Court File No. CV-12-9622-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, . B-3, AS AMENDED

B E T W E E N:

CCM MASTER QUALIFIED FUND, LTD.

Applicant

-and-

BLUTIP POWER TECHNOLOGIES LTD.

Respondent

FACTUM OF DUFF & PHELPS CANADA RESTRUCTURING INC. IN ITS CAPACITY AS RECEIVER OF BLUTIP POWER TECHNOLOGIES LTD.

March 13, 2012

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FACTUM OF THE RECEIVER

PART I - OVERVIEW

1. Pursuant to an order of the Ontario Superior Court of Justice (the "**Court**") made on February 28, 2012 (the "**Receivership Order**"), Duff & Phelps Canada Restructuring Inc. ("**D&P**") was appointed receiver (in such capacity, the "**Receiver**") of the properties, assets and undertakings (collectively, the "**Assets**") of blutip Power Technologies Ltd. (the "**Company**") pursuant to section 243(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended.

2. This motion is brought by the Receiver for, *inter alia*, the approval of a Sales Process (all capitalized terms as defined below) and Bidding Procedures proposed

to effect the sale of the Company's business and Assets, and approval of a credit bid Stalking Horse Offer to establish the baseline price of a transaction to be completed pursuant to the Sales Process.

3. The receivership is currently being financed by the Company's primary secured creditor. The Receiver does not have the resources to sustain a prolonged sales process and maintaining the confidence of its stakeholders is critical to its chances for ongoing operations. Accordingly, the Receiver believes a focused, transparent and expedited process is in the best interest of all stakeholders, given the current liquidity crisis.

4. The Receiver also believes that the proposed Sales Process and Bidding Procedures represent a fair, accessible, and efficient means for marketing and selling the Company's business and Assets in the timeline required.

5. The Receiver further believes that the Stalking Horse Offer from the Company's secured creditor represents a fair and efficient means for setting a baseline price, that it is consistent with the terms of stalking horse agreements previously approved by this Court, and that this Court's approval of the Stalking Horse Offer for such purpose is in the best interests of the Company's stakeholders generally.

6. The Receiver is also seeking an order from this Court that will grant the ordinary priority to the Receiver's Charge and Receiver's Borrowings Charge (which charges were not given priority upon the appointment of the Receiver, because such appointment was sought on short notice) and an order approving the activities of the

Receiver, as further set out in the First Report to Court of the Receiver dated March 9, 2012 (the "**Report**").

PART II – FACTS

blutip Power Technologies Ltd.

7. The Company is a publicly listed technology company based in Mississauga, Ontario, which engages in the research, development and sale of hydrogen generating systems and combustion controls. The Company presently employs ten individuals. The workforce is not unionized and the Company does not maintain any pension plans.

- Report, at para. 2.0, Motion Record Tab 2, page 13.

8. As of the appointment of the Receiver, the Company was in a development phase with no significant sources of revenue. Accordingly, prior to the appointment of the Receiver, the Company depended on external sources of funding to continue to operate as a going concern.

- Report, at para. 2.0, Motion Record Tab 2, page 13.

Intellectual Property

9. The Company has invested in the research and development of hydrogen generating systems and control technology resulting in proprietary, patented and patent-pending technology. The Receiver is aware of certain proprietary and damage claims

made by third parties against the Company, including with respect to certain of its intellectual property, as further set out in the Report.

- Report, at para. 2.1, Motion Record Tab 2, page 13.

CCM Master Qualified Fund, Ltd.

10. CCM is a secured creditor of the Company and the Applicant in these proceedings. According to the Company's books and records, the Company's indebtedness to CCM presently totals approximately $3.7 million, comprised of the following:

(a) A convertible senior secured promissory note dated October 21, 2011 issued by the Company to CCM in the amount of $2,600,000 (the "**October Note**");

(b) A convertible senior secured promissory note dated December 29, 2011 issued by the Company to CCM in the amount of $800,000 (the "**December Note**", together with the October Note, the "**Notes**");

(c) $65,000 advanced by CCM to the Receiver pursuant to a Receiver's Certificate dated February 29, 2012 pursuant to a $400,000 term sheet dated February 27, 2012 between the Receiver and CCM (the "**Term Sheet**"); and,

(d) $47,500, on account of CCM's costs of appointing the Receiver, pursuant to Paragraph 30 of the Receivership Order (the "**Appointment Costs**").

- Report, at para. 4.0, Motion Record Tab 2, page 15, and para. 5.0, Motion Record Tab 2, page 18.

11. The terms of the October Note and December Note were, respectively, two years and 22 months, and both Notes bear interest at 15% per annum. As discussed further below, the proceeds of the Notes were used to, *inter alia*, "pre-pay" interest and fees. This issue has been considered by the Receiver in determining the quantum of the credit bid, and is discussed and analyzed below.

- Report, at para. 4.0, Motion Record Tab 2, page 15.

CCM Security

12. The Company's obligations to CCM pursuant to the Notes and the Appointment Costs are secured pursuant to a general security agreement granted by the Company in favour of CCM, dated as of October 21, 2011 (the "**Security**").

- Affidaivt of James Schuler, sworn February 27, 2012, (the "**Schuler Affidavit**") at para. 27, Motion Record Tab 2B, page 59 & 60.

13. The Receiver's counsel, Blake, Cassels & Graydon LLP ("**Blakes**") has rendered an opinion (the "**Opinion**") that, subject to the standard assumptions and qualifications set out therein, the security granted by the Company in favour of CCM, as registered pursuant to the *Personal Property Security Act* (Ontario) (the "**PPSA**"), creates a valid and perfected security interest in the business and assets of the Company. The Opinion does not speak to the quantum of CCM's secured debt.

CCM's Stalking Horse Credit Bid

14. On March 3, 2012, CCM submitted to the Receiver an offer to purchase the business and Assets of the Company in the form of an asset purchase agreement between CCM and the Receiver (the "**Stalking Horse Offer**"). In the days following its

submission, the Receiver, CCM and their respective legal counsel negotiated the terms and provisions of the Stalking Horse Offer.

- Report, at para. 5.0, Motion Record Tab 2, page 18.

15. As set out in further detail in Section 5.0 of the Report, the Stalking Horse Offer provides, *inter alia*, that:

(a) CCM would acquire substantially all of the Company's business and Assets;

(b) The purchase price is equal to the Assumed Liabilities (as defined in the Stalking Horse Offer), plus a credit bid of CCM's secured debt outstanding: (i) under the Notes (decreased from its face amount to reflect a reduction in effective interest paid, as discussed below); (ii) the costs of seeking and obtaining the Receivership Order; and (iii) under the Term Sheet as evidenced by Receiver's Certificates (collectively, the "**Purchase Price**"). The Purchase Price is estimated to be up to approximately $3,744,000 (the "**Estimated Purchase Price**"), before the value of Assumed Liabilities (defined below);

(c) CCM will assume certain liabilities, as set out in Section 5.0 of the Report, including certain obligations in respect of employees that will be offered employment if the Stalking Horse Offer is accepted (collectively, the "**Assumed Liabilities**");

(d) The Stalking Horse Offer includes a reimbursement of CCM's reasonable expenses incurred in connection with the negotiation and ultimate consummation of the transaction contemplated by the Stalking Horse Offer, to a maximum of $75,000 (the "**Expense Reimbursement**"), payable to CCM out of the proceeds of sale if CCM is not the Successful Bidder (as defined below);

(e) The Stalking Horse Offer is on an "as is, where is" basis with basic market standard representations and warranties only;

(f) The closing date is anticipated to be on or around May 3, 2012; and

(g) The Stalking Horse Offer is subject to being selected as the "**Successful Bid**" in accordance with the Bidding Procedures (discussed below) and the approval of the Court, representing the only material conditions precedent to the transaction.

- Report, at para. 5.0, Motion Record Tab 2, page 18 & 19.

Sales Process & Bidding Procedures

16. As set out in detail in the Report, the Receiver seeks this Court's approval of an orderly process for the marketing and sale of the business and Assets of the Company (the "**Sales Process**"), which includes a detailed set of bidding procedures, attached to the Stalking Horse Offer (the "**Bidding Procedures**").

17. A summary of the proposed Sales Process is as follows:

(a) The Receiver shall distribute to prospective purchasers a brief interest solicitation letter explaining that the Assets are for sale, including a form of confidentiality agreement ("**CA**"), and the sale shall be advertised in the Globe and Mail (National Edition);

(b) A confidential information memorandum ("**CIM**") that provides an overview of the Company's business, assets and financial results would be made available to parties that execute a CA;

(c) Upon execution of a CA, prospective bidders will be provided with the opportunity to commence due diligence, including reviewing information regarding the Company's patents and other relevant information on the Company's intellectual property; and,

(d) Prospective purchasers will be provided with a copy of the Stalking Horse Offer, and will be required to submit offers in the form of the Stalking Horse Offer.

- Report, at para. 6.0, Motion Record Tab 2, page 19 & 20.

18. In carrying out the Sales Process, none of the details of the Sales Process that would not otherwise be made available to other prospective purchasers, including the identity and/or number of parties participating in the process, will be disclosed by the Receiver to CCM or its legal counsel (other than in connection with open bidding at any auction).

- Report, at para. 6.0, Motion Record Tab 2, page 20.

Bidding Procedures

19. The Sales Process proposed by the Receiver will be subject to the Bidding Procedures, which will govern the process pursuant to which interested parties may place bids on the Company's business and Assets.

20. The Bidding Procedures, set out in full in the attachment to the Stalking Horse Offer, include the following key elements:

(a) Offers will be required to be submitted to the Receiver by 10:00 am (Toronto time) on April 16, 2012 (the "**Bid Deadline**");

(b) Offers will have to provide certain information and documentation to the Receiver, as further set out in Section 6.0 of the Report;

(c) A bid must comply with certain formal requirements, including that it must: (a) be in the form of an executed asset purchase agreement with marked revisions to the Stalking Horse Offer; (b) be irrevocable until a certain date; (c) not be subject to any conditions more burdensome than the conditions in the Stalking Horse Offer; (d) be accompanied by a cash deposit of not less than 15% of the bid; and (e) contemplate a purchase price equal to or greater than the Estimated Purchase Price of $3,744,000 plus an initial minimum overbid increment of $100,000 plus the $75,000 Expense Reimbursement, for a total aggregate cash consideration of $3,919,000 (such bid, a "**Qualified Bid**");

(d) If no Qualified Bids are submitted by the Bid Deadline, the Stalking Horse Offer shall be accepted, subject to Court approval;

(e) If one or more Qualified Bids are received by the Bid Deadline, the Receiver shall conduct an auction on April 20, 2012 at 10:00 AM (Toronto time) to determine the highest and/or best Qualified Bid with respect to the Assets;

(f) Bidding at the Auction shall be conducted in rounds, and the Receiver, with the assistance of its advisors, will determine the opening bid in each round (the "**Opening Bid**");

(g) If, in any round of bidding, no new overbid is made, the auction shall be closed and the Receiver shall declare the last Opening Bid as the "Successful Bid" and the second highest bid as the "Back-Up Bid" (each as defined in the Bidding Procedures); and,

(h) The Receiver shall, within seven days of the conclusion of the auction, or if there is no auction, on April 20, 2012, serve notice of a sale hearing to approve the sale of the Assets purchased by the Successful Bidder.

- Report, at para. 6.0, Motion Record Tab 2, page 22 - 22.

PRIORITY OF CHARGES

21. The hearing to obtain the Receivership Order was brought by CCM on February 28, 2012 on an urgent basis because the Company did not have the financial resources to meet its obligations, including a March 2, 2012 payroll, and all of the

Company's directors and officers (other than the Corporate Secretary) had resigned as of February 22, 2012.

- Report, at para. 3.1, Motion Record Tab 2, page 14.
- Schuler Affidavit, at paras. 42 & 49, Motion Record Tab 2B, pages 62 & 65.

22. As notice of the application for the Receivership Order was not given to parties who may have been effected by a priority charge, priority over existing perfected security interests and statutory encumbrances was not sought for the "**Receiver's Charge**" or the "**Receiver's Borrowings Charge**" (each as defined in the Receivership Order).

- Report, at para. 3.1, Motion Record Tab 2, page 14.

23. As set out further below, notice of this motion has been given to all parties known to the Receiver who may have an interest in these proceedings.

- Report, at para. 3.1, Motion Record Tab 2, page 14.

RECEIVER'S RECOMMENDATIONS

24. The Receiver has respectfully recommended that this Court approve the Sales Process and Bidding Procedures, including the establishment of the Stalking Horse Offer as the baseline for bids.

- Report, at para. 6.1 and 8.0, Motion Record Tab 2, pages 22 & 24.

PART III - ISSUES

25. The issues on this application are as follows:

(a) Should this Court approve the Sales Process, including the Bidding Procedures and establishment of the Stalking Horse Offer as the baseline for bids?

(b) Should this Court order that the Receiver's Charge and the Receiver's Borrowings Charge have the standard priority of such charges set out in the model receivership order?

PART IV- THE LAW AND ARGUMENT

STALKING HORSE CREDIT BID

26. The Stalking Horse Offer is intended to establish a floor price and transactional structure for any potential subsequent bids from interested parties. Stalking horse offers, combined with court-approved bidding procedures, are commonly used in insolvency scenarios to facilitate sales of businesses and assets.

- *Graceway Canada Co., Re*, 2011 Carswell Ont 11687, 207 A.C.W.S. (3d) 400 (Ont. S.C.J. [Commercial List]), Receiver's Book of Authorities ("**BOA**") Tab 2, page 25;
- *Parlay Entertainment Inc., Re*, 2011 CarswellOnt 5929, 81 C.B.R. (5th) 58 (Ont. S.C.J. [Commercial List]) ("***Parlay***"), BOA Tab 3, page 27;
- *Re Canwest Publishing Inc./Publications Canwest Inc*, 2010 CarswellOnt 3509, 68 C.B.R. (5th) 233 (Ont. S.C.J. [Commerical List]) ("***Canwest***"), BOA Tab 4, page 31;.
- *White Birch Paper Holding Co., Re*, 2010 CarswellQue 9720, (2010) QCCS 4382 (Q.S.C.), BOA Tab 5, page 38;

- *Nortel Networks Corp., Re*, 2009 CarswellOnt 4467, 550 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) BOA Tab 6, page 43;
- *Nortel Networks Corp., Re,* 2009 CarswellOnt 4839, 56 C.B.R. (5th) 74 (Ont. S.C.J. [Commercial List]) ("***Nortel***"), BOA Tab 7, page 55;
- *Indalex Ltd., Re*, 2009 CarswellOnt 4262, 79 C.C.P.B. 101 (Ont. S.C.J. [Commercial List]), BOA Tab 8, page 60.

27. A core component of the Purchase Price contemplated by the Stalking Horse Offer is CCM's credit bid, pursuant to which CCM will in effect pay an amount equal to its secured claim against the Company (adjusted to account for certain interest amounts, as described below). Credit bidding of this sort is increasingly common in Court-approved stalking horse sales processes.

- *Parlay,* BOA Tab 3, page 27;
- *White Birch Paper Holding Co., Re*, 2010 CarswellQue 10954, (2010) QCCS 4915 (Q.S.C.) ("***White Birch***"), BOA Tab 9, page 63;
- *Canwest* BOA Tab 4, page 31.

28. It is submitted that the credit bidding mechanism will not result in unfair or preferential treatment for CCM, economic or otherwise. CCM is merely proposing to satisfy the Purchase Price by giving credit to the Receiver and the Company against the secured indebtedness owed to it by the Receiver and the Company. The credit being granted is equal to the amount of the proceeds of sale to which CCM would be entitled to on a distribution of proceeds in accordance with its secured position. If the Stalking Horse Offer becomes the Successful Bid, rather than paying the Receiver and then accepting such amounts back as part of a Court-approved distribution in satisfaction of its secured claim, CCM will simply release the secured claim: the economic effect is the same.

29. To the extent that any creditor validly asserted a claim to sale proceeds in priority to CCM, the Receiver notes that claims that are not paid in full on closing that rank in priority to CCM's secured claim, if any, will become an Assumed Liability under the Stalking Horse Offer. Accordingly, the relative priority of prior ranking creditors, if any, will be no worse than it is currently.

30. Moreover, the Receiver is seeking approval of the Stalking Horse Offer solely for the purpose of establishing a baseline for bids and approving the Expense Reimbursement. If the Stalking Horse Offer is ultimately the Successful Bid, the proposed Bidding Procedures require the Receiver to return to Court, on notice, to seek approval of the sale to CCM.

Interest under the Notes

31. As discussed above, the rate of interest under the Notes was contractually fixed at 15% and has been prepaid in full. If the Notes are repaid on the anticipated closing date of May 3, 2012, the effective annual rate of interest on the Notes will be significantly higher than 15% per annum. The Receiver has considered this issue and has advised CCM that the amount of the secured indebtedness under the Notes that is eligible for the credit bid is to be $103,500 less than the face value of the Notes, for the reasons that follow.

Scope of "Interest"

32. The scope of "interest" under the Criminal Code is very broad, and includes "the aggregate of all charges and expenses... paid or payable for the advancing of credit under an agreement or arrangement...". The Supreme Court of Canada has

held that for the purposes of s. 347, "interest" is an extremely comprehensive term, encompassing many types of fixed payments which would not be considered interest proper at common law or under general accounting principles.

- *Criminal Code* (R.S.C., 1985, c. C-46), s. 347(2) "interest", Factum Schedule B.
- *Garland v. Consumer' Gas Co.*, 1998 CarswellOnt 4053, [1998] 3 S.C.R. 112 (SCC), at para. 27, BOA Tab 10, page 90.

Term of Indebtedness

33. The Supreme Court of Canada has furthermore held that for the purposes of calculating interest under the Criminal Code, the effective annual rate of interest arising from a payment is calculated over the period during which credit is actually outstanding.

- *Degelder Construction Co. v. Dancorp Developments Ltd.*, 1998 CarswellBC 2246, [1998] 3 S.C.R. 90 (SCC) at para. 34, BOA Tab 11, page 117.

Calculating Effective Rate of Interest on Notes

34. Given that the credit will actually be outstanding under the Notes for a period of less than their full terms (assuming an anticipated closing date of May 3, 2012), in the Receiver's view it is necessary to calculate the effective annual interest rate taking into account (a) the total cost of borrowing that has been paid by the Company to CCM (including commitment and legal fees), and (b) the period during which the credit provided pursuant to the Notes is actually outstanding.

35. Using this method of calculation, and assuming the Stalking Horse Offer or another transaction resulting from the Sales Process closes and the Notes are to be effectively repaid on May 3, 2012, as anticipated, the effective annual rates of

interest under the October Note would be 57.6%, and under the December Note would be 97.4%.

- Report, at para. 4.0, Motion Record Tab 2, page 16 & 17.

36. The Criminal Code proscribes interest at an effective annual rate in excess of 60%.

- *Criminal Code* (R.S.C., 1985, c. C-46), s. 347(2) "criminal rate", Factum Schedule B.

Notional Severance

37. In a case involving a criminal rate of interest among sophisticated commercial parties, the majority of the Supreme Court of Canada endorsed the remedy of "notional severance," whereby the Court reduced the effective annual rate of interest payable by the borrower to a legal amount, rather than severing the offending interest section from the agreement entirely. The Receiver believes that notional severance is the appropriate approach to the December Note. The December Note also specifically provides for notional severance at Section 17.

- *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 CarswellOnt 512, [2004] 1 S.C.R. 249 (SCC), BOA Tab 12, page 118.
- December Note, Application Record of CCM, dated February 27 Tab 2B, page 55.

38. If the cost of borrowing to the Company under the December Note is reduced from $268,932 to $165,432 (a reduction of $103,500), the effective annual rate of interest under the December Note, assuming a May 3, 2012 closing, would be 59.9%.

- Report, at para. 4.0, Motion Record Tab 2, page 16 and Appendix "D" thereto, Motion Record Tab 2, page 74.

39. Accordingly, the aggregate amount of the proposed credit bid relating to the secured indebtedness under the Notes is $3,296,500, being the aggregate principal face value of the Notes of $3,400,000, less $103,500. The balance of the credit bid is comprised of obligations by the Receiver under the Term Sheet and the Company on account of the Appointment Costs.

Expense Reimbursement

40. The expense reimbursement mechanism in stalking horse bids has been used on many occasions in Canadian insolvency proceedings. The Expense Reimbursement in the present case is limited to a maximum of $75,000, representing a maximum of approximately 2% of the value of the Estimated Purchase Price, which in the Receiver's view is reasonable and consistent with amounts used generally in Canadian insolvency proceedings. In addition, CCM does not receive an unfair advantage or windfall, as there is no break fee or similar payment contemplated by the Stalking Horse Offer.

- *Parlay* at para. 12 (break fee + expense reimbursement = 4.76% of $2.1MM bid), BOA Tab 3, page 29.
- *White Birch* at paras. 4 & 7 (break fee + expense reimbursement = 1.8% of estimated $164MM bid), BOA Tab 9, pages 65 & 66.
- *Nortel* at para. 12 (break fee + expense reimbursement = 5% of $475MM bid), BOA Tab 7, page 57.

41. It is submitted that the Expense Reimbursement is necessary and will not discourage a third party from submitting an offer that is superior to the Stalking Horse Offer.

SALES PROCESS & BIDDING PROCEDURES

42. The Court appointed the Receiver to, among other things, market any or all of the Assets, including advertising and soliciting offers in respect of the Assets, and to negotiate such terms and conditions of sale as the Receiver in its discretion may deem appropriate. The Receiver has determined that the Sales Process is an appropriate and efficient means of marketing and selling the Assets in the circumstances.

