rent. P. Ltd. argued that it was a secured creditor. If this were held to be so, the plan likely was not approved by at least three-fourths of that class of creditors, as required by the Act. In addition, the plan assumed a dramatic reversal in the debtor's business, and appeared to be economically unfeasible.

As well, there were shortcomings in the manner in which the debtor's original ex parte application had been brought. The Act refers to "a summary application", which does not necessarily mean an ex parte application. Also, the material filed on that application failed to disclose some material information. While none of these individual circumstances would necessarily be fatal to the application, their cumulative effect should cause the court to exercise its discretion under s. 6 of the Act and refuse to sanction the plan.

Cases considered:

Alabama, New Orleans, Texas & Pac. Junction Ry. Co., Re, [1891] 1 Ch. 213, 60 L.J. Ch. 221 (C.A.) — *considered*

Can. Hidrogas Resources Ltd., Re, [1979] 6 W.W.R. 705, 8 B.L.R. 104 (B.C.S.C.) — *referred to*

Dairy Corp. of Can., Re, [1934] O.R. 436, [1934] 3 D.L.R. 347 (C.A.) — *applied*

Northland Properties Ltd., Re (1988), 31 B.C.L.R. (2d) 35 (S.C.) — *distinguished*

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

Statutes considered:

Bankruptcy Act, R.S.C. 1970, c. B-3 [now R.S.C. 1985, c. B-3]

Company Act, R.S.B.C. 1979, c. 59

s. 276

s. 277(1)

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Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25 [now R.S.C. 1985, c. C-36]

ss. 2-7

Application for approval of reorganization plan.

***Hinds J.*:**

Introduction

1 The petitioner has applied under s. 6 of the Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25 ("the Act"), for sanction of a compromise or arrangement reached between the petitioner and most of its creditors under the provisions of the Act. It will be called the "reorganization plan". It is opposed by Pontiac Holdings Ltd. ("Pontiac").

Background and Chronology of Events

2 Since October 1986 the petitioner has operated a cabaret at 1250 Richards Street, Vancouver, British Columbia, under the name of "Graceland". The premises were leased from Pontiac and were renovated by the petitioner at its expense. It failed to pay for much of the renovations, with the result that liens totalling approximately $475,000 were filed against the premises. The major lien holder, Barclay Construction Corp. ("Barclay"), sued the petitioner and Pontiac and after a trial in the spring of 1988, judgment was granted against both the petitioner, as the party authorizing the renovations, and Pontiac, as the owner of the building in which the leased premises were located.

3 Due to the foregoing judgment, the claims of the other lien holders, the claim of Pontiac for rental arrears of approximately $378,000 and other business reverses, the petitioner became insolvent. The two shareholders of the petitioner, who are the sole directors and officers of the company, decided to attempt to obtain relief under the provisions of the Act, rather than apply under the Bankruptcy Act, R.S.C. 1970, c. B-3.

4 The Act came into force in 1933. It was part of Canada's depression legislation. It was frequently used during the depression years, but later it fell into disuse. Recently reliance upon it has been revived.

5 On 3rd June 1988 the petitioner filed under the Act a petition and supporting affidavits. The matter was heard ex parte on 6th June 1988, and an order was granted ("the first order") whereby, inter alia, the petitioner was authorized to file on or before 15th July 1988 the reorganization plan between the petitioner and its secured and unsecured creditors. On 15th July 1988 an amended petition was filed, which incorporated a number of matters referred to in the first order.

6 On 4th August 1988 Barclay filed a notice of motion to set aside the first order. Negotiations ensued between Barclay and the petitioner and they reached a compromise. The Barclay application was adjourned sine die.

7 The meeting of creditors which had been scheduled to be held on 19th August 1988 was adjourned to 8th September 1988, by an order dated 11th August 1988 ("the second order"). On 30th August 1988 a further amended petition was filed. On 8th September 1988 the meeting of creditors scheduled to be held on that date was adjourned to 26th September 1988 by a further order ("the third order"). On the date last mentioned the meeting of creditors was finally held. Pontiac and its solicitors attended the meeting and, before it was formally convened, they endeavoured to obtain changes in the reorganization plan. They were unsuccessful and they left the meeting before its formal commencement. The reorganization plan was approved unanimously by the secured and unsecured creditors who voted at the meeting.

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8 On 31st October 1988 a notice of motion and a further further amended petition were filed by the petitioner. The matter was adjourned from time to time and eventually came on before me on 14th November 1988.

9 The hearing of the "further-further-amended" petition was supported by voluminous affidavits with numerous exhibits attached thereto, filed by both sides. During the course of the hearing counsel for the petitioner was granted leave, over the objection of counsel for Pontiac, to file a further affidavit. Following the completion of the hearing counsel for the petitioner forwarded to the registry, with the consent of counsel for Pontiac, a letter requesting a number of amendments to the proposed order, which would include minutes pertaining to the details of the reorganization plan. In effect, it amounts to a further-further-further-amended petition.

Issue

10 The issue to be determined on this application is whether, under s. 6 of the Act, the reorganization plan should be sanctioned by the court.

The Act

11 In order to place the foregoing issue in perspective, reference to ss. 2 to 7 of the Act will be of assistance.

12 Section 2 provides for various definitions, including a definition for "debtor company". It is defined to mean:

> 13 ... any company that is bankrupt or insolvent or has committed an act of bankruptcy within the meaning of the *Bankruptcy Act* or is deemed insolvent within the meaning of the *Winding-up Act*, whether or not proceedings in respect of such company have been taken under either the *Winding-up Act* or the *Bankruptcy Act*, or has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy Act*, or is in course of being wound up under the *Winding-up Act* because the company is insolvent ...

14 Section 3 deals with the application of the Act; it states:

> 15 3. This Act does not apply in respect of a debtor company unless
>
> 16 (*a*) the debtor company has outstanding an issue of secured or unsecured bonds, debentures, debenture stock or other evidences of indebtedness 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
>
> 17 (*b*) the compromise or arrangement that is proposed under section 4 or section 5 in respect of the debtor company includes a compromise or arrangement between the debtor company and the holders of an issue referred to in paragraph (*a*).

18 Section 4 deals with a compromise involving unsecured creditors; it provides:

> 19 4. Where a compromise or 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 or of any such creditor or of the trustee in bankruptcy or liquidator of the company, order a meeting of such creditors or class of creditors, and, if the court so determines, of the shareholders of such company, to be summoned in such manner as the court directs.

20 Section 5 deals with a compromise involving secured creditors. In all other respects it is the same as s. 4.

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21 Section 6 involves the sanction of a compromise by the court. It states:

> 22 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 such sections, agree to any compromise or arrangement either as proposed or as altered or modified at such meeting or meetings, the compromise or arrangement may be sanctioned by the court, and if so sanctioned is binding 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 is also binding on the company, and 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 course of being wound up under the *Winding-up Act*, is also binding on the trustee in bankruptcy or liquidator and contributories of the company.

It is noted that the sanction to be given by the court is discretionary, not mandatory.

23 Section 7 deals with directions which may be given by the court. It states:

> 24 7. Where an alteration or modification of any compromise or arrangement is proposed at any time after the court has directed a meeting or meetings to be summoned, such meeting or meetings may be adjourned on such term as to notice and otherwise as the court may direct, and such directions may be given as well after as before adjournment of any meeting or meetings, and the court may in its discretion direct that it shall not be necessary to adjourn any meeting or to convene any further meeting of any class of creditors or shareholders that in the opinion of the court is not adversely affected by the alteration or modification proposed, and a compromise or arrangement so altered or modified may be sanctioned by the court and have effect under section 6.

25 Unlike the Bankruptcy Act, which has many sections and involves much detailed legislation, the Act has only a limited number of sections and is sparse in detail. Its final section, s. 20, provides that the Act is to be applied conjointly with other federal and provincial Acts. It states:

> 26 20. The provisions of this Act may be applied conjointly with the provisions of any Act of Canada or of any province, authorizing or making provision for the sanction of compromises or arrangements between a company and its shareholders or any class of them.

27 Pursuant to the provisions of s. 20, both counsel acknowledged that some sections of the Company Act, R.S.B.C. 1979, c. 59 ("the Company Act"), may be applicable to the circumstances of this application.

Principles Involved in Discretionary Sanction

28 In *Re Dairy Corp. of Can.*, [1934] O.R. 436, [1934] 3 D.L.R. 347 (C.A.), Middleton J.A., in considering the provisions of the Ontario Companies Act, stated, at p. 439:

> 29 Upon this motion I think it is incumbent upon the Judge to ascertain if all statutory requirements which are in the nature of conditions precedent have been strictly complied with and I think the Judge also is called upon to determine whether anything has been done or purported to have been done which is not authorized by this Statute. Beyond this there is, I think, the duty imposed upon the Court to criticize the scheme and ascertain whether it is in truth fair and reasonable.

30 That statement of general principle has been cited with approval in many subsequent cases and is applicable to the sanction by the court of an arrangement made under the Act and under the Company Act: see *Re Wellington Bldg. Corp.*, [1934] O.R. 653, 16 C.B.R. 48, [1934] 4 D.L.R. 626 (S.C.), and *Re Can. Hidrogas Resources Ltd.*, [1979] 6 W.W.R. 705, 8 B.L.R. 104 (B.C.S.C.), respectively.

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31 The first matter to be determined is whether there was compliance with the statutory requirements in the nature of conditions precedent. Counsel for Pontiac conceded that the petitioner comes within the definition of a "debtor company" in s. 2 of the Act, and that it has an outstanding issue of secured or unsecured bonds, as required by s. 3 of the Act. Compliance was therefore made with the conditions precedent under the Act.

32 By s. 20 of the Act the provisions of the Company Act making provision for the sanction of compromises or arrangements is to be applied conjointly with the provisions of the Act. Section 276 of the Company Act provides for court sanction of a compromise or arrangement between a company and its creditors in terms not dissimilar to the terms contained in the Act. Section 277(1) of the Company Act deals with the information respecting the compromise or arrangement which is to be sent to the creditors. It states:

> 33 277. (1) Where a meeting is convened under section 276, the company shall include in any notice of the meeting
>
> 34 (*a*) that is sent to a creditor or member of a company, a statement, which may be included in the information circular or a reporting company, explaining the effect of the compromise or arrangement and in particular stating
>
> 35 (i) any material interest of every director and officer, whether as director, officer, member or creditor of the company, or otherwise; and
>
> 36 (ii) the effect of the compromise or arrangement on those persons in so far as it is different from the effect on the like interests of other persons ...

37 The material which accompanied the notice of meeting of creditors sent out by the petitioner failed to comply with the requirements of s. 277(1)(*a*)(i) and (ii) of the Company Act.

38 The second general principle to be considered is "whether anything has been done or purported to have been done which is not authorized by the statute". Unlike the more careful procedures followed in *Re Northland Properties Ltd.*, a decision of Trainor J., 5th August 1988, Vancouver No. A880966, B.C.S.C. [now reported 31 B.C.L.R. (2d) 35], no application was made to the court for directions for the determination of the constitution of classes of creditors prior to the meeting of creditors held on 29th September 1988. At that meeting there was no separation of the major groups of creditors, secured or unsecured, and there was no separation of the classes within those major groups of creditors. A pool vote of all creditors was taken. That procedure fell short of the underlying requirements of ss. 4, 5 and 6 of the Act, where the "unsecured creditors or any class of them", the "secured creditors or any class of them", and "three-fourths in value of the creditors, or class of creditors, as the case may be" are referred to, respectively.

39 In *Re Wellington Bldg. Corp.*, supra, Kingstone J. accepted the following statements made in *Re Alabama, New Orleans, Texas & Pac. Junction Ry. Co.*, [1891] 1 Ch. 213, 60 L.J. Ch. 221 (C.A.), which set forth the reason for creditor classification in the type of legislation contained in the Act. At p. 243 [Ch.] Bowen L.J. stated:

> 40 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.

At p. 245 [Ch.] he stated:

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> 41 It is in my judgment desirable to call attention to this section, and to the extreme care which ought to be brought to bear upon the holding of meetings under it. It enables a compromise to be forced upon the outside creditors by a majority of the body, or upon a class of the outside creditors by a majority of that class.

42 The third general principle to be considered is whether the compromise or arrangement is fair and reasonable.

43 In general terms, the essence of the reorganization plan is that for a period starting in August 1988 and continuing until the autumn of 1989, or perhaps a little longer, a monthly amount will be paid by the petitioner to a trustee which will enable interest at 5 per cent per annum to be paid on the debts of the petitioner, which will amount to approximately $1,800,000. The liquor licence presently used by the cabaret is a preclearance class C licence. It is anticipated that in the fall of 1989 application can be made for a permanent liquor licence. It is then intended to sell the cabaret and to distribute the proceeds equally between all of the creditors save and except Messrs. Vincent Alvaro and Neil McPherson, the two shareholders of the petitioner, who are creditors of the petitioner to the extent of approximately $450,000 and who shall not receive repayment until all other creditors have been paid in full. There is some vague indication in the material that the cabaret with a permanent liquor licence may be worth $600,000. If that selling price is achieved, and if the claims of Messrs. Alvaro and McPherson are excluded, the other creditors may receive approximately 50 per cent of their claims. The amount they receive on the sale of the cabaret will be deemed to be satisfaction in full of their total claims.

44 The reorganization plan is unacceptable to Pontiac, for several reasons. It holds the joint and several personal guarantee of Messrs. Alvaro and McPherson with respect to the payment of rent by the petitioner. The anticipated distribution to creditors under the reorganization plan would release Messrs. Alvaro and McPherson of their liabilities to Pontiac under the guarantee.

45 The pre-clearance class C licence is held in the names of Messrs. Alvaro and McPherson. It was pledged by them to Pontiac as additional security for the payment of rent by the petitioner. The reorganization plan improperly treats it as an asset belonging to the petitioner. In effect, the reorganization plan confiscates, for the benefit of all of the other creditors, the security held by Pontiac.

46 Pontiac claims that it is a secured creditor of the petitioner due to its status as its landlord. It further claims that the lien holders are secured creditors and if Pontiac is obliged to pay off the lien holders it will be subrogated to their secured creditor status. The petitioner rejects the contention that Pontiac occupies the position of a secured creditor, but no application to court for directions has been made. If Pontiac is held to be a secured creditor, the approval of the reorganization plan by at least three-fourths of that class of creditors would likely fail.