- Receivership Order, paragraph 3(j)

43. Pursuant to the Sales Process and the Bidding Procedures, the Receiver will attempt to obtain the best price for the business and Assets of the Company in a fair, efficient, accessible and transparent manner. In *Royal Bank v. Soundair Corp.*, the Ontario Court of Appeal held that when deciding whether to approve the *sale* of property subject to receivership, the Court has the following duties:

> to consider whether the receiver has made a sufficient effort to obtain the best price and has not acted improvidently; to consider the efficacy and integrity of the process by which offers have been obtained; to consider whether there has been unfairness in the working out of the process; and to consider the interest of the parties

- *Royal Bank v. Soundair,* 1991 CarswellOnt 205, 7 C.B.R. (3d) 1 (Ont.C.A.) at para. 16 ("***Soundair***"), BOA Tab 1, page 5.

44. The Sales Process and Bidding Procedures proposed by the Receiver will address each of these *Soundair* considerations:

Best Price Possible

45. As set out above, the initial step in the Sales Process is that the Receiver will notify potentially interested parties that the Company's business and Assets are available for sale, and will advertise the sale in the National edition of a major

Canadian newspaper. This will expose the Assets to the market as broadly as is prudent, given the Company's financial situation and the need for an expeditious sales process.

46. The Estimated Purchase Price is approximately CDN$3,744,000, plus the value of the Assumed Liabilities. If this is not the highest price attainable for the Assets, the mechanics of the Sales Process, Bidding Procedures and auction (if necessary) will allow interested parties to bid up the price, resulting in an adequately canvassed market ultimately setting the sale price.

Integrity of the Process

47. The Sales Process will expose the Assets to a broad market, and assist in the Receiver's attempts to sell them in a commercially reasonable manner, for the general benefit of the Company's stakeholders. The Receiver will oversee the Sales Process, Bidding Procedures and auction (if necessary) at each stage, and report to the Court on the integrity of the process generally.

48. This Court will ultimately be asked to determine whether the process was conducted with integrity at a hearing to approve the Successful Bid, at which hearing any aggrieved parties will have an opportunity to advise the Court of any purported deviation from the approved process.

Unfairness in working out the process

49. Whether or not there has actually been unfairness in executing the Sales Process will ultimately be a question for the Court when the Receiver seeks its approval of

the sale. However, the Sales Process and Bidding Procedures provide a transparent, fair and accessible means for selling the Assets.

50. The Receiver does not have access to sufficient funding to support operations during a lengthy sales process, however, in the Receiver's view, the one month Sales Process is sufficient to allow interested parties to perform diligence and to submit offers.

- Report, at para. 6.1, Motion Record Tab 2, page 22.

Interests of the Parties

51. Whether or not the interests of the parties are optimally served will also be a question for the Court when the Receiver seeks its approval of the sale. As with the consideration of any unfairness in the process, however, the Sales Process is transparent and inclusive, and the ultimate sale price will be determined by the market. Accordingly, the Sales Process should protect the interests of all stakeholders, under the circumstances.

52. The duration of the proposed Sales Process and the existence of the Stalking Horse Offer should assist in creating certainty for all stakeholders, particularly the Company's employees and potential customers. In this regard, the Company is in its development stage and certain customer trials are ongoing, and so it is important that the Sales Process be completed expeditiously so that stakeholders understand that the Company is to continue to operate as a going concern.

- Report, at para. 6.1, Motion Record Tab 2, page 23.

PRIORITY OF CHARGES

53. Section 243 of the BIA, which is reproduced in full at Schedule B of this factum, provides at subsection (6) that this Court may make an order respecting the payment of fees and disbursements of a receiver, including one that grants a charge to secure such fees and disbursements in priority to other secured creditors, provided that the Court is "satisfied that the creditors who would be materially affected by the order were given reasonable notice and an opportunity to make representations."

- *Bankruptcy and Insolvency Act* (Canada), s. 243(6), Factum Schedule B.

54. The application for the Receivership Order was made on an urgent basis for the reasons discussed above. Accordingly, no priority was sought for the Receiver's Charge and Receiver's Borrowings Charge.

55. Notice of this motion has been given to:

(a) all parties with registered security interests pursuant to the PPSA and the *Personal Property Security Act* (Alberta) (the Company is headquartered in Ontario and was originally incorporated in Alberta);

(b) all parties known to the Receiver to have commenced legal proceedings against the Company or known to be co-defendants with the Company in such proceedings;

(c) all parties who have asserted claims against the Company with respect to intellectual property;

(d) the Company's landlord; and,

(e) standard government agencies, including Canada Revenue Agency and the Ministry of Finance for the Province of Ontario and Alberta.

- Affidavit of Maria Konidis, sworn March 12, 2012, filed.

56. In a recent *Companies' Creditors Arrangement Act* (Canada) ("**CCAA**") proceeding in which priority was granted for an administrative charge comparable to the Receiver's Charge and a debtor-in-possession financing charge comparable to the Receiver's Borrowings Charge on a "comeback" hearing following the issuance of the initial CCAA order, this Court noted that expecting advisors (analogous to the Receiver and its counsel) to take the business risk of participating in proceedings without the security of a charge for their fees is "neither reasonable nor realistic," and that "it is neither reasonable nor realistic to expect a commercially motivated DIP lender to advance funds in a DIP facility without super priority."

- *Timminco Ltd., Re*, 2012 CarswellOnt 1263 (Ont. S.C.J. [Commercial List]), at para. 44, BOA Tab 13, page 164.
- *Timminco Ltd., Re,* 2012 CarswellOnt 1466 (Ont. S.C.J. [Commercial List]), at para. 49, BOA Tab 14, page 177.

57. Accordingly, now that stakeholders have been notified, it is submitted that this Court should exercise its discretion under section 243(6) of the BIA and order that the Receiver's Charge and the Receivers' Borrowings Charge shall have the priority ordinarily given to them under the Ontario model receivership order.

PART V - RELIEF REQUESTED

58. For the foregoing reasons, the Receiver respectfully requests that this Court grant an order:

(a) abridging the time for service and validating the service of this Notice of Motion, the Motion Record and the Report, so that this Motion is property returnable March 15, 2012 and dispensing with further service thereof;

(b) approving the Report and the activities of the Receiver as described therein;

(c) authorizing and directing the Receiver to execute the Stalking Horse Offer so as to set a minimum floor price in respect of the Sales Process;

(d) approving and authorizing the payment of the Expense Reimbursement in the manner provided for in the Stalking Horse Offer, in conjunction with the Bidding Procedures;

(e) approving the Bidding Procedures;

(f) deeming the Stalking Horse Offer to be a Qualified Bid and accepted solely for the purposes of CCM's right to participate in the Auction (as defined in the Bidding Procedures); and,

(g) ordering that the Receiver's Charge and the Receiver's Borrowings Charge have the standard priority of such charges, as set out in the Ontario model receivership order.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

per.

Linc Rogers / Chris Burr / Jenna Willis,
Lawyers for the Court-Appointed Receiver

SCHEDULE "A"

LIST OF AUTHORITIES

TAB

1. *Royal Bank v. Soundair,* 1991 CarswellOnt 205, 7 C.B.R. (3d) 1 (Ont.C.A.)
2. *Graceway Canada Co., Re*, 2011 Carswell Ont 11687, 207 A.C.W.S. (3d) 400 (Ont. S.C.J. [Commercial List])
3. *Parlay Entertainment Inc., Re*, 2011 CarswellOnt 5929, 81 C.B.R. (5th) 58 (Ont. S.C.J. [Commercial List])
4. *Re Canwest Publishing Inc./Publications Canwest Inc*, 2010 CarswellOnt 3509, 68 C.B.R. (5th) 233 (Ont. S.C.J. [Commerical List])
5. *White Birch Paper Holding Co., Re*, 2010 CarswellQue 9720, (2010) QCCS 4382 (Q.S.C.)
6. *Nortel Networks Corp., Re*, 2009 CarswellOnt 4467, 550 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List])
7. *Nortel Networks Corp., Re,* 2009 CarswellOnt 4839, 56 C.B.R. (5th) 74 (Ont. S.C.J. [Commercial List])
8. *Indalex Ltd., Re*, 2009 CarswellOnt 4262, 79 C.C.P.B. 101 (Ont. S.C.J. [Commercial List])
9. *White Birch Paper Holding Co., Re*, 2010 CarswellQue 10954, (2010) QCCS 4915 (Q.S.C.)
10. *Garland v. Consumer' Gas Co.*,1998 CarswellOnt 4053, [1998] 3 S.C.R. 112 (SCC)
11. *Degelder Construction Co. v. Dancorp Developments Ltd.*, 1998 CarswellBC 2246, [1998] 3 S.C.R. 90 (SCC)
12. *Transport North American Express Inc. v. New Solutions Financial Corp.*, 2004 CarswellOnt 512, [2004] 1 S.C.R. 249 (SCC)
13. *Timminco Ltd., Re*, 2012 CarswellOnt 1263 (Ont. S.C.J. [Commercial List])
14. *Timminco Ltd., Re,* 2012 CarswellOnt 1466 (Ont. S.C.J. [Commercial List])

SCHEDULE "B"

RELEVANT STATUES

Bankruptcy and Insolvency Act: Section 243

Court may appoint receiver

243. (1) Subject to subsection (1.1), on application by a secured creditor, a court may appoint a receiver to do any or all of the following if it considers it to be just or convenient to do so:

(a) take possession of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt;

(b) exercise any control that the court considers advisable over that property and over the insolvent person's or bankrupt's business; or

(c) take any other action that the court considers advisable.

Restriction on appointment of receiver

(1.1) In the case of an insolvent person in respect of whose property a notice is to be sent under subsection 244(1), the court may not appoint a receiver under subsection (1) before the expiry of 10 days after the day on which the secured creditor sends the notice unless

(a) the insolvent person consents to an earlier enforcement under subsection 244(2); or

(b) the court considers it appropriate to appoint a receiver before then.

Definition of "receiver"

(2) Subject to subsections (3) and (4), in this Part, "receiver" means a person who

(a) is appointed under subsection (1); or

(b) is appointed to take or takes possession or control — of all or substantially all of the inventory, accounts receivable or other property of an insolvent person or bankrupt that was acquired for or used in relation to a business carried on by the insolvent person or bankrupt — under

(i) an agreement under which property becomes subject to a security (in this Part referred to as a "security agreement"), or

(ii) a court order made under another Act of Parliament, or an Act of a legislature of a province, that provides for or authorizes the appointment of a receiver or receiver-manager.

Definition of "receiver" — subsection 248(2)

(3) For the purposes of subsection 248(2), the definition "receiver" in subsection (2) is to be read without reference to paragraph (a) or subparagraph (b)(ii).

Trustee to be appointed

(4) Only a trustee may be appointed under subsection (1) or under an agreement or order referred to in paragraph (2)(b).

Place of filing

(5) The application is to be filed in a court having jurisdiction in the judicial district of the locality of the debtor.

Orders respecting fees and disbursements

(6) If a receiver is appointed under subsection (1), the court may make any order respecting the payment of fees and disbursements of the receiver that it considers proper, including one that gives the receiver a charge, ranking ahead of any or all of the secured creditors, over all or part of the property of the insolvent person or bankrupt in respect of the receiver's claim for fees or disbursements, but the court may not make the order unless it is satisfied that the secured creditors who would be materially affected by the order were given reasonable notice and an opportunity to make representations.

Meaning of "disbursements"

(7) In subsection (6), "disbursements" does not include payments made in the operation of a business of the insolvent person or bankrupt.

Criminal Code: Section 347

Criminal interest rate

347. (1) Despite any other Act of Parliament, every one who enters into an agreement or arrangement to receive interest at a criminal rate, or receives a payment or partial payment of interest at a criminal rate, is

(a) guilty of an indictable offence and liable to imprisonment for a term not exceeding five years; or

(b) guilty of an offence punishable on summary conviction and liable to a fine not exceeding $25,000 or to imprisonment for a term not exceeding six months or to both.

Definitions

(2) In this section,

"**credit advanced**" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

"**criminal rate**" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

"**insurance charge**" means the cost of insuring the risk assumed by the person who advances or is to advance credit under an agreement or arrangement, where the face amount of the insurance does not exceed the credit advanced;

"**interest**" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

"**official fee**" means a fee required by law to be paid to any governmental authority in connection with perfecting any security under an agreement or arrangement for the advancing of credit;

"**overdraft charge**" means a charge not exceeding five dollars for the creation of or increase in an overdraft, imposed by a credit union or caisse populaire the membership of which is wholly or substantially comprised of natural persons or a deposit taking institution the deposits in which are insured, in whole or in part, by the Canada Deposit Insurance Corporation or guaranteed, in whole or in part, by the Quebec Deposit Insurance Board;

"**required deposit balance**" means a fixed or an ascertainable amount of the money actually advanced or to be advanced under an agreement or arrangement that is required, as a condition of the agreement or arrangement, to be deposited or invested by or on behalf of the person to whom the advance is or is to be made and that may be available, in the event of his defaulting in any payment, to or for the benefit of the person who advances or is to advance the money.

Presumption

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

Proof of effective annual rate

(4) In any proceedings under this section, a certificate of a Fellow of the Canadian Institute of Actuaries stating that he has calculated the effective annual rate of interest on any credit advanced under an agreement or arrangement and setting out the calculations and the information on which they are based is, in the absence of evidence to the contrary, proof of the effective annual rate without proof of the signature or official character of the person appearing to have signed the certificate.

Notice

(5) A certificate referred to in subsection (4) shall not be received in evidence unless the party intending to produce it has given to the accused or defendant reasonable notice of that intention together with a copy of the certificate.

Cross-examination with leave

(6) An accused or a defendant against whom a certificate referred to in subsection (4) is produced may, with leave of the court, require the attendance of the actuary for the purposes of cross-examination.

Consent required for proceedings

(7) No proceedings shall be commenced under this section without the consent of the Attorney General.

Application

(8) This section does not apply to any transaction to which the Tax Rebate Discounting Act applies.

Court File No. CV-12-9622-00CL

CCM MASTER QUALIFIED FUND, LTD. -and- **BLUTIP POWER TECHNOLOGIES LTD.**

Applicant Respondent

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

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Lawyers for the Court-appointed Receiver

Court File No. CV-12-9622-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, . B-3, AS AMENDED

B E T W E E N:

CCM MASTER QUALIFIED FUND, LTD.

Applicant

-and-

BLUTIP POWER TECHNOLOGIES LTD.

Respondent

BOOK OF AUTHORITIES
(Motion Returnable March 15, 2012)

March 13, 2012

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Court File No. CV-12-9622-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 243(1) OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, . B-3, AS AMENDED

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-and-

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Respondent

INDEX

TAB 1

1991 CarswellOnt 205, 7 C.B.R. (3d) 1, 4 O.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321

1991 CarswellOnt 205, 7 C.B.R. (3d) 1, 4 O.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321

Royal Bank v. Soundair Corp.

ROYAL BANK OF CANADA (plaintiff/respondent) v. SOUNDAIR CORPORATION (respondent), CANADIAN PENSION CAPITAL LIMITED (appellant) and CANADIAN INSURERS' CAPITAL CORPORATION (appellant)

Ontario Court of Appeal

Goodman, McKinlay and Galligan JJ.A.

Heard: June 11, 12, 13 and 14, 1991
Judgment: July 3, 1991
Docket: Doc. CA 318/91

Counsel: *J. B. Berkow* and *S. H. Goldman*, for appellants Canadian Pension Capital Limited and Canadian Insurers' Capital Corporation.

J. T. Morin, Q.C., for Air Canada.

L.A.J. Barnes and *L.E. Ritchie*, for plaintiff/respondent Royal Bank of Canada.

S.F. Dunphy and *G.K. Ketcheson*, for Ernst & Young Inc., receiver of respondent Soundair Corporation.

W.G. Horton, for Ontario Express Limited.

N.J. Spies, for Frontier Air Limited.

Subject: Corporate and Commercial; Insolvency

Receivers --- Conduct and liability of receiver — General conduct of receiver.

Receivers — Sale of debtor's assets — Approval by court — Court appointing receiver to sell airline as going concern — Court considering its position when approving sale recommended by receiver.

S Corp., which engaged in the air transport business, had a division known as AT. When S Corp. experienced financial difficulties, one of the secured creditors, who had an interest in the assets of AT, brought a motion for the appointment of a receiver. The receiver was ordered to operate AT and to sell it as a going concern. The receiver had two offers. It accepted the offer made by OEL and rejected an offer by 922 which contained an unac-

ceptable condition. Subsequently, 922 obtained an order allowing it to make a second offer removing the condition. The secured creditors supported acceptance of the 922 offer. The court approved the sale to OEL and dismissed the motion to approve the 922 offer. An appeal was brought from this order.

Held:

The appeal was dismissed.

Per Galligan J.A.: When a court appoints a receiver to use its commercial expertise to sell an airline, it is inescapable that it intends to rely upon the receiver's expertise and not upon its own. The court should be reluctant to second-guess, with the benefit of hindsight, the considered business decisions made by its receiver.

The conduct of the receiver should be reviewed in the light of the specific mandate given to him by the court. The order appointing the receiver did not say how the receiver was to negotiate the sale. The order obviously intended, because of the unusual nature of the asset being sold, to leave the method of sale substantially to the discretion of the receiver.

To determine whether a receiver has acted providently, the conduct of the receiver should be examined in light of the information the receiver had when it agreed to accept an offer. On the date the receiver accepted the OEL offer, it had only two offers: that of OEL, which was acceptable, and that of 922, which contained an unacceptable condition. The decision made was a sound one in the circumstances. The receiver made a sufficient effort to obtain the best price, and did not act improvidently.

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

Per McKinlay J.A. (concurring in the result): It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. In all cases, the court should carefully scrutinize the procedure followed by the receiver. While the procedure carried out by the receiver in this case was appropriate, given the unfolding of events and the unique nature of the asset involved, it may not be a procedure that is likely to be appropriate in many receivership sales.

Per Goodman J.A. (dissenting): It was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to the receiver. The offer accepted by the receiver was improvident and unfair insofar as two creditors were concerned.

Cases considered:

Beauty Counsellors of Canada Ltd., Re (1986), 58 C.B.R. (N.S.) 237 (Ont. S.C.) — *referred to*

British Columbia Development Corp. v. Spun Cast Industries Ltd. (1977), 26 C.B.R. (N.S.) 28, 5 B.C.L.R. 94 (S.C.) — *referred to*

Cameron v. Bank of Nova Scotia (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.) —

referred to

Crown Trust Co. v. Rosenburg (1986), 67 C.B.R. (N.S.) 320n, 60 O.R. (2d) 87, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526 (H.C.) — *applied*

Salima Investments Ltd. v. Bank of Montreal (1985), 59 C.B.R. (N.S.) 242, 41 Alta. L.R. (2d) 58, 65 A.R. 372, 21 D.L.R. (4th) (C.A.) — *referred to*

Selkirk, Re (1986), 58 C.B.R. (N.S.) 245 (Ont. S.C.) — *referred to*

Selkirk, Re (1987), 64 C.B.R. (N.S.) 140 (Ont. S.C.) — *referred to*

Statutes considered:

Employment Standards Act, R.S.O. 1980, c. 137.

Environmental Protection Act, R.S.O. 1980, c. 141.

Appeal from order approving sale of assets by receiver.

***Galligan J.A.*:**

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

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

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

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

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

tion of the sale of Air Toronto to Air Canada or other person.

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

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

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

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

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

8 It was well known in the air transport industry that Air Toronto was for sale. During the months following the collapse of the negotiations with Air Canada, the receiver tried unsuccessfully to find viable purchasers. In late 1990, the receiver turned to Canadian Airlines International, the only realistic alternative. Negotiations began between them. Those negotiations led to a letter of intent dated February 11, 1990. On March 6, 1991, the receiver received an offer from Ontario Express Limited and Frontier Airlines Limited, who are subsidiaries of Canadian Airlines International. This offer is called the OEL offer.

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

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

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

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

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

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

13 I will deal with the two issues separately.

1. Did the Receiver Act Properly in Agreeing to Sell to OEL?

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

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

16 As did Rosenberg J., I adopt as correct the statement made by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 60 O.R. (2d) 87, 67 C.B.R. (N.S.) 320n, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526 (H.C.), at pp. 92-94 [O.R.], of the duties which a court must perform when deciding whether a receiver who has sold a property acted properly. When he set out the court's duties, he did not put them in any order of priority, nor do I. I summarize those duties as follows:

1. It should consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently.

2. It should consider the interests of all parties.

3. It should consider the efficacy and integrity of the process by which offers are obtained.

4. It should consider whether there has been unfairness in the working out of the process.

17 I intend to discuss the performance of those duties separately.

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

18 Having regard to the fact that it was highly unlikely that a commercially viable sale could be made to anyone but the two national airlines, or to someone supported by either of them, it is my view that the receiver

acted wisely and reasonably when it negotiated only with Air Canada and Canadian Airlines International. Furthermore, when Air Canada said that it would submit no further offers and gave the impression that it would not participate further in the receiver's efforts to sell, the only course reasonably open to the receiver was to negotiate with Canadian Airlines International. Realistically, there was nowhere else to go but to Canadian Airlines International. In doing so, it is my opinion that the receiver made sufficient efforts to sell the airline.

19 When the receiver got the OEL offer on March 6, 1991, it was over 10 months since it had been charged with the responsibility of selling Air Toronto. Until then, the receiver had not received one offer which it thought was acceptable. After substantial efforts to sell the airline over that period, I find it difficult to think that the receiver acted improvidently in accepting the only acceptable offer which it had.

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

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

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

[Emphasis added.]

22 I also agree with and adopt what was said by Macdonald J.A. in *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), at p. 11 [C.B.R.]:

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

[Emphasis added.]

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

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

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

24 I now turn to consider whether the price contained in the OEL offer was one which it was provident to accept. At the outset, I think that the fact that the OEL offer was the only acceptable one available to the receiver on March 8, 1991, after 10 months of trying to sell the airline, is strong evidence that the price in it was reasonable. In a deteriorating economy, I doubt that it would have been wise to wait any longer.

25 I mentioned earlier that, pursuant to an order, 922 was permitted to present a second offer. During the hearing of the appeal, counsel compared at great length the price contained in the second 922 offer with the price contained in the OEL offer. Counsel put forth various hypotheses supporting their contentions that one offer was better than the other.

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

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

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

> If, for example, in this case there had been a second offer of a substantially higher amount, then the court would have to take that offer into consideration in assessing whether the receiver had properly carried out

his function of endeavouring to obtain the best price for the property.

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

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

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

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

[Emphasis added.]

30 What those cases show is that the prices in other offers have relevance only if they show that the price contained in the offer accepted by the receiver was so unreasonably low as to demonstrate that the receiver was improvident in accepting it. I am of the opinion, therefore, that if they do not tend to show that the receiver was improvident, they should not be considered upon a motion to confirm a sale recommended by a court-appointed receiver. If they were, the process would be changed from a sale by a receiver, subject to court approval, into an auction conducted by the court at the time approval is sought. In my opinion, the latter course is unfair to the person who has entered bona fide into an agreement with the receiver, can only lead to chaos, and must be discouraged.

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

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

33 Counsel for the appellants complained about the manner in which Rosenberg J. conducted the hearing of the motion to confirm the OEL sale. The complaint was that when they began to discuss a comparison of the two offers, Rosenberg J. said that he considered the 922 offer to be better than the OEL offer. Counsel said that when that comment was made, they did not think it necessary to argue further the question of the difference in value between the two offers. They complain that the finding that the 922 offer was only marginally better or slightly better than the OEL offer was made without them having had the opportunity to argue that the 922 offer was substantially better or significantly better than the OEL offer. I cannot understand how counsel could have thought that by expressing the opinion that the 922 offer was better, Rosenberg J. was saying that it was a signi-

ficantly or substantially better one. Nor can I comprehend how counsel took the comment to mean that they were foreclosed from arguing that the offer was significantly or substantially better. If there was some misunderstanding on the part of counsel, it should have been raised before Rosenberg J. at the time. I am sure that if it had been, the misunderstanding would have been cleared up quickly. Nevertheless, this court permitted extensive argument dealing with the comparison of the two offers.

34 The 922 offer provided for $6 million cash to be paid on closing with a royalty based upon a percentage of Air Toronto profits over a period of 5 years up to a maximum of $3 million. The OEL offer provided for a payment of $2 million on closing with a royalty paid on gross revenues over a 5-year period. In the short term, the 922 offer is obviously better because there is substantially more cash up front. The chances of future returns are substantially greater in the OEL offer because royalties are paid on gross revenues, while the royalties under the 922 offer are paid only on profits. There is an element of risk involved in each offer.

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

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

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

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

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

2. Consideration of the Interests of all Parties

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

40 In my opinion, there are other persons whose interests require consideration. In an appropriate case, the interests of the debtor must be taken into account. I think also, in a case such as this, where a purchaser has bargained at some length and doubtless at considerable expense with the receiver, the interests of the purchaser

ought to be taken into account. While it is not explicitly stated in such cases as *Crown Trust Co. v. Rosenberg*, supra, *Re Selkirk* (1986), supra, *Re Beauty Counsellors*, supra, *Re Selkirk* (1987), supra, and (*Cameron*), supra, I think they clearly imply that the interests of a person who has negotiated an agreement with a court-appointed receiver are very important.

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

3. Consideration of the Efficacy and Integrity of the Process by which the Offer was Obtained

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

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

> In dealing with the request for approval, the court has to be concerned primarily with protecting the interest of the creditors of the former bankrupt. A secondary but important consideration is that the process under which the sale agreement is arrived at should be consistent with commercial efficacy and integrity.
>
> In that connection I adopt the principles stated by Macdonald J.A. of the Nova Scotia Supreme Court (Appeal Division) in *Cameron v. Bank of N.S.* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), where he said at p. 11:
>
> > In my opinion if the decision of the receiver to enter into an agreement of sale, subject to court approval, with respect to certain assets is reasonable and sound under the circumstances at the time existing it should not be set aside simply because a later and higher bid is made. To do so would literally create chaos in the commercial world and receivers and purchasers would never be sure they had a binding agreement. On the contrary, they would know that other bids could be received and considered up until the application for court approval is heard — this would be an intolerable situation.
>
> While those remarks may have been made in the context of a bidding situation rather than a private sale, I consider them to be equally applicable to a negotiation process leading to a private sale. Where the court is concerned with the disposition of property, the purpose of appointing a receiver is to have the receiver do the work that the court would otherwise have to do.

44 In *Salima Investments Ltd. v. Bank of Montreal* (1985), 59 C.B.R. (N.S.) 242, 41 Alta. L.R. (2d) 58, 65 A.R. 372, 21 D.L.R. (4th) 473 at p. 476 [D.L.R.], the Alberta Court of Appeal said that sale by tender is not necessarily the best way to sell a business as an ongoing concern. It went on to say that when some other method is used which is provident, the court should not undermine the process by refusing to confirm the sale.

45 Finally, I refer to the reasoning of Anderson J. in *Crown Trust Co. v. Rosenberg*, supra, at p. 124 [O.R.]:

> While every proper effort must always be made to assure maximum recovery consistent with the limitations inherent in the process, no method has yet been devised to entirely eliminate those limitations or to avoid their consequences. *Certainly it is not to be found in loosening the entire foundation of the system. Thus to*

compare the results of the process in this case with what might have been recovered in some other set of circumstances is neither logical nor practical.

[Emphasis added.]

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

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

> The court ought not to sit as on appeal from the decision of the Receiver, reviewing in minute detail every element of the process by which the decision is reached. To do so would be a futile and duplicitous exercise.

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

4. Was there unfairness in the process?

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

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

51 The offering memorandum had not been completed by February11, 1991. On that date, the receiver entered into the letter of intent to negotiate with OEL. The letter of intent contained a provision that during its currency the receiver would not negotiate with any other party. The letter of intent was renewed from time to time until the OEL offer was received on March 6, 1991.

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

53 I do not think that the conduct of the receiver shows any unfairness towards 922. When I speak of 922, I

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

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

55 Further evidence of the lack of prejudice which the absence of an offering memorandum has caused 922 is found in CCFL's stance before this court. During argument, its counsel suggested as a possible resolution of this appeal that this court should call for new bids, evaluate them and then order a sale to the party who put in the better bid. In such a case, counsel for CCFL said that 922 would be prepared to bid within 7 days of the court's decision. I would have thought that, if there were anything to CCFL's suggestion that the failure to provide an offering memorandum was unfair to 922, that it would have told the court that it needed more information before it would be able to make a bid.

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

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

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

> The court should not proceed against the recommendations of its Receiver except in special circumstances and where the necessity and propriety of doing so are plain. Any other rule or approach would emasculate

> the role of the Receiver and make it almost inevitable that the final negotiation of every sale would take place on the motion for approval.

The second is at p. 111 [O.R.]:

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

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

59 In his reasons for judgment, after discussing the circumstances leading to the 922 offer, Rosenberg J. said this:

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

I agree.

60 The receiver made proper and sufficient efforts to get the best price that it could for the assets of Air Toronto. It adopted a reasonable and effective process to sell the airline which was fair to all persons who might be interested in purchasing it. It is my opinion, therefore, that the receiver properly carried out the mandate which was given to it by the order of O'Brien J. It follows that Rosenberg J. was correct when he confirmed the sale to OEL.

II. The effect of the support of the 922 offer by the two secured creditors.

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

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

63 There can be no doubt that the interests of the creditor are an important consideration in determining

whether the receiver has properly conducted a sale. The opinion of the creditors as to which offer ought to be accepted is something to be taken into account. But if the court decides that the receiver has acted properly and providently, those views are not necessarily determinative. Because, in this case, the receiver acted properly and providently, I do not think that the views of the creditors should override the considered judgment of the receiver.

64 The second reason is that, in the particular circumstances of this case, I do not think the support of CCFL and the Royal Bank of the 922 offer is entitled to any weight. The support given by CCFL can be dealt with summarily. It is a co-owner of 922. It is hardly surprising and not very impressive to hear that it supports the offer which it is making for the debtor's assets.

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

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

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

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

69 In its factum, the receiver pointed out that, because of greater liabilities imposed upon private receivers by various statutes such as the *Employment Standards Act*, R.S.O. 1980, c. 137, and the *Environmental Protection Act*, R.S.O. 1980, c. 141, it is likely that more and more the courts will be asked to appoint receivers in insolvencies. In those circumstances, I think that creditors who ask for court-appointed receivers and business people who choose to deal with those receivers should know that if those receivers act properly and providently, their decisions and judgments will be given great weight by the courts who appoint them. I have decided this appeal in the way I have in order to assure business people who deal with court-appointed receivers that they can have confidence that an agreement which they make with a court-appointed receiver will be far more than a platform upon which others may bargain at the court approval stage. I think that persons who enter into agreements

with court-appointed receivers, following a disposition procedure that is appropriate given the nature of the assets involved, should expect that their bargain will be confirmed by the court.

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

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

***McKinlay J.A.*:**

72 I agree with Galligan J.A. in result, but wish to emphasize that I do so on the basis that the undertaking being sold in this case was of a very special and unusual nature. It is most important that the integrity of procedures followed by court-appointed receivers be protected in the interests of both commercial morality and the future confidence of business persons in their dealings with receivers. Consequently, in all cases, the court should carefully scrutinize the procedure followed by the receiver to determine whether it satisfies the tests set out by Anderson J. in *Crown Trust Co. v. Rosenberg* (1986), 67 C.B.R. (N.S.) 320n, 60 O.R. (2d) 87, 22 C.P.C. (2d) 131, 39 D.L.R. (4th) 526 (H.C.). While the procedure carried out by the receiver in this case, as described by Galligan J.A., was appropriate, given the unfolding of events and the unique nature of the assets involved, it is not a procedure that is likely to be appropriate in many receivership sales.

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

***Goodman J.A.* (dissenting):**

74 I have had the opportunity of reading the reasons for judgment herein of Galligan and McKinlay JJ.A. Respectfully, I am unable to agree with their conclusion.

75 The case at bar is an exceptional one in the sense that upon the application made for approval of the sale of the assets of Air Toronto, two competing offers were placed before Rosenberg J. Those two offers were that of OEL and that of 922, a company incorporated for the purpose of acquiring Air Toronto. Its shares were

owned equally by CCFL and Air Canada. It was conceded by all parties to these proceedings that the only persons who had any interest in the proceeds of the sale were two secured creditors, viz., CCFL and the Royal Bank of Canada. Those two creditors were unanimous in their position that they desired the court to approve the sale to 922. We were not referred to, nor am I aware of, any case where a court has refused to abide by the unanimous wishes of the only interested creditors for the approval of a specific offer made in receivership proceedings.

76 In *British Columbia Developments Corp. v. Spun Cast Industries Ltd.* (1977), 26 C.B.R. (N.S.) 28, 5 B.C.L.R. 94 (S.C.), Berger J. said at p. 30 [C.B.R.]:

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

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

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

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

79 In *Cameron v. Bank of Nova Scotia* (1981), 38 C.B.R. (N.S.) 1, 45 N.S.R. (2d) 303, 86 A.P.R. 303 (C.A.), Hart J.A., speaking for the majority of the court, said at p. 10 [C.B.R.]:

> Here we are dealing with a receiver appointed at the instance of one major creditor, who chose to insert in the contract of sale a provision making it subject to the approval of the court. This, in my opinion, shows an intention on behalf of the parties to invoke the normal equitable doctrines which place the court in the position of looking to the interests of all persons concerned before giving its blessing to a particular transaction submitted for approval. In these circumstances the court would not consider itself bound by the contract entered into in good faith by the receiver but would have to look to the broader picture to see that that contract was for the benefit of the creditors as a whole. When there was evidence that a higher price was readily

available for the property the chambers judge was, in my opinion, justified in exercising his discretion as he did. Otherwise he could have deprived the creditors of a substantial sum of money.

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

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

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

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

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

84 I agree with that statement of the law. In *Re Selkirk* (1986), 58 C.B.R. (N.S.) 245 (Ont. S.C.), Saunders J. heard an application for court approval of the sale by the sheriff of real property in bankruptcy proceedings. The sheriff had been previously ordered to list the property for sale subject to approval of the court. Saunders J. said at p. 246:

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

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

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

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

87 I agree that the same reasoning may apply to a negotiation process leading to a private sale, but the procedure and process applicable to private sales of a wide variety of businesses and undertakings with the multiplicity of individual considerations applicable and perhaps peculiar to the particular business is not so clearly established that a departure by the court from the process adopted by the receiver in a particular case will result in commercial chaos to the detriment of future receivership proceedings. Each case must be decided on its own merits, and it is necessary to consider the process used by the receiver in the present proceedings and to determine whether it was unfair, improvident or inadequate.

88 It is important to note at the outset that Rosenberg J. made the following statement in his reasons:

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

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

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

91 To the extent that approval of the OEL agreement by Rosenberg J. was based on the alleged lack of good faith in bargaining and improper motivation with respect to connector traffic on the part of Air Canada and CCFL, it cannot be supported.

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

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

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

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

96 By amending agreement dated June 19, 1990, the receiver was released from its covenant to refrain from negotiating for the sale of the Air Toronto business and assets to any person other than Air Canada. By virtue of this amending agreement, the receiver had put itself in the position of having a firm offer in hand, with the right to negotiate and accept offers from other persons. Air Canada, in these circumstances, was in the subservient position. The receiver, in the exercise of its judgment and discretion, allowed the Air Canada offer to lapse. On July 20, 1990, Air Canada served a notice of termination of the April 30, 1990 agreement.

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

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

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

million and $12 million.

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

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

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

102 During the period December 1990 to the end of January 1991, the receiver advised CCFL that the offering memorandum was in the process of being prepared and would be ready soon for distribution. He further advised CCFL that it should await the receipt of the memorandum before submitting a formal offer to purchase the Air Toronto assets.

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

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

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

106 On February 28, 1991, the solicitors for CCFL telephoned the receiver and were advised for the first

time that the receiver had made a business decision to negotiate solely with OEL and would not negotiate with anyone else in the interim.

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

108 The fact of the matter is that by March 7, 1991, the receiver had received the offer from OEL which was subsequently approved by Rosenberg J. That offer was accepted by the receiver on March 8, 1991. Notwithstanding the fact that OEL had been negotiating the purchase for a period of approximately 3 months, the offer contained a provision for the sole benefit of the purchaser that it was subject to the purchaser obtaining "a financing commitment within 45 days of the date hereof in an amount not less than the Purchase Price from the Royal Bank of Canada or other financial institution upon terms and conditions acceptable to them. In the event that such a financing commitment is not obtained within such 45 day period, the purchaser or OEL shall have the right to terminate this agreement upon giving written notice of termination to the vendor on the first Business Day following the expiry of the said period." The purchaser was also given the right to waive the condition.

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

110 In my opinion, the process and procedure adopted by the receiver was unfair to CCFL. Although it was aware from December 1990 that CCFL was interested in making an offer, it effectively delayed the making of such offer by continually referring to the preparation of the offering memorandum. It did not endeavour during the period December 1990 to March 7, 1991, to negotiate with CCFL in any way the possible terms of purchase and sale agreement. In the result, no offer was sought from CCFL by the receiver prior to February 11, 1991, and thereafter it put itself in the position of being unable to negotiate with anyone other than OEL. The receiver then, on March 8, 1991, chose to accept an offer which was conditional in nature without prior consultation with CCFL (922) to see whether it was prepared to remove the condition in its offer.

111 I do not doubt that the receiver felt that it was more likely that the condition in the OEL offer would be fulfilled than the condition in the 922 offer. It may be that the receiver, having negotiated for a period of 3 months with OEL, was fearful that it might lose the offer if OEL discovered that it was negotiating with another person. Nevertheless, it seems to me that it was imprudent and unfair on the part of the receiver to ignore an offer from an interested party which offered approximately triple the cash down payment without giving a chance to the offeror to remove the conditions or other terms which made the offer unacceptable to it. The potential loss was that of an agreement which amounted to little more than an option in favour of the offeror.

112 In my opinion the procedure adopted by the receiver was unfair to CCFL in that, in effect, it gave OEL the opportunity of engaging in exclusive negotiations for a period of 3 months, notwithstanding the fact that it

knew CCFL was interested in making an offer. The receiver did not indicate a deadline by which offers were to be submitted, and it did not at any time indicate the structure or nature of an offer which might be acceptable to it.

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

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

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

114 It should be noted that on March 13, 1991, the representatives of 922 first met with the receiver to review its offer of March 7, 1991, and at the request of the receiver, withdrew the inter-lender condition from its offer. On March 14, 1991, OEL removed the financing condition from its offer. By order of Rosenberg J. dated March 26, 1991, CCFL was given until April 5, 1991, to submit a bid, and on April 5, 1991, 922 submitted its offer with the inter-lender condition removed.

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

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

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

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

118 I note that in the case at bar the 922 offer in conditional form was presented to the receiver before it accepted the OEL offer. The receiver, in good faith, although I believe mistakenly, decided that the OEL offer was the better offer. At that time the receiver did not have the benefit of the views of the two secured creditors in that regard. At the time of the application for approval before Rosenberg J., the stated preference of the two interested creditors was made quite clear. He found as fact that knowledgeable creditors would not be anxious to rely on contingencies in the present circumstances surrounding the airline industry. It is reasonable to expect that a receiver would be no less knowledgeable in that regard, and it is his primary duty to protect the interests of the creditors. In my view, it was an improvident act on the part of the receiver to have accepted the conditional offer made by OEL, and Rosenberg J. erred in failing to dismiss the application of the receiver for approval of the OEL offer. It would be most inequitable to foist upon the two creditors, who have already been seriously hurt, more unnecessary contingencies.

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

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

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

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

123 I am further of the opinion that a prospective purchaser who has been given an opportunity to engage in exclusive negotiations with a receiver for relatively short periods of time which are extended from time to time by the receiver, and who then makes a conditional offer, the condition of which is for his sole benefit and must be fulfilled to his satisfaction unless waived by him, and which he knows is to be subject to court approval, cannot legitimately claim to have been unfairly dealt with if the court refuses to approve the offer and approves a substantially better one.

124 In conclusion, I feel that I must comment on the statement made by Galligan J.A. in his reasons to the effect that the suggestion made by counsel for 922 constitutes evidence of lack of prejudice resulting from the absence of an offering memorandum. It should be pointed out that the court invited counsel to indicate the manner in which the problem should be resolved in the event that the court concluded that the order approving the OEL offer should be set aside. There was no evidence before the court with respect to what additional information may have been acquired by CCFL since March 8, 1991, and no inquiry was made in that regard. Accordingly, I am of the view that no adverse inference should be drawn from the proposal made as a result of the court's invitation.

125 For the above reasons I would allow the appeal one set of costs to CCFL-922, set aside the order of Rosenberg J., dismiss the receiver's motion with one set of costs to CCFL-922 and order that the assets of Air Toronto be sold to numbered corporation 922246 on the terms set forth in its offer with appropriate adjustments to provide for the delay in its execution. Costs awarded shall be payable out of the estate of Soundair Corporation. The costs incurred by the receiver in making the application and responding to the appeal shall be paid to him out of the assets of the estate of Soundair Corporation on a solicitor-client basis. I would make no order as to costs of any of the other parties or intervenors.

Appeal dismissed.

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TAB 2

2011 CarswellOnt 11687, 2011 ONSC 6403, 207 A.C.W.S. (3d) 400

Graceway Canada Co., Re

In the Matter of the Receivership of Graceway Canada Company, Applicant

In the Matter of the Courts of Justice Act, R.S.O. 1990, c. C.43, as Amended

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: October 17, 2011
Judgment: October 27, 2011
Docket: CV-11-9411CL

Counsel: Fred Myers, L. Joseph Latham, Caroline Descours, for Applicant

J. Swartz, for RSM Ritchter Inc., Receiver

Mark Laugesen, for Galderma S.A., **Stalking Horse** Bidder

Jeffrey Levine, for Bank of America

Subject: Insolvency; Estates and Trusts; Civil Practice and Procedure

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Jurisdiction of court to approve sale

Applicant corporation's American affiliates (US debtors) filed for bankruptcy in United States of America — Asset purchase agreement was reached with corporation and US debtors (collectively G) as sellers, and bidder as purchaser in **stalking horse** auction — Corporation and receiver brought motion to approve **bidding procedures** and asset purchase agreement — Motion granted — G pursued range of options to address their concern about ability to service debt going forward — G determined that best way to maximize value of its assets for benefit of creditors was sale of substantially all of its assets — Asset purchase agreement was negotiated at arm's length — Purchase price payable represented fair and reasonable price — Proceeding in this fashion allowed G to continue operations with least amount of disruption to business operations.

Statutes considered:

Bankruptcy Code, 11 U.S.C.

s. 363 — referred to

MOTION by corporation and receiver to approve **bidding procedures** and asset purchase agreement.