47 The evidence on the hearing of the petition establishes that in the past the cabaret has not been profitable. Indeed, it has been highly unprofitable. The petitioner now proposes to set aside $1,000 per week starting 22nd August 1988, for 11 consecutive weeks, and then to set aside $2,000 per week for 41 weeks, at the end of which time the trustee receiving the weekly payments would have accumulated $93,000. That would be just sufficient to pay interest at 5 per cent per annum for one year on the petitioner's outstanding debts of $1,800,000. The reorganization plan presupposes a dramatic reversal in the business fortunes of the petitioner. The petitioner has not provided to the creditors or to the court a balance sheet or appraisals of the market value of the cabaret. Some evidence was led concerning a recent increase in the gross sales of the petitioner but, significantly, no evidence was adduced concerning an improvement in the net profit of the petitioner. An increase in gross sales does not necessarily result in an increase in net profits.

48 On the evidence I am not satisfied that the reorganization plan is fair and reasonable. Looking at it critically, I am not satisfied that it is economically feasible.

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49 There are other matters of concern involved in this application. Sections 4 and 5 of the Act refer to an application "in a summary way". That does not necessarily mean an application ex parte, which was the procedure followed in this case. Moreover, the material filed in support of the ex parte order (the first order) failed to disclose to the court some material information. It failed to disclose: that the cabaret licence was pledged to Pontiac; that it owed approximately $350,000 in lease arrears to Pontiac; and that, while it had made payments of $65,000 to the lien claimants, it had done so only by means of discontinuing rental payments to Pontiac.

50 In summary, I do not consider that the failure of the petitioner to comply with the requirements of s. 277(1) of the Company Act, its failure to comply with the second general principle above described, its failure with respect to the third general principle (that the reorganization plan be fair and reasonable), or the shortcomings with respect to the ex parte application, taken individually, are necessarily fatal to this application. However, the cumulative effect of the foregoing matters causes me to exercise my discretion under s. 6 of the Act and to refuse to sanction the reorganization plan. That particular relief sought in the petition is denied. Costs will follow the event.

Application dismissed.

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TAB 7

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2004 CarswellAlta 1241, 2004 ABQB 705, [2004] A.W.L.D. 579, 5 C.B.R. (5th) 92, 359 A.R. 71, 42 Alta. L.R. (4th) 352, 134 A.C.W.S. (3d) 239

San Francisco Gifts Ltd., Re

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

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

Alberta Court of Queen's Bench

Topolniski J.

Heard: September 1, 2004
Judgment: September 28, 2004[FN*]
Docket: Edmonton 0403-00170

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

Michael J. McCabe, Q.C. for Monitor

Subject: Insolvency; Property

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

SF group of companies ("SF group") obtained protection under Companies' Creditors Arrangement Act under consolidated initial order — SF group was comprised of operating company and number of nominee companies — Op-

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

Cases considered by *Topolniski J.*:

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

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

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

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

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

Canadian Airlines Corp., Re (2000), 2000 ABCA 149, 2000 CarswellAlta 503, 80 Alta. L.R. (3d) 213, 19 C.B.R. (4th) 33, 261 A.R. 120, 225 W.A.C. 120 (Alta. C.A. [In Chambers]) — referred to

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

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

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2004 CarswellAlta 1241, 2004 ABQB 705, [2004] A.W.L.D. 579, 5 C.B.R. (5th) 92, 359 A.R. 71, 42 Alta. L.R. (4th) 352, 134 A.C.W.S. (3d) 239

— referred to

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

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

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

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

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

Olympia & York Developments Ltd., Re (March 14, 1994), Doc. B125/92 (Ont. Gen. Div. [Commercial List]) — referred to

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

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

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

Smoky River Coal Ltd., Re (1999), 1999 CarswellAlta 491, 175 D.L.R. (4th) 703, 237 A.R. 326, 197 W.A.C. 326, 71 Alta. L.R. (3d) 1, [1999] 11 W.W.R. 734, 12 C.B.R. (4th) 94, 1999 ABCA 179 (Alta. C.A.) — referred to

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

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

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

Statutes considered:

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

Generally — referred to

s. 4 — referred to

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s. 4(3)(c) — referred to

s. 54(3) — referred to

Commercial Tenancies Act, R.S.O. 1990, c. L.7

Generally — referred to

ss. 48-50 — referred to

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

Generally — referred to

s. 2 — referred to

s. 6 — referred to

Distress for Rent Act, 1737 (11 Geo. 2), c. 19

Generally — referred to

s. 1 — referred to

Landlord and Tenant Act, R.S.N.B. 1973, c. L-1

Generally — referred to

s. 27 — referred to

s. 29 — referred to

Tenancies and Distress for Rent Act, R.S.N.S. 1989, c. 464

Generally — referred to

s. 13 — referred to

s. 14 — referred to

Rules considered:

Alberta Rules of Court, Alta. Reg. 390/68

Generally — referred to

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Tariffs considered:

Alberta Rules of Court, Alta. Reg. 390/68

Sched. C, Tariff of Costs, column 1 — referred to

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

***Topolniski J.*:**

Introduction

1 The San Francisco group of companies (San Francisco) obtained *Companies' Creditors Arrangement Act*[FN1] (*CCAA*) protection on January 7, 2004 under a consolidated Initial Order. The Initial Order has been extended and the companies continue in business. They now propose a compromise of their debt that is spelled out in a plan of arrangement ("Plan") that has been circulated to their creditors. Like all *CCAA* plans of arrangement, this Plan proposes classes of creditors for voting purposes. Two-thirds in value and a majority in number of the creditors in each class must cast a positive vote for the Plan in order for it to pass muster. If approved, the Plan will then be presented to the Court for sanctioning at what is commonly referred to as a "fairness hearing".[FN2] These steps have been delayed by the present application.

2 The six applicants are landlords (the "objecting landlords") of retail premises in Ontario, New Brunswick, Nova Scotia and Newfoundland that were leased to San Francisco. The leases were either abandoned by San Francisco before the *CCAA* proceedings began or were later terminated with court approval. The objecting landlords seek to reclassify the creditors of San Francisco for purposes of voting on the Plan. They rely on three grounds for their application. First, they argue that they should be placed in a separate class because they have distinct legal rights, their claims are difficult to value and they are preferred over other creditors in the class. Second, they believe that their reclassification is warranted as a result of inequitable treatment of certain creditors under the Plan. Third, they seek to ban closely related creditors, or "related persons", as that phrase is defined in s. 4 of the *Bankruptcy and Insolvency Act*[FN3] (*BIA*), from voting on the Plan at all. They submit that, at the very least, related persons should be placed in a separate class to prevent them from controlling the creditor vote.

Background

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

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

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

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

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

Analysis

Classification of Creditors Generally

8 The *CCAA* does not direct how creditors should be classified for voting purposes. It does nothing more than define what a secured versus an unsecured creditor is[FN4] and specify that a plan of arrangement must be approved by the various classes of creditors affected by it.[FN5] However, a "commonality of interest" test and well-defined guidelines for classification have been set out in the case law.

9 In *Sovereign Life Assurance Co. v. Dodd*,[FN6] Lord Esher M.R. articulated the rationale for the commonality of interest test:

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

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

11 The commonality of interest test has evolved over time and now involves application of the following guidelines that were neatly summarized by Paperny J. (as she then was) in *Canadian Airlines Corp., Re* ("*Canadian Airlines*")[FN7]:

> 1. Commonality of interest should be viewed based on the non-fragmentation test,[FN8] not on an identity of interest test.
>
> 2. The interests to be considered are the legal interests that a creditor holds *qua* creditor in relationship to the debtor prior to and under the Plan as well as on liquidation.
>
> 3. The commonality of interests should be viewed purposively, bearing in mind that the object of the *CCAA*, namely to facilitate reorganizations if possible.
>
> 4. In placing a broad and purposive interpretation on the *CCAA*, the Court should be careful to resist classification approaches that would potentially jeopardize viable Plans.