***Morawetz J.*:**

1 On October 17, 2011, the motion was granted with reasons to follow. These are the reasons.

2 In a joint hearing held on October 17, 2011, the **Bidding Procedures** were approved by the U.S. Bankruptcy Court and by this court. In granting this relief, the Applicant and Receiver were authorized and directed to conduct the Sales Process and auction as contemplated in the **Bidding Procedures**. I also authorized and approved the Asset Purchase Agreement among Galderma S.A., as purchaser and the Applicant, Graceway Pharmaceuticals LLC, and its U.S. affiliates (collectively with Graceway Pharmaceutical LLC, the "U.S. Debtors"), as sellers, as the **Stalking Horse** Agreement for the purposes of conducting a **Stalking Horse** auction (the " **Stalking Horse** Process").

3 In granting this relief, I took into consideration that prior to the Chapter 11 filing, the Applicant and the U.S. Debtors (collectively, "Graceway") pursued a range of options to address Graceway's concern about its ability to service its debt going forward. Further, Graceway had determined that the best way to maximize the value of its assets for the benefit of creditors was to seek a sale of substantially all of its assets pursuant to s. 363 of the *United States Bankruptcy Code*.

4 I am satisfied that the Asset Purchase Agreement was negotiated at arm's length and that the purchase price payable represents a fair and reasonable price.

5 An auction process will take place, followed by an application for court approval, both in this court and in the United States Bankruptcy Court.

6 The Applicant is of the view that proceeding in this fashion will allow Graceway to continue operations with the least amount of disruption to its business operations, which will preserve the going concern value of the enterprise and maximize the potential recovery for creditors of both the Applicant and the U.S. Debtors. Graceway is of the view that it is in the best interests of its various estates, creditors and other stakeholders to move forward with the sales process as described in the motion record.

7 I have been satisfied that it is appropriate to grant the requested relief. An order was signed in the form submitted approving the revised **Bidding Procedures** and the Asset Purchase Agreement.

8 Finally, it is noted that the allocation of the purchase price between the Applicant and the U.S. Debtors is an outstanding issue. The Receiver, in its Report, advised that it is in discussions with the U.S. Debtors and its advisors in respect of this issue. It is expected that this issue will be resolved prior to the return of any motion to approve the sale of assets in question, which motion is currently scheduled for November 22, 2011.

Motion granted.

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TAB 3

2011 CarswellOnt 5929, 2011 ONSC 3492, 81 C.B.R. (5th) 58

Parlay Entertainment Inc., Re

In the Matter of the Notice of Intention to Make a Proposal of Parlay Entertainment Inc., Insolvent Person (Applicant)

Ontario Superior Court of Justice

Morawetz J.

Heard: June 3, 2011
Oral reasons: June 3, 2011
Written reasons: June 4, 2011
Docket: 32-1494254

Counsel: J. Fogarty for Applicant

C. Prophet for M. Projects

Subject: Insolvency; Corporate and Commercial; Estates and Trusts

Bankruptcy and insolvency --- Proposal — Time period to file — Extension of time

Insolvent company (applicant) filed notice of intention to make proposal under Bankruptcy and Insolvency Act (BIA) — Applicant and Proposal Trustee opined that sales process incorporating "**stalking horse**" bid was appropriate — Applicant brought motion for extension of time to file proposal and for ancillary relief relating to proposed sales process — Motion granted — Test under s. 50.4(9) of BIA was satisfied — Extension granted — Proposal Trustee's report established that applicant was working towards sale of assets — There were no Personal Property Security Act registrations such that proceeds of sale less expenses should be available to creditors — Applicant had been acting in good faith and with due diligence and would likely be able to make viable proposal from proceeds of sale — Proposal Trustee reported that no creditor would be materially prejudiced if extension was granted.

Bankruptcy and insolvency --- Proposal — Approval by court — General principles

Insolvent company (applicant) filed notice of intention to make proposal under Bankruptcy and Insolvency Act — Unsuccessful attempts to sell or restructure had been made — Applicant and Proposal Trustee opined that sales process incorporating "**stalking horse**" bid was appropriate — Applicant brought motion for extension of time to file proposal and for ancillary relief relating to proposed sales process — Motion granted — Transaction

and sales process should be approved — Proposal Trustee opined that process and bidding procedures were reasonable in circumstances and there was no reasonable alternative to recommended proposal — Time for implementing solution was running out — Reservations expressed relating to indirect benefits flowing to **stalking horse** bidder in form of break fee, **expense reimbursement** and overbid requirements were addressed to certain degree by concession made by **stalking horse** bidder to reduce overbid provision by 50 percent from $75,000 to $37,500.

Statutes considered:

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

s. 50.4(9) [en. 1992, c. 27, s. 19] — considered

Personal Property Security Act, R.S.O. 1990, c. P.10

Generally — referred to

MOTION by applicant for extension of time to file proposal, and for ancillary relief.

Morawetz J.:

1 On June 3, 2011, I heard the above motion. I endorsed the record as follows:

> Motion granted based on a reduction in the minimum overbid amount to $37,500. Stay extended to July 18, 2011. Reasons to follows on June 6, 2011.

2 These are the reasons relating to the June 3, 2011 endorsement.

3 The motion was not opposed.

4 The Applicant requests an extension of time to file the proposal.

5 The evidence in support is the Proposal Trustee's report. The report established that the Applicant is working towards a sale of assets. There are no PPSA registrations such that proceeds of sale less expenses should be available to creditors. I am satisfied that the Applicant has acted and is acting in good faith and with due diligence and that it will likely be able to make a viable proposal from the proceeds of sale. The Proposal Trustee reports that no creditor will be materially prejudiced if the extension is granted.

6 The test under s. 50.4(9) has, in my view, been satisfied. The extension to July 18, 2011 is granted.

7 The parties should note that any further extension requests should be supported by an affidavit of a representative of the Applicant or a satisfactory explanation as to why an affidavit is not being filed.

8 With respect to the relief relating to the proposed sales process, the report of the Proposal Trustee was reviewed by counsel in great detail. Mr. Davidson of BDO Canada also provided additional commentary.

9 The Report establishes that:

a. Parlay has been attempting for some time to restructure. There have been attempts to sell, which have proved unsuccessful;

b. Revenues have declined in a significant amount;

c. Losses of $2.5 million were incurred in 2010; and

d. Management is of the view that present revenue levels do not represent a sustainable business model.

10 The Applicant and the Proposal Trustee are now of the view that a sales process, incorporating a **stalking horse** bid is appropriate.

11 The Proposal Trustee's views to support this type of process are summarized in the memo of law submitted by the Applicant. The memo also sets out the considerations that have been taken into account in other **stalking horse** sales.

12 This particular **stalking horse** asset purchase agreement includes a $50,000 break fee, a $50,000 **expense reimbursement** provision and a $75,000 minimum overbid provision on a sales price of approximately $2.1 million. It also provides that the purchaser, who is also the DIP lender, can credit bid to the limit of the DIP Facility.

13 The Proposal Trustee is of the view that the process is reasonable and recommends that it be approved.

14 The Proposal Trustee has indicated that it will file a Supplementary Report which confirms, among other things, that it is of the view that the Bidding Procedures are reasonable in the circumstances and that there is no reasonable alternative to the recommended proposal.

15 I have also been persuaded that the time for implementing a solution is running out. The proposed transaction was referenced as being a life line. Concern was expressed with respect to the ongoing employment of Parlay's work force. I accept the legitimacy of these concerns. In the circumstances, I am satisfied that the transaction and sales process should be approved, notwithstanding reservations that I expressed relating to the indirect benefits flowing to M Projects — the **Stalking Horse** Bidder - in the form of the break fee, **expense reimbursement** and overbid requirements, when considered in totality. My reservations were addressed, to a degree, by the concession made by M Projects to reduce the overbid provision by 50% from $75,000 to $37,500.

16 The Proposal Trustee is of the view that the break-up fee and reimbursement fee and overbid provision are reasonable. In view of the aforementioned concession of M Projects, I am satisfied that the transaction and sales process, in the circumstances of this case, should be approved.

17 The Applicant also requested approval of a D & O Charge. At this point, it is uncertain if the existing D & O Policy can be extended.

18 I am satisfied that the D & O Charge should be granted, as requested, subject to the proviso that if the D & O Policy can be extended on satisfactory terms, the Proposal Trustee should report this development to the court and make appropriate recommendations as to whether the D & O Charge should be vacated.

19 The ancillary relief requested is, in my view, appropriate in the circumstances.

20 The motion is granted and an order shall issue to give effect to the foregoing.

Motion granted.

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TAB 4

C

2010 CarswellOnt 3509, 2010 ONSC 2870, 68 C.B.R. (5th) 233

Canwest Publishing Inc./Publications Canwest Inc., Re

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CANWEST PUBLISHING INC./PUBLICATIONS CANWEST INC., CANWEST BOOKS INC., AND CANWEST (CANADA) INC. (Applicants)

Ontario Superior Court of Justice [Commercial List]

Pepall J.

Judgment: May 21, 2010
Docket: CV-10-8533-00CL

Counsel: Lyndon Barnes, Alex Cobb, Betsy Putnam for Applicant, LP Entities

Mario Forte for Special Committee of the Board of Directors

David Byers, Maria Konyukhova for Monitor, FTI Consulting Canada Inc.

Andrew Kent, Hilary Clarke for Administrative Agent of the Senior Secured Lenders Syndicate

M.P. Gottlieb, J.A. Swartz for Ad Hoc Committee of 9.25% Senior Subordinated Noteholders

Robert Chadwick, Logan Willis for 7535538 Canada Inc.

Deborah McPhail for Superintendant of Financial Services (FSCO)

Thomas McRae for Certain Canwest Employees

Subject: Insolvency; Estates and Trusts

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Sale by tender — Miscellaneous

Companies' Creditors Arrangement Act — Sale and investor solicitation process — In earlier order, court approved support agreement between LP entities and senior lenders (support transaction) and commencement of

sale and investor solicitation process (SISP) — AHC bid was only superior offer as defined in SISP — AHC bid would allow for full payout of debt owed to secured lenders and provide additional value to be available for unsecured creditors — AHC transaction would be implemented pursuant to plan of compromise or arrangement — LP entities brought application for order authorizing them to enter into asset purchase agreement based on AHC bid and conditionally sanctioning support transaction, among other relief — Application granted — AHC transaction was approved — Proposed disposition of assets met criteria in s. 36 of Companies' Creditors Arrangement Act and common law — Process was reasonable — Sufficient efforts were made to attract best possible bid — AHC bid was better than support transaction — Effect of proposed sale on interested parties was positive.

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

Procedure — Court approved commencement of sale and investor solicitation process (SISP) in earlier order — AHC bid was only superior offer as defined in SISP — AHC bid would allow for full payout of debt owed to secured lenders and provide additional value to be available for unsecured creditors — LP entities brought application for order approving amended claims procedure, authorizing them to call meeting of unsecured creditors to vote on AHC plan, and amending SISP procedures so LP entities could advance AHC transaction, among other relief — Application granted — Requested claims procedure order was approved — Because AHC plan was approved, scope of process had to be expanded to ensure as many creditors as possible could participate in meeting to consider AHC plan — Meeting order to convene meeting of unsecured creditors to vote on AHC plan was granted — On consent, SISP was amended to extend date for closing of AHC transaction and to permit proposed dual track procedure — Amendments were warranted as practical matter and to procure best available going concern outcome for stakeholders and LP entities.

Bankruptcy and insolvency --- Companies' Creditors Arrangement Act — Arrangements — Approval by court — "Fair and reasonable"

In earlier order, court approved support agreement between LP entities and senior lenders (support transaction) and commencement of sale and investor solicitation process (SISP) — AHC bid was only superior offer as defined in SISP — AHC bid would allow for full payout of debt owed to secured lenders and provide additional value to be available for unsecured creditors — AHC transaction would be implemented pursuant to plan of compromise or arrangement — LP entities brought application for order authorizing them to enter into asset purchase agreement based on AHC bid and conditionally sanctioning support transaction, among other relief — Application granted — It was prudent for LP entities to simultaneously advance AHC transaction and support transaction — Support transaction was conditionally sanctioned — Excess of required majorities of senior lenders voted in favour of support transaction — Absent closing of AHC transaction, support transaction was fair and reasonable as between LP entities and creditors — There were no available commercial going concern alternatives to support transaction — There had been strict compliance with statutory requirements.

Cases considered by *Pepall J.*:

Canadian Airlines Corp., Re (2000), [2000] 10 W.W.R. 269, 20 C.B.R. (4th) 1, 84 Alta. L.R. (3d) 9, 9 B.L.R. (3d) 41, 2000 CarswellAlta 662, 2000 ABQB 442, 265 A.R. 201 (Alta. Q.B.) — followed

Canadian Airlines Corp., Re (2000), 2000 CarswellAlta 919, [2000] 10 W.W.R. 314, 20 C.B.R. (4th) 46, 84 Alta. L.R. (3d) 52, 9 B.L.R. (3d) 86, 2000 ABCA 238, 266 A.R. 131, 228 W.A.C. 131 (Alta. C.A. [In Chambers]) — referred to

Canadian Airlines Corp., Re (2000), 88 Alta. L.R. (3d) 8, 2001 ABCA 9, 2000 CarswellAlta 1556, [2001] 4 W.W.R. 1, 277 A.R. 179, 242 W.A.C. 179 (Alta. C.A.) — referred to

Canadian Airlines Corp., Re (2001), 2001 CarswellAlta 888, 2001 CarswellAlta 889, 275 N.R. 386 (note), 293 A.R. 351 (note), 257 W.A.C. 351 (note) (S.C.C.) — referred to

Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205 (Ont. C.A.) — followed

Statutes considered:

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

Generally — referred to

s. 6 — referred to

s. 6(3) — referred to

s. 6(5) — referred to

s. 6(6) — referred to

s. 11 — referred to

s. 36 — considered

APPLICATION by LP entities for various relief relating to *Companies' Creditors Arrangement Act* proceedings.

***Pepall J.*:**

Endorsement

Relief Requested

1 The LP Entities seek an order: (1) authorizing them to enter into an Asset Purchase Agreement based on a bid from the Ad Hoc Committee of 9.25% Senior Subordinated Noteholders ("the AHC Bid"); (2) approving an amended claims procedure; (3) authorizing the LP Entities to resume the claims process; and (4) amending the SISP procedures so that the LP Entities can advance the Ad Hoc Committee transaction (the AHC Transaction") and the Support Transaction concurrently. They also seek an order authorizing them to call a meeting of unsecured creditors to vote on the Ad Hoc Committee Plan on June 10, 2010. Lastly, they seek an order conditionally sanctioning the Senior Lenders' CCAA Plan.

AHC Bid

2 Dealing firstly with approval of the AHC Bid, in my Initial Order of January 8, 2010, I approved the Support Agreement between the LP Entities and the Administrative Agent for the Senior Lenders and authorized the LP Entities to file a Senior Lenders' Plan and to commence a sale and investor solicitation process (the SISP). The objective of the SISP was to test the market and obtain an offer that was superior to the terms of the Support

Transaction.

3 On January 11, 2010, the Financial Advisor, RBC Capital Markets, commenced the SISP. Qualified Bids (as that term was defined in the SISP) were received and the Monitor, in consultation with the Financial Advisor and the LP CRA, determined that the AHC Bid was a Superior Cash Offer and that none of the other bids was a Superior Offer as those terms were defined in the SISP.

4 The Monitor recommended that the LP Entities pursue the AHC Transaction and the Special Committee of the Board of Directors accepted that recommendation.

5 The AHC Transaction contemplates that 7535538 Canada Inc. ("Holdco") will effect a transaction through a new limited partnership (Opco LP) in which it will acquire substantially all of the financial and operating assets of the LP Entities and the shares of National Post Inc. and assume certain liabilities including substantially all of the operating liabilities for a purchase price of $1.1 billion. At closing, Opco LP will offer employment to substantially all of the employees of the LP Entities and will assume all of the pension liabilities and other benefits for employees of the LP Entities who will be employed by Opco LP, as well as for retirees currently covered by registered pension plans or other benefit plans. The materials submitted with the AHC Bid indicated that Opco LP will continue to operate all of the businesses of the LP Entities in substantially the same manner as they are currently operated, with no immediate plans to discontinue operations, sell material assets or make significant changes to current management. The AHC Bid will also allow for a full payout of the debt owed by the LP Entities to the LP Secured Lenders under the LP credit agreement and the Hedging Creditors and provides an additional $150 million in value which will be available for the unsecured creditors of the LP Entities.

6 The purchase price will consist of an amount in cash that is equal to the sum of the Senior Secured Claims Amount (as defined in the AHC Asset Purchase Agreement), a promissory note of $150 million (to be exchanged for up to 45% of the common shares of Holdco) and the assumption of certain liabilities of the LP Entities.

7 The Ad Hoc Committee has indicated that Holdco has received commitments for $950 million of funded debt and equity financing to finance the AHC Bid. This includes $700 million of new senior funded debt to be raised by Opco LP and $250 million of mezzanine debt and equity to be raised including from the current members of the Ad Hoc Committee.

8 Certain liabilities are excluded including pre-filing liabilities and restructuring period claims, certain employee related liabilities and intercompany liabilities between and among the LP Entities and the CMI Entities. Effective as of the closing date, Opco LP will offer employment to all full-time and part-time employees of the LP Entities on substantially similar terms as their then existing employment (or the terms set out in their collective agreement, as applicable), subject to the option, exercisable on or before May 30, 2010, to not offer employment to up to 10% of the non-unionized part-time or temporary employees employed by the LP Entities.

9 The AHC Bid contemplates that the transaction will be implemented pursuant to a plan of compromise or arrangement between the LP Entities and certain unsecured creditors (the "AHC Plan"). In brief, the AHC Plan would provide that Opco LP would acquire substantially all of the assets of the LP Entities. The Senior Lenders would be unaffected creditors and would be paid in full. Unsecured creditors with proven claims of $1,000 or less would receive cash. The balance of the consideration would be satisfied by an unsecured demand note of $150 million less the amounts paid to the $1,000 unsecured creditors. Ultimately, affected unsecured creditors with proven claims would receive shares in Holdco and Holdco would apply for the listing of its common shares

on the Toronto Stock Exchange.

10 The Monitor recommended that the AHC Asset Purchase Agreement based on the AHC Bid be authorized. Certain factors were particularly relevant to the Monitor in making its recommendation:

- the Senior Lenders will received 100 cents on the dollar;
- the AHC Transaction will preserve substantially all of the business of the LP Entities to the benefit of the LP Entities' suppliers and the millions of people who rely on the LP Entities' publications each day;
- the AHC Transaction preserves the employment of substantially all of the current employees and largely protects the interests of former employees and retirees;
- the AHC Bid contemplates that the transaction will be implemented through a Plan under which $150 million in cash or shares will be available for distribution to unsecured creditors;
- unlike the Support Transaction, there is no option *not* to assume certain pension or employee benefits obligations.

11 The Monitor, the LP CRA and the Financial Advisor considered closing risks associated with the AHC Bid and concluded that the Bid was credible, reasonably certain and financially viable. The LP Entities agreed with that assessment. All appearing either supported the AHC Transaction or were unopposed.

12 Clearly the SISP was successful and in my view, the LP Entities should be authorized to enter the Ad Hoc Committee Asset Purchase Agreement as requested.

13 The proposed disposition of assets meets the section 36 CCAA criteria and those set forth in the *Royal Bank v. Soundair Corp.*[FN1] decision. Indeed, to a large degree, the criteria overlap. The process was reasonable and the Monitor was content with it. Sufficient efforts were made to attract the best possible bid; the SISP was widely publicized; ample time was given to prepare offers; and there was integrity and no unfairness in the process. The Monitor was intimately involved in supervising the SISP and also made the Superior Cash Offer recommendation. The Monitor had previously advised the Court that in its opinion, the Support Transaction was preferable to a bankruptcy. The logical extension of that conclusion is that the AHC Transaction is as well. The LP Entities' Senior Lenders were either consulted and/or had the right to approve the various steps in the SISP. The effect of the proposed sale on other interested parties is very positive. Amongst other things, it provides for a going concern outcome and significant recoveries for both the secured and unsecured creditors. The consideration to be received is reasonable and fair. The Financial Advisor and the Monitor were both of the opinion that the SISP was a thorough canvassing of the market. The AHC Transaction was the highest offer received and delivers considerably more value than the Support Transaction which was in essence a "stalking horse" offer made by the single largest creditor constituency. The remaining subsequent provisions of section 36 of the CCAA are either inapplicable or have been complied with. In conclusion the AHC Transaction ought to be and is approved.

Claims Procedure Order and Meeting Order

14 Turning to the Claims Procedure Order, as a result of the foregoing, the scope of the claims process needs to be expanded. Claims that have been filed will move to adjudication and resolution and in addition, the scope of the process needs to be expanded so as to ensure that as many creditors as possible have an opportunity to participate in the meeting to consider the Ad Hoc Committee Plan and to participate in distributions. Dates

and timing also have to be adjusted. In these circumstances the requested Claims Procedure Order should be approved. Additionally, the Meeting Order required to convene a meeting of unsecured creditors on June 10, 2010 to vote on the Ad Hoc Committee Plan is granted.

SISP Amendment

15 It is proposed that the LP Entities will work diligently to implement the AHC Transaction while concurrently pursuing such steps as are required to effect the Support Transaction. The SISP procedures must be amended. The AHC Transaction which is to be effected through the Ad Hoc Committee Plan cannot be completed within the sixty days contemplated by the SISP. On consent of the Monitor, the LP Administrative Agent, the Ad Hoc Committee and the LP Entities, the SISP is amended to extend the date for closing of the AHC Transaction and to permit the proposed dual track procedure. The proposed amendments to the SISP are clearly warranted as a practical matter and so as to procure the best available going concern outcome for the LP Entities and their stakeholders. Paragraph 102 of the Initial Order contains a comeback clause which provides that interested parties may move to amend the Initial Order on notice. This would include a motion to amend the SISP which is effectively incorporated into the Initial Order by reference. The Applicants submit that I have broad general jurisdiction under section 11 of the CCAA to make such amendments. In my view, it is unnecessary to decide that issue as the affected parties are consenting to the proposed amendments.

Dual Track and Sanction of Senior Lenders' CCAA Plan

16 In my view, it is prudent for the LP Entities to simultaneously advance the AHC Transaction and the Support Transaction. To that end, the LP Entities seek approval of a conditional sanction order. They ask for conditional authorization to enter into the Acquisition and Assumption Agreement pursuant to a Credit Acquisition Sanction, Approval and Vesting Order.

17 The Senior Lenders' meeting was held January 27, 2010 and 97.5% in number and 88.7% in value of the Senior Lenders holding Proven Principal Claims who were present and voting voted in favour of the Senior Lenders' Plan. This was well in excess of the required majorities.

18 The LP Entities are seeking the sanction of the Senior Lenders' CCAA Plan on the basis that its implementation is conditional on the delivery of a Monitor's Certificate. The certificate will not be delivered if the AHC Bid closes. Satisfactory arrangements have been made to address closing timelines as well as access to advisor and management time. Absent the closing of the AHC Transaction, the Senior Lenders' CCAA Plan is fair and reasonable as between the LP Entities and its creditors. If the AHC Transaction is unable to close, I conclude that there are no available commercial going concern alternatives to the Senior Lenders' CCAA Plan. The market was fully canvassed during the SISP; there was ample time to conduct such a canvass; it was professionally supervised; and the AHC Bid was the only Superior Offer as that term was defined in the SISP. For these reasons, I am prepared to find that the Senior Lenders' CCAA Plan is fair and reasonable and may be conditionally sanctioned. I also note that there has been strict compliance with statutory requirements and nothing has been done or purported to have been done which was not authorized by the CCAA. As such, the three part test set forth in the *Canadian Airlines Corp., Re*[FN2] has been met. Additionally, there has been compliance with section 6 of the CCAA. The Crown, employee and pension claims described in section 6 (3),(5), and (6) have been addressed in the Senior Lenders' Plan at sections 5.2, 5.3 and 5.4.

Conclusion

19 In conclusion, it is evident to me that the parties who have been engaged in this CCAA proceeding have worked diligently and cooperatively, rigorously protecting their own interests but at the same time achieving a positive outcome for the LP Entities' stakeholders as a whole. As I indicated in Court, for this they and their professional advisors should be commended. The business of the LP Entities affects many people - creditors, employees, retirees, suppliers, community members and the millions who rely on their publications for their news. This is a good chapter in the LP Entities' CCAA story. Hopefully, it will have a happy ending.

Application granted.

FN1 [1991] O.J. No. 1137 (Ont. C.A.).

FN2 2000 ABQB 442 (Alta. Q.B.), leave to appeal refused 2000 ABCA 238 (Alta. C.A. [In Chambers]), affirmed 2001 ABCA 9 (Alta. C.A.), leave to appeal to S.C.C. refused July 12, 2001 [2001 CarswellAlta 888 (S.C.C.)].

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TAB 5

2010 CarswellQue 9720, 2010 QCCS 4382, EYB 2010-179464

2010 CarswellQue 9720, 2010 QCCS 4382, EYB 2010-179464

White Birch Paper Holding Co., Re

Dans l'affaire du plan d'arrangement relatif à: White Birch Paper Holding Company, White Birch Paper Company, Stadacona General Partner Inc., Black Spruce Paper Inc., F.F. Soucy General Partner Inc., 3120772 Nova Scotia Company, Arrimage de gros Cacouna inc. et Papier Masson ltée, Débitrices, c. Ernst & Young inc., Contrôleur, et Stadacona Limited Partnership, F.F. Soucy Limited Partnership et F.F. Soucy, inc. & Partners, Limited Partnership, Mis en cause, et Service d'impartition industriel inc et KSH Solutions inc., Opposantes

Cour supérieure du Québec

Mongeon J.C.S.

Heard: 7 septembre 2010
Judgment: 10 septembre 2010
Docket: C.S. Qué. Montréal 500-11-038474-108

Counsel: *Me Jean Fontaine*, pour les débitrices

Me Jean-Éric Guindon, pour l'Opposante Service d'Impartition Industriel Inc.

Me Pierre-Stéphane Poitras et Me Julie Lavertu, pour l'Opposante KSH Solutions Inc.

Me Louis Gouin, pour le Contrôleur

Subject: Insolvency

***Mongeon J.C.S.*:**

1 Le Tribunal a entendu en date du 7 septembre 2010 une série de requêtes de la part de divers intervenants dans le contexte d'une demande des débitrices visant l'approbation d'un processus de vente de type « **Stalking Horse** » de tous les actifs du Groupe.

2 Vu l'urgence de statuer sur ce processus, le Tribunal est d'avis que la requête des Débitrices doit être accueillie, motifs à suivre, avec certaines modifications quant aux conclusions recherchées et que les diverses requêtes des opposantes à ce processus doivent être rejetées, aussi avec motifs à être déposés ultérieurement.

3 En conséquence, le Tribunal rend l'ordonnance suivante:

The **Motion to approve a Stalking Horse Bidder to approve an Asset Sale Agreement, to approve bid-**

ding procedures for the sale of substantially all the WB Group's assets and to schedule an auction and sale hearing (no. 55) is granted, with reasons to follow, with the following modifications:

a) The dates and delays suggested in the conclusions of the Motion shall be extended to take into account the date of the present Order;

b) There shall be no Break-Up Fee of US $2,000,000.00 payable to the **Stalking Horse** Bidder or Purchaser (as defined in the ASA). The **Stalking Horse** Bidder shall, instead, be entitled to the reimbursement of its expenses up to an amount of US $3 million.

The Break-up fee and **Expense Reimbursement** proposed by the **Stalking Horse** Bidder in paragraphs 9.2 and 9.3 of the ASA shall be limited to an **Expense Reimbursement** not to exceed the sum of US $3 million;

c) The obligation of the Debtors and Mis-en-cause to pay the **Expense Reimbursement** to the Staling Horse Bidder shall be guaranteed by a « CCAA Charge » as provided for in the definition of « **Expense Reimbursement** » in section 1.1 of the ASA, the whole not to exceed the sum of US $3 million and shall be payable to the Purchaser in accordance with section 9.3 of the ASA.

Accordingly, the Order pursuant to said Motion shall read as follows:

CONSIDERING the Debtors' "Motion to Approve a **Stalking Horse** Bidder, to Approve an Asset Sale Agreement, to Approve Bidding Procedures for the Sale of Substantially All the WB Group's Assets and to Schedule an Auction and Sale Hearing" (the **"Motion"**); and its supporting exhibits;

CONSIDERING the submissions of counsel;

GIVEN the provisions of the Initial Order granted by this Court in this matter on February 24th, 2010 (the **"Initial Order"**);

GIVEN the provisions of the order of this Court approving the Sales and Investor Solicitation Process; and

GIVEN the provisions of the *Companies' Creditors Arrangement Act*, (R.S.C., 1985, c. C-36) as amended (the **"CCAA"**);

THE COURT:

GRANTS the present Motion;

DECLARES sufficient the service and notice of the present Motion;

APPROVES the Monitor's Report, Exhibit SM-1 and the addendum thereto, Exhibit SM-1A;

APPROVES as the **Stalking Horse** Agreement, the Asset Sale Agreement dated August 10th, 2010, as amended on August 23rd and August 31st, 2010, Exhibit SM-2, by and between White Birch Paper Company (together with certain subsidiaries) and BD - White Birch Investment LLC (the **"Sale Agreement"**), as these documents are modified by the present Order including, without limitation, the obligations of the Sellers to pay the **Expense Reimbursement** not to exceed the aggregate sum of US $3 million (as such expression is defined in the Sale Agreement) to the Purchaser on the terms and conditions

set forth in the Sale Agreement;

APPROVES the bidding procedures, as set out at Exhibit SM-3 (the "Bidding Procedures"), including, without limitation, the section entitled « ***Expense Reimbursement***";

ORDERS that the capitalized terms used herein but not defined shall have the meanings ascribed to them in the Bidding Procedures or, if not defined therein, in the Initial Order;

DECLARES that BD White Birch Investment LLC ("BD") shall be the **stalking horse** bidder for the purposes of the competitive bidding process set out in the Bidding Procedures, Exhibit SM-3;

AUTHORIZES AND ORDERS the WB Group, its advisors and the Monitor to conduct the competitive bidding process set out in the Bidding Procedures, Exhibit SM-3, in accordance with the Bidding Procedures;

ORDERS that, to the extent a Qualified Bid, as defined in the Bidding Procedures, Exhibit SM-3, other than the bid received from BD White Birch Investment LLC, is received by no later than 5:00 pm (Eastern time) on September 17, 2010, an auction for the Assets of the WB Group shall be held at the offices of Kirkland & Ellis, 601 Lexington Avenue, New York, New York, United States of America, 10022, beginning at 10:00 am (Eastern time) on September 21, 2010; or at such later time or other place as the WB Group shall notify all Qualified Bidders in accordance with the terms of the Bidding Procedures;

AUTHORIZES AND ORDERS the WB Group and its advisors to carry out any such Auction in accordance with the Bidding Procedures;

DECLARES that a hearing shall take place before the Superior Court of Quebec, Commercial Division, on or prior to September 24, 2010 in order to authorize and approve the sale of the WB Group's Assets, pursuant to the terms set out in the Asset Purchase Agreement, Exhibit SM-2, or pursuant to the terms of an alternative transaction with the winning bidder at the auction, as the case may be (the "Sale Hearing");

ORDERS that, in the event that no Qualified Bids other than the Qualified Bid submitted by BD are received pursuant to the terms of the Bidding Procedures, that the WB Group is authorized and ordered to (i) cancel the Auction and (ii) seek entry of the Canadian Sale Order (as defined in the Sale Agreement) in accordance with the Bidding Procedures;

DECLARES that, pursuant to the terms of the Sale Agreement and as security for the Debtors' and the Mises en Cause's obligation to pay the **Expense Reimbursement** to the Purchaser, as hereby approved under the terms and conditions set forth in the Sale Agreement and the Bidding Procedures, the Purchasers are hereby granted a hypothec on, mortgage of, lien on and security interest in the Property to the extent of the aggregate amount of the **Expense Reimbursement** (being an amount not to exceed three million United States dollars (US $3,000,000.00)), which charge shall be subordinate to the Administration Charge, the D&O Charge and the Interim Financing Charge, but shall otherwise be, and be deemed to be, an additional "CCAA Charge" under, and for the purposes of, the provisions of the Initial Order concerning the CCAA Charges;

DECLARES that, in the event that BD submits the Winning Bid (as defined in the Bidding Procedures), the provisions of the ASA that contemplate that at Closing the $10 million D&O Charge (as defined in the Initial Order) and the $3 million Administrative Charge (as defined in the Initial Order) will be discharged and expunged and replaced, in effect, with the $10 million letter of credit and the $3 million Wind-Down Amount, pursuant to the Canadian Sale Order (as defined in the ASA) and as provided for under Sections 5.2(g) and 5.18 of the ASA, respectively, are hereby approved;

ORDERS that, in connection with the Bidding Procedures and pursuant to clause 7(3)(c) of the Personal Information Protection and Electronic Documents Act (Canada), the Debtors and the Mises en Cause are authorized and permitted to disclose personal information of identifiable individuals to Qualified Bidders and their advisors, but only to the extent required in connection with the terms of the Bidding Procedures and the bidding and sale process to be conducted thereunder. Each such Qualified Bidder shall maintain and protect the privacy of such information and limit the use of such information to its participation in the Sale and, if it does not complete the Sale, shall return all such information to the Debtors and the Mises en Cause, or in the alternative, destroy all such information;

REQUESTS the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada, the United States or elsewhere, including the United States Bankruptcy Court for the Eastern District of Virginia, to give effect to this Order and to assist the Debtors, the Mises en Cause and the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Debtors, the Mises en Cause and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist the Debtors, the Mises en Cause and the Monitor and their respective agents in carrying out the terms of this Order;

THE WHOLE WITHOUT COSTS.

4 La *Requête en rétractation de jugements* (no. 58) de l'opposante Service d'Impartition Industriel Inc. est *rejetée avec dépens*, motifs à suivre;

5 La *Requête en rejet d'une demande visant à approuver une vente et pour ordonner la fin de la protection de la LACC par ordonnance* (no. 60) de l'opposante Service d'Impartition Industriel Inc. est *rejetée, sans frais*, motifs à suivre;

6 La *Contestation et Requête pour faire déclarer abusive la requête en rétractation de jugements de Service d'Impartition Industriel Inc.* (no. 62) des Débitrices est *rejetée, avec dépens*, motifs à suivre;

7 La *Réplique et contestation du contrôleur à la « Requête en rejet d'une demande visant à approuver une vente et pour ordonner la fin de la protection de la LACC par ordonnance » et à la « Requête en rétractation de jugements » de la requérante* (no. 64) est *rejetée, sans frais*, motifs à suivre;

8 La *Requête pour modification et révision de l'ordonnance initiale du 24 février 2010* (no. 71) de l'opposante KSH Solutions Inc. est *rejetée, sans frais*, motifs à suivre.

9 La *Contestation de la créancière KSH Solutions Inc. à la « Motion to approve a **Stalking Horse** Bidder,*

to approve an asset sale agreement, to approve the bidding procedures for the sale of substantiallly all the WB Group assets and to schedule an auction and sale hearing » et Requête pour ordonner la fin de la protection de la LACC (no. 72) est *rejetée, sans frais*, motifs à suivre.

END OF DOCUMENT

TAB 6

C

2009 CarswellOnt 4467, 55 C.B.R. (5th) 229

Nortel Networks Corp., Re

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

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

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

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: June 29, 2009
Written reasons: July 23, 2009
Docket: 09-CL-7950

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

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

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

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

S. Philpott for Former Employees

K. Zych for Noteholders

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

David Ward for UK Pension Protection Fund

Leanne Williams for Flextronics Inc.

Alex MacFarlane for Official Committee of Unsecured Creditors

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

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

A. Kauffman for Export Development Canada

D. Ullman for Verizon Communications Inc.

G. Benchetrit for IBM

Subject: Insolvency; Estates and Trusts

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

Telecommunication company entered protection under Companies' Creditors Arrangement Act ("Act") — Company decided to pursue "going concern" sales for various business units — Company entered into sale agreement with respect to assets in Code Division Multiple Access business and Long-Term Evolution Access assets — Company was pursuing sale of its other business units — Company brought motion for **approval** of **bidding procedures** and asset sale agreement — Motion granted — Court has jurisdiction to authorize sales process under Act in absence of formal plan of compromise or arrangement and creditor vote — Sale by company which preserved its business as going concern was consistent with objectives of Act — Unless sale was undertaken at this time, long-term viability of business would be in jeopardy.

Bankruptcy and insolvency --- Administration of estate — Sale of assets — Jurisdiction of court to approve sale

Telecommunication company entered protection under Companies' Creditors Arrangement Act ("Act") — Company decided to pursue "going concern" sales for various business units — Company entered into sale agreement with respect to assets in Code Division Multiple Access business and Long-Term Evolution Access assets — Company was pursuing sale of its other business units — Company brought motion for **approval** of **bidding procedures** and asset sale agreement — Motion granted — Court has jurisdiction to authorize sales process under Act in absence of formal plan of compromise or arrangement and creditor vote — Sale by company which preserved its business as going concern was consistent with objectives of Act — Unless sale was undertaken at this time, long-term viability of business would be in jeopardy.

Cases considered by *Morawetz J.*:

Asset Engineering LP v. Forest & Marine Financial Ltd. Partnership (2009), 2009 BCCA 319, 2009 CarswellBC 1738 (B.C. C.A.) — followed

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 ONCA 587, 2008 CarswellOnt 4811, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 240 O.A.C. 245, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 296 D.L.R. (4th) 135, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 92 O.R. (3d) 513, 45 C.B.R. (5th) 163, 47 B.L.R. (4th) 123 (Ont. C.A.) — considered

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 CarswellOnt 5432, 2008 CarswellOnt 5433 (S.C.C.) — referred to

Boutiques San Francisco Inc., Re (2004), 2004 CarswellQue 10918, 7 C.B.R. (5th) 189 (Que. S.C.) — referred to

Calpine Canada Energy Ltd., Re (2007), 2007 CarswellAlta 1050, 2007 ABQB 504, 35 C.B.R. (5th) 1, 415 A.R. 196, 33 B.L.R. (4th) 68 (Alta. Q.B.) — referred to

Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re (1998), 1998 CarswellOnt 3346, 5 C.B.R. (4th) 299, 72 O.T.C. 99 (Ont. Gen. Div. [Commercial List]) — considered

Caterpillar Financial Services Ltd. v. Hard-Rock Paving Co. (2008), 2008 CarswellOnt 4046, 45 C.B.R. (5th) 87 (Ont. S.C.J.) — referred to

Cliffs Over Maple Bay Investments Ltd. v. Fisgard Capital Corp. (2008), 2008 BCCA 327, 2008 CarswellBC 1758, 83 B.C.L.R. (4th) 214, 296 D.L.R. (4th) 577, 434 W.A.C. 187, 258 B.C.A.C. 187, 46 C.B.R. (5th) 7, [2008] 10 W.W.R. 575 (B.C. C.A.) — distinguished

Consumers Packaging Inc., Re (2001), 150 O.A.C. 384, 27 C.B.R. (4th) 197, 2001 CarswellOnt 3482, 12 C.P.C. (5th) 208 (Ont. C.A.) — considered

Lehndorff General Partner Ltd., Re (1993), 17 C.B.R. (3d) 24, 9 B.L.R. (2d) 275, 1993 CarswellOnt 183 (Ont. Gen. Div. [Commercial List]) — referred to

PSINET Ltd., Re (2001), 28 C.B.R. (4th) 95, 2001 CarswellOnt 3405 (Ont. S.C.J. [Commercial List]) — considered

Residential Warranty Co. of Canada Inc., Re (2006), 2006 ABQB 236, 2006 CarswellAlta 383, (sub nom. *Residential Warranty Co. of Canada Inc. (Bankrupt), Re)* 393 A.R. 340, 62 Alta. L.R. (4th) 168, 21 C.B.R. (5th) 57 (Alta. Q.B.) — referred to

Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, 83 D.L.R. (4th) 76, 46 O.A.C. 321, 4 O.R. (3d) 1, 1991 CarswellOnt 205 (Ont. C.A.) — considered

Stelco Inc., Re (2004), 2004 CarswellOnt 4084, 6 C.B.R. (5th) 316 (Ont. S.C.J. [Commercial List]) — referred to

Tiger Brand Knitting Co., Re (2005), 2005 CarswellOnt 1240, 9 C.B.R. (5th) 315 (Ont. S.C.J.) — referred to

Winnipeg Motor Express Inc., Re (2008), 2008 CarswellMan 560, 2008 MBQB 297, 49 C.B.R. (5th) 302 (Man. Q.B.) — referred to

Statutes considered:

Bankruptcy Code, 11 U.S.C.

s. 363 — referred to

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

Generally — referred to

s. 11 — referred to

s. 11(4) — considered

MOTION by company for **approval** of **bidding procedures** for sale of business and asset sale agreement.

***Morawetz J.*:**

Introduction

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

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

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

4 The following are my reasons for granting these orders.

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

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

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

Background

8 The Applicants were granted CCAA protection on January 14, 2009. Insolvency proceedings have also

been commenced in the United States, the United Kingdom, Israel and France.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Issues and Discussion

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

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

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

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

28 The CCAA is a flexible statute and it is particularly useful in complex insolvency cases in which the

court is required to balance numerous constituents and a myriad of interests.

29 The CCAA has been described as "skeletal in nature". It has also been described as a "sketch, an outline, a supporting framework for the resolution of corporate insolvencies in the public interest". (2008), 45 C.B.R. (5th) 163 (Ont. C.A.) at paras. 44, 61, leave to appeal refused [2008] S.C.C.A. No. 337 (S.C.C.). ("ATB Financial").

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

> (a) the power of the court to impose terms and conditions on the granting of a stay under s. 11(4) of the CCAA;
>
> (b) the specific provision of s. 11(4) of the CCAA which provides that the court may make an order "on such terms as it may impose"; and
>
> (c) the inherent jurisdiction of the court to "fill in the gaps" of the CCAA in order to give effect to its objects. *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re* (1998), 5 C.B.R. (4th) 299 (Ont. Gen. Div. [Commercial List]) at para. 43; *PSINET Ltd., Re* (2001), 28 C.B.R. (4th) 95 (Ont. S.C.J. [Commercial List]) at para. 5, *ATB Financial, supra*, at paras. 43-52.

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

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

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

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

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

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

35 Counsel to the Applicants makes reference to a number of cases where courts in Ontario, in appropriate cases, have exercised their jurisdiction to approve a sale of assets, even in the absence of a plan of arrangement

being tendered to stakeholders for a vote. In doing so, counsel to the Applicants submits that the courts have repeatedly recognized that they have jurisdiction under the CCAA to approve asset sales in the absence of a plan of arrangement, where such sale is in the best interests of stakeholders generally. *Canadian Red Cross Society / Société Canadienne de la Croix-Rouge, Re, supra, Re PSINet, supra, Consumers Packaging Inc., Re* [2001 CarswellOnt 3482 (Ont. C.A.)], *supra, Stelco Inc., Re* (2004), 6 C.B.R. (5th) 316 (Ont. S.C.J. [Commercial List]) at para. 1, *Tiger Brand Knitting Co., Re* (2005), 9 C.B.R. (5th) 315 (Ont. S.C.J.), *Caterpillar Financial Services Ltd. v. Hard-Rock Paving Co.* (2008), 45 C.B.R. (5th) 87 (Ont. S.C.J.) and *Lehndorff General Partner Ltd., Re* (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div. [Commercial List]).