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5. Absent bad faith, the motivations of creditors to approve or disapprove [of the Plan] are irrelevant.

6. The requirement of creditors being able to consult together means being able to assess their legal entitlement as creditors before or after the Plan in a similar manner.

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

(i) Since the *CCAA* is to be given a liberal and flexible interpretation, classification hearings should be dealt with on a fact specific basis and the court should avoid rigid rules of general application.[FN9]

(ii) In determining commonality of interests, the court should also consider factors like the plan's treatment of creditors, the business situation of the creditors, and the practical effect on them of a failure of the plan.[FN10]

Landlord Classifications Generally

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

14 Mr. Stevenson's list is not, nor does it purport to be, an exhaustive review of classifications in multi-location *CCAA* restructurings across Canada. Further, he provides no insight as to whether it was the debtor company or the court which decided that a separate class was appropriate in each of the cases to which he referred. Nor does not provide any information as to why a particular classification decision was made in the first place. There may be valid reasons for a debtor to segregate landlords. For example, in *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce*,[FN11] the court refused to disturb a separate class proposed by the debtor company for 130 landlords. A landlord in that case was funding the Plan.

15 *Grafton-Fraser Inc.* is cited as authority for the general proposition that landlords should be entitled to a separate class. In his brief reasons, Houlden J. indicated that he was allowing the separate class to remain on the basis that, as compared to other creditors, landlords would have difficulty valuing their claims and would be enjoined from exercising the contractual and statutory claims that they would ordinarily enjoy on a tenant's insolvency. *Grafton-Fraser Inc.*, like all *CCAA* cases, was doubtless decided on its facts. It was considered, but not applied, in *Woodward's Ltd., Re*, a case that brought widespread attention to the non-fragmentation and contextual approach in classification.[FN12]

16 Landlords are not entitled to a separate class simply because of who they are. There must be sufficient evidence that their claims are materially different from the claims of other creditors in the class to warrant that. To find otherwise would require that I ignore the contextual and non-fragmentation approach (which I observe does not appear to have firmly take hold until after *Grafton-Fraser Inc.* was decided), and give excessive power to one creditor group in relation to a plan of arrangement designed for the benefit of all of the creditors. This concern was expressed by Borins J. in *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia*[FN13] in dismissing a landlord's plea for a separate class so that it's intended negative vote would not be fruitless. A similar caution was voiced by Blair J. in *Armbro Enterprises Inc., Re*[FN14]. He too found that a separate class for landlords was unwarranted in that case.

Distinct Legal Rights and Valuation Issues

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

1. Rights Arising from Clandestine Removal of Goods

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

19 Ontario and New Brunswick's legislation allows a landlord the right to follow and seize goods that were fraudulently and clandestinely removed to prevent the landlord from distraining for rental arrears. There is a thirty day time limit on this right to seize. The landlord is also granted a right of action against any person who knowingly aided in the removal or concealment of the goods.[FN15] These remedies are akin to those provided in the 1737 *Distress for Rent Act* of England,[FN16] commonly called *The Statute of George*, 11 Geo. II, c. 19. Nova Scotia's legislation differs from that in Ontario and New Brunswick in that it does not provide for the third party right of action and the time period for following the goods and seizing is twenty-one rather than thirty days.[FN17] Newfoundland lacks any specific legislation granting these remedies, and it is questionable if *The Statute of George*, although incorporated into the laws of Newfoundland before December 31, 1831, remains in effect there.[FN18]

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

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

22 The objecting landlords rely on two leases, which they say are typical of the leases entered into between them and San Francisco (or its nominee corporations), to demonstrate that there were arrears owing at the date of abandonment. The alleged arrears are comprised of accelerated rent which, under the terms of the leases, became due on termination and are contractually deemed arrears. Without deciding on the correctness of the objecting landlords' assertion, I find that there is sufficient evidence to establish at least an arguable case that there are arrears of rent.

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

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

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25 The Initial Order specifically preserved all creditors' rights to take or continue an action against San Francisco if their claims were subject to statutory time limitations.[FN19] The objecting landlords elected not to pursue their statutorily time limited remedy of following and seizing goods within the time permitted. As a result, it is unreasonable to allow them to now assert that entitlement as the justification for a separate class. Moreover, in the context of a bankruptcy, the remedy is generally academic since there are no goods available for distraint. For these reasons, the inability to follow and seize goods cannot support the ordering of a separate class.

26 The Plan requires that all creditors give up claims against the company, its officers, employees, agents, affiliates, associates and directors. This requirement is subject to the qualification that an action based on allegations of misrepresentations made by a director to creditors or of *wrongful or oppressive conduct by a director* is preserved (emphasis added).[FN20] While candidly acknowledging that their best chance of financial recovery on a successful action would be against Slawsky, the objecting landlords contend that preserving their right of action only against him would be insufficient protection given that they do not know at the moment whether he alone was the person who orchestrated or aided in the removal of San Francisco's goods. In view of Slawsky's apparent level of control over the companies, it might be reasonable to conclude that he was involved in the decision to abandon the premises. However, that is speculative at this point and others may well have been involved.

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

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

1. Unlike the ability to follow and seize goods, which has been rendered academic, this right of action is potentially meaningful.

2. The Plan does not offer compensation for deprivation of this right of action, resulting in a "confiscation" of the objecting landlords' right as described in *Sovereign Life*.

3. Unlike claims that would be extinguished on a bankruptcy of the companies, this right of action would survive since it is against third parties.

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

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

31 Directing that the Plan be amended to compensate the objecting landlords for the loss of their potential rights of

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

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

33 As to dealing with the matter at a fairness hearing, I note that the *CCAA* does not require that debtors present a 'guaranteed winner' of a plan to their creditors. Debtors can make any proposal to their creditors and take whatever chances they might consider appropriate. However, to succeed, they must act in good faith and present a plan of arrangement at the end of the day which is fair and reasonable. If they fail to do so, the process is a waste of time and valuable resources. It accomplishes nothing but an erosion of assets that otherwise would be available to creditors on liquidation. This is precisely what Tysoe J. sought to avoid when he ordered a separate class for guarantee holders in *Woodward's Ltd., Re*, on being convinced that the plan in that case was unfair to them.[FN21]

34 The opposite result occurred in *Canadian Airlines*, where Madam Justice Paperny deferred the classification issue to the fairness hearing. *Canadian Airlines* presented quite a different scenario to that in *Woodward's Ltd., Re* or the one before me. The concern in *Canadian Airlines* was with Air Canada voting in the same class as other unsecured creditors when it had appointed the board which directed the *CCAA* proceedings, was funding the Plan, and fears existed about its acquisition of deficiency claims to secure a positive vote. The court was not concerned about a confiscation of legal rights but was attempting to safeguard against "ballot stuffing".[FN22]

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

2. Loss of Default/Insolvency Clause Remedy

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

37 The Initial Order enjoined all of San Francisco's landlords from enforcing contractual insolvency clauses. This is a common prohibition designed, at least in part, to avoid a creditor frustrating the restructuring by relying on a contractual breach occasioned by the very insolvency that gave rise to the proceedings in the first place.[FN23] The objecting landlords complain that their rights are permanently lost because of the Release contained in the Plan. They do not acknowledge that the stay is essential to the longer-term feasibility of the *CCAA* restructuring and something which courts have granted with increasing regularity to give effect to the remedial nature of the *CCAA*.[FN24] Even ignoring this pragmatic consideration, the objecting landlords' argument fails. The contractual right that is affected is neither unique, nor of any practical use. Thirteen other creditors, mainly equipment lessors and utility providers, have similar contractual default provisions. Further, all of the leases have already been terminated.

3. Difficulty in Valuing Claim

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

39 The Claims Procedure Order, issued on June 22, 2004 in this matter, establishes a mechanism for valuing landlords' abandoned premises claims that reflects the methodology established by the Supreme Court of Canada in *Highway Properties Ltd. v. Kelly, Douglas & Co.*[FN25] The valuation mechanism, set out in para. 12 of the Order,[FN26] is straightforward. A claimant simply follows the formula. There is a clear cut-off date for mitigation efforts and a readily calculable present value. The landlords' claims will not be difficult to value.

Inequitable Treatment of Creditors

1. Preferential Treatment of Some Landlords

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

41 Presumably, the objecting landlords could re-let the premises the following day and still base their claim on the value of unpaid rent for the unexpired portion of the term of their lease. While they might receive a benefit, it is trite that there must always be a cut-off date for mitigation when future losses are the subject of a *CCAA* creditor claim. San Francisco chose the claims bar date for ease of analyzing claims for voting purposes. Its choice makes practical sense and is not facially offensive. As noted in *Alternative Fuel Systems Inc., Re*,[FN27] courts have approved a variety of solutions to quantifying landlords' claims. That approach is in keeping with the distinct purpose of the *CCAA*. Further, the treatment of landlords' claims under a plan of arrangement is an issue for negotiation and, ultimately, court approval.

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

2. Preferential Treatment of Slawsky and Laurier

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

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

Related Parties

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45 The objecting landlords take umbrage with Slawsky, his son Aaron, Laurier, and other corporate entities in which Slawsky has an interest, voting on the Plan. They want to import into the *CCAA* proceedings the *BIA* prohibition against "related persons" voting in favour of a proposal, urging that the same policy considerations apply against allowing an insider to control the vote.[FN28]

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

47 The objecting landlords find support for their position in *Northland Properties Ltd., Re* [FN29] Trainor J. in that case refused to allow a subsidiary to vote on its parent's *CCAA* plan. While care should be exercised to avoid a corporation "stuffing the ballot boxes in its own favour",[FN30] a blanket ban on insider voting is not always necessary or desirable. Safeguards against potential abuses can be built into a plan and the voting mechanism. For example, the Monitor could procure sworn declarations from insiders as to their direct and indirect shareholdings in order to help track voting. That information, together with proofs of claim, proxies, and ballots, which relate to the insiders' claims could then be presented at the fairness hearing. This type of safeguard was taken in *Canadian Airlines*. Paperny J. observed in that case that "absent bad faith, who creditors are is irrelevant".[FN31]

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

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

Conclusions

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

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

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

53 Although success on this application has been somewhat divided, the objecting landlords have enjoyed greater success. There are no provisions in the *CCAA* dealing with costs, however, the Court has the discretion to award costs under the *Rules of Court* and its inherent jurisdiction.[FN32] The nature of the relief granted to the objecting landlords is akin to declaratory relief and accordingly, costs under Column 1 of Schedule C to the *Rules of Court* are appropriate. The costs are payable forthwith.

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

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

(iii) In instances where a lease has been repudiated by the Companies (whether or not the repudiation occurred before or after January 7, 2004), the present value (using an interest factor of 3.65%) of rents payable under the lease as at the date of the Proof of Claim through to the end of the unexpired term of the lease (if any) less any revenue to be received during that time period from any reletting of the premises (in whole or in part) which has occurred prior to the date of the Proof of Claim.

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

Order accordingly.

FN* Leave to appeal refused *San Francisco Gifts Ltd., Re* (2004), 5 C.B.R. (5th) 300, 42 Alta. L.R. (4th) 371, 361 A.R. 220, 339 W.A.C. 220, 2004 ABCA 386, 2004 CarswellAlta 1607 (Alta. C.A.).

FN1 R.S.A. 1985, c. C-36, as am.

FN2 The considerations at this hearing are typically whether there has been strict compliance with statutory requirements, whether any unauthorized acts have occurred, and whether the plan is fair and reasonable: see *Sammi Atlas Inc., Re* (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div. [Commercial List]).

FN3 R.S.C. 1985, c. B-3, as am.

FN4 *CCAA*, s. 2.

FN5 *CCAA*, s. 6.

FN6 *Sovereign Life Assurance Co. v. Dodd*, [1892] 2 Q.B. 573 (Eng. C.A.), at 583.

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2004 CarswellAlta 1241, 2004 ABQB 705, [2004] A.W.L.D. 579, 5 C.B.R. (5th) 92, 359 A.R. 71, 42 Alta. L.R. (4th) 352, 134 A.C.W.S. (3d) 239

FN7 *Canadian Airlines Corp., Re* (2000), 19 C.B.R. (4th) 12 (Alta. Q.B.), leave to appeal denied (2000), 19 C.B.R. (4th) 33 (Alta. C.A. [In Chambers]), cited in the Court of Appeal's subsequent decision in *Canadian Airlines Corp., Re* (2000), 261 A.R. 120, 2000 ABCA 149 (Alta. C.A. [In Chambers]) at para. 27: see also *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Gen. Div.)).

FN8 "Non-fragmentation" means that a multiplicity of classes should be avoided if possible. The notion was first expressed in the Canadian context in *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988), 72 C.B.R. (N.S.) 20 (Alta. Q.B.), but does not appear to have gained wide acceptance until 1993 when *Woodward's Ltd., Re* (1993), 20 C.B.R. (3d) 74 (B.C. S.C.), at 81 was decided. There were five creditor groups in *Woodward's Ltd., Re*, including one group of landlords of abandoned premises and another of creditors holding cross-corporate guarantees or joint covenants, which sought separate classes. The court ruled that, given there was sufficient commonality of interest among the general body of creditors and the applicant landlords, a separate class was unwarranted. Tysoe J. rejected the landlords' proposition that their legal interests differed from that of the other creditors in that repudiation of an anchor tenant's lease would cause the landlord to be in breach of other tenant obligations. He did, however, order a separate class for the holders of cross-corporate guarantees, observing that their unique rights were "confiscated without compensation" under the plan. Interestingly, Tysoe J. rejected the suggestion that the issue be dealt with at the fairness hearing because he was convinced that the scheme was so unfair that he would refuse to sanction a successful outcome, rendering the creditors' vote pointless.

FN9 *Fairview Industries Ltd., Re* (1991), 109 N.S.R. (2d) 32, 11 C.B.R. (3d) 71 (N.S. T.D.).

FN10 *Woodward's Ltd., Re* at p. 81.

FN11 *Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce* (1992), 90 D.L.R. (4th) 285, 11 C.B.R. (3d) 161 (Ont. Gen. Div.).

FN12 Peter B. Birkness, "Re Woodward's Limited — The Contextual Commonality of Interest Approach to Classification of Creditors" (1993), 20 C.B.R. (3d) 91 at 92.

FN13 *Sklar-Peppler Furniture Corp. v. Bank of Nova Scotia* (1991), 86 D.L.R. (4th) 621, 8 C.B.R. (3d) 312 (Ont. Gen. Div.).

FN14 *Armbro Enterprises Inc., Re* (1993), 22 C.B.R. (3d) 80 (Ont. Bktcy.).