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

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

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

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

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

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

> I would observe that usually it is the creditor side which wishes to terminate CCAA proceedings and that when the creditors threaten to take action, there is a realization that a liquidation scenario will not only have a negative effect upon a CCAA applicant, but also upon its workforce. Hence, the CCAA may be employed to provide stability during a period of necessary financial and operational restructuring - and if a restructuring of the "old company" is not feasible, then there is the exploration of the feasibility of the sale of the operations/enterprise as a going concern (with continued employment) in whole or in part. *Re Stelco Inc, supra* , at para. 1.

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

41 Counsel to the Applicants also referred to decisions from the courts in Quebec, Manitoba and Alberta which have similarly recognized the court's jurisdiction to approve a sale of assets during the course of a CCAA proceeding. *Boutiques San Francisco Inc., Re* (2004), 7 C.B.R. (5th) 189 (Que. S.C.), *Winnipeg Motor Express Inc., Re* (2008), 49 C.B.R. (5th) 302 (Man. Q.B.) at paras. 41, 44, and *Calpine Canada Energy Ltd., Re* (2007), 35 C.B.R. (5th) 1 (Alta. Q.B.) at para. 75.

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

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

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

45 The *Cliffs Over Maple Bay* decision has recently been the subject of further comment by the British Columbia Court of Appeal in *Asset Engineering LP v. Forest & Marine Financial Ltd. Partnership*, 2009 BCCA 319 (B.C. C.A.).

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

> 24. In *Cliffs Over Maple Bay*, the debtor company was a real estate developer whose one project had failed. The company had been dormant for some time. It applied for CCAA protection but described its proposal for restructuring in vague terms that amounted essentially to a plan to "secure sufficient funds" to complete the stalled project (Para. 34). This court, per Tysoe J.A., ruled that although the Act can apply to single-project companies, its purposes are unlikely to be engaged in such instances, since mortgage priorities are fully straight forward and there will be little incentive for senior secured creditors to compromise their interests (Para. 36). Further, the Court stated, the granting of a stay under s. 11 is "not a free standing remedy that the court may grant whenever an insolvent company wishes to undertake a "restructuring"...Rather, s. 11 is ancillary to the fundamental purpose of the CCAA, and a stay of proceedings freezing the rights of creditors should only be granted in furtherance of the CCAA's fundamental purpose". That purpose has been described in *Meridian Developments Inc. v. Toronto Dominion Bank* (1984) 11 D.L.R. (4th) 576 (Alta. Q.B.):

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

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

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

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

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

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

> (a) is a sale transaction warranted at this time?
>
> (b) will the sale benefit the whole "economic community"?
>
> (c) do any of the debtors' creditors have a *bona fide* reason to object to a sale of the business?
>
> (d) is there a better viable alternative?

I accept this submission.

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

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

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

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

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

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

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

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

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

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

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

Disposition

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

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

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

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

58 In **approving** the **Bidding Procedures**, I have also taken into account that the auction will be conducted

prior to the sale approval motion. This process is consistent with the practice of this court.

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

Motion granted.

END OF DOCUMENT

TAB 7

2009 CarswellOnt 4839, 56 C.B.R. (5th) 74

Nortel Networks Corp., Re

In the matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as Amended (Applicants)

And In the Matter of a Plan of Compromise or Arrangement of Nortel Networks Corporation, Nortel Networks Limited, Nortel Networks Global Corporation, Nortel Networks International Corporation and Nortel Networks Technology Corporation

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: August 4, 2009
Judgment: August 4, 2009
Docket: 09-CL-7950

Counsel: Mr. D. Tay, Mr. M. Kotrly for Nortel Networks Corporation et al.

Mr. J.A. Carfagnini, Mr. C.G. Armstrong for Monitor, Ernst and Young Incorporated

Mr. J. Bunting for Nortel Networks UK Limited (In Administration)

Mr. S.R. Orzy for Noteholders

Mr. S. Kukulowiz for Canadian Lawyers, for Unsecured Creditors' Committee

Ms T. Lie for Superintendent of Financial Services of Ontario

Mr. C. Thorburn for Canadian Lawyers, for Matlin Patterson

Mr. K. McElcheran for Avaya Inc.

Ms F. Baloo for CAW Canada Legal Department

Mr. D. Yiokaris for Former Employees

Ms L. Pillon for Enterprise Network Holdings Bv

Subject: Insolvency

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

Telecommunications company entered protection under Companies' Creditors Arrangement Act — Telecommunications company wished to execute sale agreement for certain assets and undertake auction regarding other assets — Telecommunications company brought motion for approval of process and sale, and to seal certain records, with parallel motion brought in United States — Motion granted — Court had jurisdiction to authorize sale agreement — Approving sale was appropriate — Fact that plan was absent did not prevent sale — Sale was subject to further court approval — Informal objections in United States had been resolved.

Cases considered by *Morawetz J.*:

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4467 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

Generally — referred to

MOTION by debtor for approval of sale of business under protection of *Companies' Creditors Arrangement Act*.

***Morawetz J.*:**

1 This Hearing was conducted by way of video conference with a parallel motion being heard in the United States Bankruptcy Court with His Honor Judge Gross presiding over the Hearing in the U.S. Court.

2 This Joint Hearing was conducted in accordance with the provisions of the Cross-Border Protocol which has previously been approved by both the U.S. Court and by this court.

3 Nortel brings this motion for the approval of the Bidding Procedures relating to the Enterprise Solutions Business. It also seeks approval of the Sale Agreement among Nortel Networks Corporation ("NNC"), Nortel Networks Limited ("NNL") and Nortel Networks Inc. ("NNI") and their affiliates as "Sellers" and Avaya Inc. as "Purchaser."

4 In addition, the Applicants also request the approval of a Side Agreement among the Sellers and the court appointed administrators, which Side Agreement is attached to the Eighteenth Report filed by Ernst and Young Inc., the Monitor.

5 Finally, the Applicants seek a Sealing Order to seal the Confidential Appendix to the Eighteenth Report pending further Order of this court.

6 The Bidding Procedures and Sale Agreement are described in the affidavit of Mr. George Riedel, Chief Strategy Officer of Nortel, sworn July 30, 2009 and they are also described in the Eighteenth Report of the Monitor.

7 Nine formal and informal objections were filed in the U.S. Proceedings. These objections have been resolved and in some cases minor modifications have been made to the Bidding Procedures.

8 I am satisfied that no further comment is required in this Endorsement with respect to the objections filed in

the U.S. Proceedings.

9 The transaction described in the Sale Agreement is very complex. The Monitor has made specific reference to the transaction. The Enterprise Solutions business involved addresses the communications needs of large and small businesses across various industries by providing products and services that integrate voice, E-mail, conferencing, video and instant messaging. Competitors to the business include Cisco, Avaya, Alcatel-Lucent, Siemens Enterprise Communications, NEC and others.

10 This business operates globally in approximately 121 countries. The Monitor has indicated that the business has an installed base with over 75 million voice lines and 75 million data ports. The fiscal revenues in 2008 were $2.8 billion representing approximately 27% of Nortel's 2008 revenues.

11 With respect to the Canadian aspect, the fiscal 2008 revenues in Canada were $183 million representing approximately 26% of Nortel's 2008 Canadian revenue.

12 The base purchase price as set out in the Stalking Horse Agreement is $475 million. It also provides for a Break-Up-Fee of $14.25 million and an Expense Reimbursement cap of $9.5 million.

13 The materials indicate that Bids are to be received by September 4, 2009 with the Sellers to conduct an auction on September 11, 2009 followed by a motion to approve any transaction both before this court and the U.S. Court.

14 With respect to the evidence in support of the transaction, I refer to the conclusions of Mr. Riedel at paragraphs 38 to 40 of his affidavit where he states as follows:

> 38. "I believe that the Sale Agreement is the product of a vigorous, comprehensive and fair process. The proposed Auction Sale Process for the Enterprise Solutions Business, based on the Sale Agreement as a stalking horse bid, is the best way to preserve the business as a going concern and to maximize value and preserve as many jobs as possible for the Applicants' employees. I further believe that exploration of the sale of the other businesses as a going concern through this process will provide the greatest chances for further value and maximization and job preservation."
>
> 39. "Based on the Applicants' previous consideration of potential transactions involving the Enterprise Solutions Business and after re-canvassing the marketplace since the commencement of these proceedings, I believe that the proposed transaction with the Purchaser represents the highest and best proposal available for the Enterprise Solutions Business, subject to the receipt of a better bid through the auction process contemplated in this motion."
>
> 40. "The Sale Agreement also requires an expeditious sale process and provides the Purchaser the right to terminate the Sale Agreement if certain milestones in the sale process are not timely met. For these reasons, the expeditious sale of the Assets is critical to the maximization of the value of the Applicants' assets and, in turn, to a recovery for the Applicants' estates."

15 The Monitor has similarly provided extensive background to the transaction and reports its analysis and recommendations at paragraph 92 of the Eighteenth Report where it states as follows:

92. "The Monitor has reviewed Nortel's efforts to divest its Enterprise Solutions Business and is of the view that the Company is acting in good faith to maximize the value. The Monitor recommends approval of the Avaya Agreement as a "stalking horse" bid, approval of the Bidding Procedures as described and approval of the Side Agreement. In so doing, the Monitor considers the potential payment of the Break Fee and Expense Reimbursement to Avaya as reasonable in the circumstances."

16 The Bidding Procedures, as proposed, are not unlike the Bidding Procedures which have previously been approved in the sale of the CMDA Business and the LTE Business. The Bidding Procedures in respect of these businesses were approved by this court on June 29, 2009 with Reasons released on July 23, 2009 [2009 CarswellOnt 4467 (Ont. S.C.J. [Commercial List])].

17 Likewise, as with the previous transaction, I am satisfied that this court has the jurisdiction to authorize the Sale Agreement. (See Reasons from July 23, 2009.)

18 Turning now to a consideration of whether it is appropriate in this case to approve the sale process.

19 The factors to consider on a sales process under the CCAA, in the absence of a plan, has been previously considered in these proceedings, and again, I refer to the Nortel Reasons of July 23, 2009 at paragraph 49. Those factors are as follows:

1) Is a sales transaction warranted at this time?

2) Will the sale benefit the whole "economic community?"

3) Do any of the debtor's creditors have a bona fide reason to object to a sale of the business?

4) Is there a better viable alternative?

20 In this case the details of the transaction and the sales process, as described in Mr. Riedel's affidavit and in the Monitor's Eighteenth Report, establish, in my view, that it is appropriate to approve the Sale Agreement. The factors, as set out and previously accepted in the Reasons of July 23, are equally applicable in this transaction.

21 I also note that there were no objections with respect to the sale process.

22 I also note that the sale is subject to further court approval, and, again, the court will expect that the Applicants will make reference to the *Soundair* principles at such time.

23 As it was previously noted in the Reasons of July 23, the Applicants are part of a complicated corporate group, they carry on an active international business, and I accept that an important fact to consider in the CCAA process is whether the case can be made to continue the business as a going concern.

24 I am satisfied, having considered the factors referenced above, as well as the facts summarized in the affidavit of Mr. Riedel, and in the Eighteenth Report, that the Applicants have met the test and I am therefore satisfied that this motion should be granted.

25 Accordingly I approve the Bidding Procedures as described in Mr. Riedel's affidavit and in the Eighteenth Report which procedures have also been approved this morning by Judge Gross in the U.S. Court.

26 I am also satisfied that the Sale Agreement and Side Agreement should be approved.

27 Further, that the Sale Agreement be accepted for purposes of conducting the Stalking Horse Bid in accordance with the Bidding Procedures including, without limitation the Break Up Fee, and the Expense Reimbursement.

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

29 In approving the Bidding Procedures, I have also taken into account that the auction will be conducted prior to the Sale Approval motion. This process is consistent with the practice of this court.

30 This concludes my Endorsement in respect of the Bidding Procedures and the Sale Agreement.

Motion granted.

END OF DOCUMENT

TAB 8

2009 CarswellOnt 4262, 79 C.C.P.B. 101

Indalex Ltd., Re

IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C., c. C-36, AS AMENDED AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF INDALEX LIMITED, INDALEX HOLDINGS (B.C.) LTD., 6326765 CANADIAN INC. AND NOVAR INC. (Applicants)

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: July 2, 2009
Judgment: July 2, 2009
Docket: CV-09-8122-00CL

Counsel: Linc Rogers, Katherine McEachern, Jackie Moher for Applicants

Ashley Taylor, Lesley Mercer for FTI Consulting Canada ULC, Monitor

Paul Macdonald, Jeff Levine for JPMorgan (DIP Lender)

Kenneth D. Kraft for SAPA Holding AB

Andrew Hatnay, Demetrios Yiokaris, Andrew Mckinnon for Keith Carruthers, SERP Retirees

Brian Empey for Sun Indalex

John D. Leslie for U.S. Unsecured Creditors' Committee

G. Finlayson for U.S. Bank as Trustee for the Noteholders

Subject: Corporate and Commercial; Civil Practice and Procedure; Insolvency; International

Pensions --- Practice in pension actions — Miscellaneous

Applicant company was insolvent — Applicants put forth marketing process, which was court approved — Bid was submitted — Bidder was not assuming pension liabilities — Retirees objected to bid — Applicants brought application for order approving **bidding procedures**, order deeming bid to be qualifying bid, and order approving breakup fee — Application granted — Applicants adhered to court approved process — There was no basis on which to delay process or to give effect to objection raised by retirees.

APPLICATION by insolvent company for order approving **bidding procedures**, order deeming bid to be qualifying bid, and order approving breakup fee.

Morawetz J.:

1 The Applicants seek an Order approving the **Bidding Procedures** as well as an Order deeming the **Stalking Horse** Bid to be a Qualified Bid pursuant to the **Bidding Procedures** as well as approval of the Breakup Fee.

2 The Monitor recommends that the relief be granted. No party, with the exception of Mr. Carruthers and the SERP Retirees, is opposed.

3 This motion stems directly from the Marketing Process which was approved by the Court on April 22, 2009. The conduct of the Marketing Process is set out both in the Affidavit of Mr. Fazio and in the Monitor's Reports. The **Stalking Horse** Bid of SAPA Holdings was executed on June 16, 2009. The Notice of Motion was served on June 17, 2009.

4 The Marketing Process was conducted in both U.S. and Canada. Mr. Rogers advised that the **Bidding Procedures** were approved, with minor modification, by the U.S. Bankruptcy Court earlier today.

5 It is also noted that it is a condition precedent to the performance of the **Stalking Horse** Bidder that the **Bidding Procedures** be Court approved by today.

6 Mr. Rogers expressed the view that the **Stalking Horse** Bid is a worst-case scenario - but that it does represent a "bird in the hand".

7 This is not a motion to approve the transaction. This issue will be addressed at a future time.

8 The approval of the **Bidding Procedures** is opposed by Mr. Hatnay on behalf of certain retirees. Mr. Hatnay requests a 7-day adjournment. That request is problematic in view of the aforementioned condition precedent. The main concern of the retirees is that their position and views have not been considered in this process. The **Stalking Horse** Bidder is *not* assuming the pension liabilities. Further, Mr. Hatnay submits that there are a number of unanswered questions relating to both the Executive Pension and the Supplementary Pension.

9 The position facing the retirees is unfortunate. The retirees are currently not receiving what they bargained for. However, reality cannot be ignored and the nature of the Applicants' insolvency is such that there are insufficient assets to meet its liabilities. The retirees are not alone in this respect. The objective of these proceedings is to achieve the best possible outcome for the stakeholders. In addressing this objective, the Applicants put forth a process - the Marketing Process - which has already been Court approved. No party objected to the previous approval. In my view, the Applicants have adhered to the Court approved process and there is no basis to either delay the consideration of this motion or to give effect to the objection raised by the retirees. To hold otherwise would be to jeopardize the **Stalking Horse** Bid.

10 In my view, the issues raised by the retirees do not have any impact on the **Bidding Procedures**. The issues can be raised by the retirees on any application to approve a transaction - but that is for another day. The *Soundair* principles raised by Mr. Hatnay are more applicable, in my view, to any sale approval motion. For today's motion, the process that is relevant is the Marketing Process as approved on April 22, 2009 which the Applicants have followed.

11 The **Bidding Procedures** are therefore approved. The **Stalking Horse** Bid is deemed to be a Qualifying Bid and the Breakup Fee is approved.

12 The Monitor filed a Supplement to the Sixth Report. In my view, this document contains confidential information the release of which could be prejudicial to the interests of the Applicants and stakeholders. In my view, it is appropriate to grant a sealing order with respect to this Supplement. The document is to be sealed pending further order.

Application granted.

END OF DOCUMENT

TAB 9

H

2010 CarswellQue 10954, 2010 QCCS 4915, EYB 2010-180748, J.E. 2010-2002, 72 C.B.R. (5th) 49

White Birch Paper Holding Co., Re

In the Matter of the Plan of Arrangement and Compromise of : White Birch Paper Holding Company, White Birch Paper Company, Stadacona General Partner Inc., Black Spruce Paper Inc., F. F. Soucy General Partner Inc., 3120772 Nova Scotia Company, Arrimage de gros Cacouna inc. and Papier Masson ltée (Petitioners) v. Ernst & Young Inc. (Monitor) and Stadacona Limited Partnership, F. F. Soucy Limited Partnership and F. F. Soucy Inc. & Partners, Limited Partnership (Mises en cause) and Service d'impartition Industriel Inc., KSH Solutions Inc. and BD White Birch Investement LLC (Intervenant) and Sixth Avenue Investment Co. LLC, Dune Capital LLC and Dune Capital International Ltd. (Opposing parties)

Cour supérieure du Québec

Robert Mongeon, J.C.S.

Heard: 24 september 2010
Oral reasons: 24 september 2010[FN*]
Written reasons: 15 october 2010
Docket: C.S. Montréal 500-11-038474-108

Proceedings: refused leave to appeal *White Birch Paper Holding Co., Re* (2010), 2010 QCCA 1950 (Que. C.A.)

Counsel: None given.

Subject: Insolvency; Corporate and Commercial

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

Corporation experienced financial difficulties and placed itself under protection of Companies' Creditors Arrangement Act — In context of its restructuring, corporation contemplated sale of all its assets — Bidding process was launched and several investors filed offers — Corporation entered into asset sale agreement with winning bidder — US bankruptcy court approved process without modifications — Court approved process with some modifications and set date of September 17, 2010, as limit to submit bid — On September 17, unsuccessful bidder filed new bid — At outcome of bidding process, corporation decided to sell its assets once again to winning bidder — On September 24, corporation brought motion seeking court's approval of sale — Motion granted — Evidence showed that no stakeholder objected to sale and that all parties agreed to participate in bidding process — Once bidding process was started, there was no turning back unless process was defective — Court was not convinced that winning bid should be set aside just because unsuccessful bidder lost — Court was

of view that bidding process met criteria established by jurisprudence — In addition, monitor supported position of winning bidder — Therefore, sale should be approved as is.

Faillite et insolvabilité --- Loi sur les arrangements avec les créanciers des compagnies — Divers

Société a connu des difficultés financières et s'est mise sous la protection de la Loi sur les arrangements avec les créanciers des compagnies — Dans le cadre de sa restructuration, la société a considéré vendre tous ses actifs — Processus d'appel d'offres a été lancé et plusieurs investisseurs ont déposé leurs offres — Société a signé une entente de vente d'actifs avec le soumissionnaire gagnant — Tribunal américain de faillite a approuvé le processus sans modifications — Tribunal a approuvé le processus avec quelques modifications et a fixé la date du 17 septembre 2010 comme étant la date limite pour soumettre une soumission — Soumissionnaire déçu a déposé une nouvelle offre le 17 septembre — Au terme du processus d'appel d'offres, la société a décidé de vendre ses actifs une fois de plus au soumissionnaire gagnant — Société a déposé, le 24 septembre, une requête visant à obtenir l'approbation de la vente par le tribunal — Requête accueillie — Preuve démontrait qu'aucune partie intéressée ne s'était opposée à la vente et que toutes les parties avaient convenu de participer au processus d'appel d'offres — Une fois le processus d'appel d'offres lancé, il n'était pas question de l'interrompre à moins que le processus ne s'avère déficient — Tribunal n'était pas convaincu que le soumissionnaire gagnant devrait être exclu simplement parce que le soumissionnaire déçu avait perdu — Tribunal était d'avis que le processus d'appel d'offres satisfaisait aux critères établis par la jurisprudence — De plus, le contrôleur était en faveur de la position défendue par le soumissionnaire gagnant — Par conséquent, la vente devrait être approuvée telle quelle.

Cases considered by *Robert Mongeon, J.C.S.*:

AbitibiBowater inc., Re (2010), 2010 QCCS 1742, 2010 CarswellQue 4082 (Que. S.C.) — considered

Canwest Publishing Inc./Publications Canwest Inc., Re (2010), 68 C.B.R. (5th) 233, 2010 CarswellOnt 3509, 2010 ONSC 2870 (Ont. S.C.J. [Commercial List]) — considered

Cie Montréal Trust c. Jori Investments Inc. (1980), 1980 CarswellQue 85, 13 R.P.R. 116 (Que. S.C.) — referred to

Eugène Marcoux Inc. c. Côté (1990), [1990] R.D.I. 551, [1990] R.J.Q. 1221 (Que. C.A.) — referred to

Maax Corporation, Re (July 10, 2008), Doc. 500-11-033561-081 (Que. S.C.) — referred to

Nortel Networks Corp., Re (2009), 56 C.B.R. (5th) 224, 2009 CarswellOnt 4838 (Ont. S.C.J. [Commercial List]) — followed

Statutes considered:

Code de procédure civile, L.R.Q., c. C-25

art. 689 — referred to

art. 730 — referred to

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

Generally — referred to

s. 36 — considered

s. 36(1) — considered

s. 36(3) — considered

s. 36(3)(a) — considered

s. 36(3)(b) — considered

s. 36(3)(c) — considered

s. 36(3)(d) — considered

s. 36(3)(f) — considered

s. 36(6) — considered

MOTION by corporation seeking court's approval of sale.

***Robert Mongeon, J.C.S.*:**

BACKGROUND

1 On 24 February 2010, I issued an Initial Order under the CCAA protecting the assets of the Debtors and Mis-en-cause (the WB Group). Ernst & Young was appointed Monitor.

2 On the same date, Bear Island Paper Company LLC (Bear Island) filed for protection of Chapter 11 of the US Bankruptcy code before the US Bankruptcy Court for the Eastern District of Virginia.

3 On April 28, 2010, the US Bankruptcy Court issued an order approving a Sale and Investor Solicitation Process (« SISP ») for the sale of substantially all of the WB Group's assets. I issued a similar order on April 29, 2010. No one objected to the issuance of the April 29, 2010 order. No appeal was lodged in either jurisdiction.

4 The SISP caused several third parties to show some interest in the assets of the WG Group and led to the execution of an Asset Sale Agreement (ASA) between the WB Group and BD White Birch Investment LLC (« BDWB »). The ASA is dated August 10, 2010. Under the ASA, BDWB would acquire all of the assets of the Group and would:

> a) assume from the Sellers and become obligated to pay the Assumed Liabilities (as defined in the ASA);
>
> b) pay US$90 million in cash;
>
> c) pay the Reserve Payment Amount (as defined);
>
> d) pay all fees and disbursements necessary or incidental for the closing of the transaction; and
>
> e) deliver the Wind Down Amount (as defined).

the whole for a consideration estimated between $150 and $178 million dollars.

5 BDWB was to acquire the Assets through a Stalking Horse Bid process. Accordingly, Motions were brought before the US Bankruptcy Court and before this Court for orders approving:

a) the ASA

b) BDWB as the stalking horse bidder

c) The Bidding Procedures

6 On September 1, 2010, the US Bankruptcy Court issued an order approving the foregoing without modifications.

7 On September 10, 2010, I issued an order approving the foregoing with some modifications (mainly reducing the Break-Up Fee and Expense Reimbursement clauses from an aggregate total sought of US$5 million, down to an aggregate total not to exceed US$3 million).

8 My order also modified the various key dates of implementation of the above. The date of September 17 was set as the limit to submit a qualified bid under stalking horse bidding procedures, approved by both Courts and the date of September 21st was set as the auction date. Finally, the approval of the outcome of the process was set for September 24, 2010[FN1].

9 No appeal was lodged with respect to my decision of September 10, 2010.

10 On September 17, 2010, Sixth Avenue Investment Co. LLC (« Sixth Avenue ») submitted a qualified bid.

11 On September 21, 2010, the WB Group and the Monitor commenced the auction for the sale of the assets of the group. The winning bid was the bid of BDWB at US$236,052,825.00.

12 BDWB's bid consists of:

i) US$90 million in cash allocated to the current assets of the WB Group;

ii) $4.5 million of cash allocated to the fixed assets;

iii) $78 million in the form of a credit bid under the First Lien Credit Agreement allocated to the WB Group's Canadian fixed assets which are collateral to the First Lien Debt affecting the WB Group;

iv) miscellaneous additional charges to be assumed by the purchaser.

13 Sixth Avenue's bid was equivalent to the BDWB winning bid less US$500,000.00, that is to say US$235,552,825.00. The major difference between the two bids being that BDWB used credit bidding to the extent of $78 million whilst Sixth Avenue offered an additional $78 million in cash. For a full description of the components of each bid, see the Monitor's Report of September 23, 2010.

14 The Sixth Avenue bidder and the BDWB bidder are both former lenders of the WB Group regrouped in

new entities.

15 On April 8, 2005, the WB Group entered into a First Lien Credit Agreement with Credit Suisse AG Cayman Islands and Credit Suisse AG Toronto acting as agents for a number of lenders.

16 As of February 24, 2010, the WB Group was indebted towards the First Lien Lenders under the First Lien Credit Agreement in the approximate amount of $438 million (including interest). This amount was secured by all of the Sellers' fixed assets. The contemplated sale following the auction includes the WB Group's fixed assets and unencumbered assets.

17 BDWB is comprised of a group of lenders under the First Lien Credit Agreement and hold, in aggregate approximately 65% of the First Lien Debt. They are also « Majority Lenders » under the First Lien Credit Agreement and, as such, are entitled to make certain decisions with respect to t he First Lien Debt including the right to use the security under the First Lien Credit Agreement as tool for credit bidding.

18 Sixth Avenue is comprised of a group of First Lien Lenders holding a minority position in the First Lien Debt (approximately 10%). They are not « Majority Lenders » and accordingly, they do not benefit from the same advantages as the BDWB group of First Lien Lenders, with respect to the use of the security on the fixed assets of the WB Group, in a credit bidding process[FN2].

19 The bidding process took place in New York on September 21, 2010. Only two bidders were involved: the winning bidder (BDWB) and the losing bidder[FN3] (Sixth Avenue).

20 In its Intervention, BDWB has analysed all of the rather complex mechanics allowing it to use the system of credit bidding as well as developing reasons why Sixth Avenue could not benefit from the same privilege. In addition to certain arguments developed in the reasons which follow, I also accept as my own BDWB's submissions developed in section (e), paragraphs [40] to [53] of its Intervention as well as the arguments brought forward in paragraphs [54] to [60] validating BDWB's specific right to credit bid in the present circumstances.

21 Essentially, BDWB establishes its right to credit bid by referring not only to the September 10 Court Order but also by referring to the debt and security documents themselves, namely the First Lien Credit Agreement, the US First Lien Credit Agreement and under the Canadian Security Agreements whereby the « Majority Lender » may direct the « Agents » to support such credit bid in favour of such « Majority Lenders ». Conversely, this position is not available to the « Minority Lenders ». This reasoning has not been seriously challenged before me.

22 The Debtors and Mis-en-cause are now asking me to approve the sale of all and/or substantially all the assets of the WB Group to BDWB. The disgruntled bidder asks me to not only dismiss this application but also to declare it the winning bidder or, alternatively, to order a new auction.

23 On September 24, 2010, I delivered oral reasons in support of the Debtors' Motion to approve the sale. Here is a transcript of these reasons.

REASONS (delivered orally on September 24, 2010)

24 I am asked by the Petitioners to approve the sale of substantially all the WB Group's assets following a bid process in the form of a « Stalking Horse » bid process which was not only announced in the originating pro-

ceedings in this file, I believe back in early 2010, but more specifically as from May/June 2010 when I was asked to authorise the Sale and Investors Solicitation Process (SISP). The SISP order led to the canvassing of proposed bidders, qualified bidders and the eventual submission of a « Stalking Horse » bidder. In this context, a Motion to approve the « Stalking Horse » Bid process to approve the assets sale agreement and to approve a bidding procedure for the sale of substantially all of the assets of the WB Group was submitted and sanctioned by my decision of September 10, 2010.

25 I note that throughout the implementation of this sale process, all of its various preliminary steps were put in place and approved without any contestation whatsoever by any of the interested stakeholders except for the two construction lien holders KSH[FN4] and SIII[FN5] who, for very specific reasons, took a strong position towards the process itself (not that much with the bidding process but with the consequences of this process upon their respective claims.

26 The various arguments of KSH and SIII against the entire Stalking Horse bid process have now become moot, considering that both BDWB and Sixth Avenue have agreed to honour the construction liens and to assume the value of same (to be later determined).

27 Today, the Motion of the Debtors is principally contested by a group which was identified as the « Sixth Avenue » bidders and more particularly, identified in paragraph 20 of the Motion now before me. The « Stalking Horse » bidder, of course, is the Black Diamond group identified as « BD White Birch Investment LLC ». The Dune Group of companies who are also secured creditors of the WB Group are joining in, supporting the position of Sixth Avenue. Their contestation rests on the argument that the best and highest bid at the auction, which took place in New York on September 21, should not have been identified as the Black Diamond bid. To the contrary, the winning bid should have been, according to the contestants, the « Sixth Avenue » bid which was for a lesser dollar amount ($500,000.00), for a larger cash amount (approximately $78,000,000.00 more cash) and for a different allocation of the purchase price.

28 Notwithstanding the foregoing, the Monitor, in its report of August 23, supports the « Black Diamond » winning bid and the Monitor recommends to the Court that the sale of the assets of the WB Group be made on that basis.

29 The main argument of « Sixth Avenue » as averred, sometimes referred to as the « bitter bidder », comes from the fact that the winning bid relied upon the tool of credit bidding to the extent of $78,000,000.00 in arriving at its total offer of $236,052,825.00.

30 If I take the comments of « Sixth Avenue », the use of credit bidding was not only a surprise, but a rather bad surprise, in that they did not really expect that this would be the way the « Black Diamond » bid would be ultimately constructed. However, the possibility of reverting to credit bidding was something which was always part of the process. I quote from paragraph 7 of the Motion to Approve the Sale of the Assets, which itself quotes paragraph 24 of the SISP Order, stating that:

> 24. Notwithstanding anything herein to the contrary, including without limitation, the bidding requirements herein, the agent under the White Birch DIP Facility (the « DIP Agent ») and the agent to the WB Group's first lien term loan lenders (the First Lien Term Agent »), on behalf of the lenders under White Birch DIP Facility and the WB Group's first lien term loan lenders, respectively, shall be deemed Qualified Bidders and any bid submitted by such agent on behalf of the respective lenders in respect of all or a portion of the Assets shall be deemed both Phase 1 Qualified Bids and Phase 2 Qualified Bids. The DIP Agent and First

> Lien Term Agent, on behalf of the lenders under the White Birch DIP Facility and the WB Group's first lien term loan lenders, respectively, shall be permitted in their sole discretion, to credit bid up to the full amount of any allowed secure claims under the White Birch DIP Facility and the first lien term loan agreement, respectively, to the extent permitted under Section 363(k) of the Bankruptcy Code and other applicable law.

31 The words « and other applicable law » could, in my view, tolerate the inclusion of similar rules of procedure in the province of Quebec.[FN6]

32 The possibility of reverting to credit bidding was also mentioned in the bidding procedure sanctioned by my decision of September 10, 2010 as follows and I now quote from paragraph 13 of the Debtors' Motion:

> 13. « Notwithstanding anything herein to the contrary, the applicable agent under the DIP Credit Agreement and the application agent under the First Lien Credit Agreement shall each be entitled to credit bid pursuant to Section 363(k) of the Bankruptcy Code and other applicable law.

33 I draw from these excerpts that when the « Stalking Horse » bid process was put in place, those bidders able to benefit from a credit bidding situation could very well revert to the use of this lever or tool in order to arrive at a better bid[FN7]

34 Furthermore, many comments were made today with respect to the dollar value of a credit bid versus the dollar value of a cash bid. I think that it is appropriate to conclude that if credit bidding is to take place, it goes without saying that the amount of the credit bid should not exceed, but should be allowed to go as, high as the face value amount of the credit instrument upon which the credit bidder is allowed to rely. The credit bid should not be limited to the fair market value of the corresponding encumbered assets. It would then be just impossible to function otherwise because it would require an evaluation of such encumbered assets, a difficult, complex and costly exercise.

35 Our Courts have always accepted the dollar value appearing on the face of the instrument as the basis for credit bidding. Rightly or wrongly, this is the situation which prevails.

36 Many arguments were brought forward, for and against the respective position of the two opposing bidders. At the end of the day, it is my considered opinion that the « Black Diamond » winning bid should prevail and the « Sixth Avenue » bid, the bitter bidder, should fail.

37 I have dealt briefly with the process. I don't wish to go through every single step of the process but I reiterate that this process was put in place without any opposition whatsoever. It is not enough to appear before a Court and say: « Well, we've got nothing to say now. We may have something to say later » and then, use this argument to reopen the entire process once the result is known and the result turns out to be not as satisfactory as it may have been expected. In other words, silence sometimes may be equivalent to acquiescence. All stakeholders knew what to expect before walking into the auction room.

38 Once the process is put in place, once the various stakeholders accept the rules, and once the accepted rules call for the possibility of credit bidding, I do not think that, at the end of the day, the fact that credit bidding was used as a tool, may be raised as an argument to set aside a valid bidding and auction process.

39 Today, the process is completed and to allow "Sixth Avenue" to come before the Court and say: "My bid is essentially better than the other bid and Court ratify my bid as the highest and best bid as opposed to the win-

ning bid" is the equivalent to a complete eradication of all proceedings and judgments rendered to this date with respect to the Sale of Assets authorized in this file since May/June 2010 and I am not prepared to accept this as a valid argument. Sixth Avenue should have expected that BDWB would want to revert to credit bidding and should have sought a modification of the bidding procedure in due time.

40 The parties have agreed to go through the bidding process. Once the bidding process is started, then there is no coming back. Or if there is coming back, it is because the process is vitiated by an illegality or non-compliance of proper procedures and not because a bidder has decided to credit bid in accordance with the bidding procedures previously adopted by the Court.

41 The Court cannot take position today which would have the effect of annihilating the auction which took place last week. The Court has to take the result of this auction and then apply the necessary test to approve or not to approve that result. But this is not what the contestants before me ask me to do. They are asking me to make them win a bid which they have lost.

42 It should be remembered that "Sixth Avenue" agreed to continue to bid even after the credit bidding tool was used in the bidding process during the auction. If that process was improper, then "Sixth Avenue" should have withdrawn or should have addressed the Court for directions but nothing of the sort was done. The process was allowed to continue and it appears evident that it is only because of the end result which is not satisfactory that we now have a contestation of the results.

43 The arguments which were put before me with a view to setting aside the winning bid (leaving aside those under Section 36 of the CCAA to which I will come to a minute) have not convinced me to set it aside. The winning bid certainly satisfies a great number of interested parties in this file, including the winning bidders, including the Monitor and several other creditors.

44 I have adverse representations from two specific groups of creditors who are secured creditors of the White Birch Group prior to the issue of the Initial Order which have, from the beginning, taken strong exceptions to the whole process but nevertheless, they constitute a limited group of stakeholders. I cannot say that they speak for more interests than those of their own. I do not think that these creditors speak necessarily for the mass of unsecured creditors which they allege to be speaking for. I see no benefit to the mass of creditors in accepting their submissions, other than the fact that the Monitor will dispose of US$500,000.00 less than it will if the winning bid is allowed to stand.

45 I now wish to address the question of Section 36 CCAA.

46 In order to approve the sale, the Court must take into account the provisions of Section 36 CCAA and in my respectful view, these conditions are respected.

47 Section 36 CCAA reads as follows:

> 36. (1) A debtor company in respect of which an order has been made under this Act may not sell or otherwise dispose of assets outside the ordinary course of business unless authorized to do so by a court. Despite any requirement for shareholder approval, including one under federal or provincial law, the court may authorize the sale or disposition even if shareholder approval was not obtained.
>
> (2) A company that applies to the court for an authorization is to give notice of the application to the se-

cured creditors who are likely to be affected by the proposed sale or disposition.

(3) In deciding whether to grant the authorization, the court is to consider, among other things,

(a) whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

(b) whether the monitor approved the process leading to the proposed sale or disposition;

(c) whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

(d) the extent to which the creditors were consulted;

(e) the effects of the proposed sale or disposition on the creditors and other interested parties; and

(f) whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.

(4) If the proposed sale or disposition is to a person who is related to the company, the court may, after considering the factors referred to in subsection (3), grant the authorization only if it is satisfied that

(a) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and

(b) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.

(5) For the purpose of subsection (4), a person who is related to the company includes

(a) a director or officer of the company;

(b) a person who has or has had, directly or indirectly, control in fact of the company; and

(c) a person who is related to a person described in paragraph (*a*) or (*b*).

(6) The court may authorize a sale or disposition free and clear of any security, charge or other restriction and, if it does, it shall also order that other assets of the company or the proceeds of the sale or disposition be subject to a security, charge or other restriction in favour of the creditor whose security, charge or other restriction is to be affected by the order.

(7) The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(4)(*a*) and (5)(*a*) if the court had sanctioned the compromise or arrangement.

2005, c. 47, s. 131; 2007, c. 36, s. 78.

(added underlining)

48 The elements which can be found in Section 36 CCAA are, first of all, not limitative and secondly they

need not to be all fulfilled in order to grant or not grant an order under this section.

49 The Court has to look at the transaction as a whole and essentially decide whether or not the sale is appropriate, fair and reasonable. In other words, the Court could grant the process for reasons others than those mentioned in Section 36 CCAA or refuse to grant it for reasons which are not mentioned in Section 36 CCAA.

50 Nevertheless, I was given two authorities as to what should guide the Court in similar circumstances, I refer firstly to the comments of Madame Justice Sarah Peppall in *Canwest Publishing Inc./Publications Canwest Inc., Re*, 2010 CarswellOnt 3509 (Ont. S.C.J. [Commercial List]), and she writes at paragraph 13:

> The proposed disposition of assets meets the Section 36 CCAA criteria and those set forth in the *Royal Bank v. Soundair Corp.* decision. Indeed, to a large degree, the criteria overlap. The process was reasonable as the Monitor was content with it (and this is the case here). Sufficient efforts were made to attract the best possible bid (this was done here through the process, I don't have to review this in detail); the SISP was widely publicized (I am given to understand that, in this present instance, the SISP was publicized enough to generate the interest of many interested bidders and then a smaller group of Qualified Bidders which ended up in the choice of one « Stalking Horse » bidder); ample time was given to prepare offers; and there was integrity and no unfairness in the process. The Monitor was intimately involved in supervising the SISP and also made the Superior Cash Offer recommendation. The Monitor had previously advised the Court that in its opinion, the Support Transaction was preferable to a bankruptcy (this was all done in the present case.) The logical extension of that conclusion is that the AHC Transaction is as well (and, of course, understand that the words « preferable to a bankruptcy » must be added to this last sentence). The effect of the proposed sale on other interested parties is very positive. (It doesn't mean by saying that, that it is positive upon all the creditors and that no creditor will not suffer from the process but given the representations made before me, I have to conclude that the proposed sale is the better solution for the creditors taken as a whole and not taken specifically one by one) Amongst other things, it provides for a going concern outcome and significant recoveries for both the secured and unsecured creditors.

51 Here, we may have an argument that the sale will not provide significant recoveries for unsecured creditors but the question which needs to be asked is the following: "Is it absolutely necessary to provide interest for all classes of creditors in order to approve or to set aside a "Stalking Horse bid process"?

52 In my respectful view, it is not necessary. It is, of course, always better to expect that it will happen but unfortunately, in any restructuring venture, some creditors do better than others and sometimes, some creditors do very badly. That is quite unfortunate but it is also true in the bankruptcy alternative. In any event, in similar circumstances, the Court must rely upon the final recommendation of the Monitor which, in the present instance, supports the position of the winning bidder.

53 In *Nortel Networks Corp., Re*, Mister Justice Morawetz, in the context of a Motion for the Approval of an Assets Sale Agreement, Vesting Order of approval of an intellectual Property Licence Agreement, etc. basically took a similar position (2009 CarswellOnt 4838 (Ont. S.C.J. [Commercial List]), at paragraph 35):

> The duties of the Court in reviewing a proposed sale of assets are as follows:
>
> 1) It should consider whether sufficient effort has been made to obtain the best price and that the debtor has not acted improvidently;

2) It should consider the interests of all parties;

3) It should consider the efficacy and integrity of the process by which offers have been obtained;

4) and it should consider whether there has been unfairness in the working out of the process.

54 I agree with this statement and it is my belief that the process applied to the present case meets these criteria.

55 I will make no comment as to the standing of the « bitter bidder ». Sixth Avenue mayo have standing as a stakeholder while it may not have any, as a disgruntled bidder.

56 I am, however, impressed by the comments of my colleague Clément Gascon, j.s.c. in *Abitibi Bowater*, in his decision of May 3rd, 2010 where, in no unclear terms he did not think that as such, a bitter bidder should be allowed a second strike at the proverbial can.

57 There may be other arguments that could need to be addressed in order to give satisfaction to all the arguments provided to me by counsel. Again, this has been a long day, this has been a very important and very interesting debate but at the end of the whole process, I am satisfied that the integrity of the « Stalking Horse » bid process in this file, as it was put forth and as it was conducted, meets the criteria of the case law and the CCAA. I do not think that it would be in the interest of any of the parties before me today to conclude otherwise. If I were to conclude otherwise, I would certainly not be able to grant the suggestion of « Sixth Avenue », to qualify its bid as the winning bid; I would have to eradicate the entire process and cause a new auction to be held. I am not prepared to do that.

58 I believe that the price which will be paid by the winning bidder is satisfactory given the whole circumstances of this file. The terms and conditions of the winning bid are also acceptable so as a result, I am prepared to grant the Motion. I do not know whether the Order which you would like me to sign is available and I know that some wording was to be reviewed by some of the parties and attorneys in this room. I don't know if this has been done. Has it been done? Are KSH and SIII satisfied or content with the wording?

Attorney:

I believe, Mister Justice, that KSH and SIII have.....their satisfaction with the wording. I believe also that Dow Jones, who's present, ...their satisfaction. However, AT&T has communicated that they wish to have some minor adjustments.

The Court:

Are you prepared to deal with this now or do you wish to deal with it during the week-end and submit an Order for signature once you will have ironed out the difficulties, unless there is a major difficulty that will require further hearing?