FN15 *Commercial Tenancies Act*, R.S.O.1990, c. L-7, ss. 48-50 and *Landlord and Tenant Act*, R.S.N.B. 1973, c. L-1, ss. 27, 29.

FN16 *Distress for Rent Act 1737*, 11 Geo. 2, c. 19, s. 1, which provides: "In case of any tenant or tenants, lessee or lessees ... upon the demise or withholding whereof, any rent is or shall be reserved due or payable, shall fraudulently or clandestinely, convey away, or carry off or from such premises, his or her or their goods or chattels, to prevent the landlord or lessor ... from distraining the same for arrears of rent, it shall or may be lawful for every landlord or lessee ... to take or seize such goods and chattels wherever the same shall be found as distress for the said arrears of rent. "

FN17 *An Act Respecting Tenancies and Distress for Rent*, R.S.N.S. 1989, c. 464, ss. 13 and 14.

FN18 *Buyer's Furniture Ltd. v. Barney's Sales & Transport Ltd.* (1982), 137 D.L.R. (3d) 320 (Nfld. T.D.), affirmed (1983), 3 D.L.R. (4th) 704 (Nfld. C.A.).

FN19 The amendment on January 12, 2004 does not affect the issues at bar.

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FN20 Article 6.1 of the Plan provides as follows: "On the Effective Date, and except as provided below, each of the Companies, the Monitor, and the past and present directors, officers, employees, agents, affiliates and associates of each of the foregoing parties (the "Released Parties") shall be released and discharged by all Creditors, including holders of Unsecured Creditor Claims, and Goods and Services Tax Claims from any and all demands, claims, including claims of any past and present officers, directors or employees for contribution and indemnity, actions, causes of action, counterclaims, suits, debts, sums of money, accounts, covenants, damages, judgments, expenses, executions, charges and other recoveries on account of any liability, obligation, demand or cause of action of whatever nature which any person may be entitled to assert, including, without limitation, any and all claims in respect of any environmental condition or damage affecting any of the property or assets of the Companies, whether known or unknown, matured or unmatured, foreseen or unforeseen, existing or hereafter arising, based in whole or in part on any act or omission, transaction, dealing or other occurrence existing or taking place on or prior to the Effective Date relating to, arising out of or in connection with any Claims, the business and affairs of the Companies, whenever and however conducted, this Plan and the *CCAA* Proceedings, and any Claim that has been barred or extinguished by the Claims Procedure Order shall be irrevocably released and discharged, provided that this release shall not affect the rights of any Person to pursue any recoveries for a Claim against a director or the Companies that: (a) relates to contractual rights of one or more creditors against a director; or (b) are based on allegations of misrepresentations made by a director to creditors or of wrongful or oppressive conduct by a director."

FN21 At para. 11.

FN22 *Olympia & York Developments Ltd., Re*, [1994] O.J. No. 1335 (Ont. Gen. Div. [Commercial List]) at para. 24.

FN23 See for example: *Norcen Energy Resources Ltd.*, where one of the debtor's joint venture partners was enjoined from relying on an insolvency clause to replace the operator under a petroleum operating agreement.

FN24 As noted by Spence J. in *Playdium Entertainment Corp., Re* (2001), 31 C.B.R. (4th) 309 (Ont. S.C.J. [Commercial List]) at para. 32: "If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the *CCAA* order could not be asserted by the Famous Players after the stay period. If such an order could not be made the *CCAA* regime would prospectively be of no value even though a compromise of creditor claims might be worked out in the stay period." See also *Smoky River Coal Ltd., Re* (1999), 237 A.R. 326 (Alta. C.A.).

FN25 *Highway Properties Ltd. v. Kelly, Douglas & Co.*, [1971] S.C.R. 562 (S.C.C.).

FN26 12(a) With respect to Proofs of Claim to be filed with the Monitor by a Landlord of retail premises currently or formerly occupied by the Companies ("Landlord"), a Landlord is to value and calculate its claim ("Landlord's Claim") as being the aggregate of:

FN27 *Alternative Fuel Systems Inc., Re* (2004), 236 D.L.R. (4th) 155 at paras. 64-69, 2004 ABCA 31 (Alta. C.A.).

FN28 The *BIA*, s. 4(3)(c) definition of "related person" includes a controlling shareholder of a corporation. Section 54(3) provides that a creditor related to the debtor may vote against but not for the acceptance of a proposal.

FN29 *Northland Properties Ltd., Re* (1988), 73 C.B.R. (N.S.) 166 (B.C. S.C.), at 170. See also: *Wellington Building Corp., Re*, [1934] O.R. 653 (Ont. S.C.) and *Dairy Corp. of Canada, Re*, [1934] O.R. 436 (Ont. C.A.), referred to in *Northland Properties Ltd., Re*.

FN30 *Olympia & York Developments Ltd., Re* at para.24, per Farley J.

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2004 CarswellAlta 1241, 2004 ABQB 705, [2004] A.W.L.D. 579, 5 C.B.R. (5th) 92, 359 A.R. 71, 42 Alta. L.R. (4th) 352, 134 A.C.W.S. (3d) 239

FN31 At para. 37.

FN32 *Jackpine Forest Products Ltd., Re*, 2004 BCSC 20 (B.C. S.C.).

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TAB 8

1990 CarswellNS 33, 79 C.B.R. (N.S.) 1, 97 N.S.R. (2d) 295, 258 A.P.R. 295

NsC Diesel Power Inc., Re

Re NsC DIESEL POWER INCORPORATED

Nova Scotia Supreme Court, Trial Division

Davison J.

Judgment: January 22, 1990
Docket: No. 70709

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Counsel: *D. Pink, D. Tupper* and *C. Sutherland*, for NsC Diesel.

N. Blackburn, Q.C., for SEA Ltd.

T. Boyne, Q.C., for ABN Bank of Canada.

R. MacKeigan, Q.C., for Black & McDonald Ltd.

J. Merrick, Q.C., and *D. Jamieson-Fraser*, for Foundation Co. of Canada, Gardner Electric Ltd., Surfline Engineering Ltd., Cherubina Metal and Sagadore Crane.

B. Stilwell and *H. Robertson*, for custodian, Ernst & Young Inc.

T. Burchell, Q.C., and *W. Howatt*, for Smith Development Group Ltd. and Atlantic Tile Ltd.

T. MacDonald and *J. Fury*, for Krupp MaK Maschinenbau GmbH.

W. Ryan, Q.C., and *David Farrar*, for Seabord Construction Corp. and Lyons Machinery Co. Ltd.

A. Schurman, for McQuay Canada Inc.

D. Dexter, for Cole Harbour Plumbing Ltd.

D. Grant, for Viking Fire Protection Ltd.

Subject: Corporate and Commercial; Insolvency

Corporations --- Arrangements and compromises — Under Companies' Creditors Arrangements Act.

Debtor's relief legislation — Companies' Creditors Arrangement Act — Act to be interpreted liberally and with reference to present state of bankruptcy law — Court having wide discretion in exercising supervisory role under Act — Definition of secured creditor under Act including subcontractors with liens against property of debtor.

Secured creditors — Mechanics liens — Subcontractors with liens against property of debtor falling within definition of secured creditor under Companies' Creditors Arrangement Act for purposes of voting on proposed arrangement — Subcontractors to comprise class separate from lienholders with direct contracts with the owner.

To avoid a forced liquidation, the debtor company applied under the Companies' Creditors Arrangement Act and obtained an order that, inter alia, allowed it to remain in possession of its assets, stayed proceedings against it and called for a meeting of the secured and unsecured creditors to vote on an arrangement to be proposed by the company. Pursuant to ss. 4 and 5 of the Act, the creditors had to be categorized as secured or unsecured creditors. On an application for an order to classify the creditors, the question arose whether subcontractors who had liens against the company's property should be included in a category and be given the right to vote as secured creditors.

Held:

Subcontractors classified as secured creditors.

The Act was passed during the depression years for the purpose of permitting an insolvent company to avoid bankruptcy and make rearrangements concerning the rights of its shareholders and creditors and, at the same time, permit it to continue as a going concern. It is a companion to the Bankruptcy Act and cannot be interpreted in isolation and without reference to the realities in 1990, including the present state of the law of bankruptcy. As bankruptcy legislation, the Act has as an objective the orderly arrangement of affairs and equal treatment of creditors of the same class. The Act has similar objectives as the Bankruptcy Act, except that: (1) it does not apply unless the debtor had outstanding an issue of secured or unsecured bonds, debentures or other indebtedness issued on a trust deed or other instrument in favour of a trustee; (2) it permits an agreement to be sought and still permits the company to continue operating; and (3) it was never intended to disadvantage any group which, but for the Act, would have enjoyed rights and priorities vis-à-vis the debtor or the debtor's assets.

The court, in dealing with the Act, has to exercise wide discretion in fulfilling its supervisory role. The little guidance contained in the Act is not to be interpreted strictly or literally, as such would frustrate the Act's object. The Bankruptcy Act does not distinguish between lienholders who file as subcontractors and those who file with privity of contract with the owner. The definition of secured creditor under the Companies' Creditors Arrangement Act is even wider. To restrict secured creditors to those lienholders who have direct contract with the debtor would be unfair and contrary to the spirit of the legislation. The subcontractors fell into the plain meaning of "secured creditor" under the Act as they held liens against the property of the company and the liens were security for an indebtedness of the company.

The court should avoid putting parties with a potential conflict of interest in the same class. A class should be made 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". As a conflict could arise between subcontractors and those with direct contracts with the owner, the subcontractors should comprise a separate class.

Cases considered:

Can. Bed & Breakfast Registry Ltd., Re (1986), 65 C.B.R. (N.S.) 115 (B.C.S.C.) — *referred to*

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Panver Const. Ltd., Re (1987), 57 O.R. (2d) 758, 62 C.B.R. (N.S.) 222, 23 C.L.R. 233, 34 D.L.R. (4th) 316 (S.C.) — *referred to*

Pisiak v. Dyck (1986), 63 C.B.R. (N.S.) 151, 32 D.L.R. (4th) 287, 56 Sask. R. 107 (Q.B.) — *referred to*

Sovereign Life Assur. Co. v. Dodd, [1982] 2 Q.B. 573 (C.A.) — *applied*

United Maritime Fishermen Co-op., Re (1987), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, (sub nom. *Can. Co-op. Leasing Services v. United Maritime Fishermen Co-op.)* 88 N.B.R. (2d) 253, 224 A.P.R. 253 (C.A.) — *referred to*

Victoria Bed & Mattress Co., Re (1960), 1 C.B.R. (N.S.) 175, 35 W.W.R. 259, 24 D.L.R. (2d) 414 (B.C.S.C.) — *referred to*

Statutes considered:

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

s. 2 "secured creditor"

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

s. 2 "secured creditor"

s. 4

s. 5

s. 6

s. 12(2)

Mechanics' Lien Act, R.S.N.S. 1967, c. 178 [now R.S.N.S. 1989, c. 227]

Authorities considered:

Edward, "Reorganizations under the Companies' Creditors Arrangement Act" (1947), 25 Can. Bar Rev. 587, at pp. 594, 595 and 600.Houlden and Morawetz, Bankruptcy Law of Canada, 3rd ed., vol. 1, p. 2-102.Macklem and Bristow, Construction and Mechanics' Liens in Canada, 5th ed. (1985), p. 347.
Application for order to classify creditors under Companies' Creditors Arrangement Act.

***Davison J.* (orally):**

1 This is an application for an order to classify creditors of NsC Diesel Power Incorporated pursuant to ss. 4 and 5 of the Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25 [now R.S.C. 1985, c. C-36] (the "Act").

2 NsC Diesel Power Incorporated was incorporated on 3rd March 1988, for the purpose of building, in Sheet Harbour, a facility for testing and certifying diesel engines, including a diesel electric propulsion system being pro-

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vided by Krupp MaK Maschinenbau GmbH of West Germany to Halifax/Dartmouth Industries Limited for installation in a Coast Guard vessel.

3 NsC encountered difficulties, the details of which are unnecessary for the present application, but which rendered the company insolvent. To avoid the forced liquidation of the company, NsC made an application under the Act, a little used statute, and was successful in securing from this court an order dated 28th November 1989, which order declared NsC a corporation under the Act, stayed proceedings against NsC until 13th December 1989, and permitted NsC to remain in possession of its profits, assets and undertakings.

4 On 14th December 1989 Mr. Justice Nunn, of this court, granted an order continuing the stay set out in the order of 28th November 1989, until 31st January 1990, appointing Ernst and Young Incorporated as custodians of the property and assets of the company, and prohibiting persons from taking or continuing any legal proceedings except for lien claimants who were entitled to mechanics' liens under the provisions of the Mechanics' Lien Act, R.S.N.S. 1967, c. 178 [now R.S.N.S. 1989, c. 227]. The order also provided for a meeting of the unsecured creditors and the secured creditors to be held pursuant to s. 6 of the Act on or before 29th January 1990, for the purpose of voting on an arrangement to be proposed by the company. The order stipulated, for the purposes of voting, the company shall, pursuant to s. 12(2) of the Act, admit the amount of each creditor's claim. The order further provided that if the proposal to the creditors was not accepted in accordance with the terms of the Act at the meeting, the custodian would become the receiver/manager of the property.

5 In the application before me, the solicitor for NsC filed an affidavit wherein he advised he was instructed to attempt to classify creditors pursuant to ss. 4 and 5 of the Act as secured creditors, unsecured creditors and lien claimants, and the affidavit attached an exhibit wherein he set forth these classifications and named the creditors with respect to each classification and the respective amounts owed to the creditors.

6 In response to a notice of the application, approximately 20 creditors, represented by counsel, appeared in chambers. The major issue for determination by me is the classification of subcontractors who have liens against the company's property. It is the position of the company, and at least one general contractor, that these subcontractors should not be included in a category and should not have the right to vote as secured creditors because they do not fall within the definition of "secured creditor" under the Act, which reads in part as follows:

> "secured creditor" means a holder of a ... lien or privilege on or against, or any assignment, cession or transfer of, all or any property of a debtor company as security for indebtedness of the debtor company ...

7 The Act was passed in 1932 during the depression years for the purpose of permitting an insolvent company to avoid bankruptcy and make rearrangements concerning the rights of its shareholders and creditors and, at the same time, permit it to continue as a going concern. I have been advised that there is no report which would indicate the Act has been considered by any court in Nova Scotia and it was only once the subject of reported litigation in the Atlantic Provinces. It is a statute which fell into disuse but which seems to have been reactivated to a certain extent over the last decade, mostly in Ontario and British Columbia. A very useful article by one Stanley E. Edwards concerning the Act appears in the Canadian Bar Review (1947), vol. 25, at p. 587 ["Reorganizations under the Companies' Creditors Arrangements Act"].

8 In his opening comments, the solicitor for the company in the proceeding before me referred to the legislation as "companion to the Bankruptcy Act" and I consider this description to be an apt one and I refer to the words of Mr. Edwards in his article at p. 600 where he stated that the Act has been held "constitutional as being legislation relating to bankruptcy and insolvency, the primary purpose of which has traditionally been to protect the rights of creditors". No judicial authority is cited by Mr. Edwards for this statement, but it is clear, in my view, that one cannot interpret the Act in isolation and without reference to the realities in 1990, including the present state of the law of bankruptcy. As bankruptcy legislation, the Act has an objective which includes the orderly arrangement of affairs and equal treatment

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of creditors of the same class.

9 The Act gives little guidance as to the procedure to be followed and, in this respect, is in marked contrast to the detailed provisions of the Bankruptcy Act. It is anticipated that the process receive the guidance of the court as the parties work towards an arrangement. It is imperative that the arrangement be both feasible and fair. The court has a wide discretion to see that these objectives are obtained. I refer to Houlden and Morawetz, Bankruptcy Law of Canada, 3rd ed., at p. 2-102, wherein, referring to the Companies' Creditors Arrangement Act, the authors say:

> 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 ...

In my view, there is no room for strict and literal interpretation of what little is available by way of legislative guidance where such interpretation would frustrate the object to which I have made reference.

10 Since 1932 there have been major changes in the social and commercial conditions of this country to the extent that major revisions have been made in the Bankruptcy Act in 1949 and 1966. The Act before me remains as originally drafted. The Act was prepared and passed for the purposes as enunciated by the then Secretary of State in Parliament who, after referring to the Bankruptcy Act and the Winding-Up Act, had this to say, and I quote from the debates in Hansard, Thursday, 20th April 1933:

> There is no mode or method under our laws whereby the creditors of a company may be brought into court and permitted by amicable agreement between themselves to arrange for a settlement or compromise of the debts of the company in such a way as to permit the company effectively to continue its business by its reorganization ...
>
> At the present time some legal method of making arrangements and compromises between creditors and companies is perhaps more necessary because of the prevailing commercial and industrial depression, and it was thought by the government that we should adopt some method whereby compromises might be carried into effect under the supervision of the courts without utterly destroying the company or its organization, without loss of good-will and without forcing the improvident sale of its assets.

11 From these excerpts and from the reading of the Act, and from other authorities which I have read, certain general propositions are clear to me which relate to the question which I have been asked to determine:

12 1) The court has to exercise a wide discretion in fulfilling its supervisory role;

13 2) The Act has objectives similar to the Bankruptcy Act except that:

> (1) It does not apply unless the debtor has outstanding an issue of secured or unsecured bonds, debentures or other indebtedness issued under a trust deed or other instrument in favour of a trustee;
>
> (2) It permits an agreement to be sought and still permits the company to continue operating;
>
> (3) It was, in my view, never intended to disadvantage any group which, but for the Act, would have enjoyed rights and priorities vis-à-vis the debtor or the debtor's assets. It should be remembered a secured creditor is relatively free from the provisions of the Bankruptcy Act.

14 In this proceeding, NsC created the trust deed and issued the debentures for the purpose of qualifying under the Act. Although it is clear that such a procedure has been sanctioned by the court, and I refer to *Re United Maritime*

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Fishermen Co-op. (1988), 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, 88 N.B.R. (2d) 253 (sub mom. *Can. Co-op. Leasing Services v. United Maritime Fishermen Co-op.*), 224 A.P.R. 253 (C.A.), and in *Re Can. Bed & Breakfast Registry Ltd.* (1986), 65 C.B.R. (N.S.) 115 (B.C.S.C.), it would be incongruous and inappropriate if a debtor, by taking such an artificial step, could deprive interested parties of the rights they had under other legislation. As stated by Mr. Edwards in his article at p. 595:

> 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.

15 Under the Bankruptcy Act, a mechanic's lienholder is a secured creditor. I refer to *Pisiak v. Dyck* (1986), 63 C.B.R. (N.S.) 151, 32 D.L.R. (4th) 287, 56 Sask. R. 107 (Q.B.); *Re Panver Const. Ltd.* (1987), 57 O.R. (2d) 758, 62 C.B.R. (N.S.) 222, 23 C.L.R. 233, 34 D.L.R. (4th) 316 (S.C.); *Re Victoria Bed & Mattress Co.* (1960), 1 C.B.R. (N.S.) 175, 35 W.W.R. 259, 24 D.L.R. (2d) 414 (B.C.S.C.); and Macklem and Bristow, Construction and Mechanics' Liens in Canada, 5th ed. (1985), p. 347. The determination made by these authorities resulted from consideration of the definition of secured creditor in s. 2 of the Bankruptcy Act which reads:

> "secured creditor" means a person holding a ... lien or privilege on or against the property of the debtor or any part thereof as security for a debt due or accruing *due to him* from the debtor ... [emphasis added]

16 I saw nothing in any of the authorities I have read which distinguished under the Bankruptcy Act the status of lienholders who file as subcontractors and those who file with privity of contract with the owner.

17 Furthermore, it is apparent that the definition of secured creditor under the Act before me is wider in one important respect than under the Bankruptcy Act. The words "to him" or "to the creditor" do not appear after the words "as security for indebtedness of the debtor company" in the Bankruptcy Act. If Parliament had intended that the classification of secured creditors should be restricted to lienholders who had a direct contract with a debtor, it would have been simple to express that intention by words of restriction such as appear in the Bankruptcy Act.

18 It is interesting to note the words of Mr. Edwards in his article at pp. 594-95:

> 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.

19 For all of the reasons I have advanced, I am not prepared to inject further words in the section to arrive at a result I consider unfair and contrary to the spirit of the existing legislation. The lienholders who are subcontractors fit the plain meaning of the words of the section in that:

20 1. They are holders of liens;

21 2. The liens are against the property of NsC;

22 3. The liens are as security for an indebtedness of NsC.

23 I therefore find that the lienholders are secured creditors for the purpose of these proceedings.

24 There remains the submission of Mr. MacKeigan — I think he is the only one that addressed it — that the subcontractors should comprise a separate classification.

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25 Referring to Hansard again, the Secretary of State stated again, in the third reading:

> The gist of the whole bill is this, that any class of creditors of an insolvent or a bankrupt company may by a three-fourths vote among themselves agree to a compromise between the company and that class of its creditors. Each class of creditors who have the same interests may decided by a three-fourths majority with respect to any proposed compromise and, if approved by the court, such compromise becomes effective.

26 The Secretary went on to say with respect to discussions about s. 5 of the Act:

> The suggestion is that it should be made clear that each class of creditors having the same interest shall decide among themselves as to the terms of the compromise ...

27 In my view, the court should avoid putting in the same class parties with a potential conflict of interest. I see that such a conflict could arise as between subcontractors and those with direct contracts with the owner. They have different contractual rights. A subcontractor may vote for a reduced amount of claim knowing he could still claim the deficiency from the general contractor, and this is cited as only an example of the possibility of conflict.

28 The test that was suggested by Bowen L.J. in *Sovereign Life Assur. Co. v. Dodd*, [1892] 2 Q.B. 573 (C.A.), dealing with the English legislation, is to place in one class persons "whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".

29 With those principles in mind, I would direct the subcontractors with liens to comprise a separate class.

Order accordingly.

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

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

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

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

Proceeding commenced at Toronto

BRIEF OF AUTHORITIES OF THE UNDERWRITERS NAMED IN CLASS ACTIONS

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