Attorney:

I think that the second option you suggested is probably the better one. So, we'd be happy to reach an agreement and then submit it to you and we'll recirculate everyone the wording.

The Court:

Very well.

The Motion to Approve the Sale of substantially all of the WB Group assets (no. 87) is *granted,* in accordance with the terms of an Order which will be completed and circulated and which will be submitted to me for signature as of Monday, next at the convenience of the parties;

The Motion of Dow Jones Company Inc. (no. 79) will be continued sine die;

The Amended Contestation of the Motion to Approve the Sale (no. 84) on behalf of « Sixth Avenue » is *dismissed* without costs (I believe that the debate was worth the effort and it will serve no purpose to impose any cost upon the contestant);

Also for the position taken by Dunes, there is no formal Motion before me but Mr. Ferland's position was important to the whole debate but I don't think that costs should be imposed upon his client as well;

The Motion to Stay the Assignment of a Contract from AT&T (no. 86) will be continued sine die;

The Intervention and Memorandum of arguments of BD White Birch Investment LLC is *granted,* without costs.

> 689. The purchase price must be paid within five days, at the expiry of which time interest begins to run.
>
> Nevertheless, when the immovable is adjudged to the seizing creditor or any hypothecary creditor who has filed an opposition or whose claim is mentioned in the statement certified by the registrar, he may retain the purchase-money to the extent of the claim until the judgment of distribution is served upon him.
>
> 730. A purchaser who has not paid the purchase price must, within ten days after the judgment of homologation is transmitted to him, pay the sheriff the amounts necessary to satisfy the claims which have priority over his own; if he fails to do so, any interested party may demand the resale of the immovable upon him for false bidding.
>
> When the purchaser has fulfilled his obligation, the sheriff must give him a certificate that the purchase price has been paid in full.

See also Denis Ferland and Benoit Emery, 4ème edition, volume 2 (Éditions Yvon Blais (2003)):

> La loi prévoit donc que, lorsque l'immeuble est adjugé au saisissant ou à un créancier hypothécaire qui a fait opposition, ou dont la créance est portée à l'état certifié par l'officier de la publicité des droits, l'adjudicataire peut retenir le prix, y compris le prix minimum annoncé dans l'avis de vente (art. 670, al. 1, e), 688.1 C.p.c.), jusqu'à concurrence de sa créance et tant que ne lui a pas été signifié le jugement de distribution prévu à l'article 730 C.p.c. (art. 689, al 2 C.p.c.). Il n'aura alors à payer, dans les cinq jours suivant la signification de ce jugement, que la différence entre le prix d'adjudication et le montant de sa créance pour satisfaire aux créances préférées à la sienne (art. 730, al. 1 C.p.c.). La Cour d'appel a déclaré, à ce sujet, que puisque le deuxième alinéa de l'article 689 C.p.c. est une exception à la règle du paiement lors de la vente

> par l'adjudicataire du prix minimal d'adjudication (art. 688.1, al. 1 C.p.c.) et à celle du paiement du solde du prix d'adjudication dans les cinq jours suivants (art. 689, al. 1 C.p.c.), il doit être interprété de façon restrictive. Le sens du mot « créance », contenu dans cet article, ne permet alors à l'adjudicataire de retenir que la partie de sa créance qui est colloquée ou susceptible de l'être, tout en tenant compte des priorités établies par la loi.

See, finally, *Cie Montréal Trust c. Jori Investments Inc.*, J.E. 80-220 (Que. S.C.) [1980 CarswellQue 85 (Que. S.C.)], *Eugène Marcoux Inc. c. Côté*, [1990] R.J.Q. 1221 (Que. C.A.)

See paragraphs 24, 25 and 26 of BDWB's Intervention.

As for the right to credit bid in a sale by auction under the CCAA, see *Maax Corporation, Re* (July 10, 2008), Doc. 500-11-033561-081 (Que. S.C.) (Buffoni J.)

See also Re: *Brainhunter* (OSC Commercial List, no.09-8482-00CL, January 22, 2010)

Motion granted.

FN* Leave to appeal refused at *White Birch Paper Holding Co., Re* (2010), 2010 CarswellQue 11534, 2010 QCCA 1950 (Que. C.A.).

FN1 See my Order of September 10, 2010.

FN2 For a more comprehensive analysis of the relationship of BDWB members and Sixth Avenue members as lenders under the original First Lien Credit Agreement of April 8, 2005, see paragraphs 15 to 19 of BDWB's Intervention.

FN3 Sometimes referred to as the « bitter bidder » or « disgruntled bidder » See *AbitibiBowater inc., Re*, 2010 QCCS 1742 (Que. S.C.) (Gascon J.)

FN4 KSH Solutions Inc.

FN5 Service d'Impartition Industriel Inc.

FN6 The concept of credit bidding is not foreign to Quebec civil law and procedure. See for example articles 689 and 730 of the Quebec code of Civil Procedure which read as follows:

FN7 The SISP, the bidding procedure and corresponding orders recognize the principle of credit bidding at the auction and these orders were not the subject of any appeal procedure.

END OF DOCUMENT

TAB 10

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

Garland v. Consumers' Gas Co.

Gordon Garland, Appellant v. The Consumers' Gas Company Limited, Respondent

Supreme Court of Canada

L'Heureux-Dubé, Cory, McLachlin, Iacobucci, Major, Bastarache, Binnie JJ.

Heard: March 23, 1998
Judgment: October 30, 1998
Docket: 25644

Proceedings: reversing (1996), 30 O.R. (3d) 414 (Ont. C.A.); affirming (1995), 22 O.R. (3d) 451 (Ont. Gen. Div.); additional reasons at (1995), 22 O.R. (3d) 767 (Ont. Gen. Div.)

Counsel: *Barbara L. Grossman* , *Michael L. McGowan* , *Christopher D. Woodbury* and *Dorothy Fong* , for the appellant.

Fred D. Cass , *John J. Longo* , *Daniel Boivin* and *Janet Clark* , for the respondent.

Subject: Criminal; Civil Practice and Procedure; Property

Public utilities --- Operation of utility — Rates — Fairness and impartiality

Late payment charges — Respondent gas utility's late payment penalty constituting criminal rate of interest if paid within 38 days of due date — Majority of late customers paying within 38 days of due date and incurring criminal rate of interest in violation of s. 347 of Criminal Code — Criminal Code, R.S.C. 1985, c. C-46, s. 347.

Services d'utilités publiques --- Exploitation des services — Taux — Équité et impartialité

Frais pour paiements en retard — Pénalité pour paiement en retard imposée par l'entreprise de fourniture de gaz intimée constituant un taux d'intérêt criminel si elle est acquittée dans les 38 jours de la date d'échéance — Majorité des clients en retard payant dans les 38 jours de la date d'échéance et payant un taux d'intérêt criminel contrevenant à l'art. 347 du Code criminel — Code criminel, L.R.C. 1985, c. C-46, art. 347.

The respondent gas utility billed its customers on a monthly basis. Its rates and payment policies were governed

by the Ontario Energy Board. Customers who did not pay their bills by the due date incurred a late payment penalty ("LPP") of five per cent of the unpaid charges for that month. The LPP was a one-time penalty which was not compounded. The primary purpose of the LPP was to encourage customers to pay their bills on time and thus reduce administrative costs.

The appellant initiated a class action against the respondent gas utility. The appellant alleged that, for the majority of customers, the LPP violated s. 347 of the *Criminal Code* . Actuarial evidence was submitted to show that the LPP gave rise to an interest rate exceeding 60 per cent per annum for those customers who paid within 37 days of the due date. Only after the 38th day did the interest rate fall below 60 per cent. The evidence also showed that of the customers who failed to meet the due date, 81 per cent paid their bills within 10 days.

The appellant and respondent had filed cross-motions for summary judgment. The motions judge found in favour of the respondent, on the ground that payment of the LPP penalty turned on the voluntary conduct of customers and therefore could not violate s. 347. That finding was upheld on appeal.

The appellant appealed from the dismissal of the claim on the grounds that the LPP came within the scope of s. 347 and that the motions judge erred in awarding costs against the appellant in his personal capacity.

Held: The appeal was allowed.

Per Major J. (L'Heureux-Dubé, McLachlin, Iacobucci and Binnie JJ. concurring): The scope of s. 347 was very broad. "Interest" under s. 347 expressly included charges or expenses "in the form of a penalty." However, to constitute "interest" the charge must be "paid or payable for the advancing of credit under an agreement or arrangement."

The first step was to determine whether the relationship involved any advancement of credit within the meaning of s. 347. The respondent did not lend any money to its customers. However, "credit advanced" was broadly defined under s. 347(2) and not confined exclusively to loans of money. An "advance" of the "monetary value" of goods and services meant a deferral of payment for such items. A credit arose when debt was incurred for goods, services or benefits and the debt was then deferred by agreement. The "credit advanced" consisted of the monetary value and not the goods and services themselves.

The respondent gas utility provided goods and services to its customers for which a specified amount of money was payable every month on a certain date. The deferral of that payment constituted a "credit advanced" within the meaning of s. 347(2).

While s. 347 did not apply to situations where a consumer simply failed to pay for goods and services on time, unilaterally and without consent, the facts of this case presented a different situation. The respondent had a standing arrangement with its customers, the terms which provided that a gas bill could be paid either before or after the due date. The respondent preferred payment by the due date and customers who failed to meet the deadline paid a five per cent penalty.

While the LLP's intended purpose was to discourage the taking of credit in the first place, its second purpose was to offset the cost of carrying accounts receivable. Compensation for the cost of payment deferred was the hallmark of a credit arrangement. The nature of the arrangement was a question of law which turned on how the LPP operated in substance, not on what the respondent hoped to achieve by imposing it. The LPP was a charge "in the form of . . . a penalty . . . payable for the advancing of credit under an agreement or arrangement" and,

as such, was an interest charge for the purposes of s. 347.

The statute creates two offences. Under s. 347(1)(a), it was illegal to enter into an agreement or arrangement to receive interest at a criminal rate. The arrangement between the respondent and its customers did not violate s. 347(1)(a) since, on its face, it did not require the payment of interest at a criminal rate. Under s. 347(1)(b), which was to be broadly construed, it was illegal to receive a payment or partial payment of interest at a criminal rate. Whether a payment violated this subsection was determined when that payment was received.

The application of s. 347(1)(a) was not precluded by *Nelson v. C.T.C. Mortgages Corp* . Customers did not voluntarily pay the LLP. A penalty was not voluntary simply because it could have been avoided. Further, while customers could delay payment beyond 37 days, there was no invitation to do so. If bills became long overdue, the customer risked discontinuation of service, reconnection charges and security deposit payment. The LPP charged by the respondent came within the scope of s. 347 of the *Criminal Code* .

The motions judge erred in awarding costs against the appellant in his personal capacity. The purpose of s. 59.4 of the *Law Society Act* was to protect class representatives from personal exposure to costs in actions where financial support was granted by the Class Proceedings Fund. The appellant successfully applied for such financial support and should not have been exposed to personal liability for costs.

Per Bastarache J. (dissenting): Customers had only one payment option, which was to pay on time. The only question remaining was the characterization of the late payment. The definition of "interest" in s. 347 included the notion of "penalty." However, the application of s. 347 was predicated upon the existence of an "agreement or arrangement" for the advancement of credit and upon a consensual extension of credit. On the facts of this case, there was no such consensual extension of credit. The respondent's late penalty payment represented an effort to prevent or deter the unilateral taking of credit by customers. Rather than having permission to pay late, customers were encouraged to pay on time by the imposition of a penalty. Section 347 of the *Criminal Code* was not applicable.

L'entreprise de distribution de gaz intimée facturait ses clients mensuellement. Ses tarifs et ses pratiques de perception étaient régis par la Commission de l'énergie de l'Ontario. Les clients qui ne payaient pas leurs comptes à échéance encouraient une pénalité pour paiement en retard (« PPR ») de cinq pour cent du montant impayé pour ce mois. La PPR était imposée une seule fois, ne comportait aucun intérêt composé et n'augmentait pas avec le temps. L'objet de la PPR était d'inciter les clients à respecter l'échéance de paiement, réduisant ainsi les frais de gestion.

L'appelant a intenté un recours collectif contre l'intimée. L'appelant a prétendu que, pour la majorité des clients, la PPR contrevenait à l'art. 347 du *Code criminel* . Une preuve actuarielle a été soumise pour démontrer que la PPR se traduisait par un taux d'intérêt supérieur à 60 pour cent par année pour les clients qui payaient leur compte dans les 37 jours suivant la date d'échéance. Ce n'est que le 38e jour que le taux d'intérêt redescendait sous le seuil du 60 pour cent. Des statistiques présentés en preuve ont également indiqué que 81 pour cent des clients en défaut de paiement à la date d'échéance payaient leur compte dans 10 jours.

L'appelant et l'intimée avaient présenté des requêtes pour obtenir un jugement sommaire. Le juge des requêtes a donné raison à l'intimée, jugeant que le paiement de la PPR dépendait de la conduite volontaire des clients et, par conséquent, ne contrevenait pas à l'art. 347. Á la suite d'une requête visant à amender le dispositif du jugement, le juge des requêtes a condamné l'appelant aux dépens personnellement. La Cour d'appel a confirmé ce jugement.

L'appelant a formé un pourvoi, soutenant que la PPR était visée par l'art. 347, et que le juge du procès avait commis une erreur en le condamnant personnellement aux dépens.

Arrêt: Le pourvoi a été accueilli.

Major, J. (L'Heureux-Dubé, McLachlin, Iaccobucci et Binnie, JJ., souscrivant) : La portée de l'art. 347 du *Code criminel* était très étendue. Selon l'art. 347, l'« intérêt » incluait expressément des frais sous forme de pénalités. Pourtant, pour constituer de l'« intérêt », les frais devraient être « payés ou payables en contrepartie du capital prêté ou à prêter dans le cadre d'une convention ou d'une entente ».

Premièrement, il fallait déterminer si la relation qui existe entre l'intimée et ses clients comprenait un prêt de capital au sens de l'art. 347. L'intimée n'avait pas prêté d'argent à ses clients. Toutefois, le « capital prêté » était défini en des termes très large à l'art. 347(2) et ne comprenait pas uniquement des prêts d'argent. Le « prêt » de la « valeur pécuniaire [. . .] de tous les biens, services ou prestations » s'entendait du paiement différé de ces éléments. Le capital se matérialisait lorsqu'une dette était contractée pour des biens, services ou prestations, et le paiement de cette dette était ensuite différé avec l'accord des parties. Le « capital prêté » était une « valeur pécuniaire » et ne représentait pas les biens, services ou prestations mêmes.

L'intimée fournissait des biens et des services à ses clients pour lesquels une somme d'argent déterminée était payable chaque mois à une certaine date. Le paiement reporté à une date postérieure à la date d'échéance constituait un « capital prêté » au sens du par. 347(2).

L'article 347 ne s'appliquait pas aux situations où un acheteur ou un consommateur omettait de payer à temps, sans le consentement de l'autre partie, des biens, des services ou des prestations. Toutefois, les faits de la présente affaire révélaient une situation différente. La relation de paiement qui existait entre l'intimée et ses clients était définie par une entente permanente qui précisait clairement que la facture de gaz d'un client pouvait être payée avant ou après échéance. L'intimée préférait recevoir le paiement au plus tard à la date d'échéance, et les clients qui ne respectaient pas cette date d'échéance, devaient payer des frais supplémentaires de cinq pour cent.

La PPR avait pour objet de dissuader les clients de payer en retard, mias un autre objet était d'assurer que le coût du report des comptes client soit assumé par les clients. L'indemnisation du coût d'un paiement différé était la caractéristique d'une entente de prêt. La nature de l'entente entre l'intimée et ses clients est une question de droit. Cette question dépendait de la façon dont la PPR fonctionnait essentiellement, et non de ce que l'intimée comptait obtenir en l'imposant. La PPR représentait des « frais » sous forme de « pénalités [. . .] payables [. . .] en contrepartie du capital prêté ou à prêter [dans le cadre d'une convention ou d'une entente] ». Il s'agissait donc de frais d'intérêt aux fins de l'art. 347.

L'article 347 a créé deux infractions distinctes. Aux termes de l'al. 347(1)a), il était illégal de conclure une convention ou une entente pour percevoir des intérêts à un taux criminel. L'entente entre l'intimée et ses clients ne contrevenait pas à l'al. 347(1)a), puisque, à première vue, elle n'imposait pas des intérêts à un taux criminel. Aux termes de l'al. 347(1)b), qui devrait être interprété largement, il était illégal de recevoir un paiement ou un paiement partiel d'intérêt à un taux criminel. La question de savoir si un paiement d'intérêt violait cet alinéa était déterminée au moment de la réception du paiement.

Nelson c. C.T.C. Mortgage Corp. n'empêchait pas l'application de l'al. 347(1)a). Les clients ne payaient pas « volontairement » la PPR. Une pénalité n'était pas « volontaire » pour la simple raison qu'on aurait pu l'éviter. Il

était vrai que les clients pouvaient attendre plus de 37 jours pour payer la PPR, mais on ne les invitait pas à le faire. Si des comptes étaient en souffrance depuis trop longtemps, le client s'exposait à une interruption d'approvisionnement et gaz, occasionnant un désagrément personnel, des frais de rebranchement et un dépôt en garantie. La PPR était visée par l'art. 347 du *Code criminel* .

Le juge des requêtes a commis une erreur en condamnant l'appelant aux dépens personnellement. L'objet de l'art. 59.4 de la *Loi sur le Barreau* était de protéger les représentants des membres d'un groupe de personnes dans un recours collectif contre toute condamnation personnelle aux dépens dans le cadre d'une instance où une aide financière a été accordée par le Fonds d'aide aux recours collectifs. L'appelant a réussi à obtenir une aide financière du Fonds d'aide aux recours collectifs et ne devait pas risquer d'être tenu personnellement responsable des dépens.

Bastarache, J. (dissident) : Les clients n'avaient qu'une seule possibilité de paiement, c'est-à-dire de payer à temps. Il restait donc à qualifier le paiement fait après l'échéance. La définition de l'« intérêt » à l'art. 347 incluait la notion de « pénalité », mais l'application de l'art. 347 dépendait de l'existence « d'une convention ou d'une entente » de prêt et aussi d'un prêt consensuel de capital. À la lumière des faits, il n'y avait pas eu un tel prêt consensuel de capital. La PPR imposée par l'intimée représentait une tentative d'empêcher ou de dissuader les clients de s'approprier unilatéralement du capital. Les clients étaient plutôt encouragés à payer à temps par l'imposition d'une pénalité devant être ajoutée aux paiements en retard. L'article 347 du *Code criminel* ne s'appliquait pas en l'espèce.

Cases considered by/Jurisprudence citée par *Major J.* (*L'Heureux-Dubé, McLachlin, Iacobucci* and *Binnie JJ.* concurring):

Aectra Refining & Marketing Inc. v. Lincoln Capital Funding Corp. (1991), 6 O.R. (3d) 146, 85 D.L.R. (4th) 595, 4 B.L.R. (2d) 45 (Ont. Gen. Div.) — considered

Degelder Construction Co. v. Dancorp Developments Ltd. (October 30, 1998), Doc. 25355 (S.C.C.) — applied

Delta (Municipality) v. Active Chemicals Ltd. (1984), 57 B.C.L.R. 213 (B.C. C.A.) — considered

Immeubles Fournier Inc. v. Construction St. Hilaire Ltée (1974), [1975] 2 S.C.R. 2, 52 D.L.R. (3d) 89, 10 N.R. 541 (S.C.C.) — considered

Mira Design Co. v. Seascape Holdings Ltd. (1981), [1982] 1 W.W.R. 744, 34 B.C.L.R. 55, 22 R.P.R. 193 (B.C. S.C.) — considered

Nelson v. C.T.C. Mortgage Corp. (1984), [1985] 2 W.W.R. 560, 59 B.C.L.R. 221, 16 D.L.R. (4th) 139, 67 N.R. 162 (B.C. C.A.) — distinguished

Nelson v. C.T.C. Mortgage Corp., [1986] 4 W.W.R. 481, [1986] 1 S.C.R. 749, 67 N.R. 161, 29 D.L.R. (4th) 159, 32 B.C.L.R. (2d) xxx (note) (S.C.C.) — referred to

Ontario (Attorney General) v. Barfried Enterprises Ltd., [1963] S.C.R. 570, 42 D.L.R. (2d) 137 (S.C.C.) — considered

Tomell Investments Ltd. v. East Markstock Lands Ltd. (1977), [1978] 1 S.C.R. 974, 16 N.R. 139, 2 R.P.R.

69, 77 D.L.R. (3d) 145 (S.C.C.) — considered

William E. Thomson Associates Inc. v. Carpenter (1989), 61 D.L.R. (4th) 1, 44 B.L.R. 125, 34 O.A.C. 365, 69 O.R. (2d) 545 (Ont. C.A.) — referred to

Cases considered by/Jurisprudence citée par *Bastarache J.* (dissenting):

Coffelt v. Arkansas Power & Light Co. (1970), 248 Ark. 313, 451 S.W.2d 881 (U.S. Ark.) — considered

State ex rel. Utilities Commission v. North Carolina Consumers Council Inc. (1973), 18 N.C. App. 717, 198 S.E.2d 98 (U.S. N.C. Ct. App.) — referred to

Statutes considered by/Législation citée par *Major J.* (*L'Heureux-Dubé, McLachlin, Iacobucci* and *Binnie JJ.* concurring):

Class Proceedings Act, 1992/Recours collectifs, Loi de 1992 sur les, S.O./L.O. 1992, c. 6

Generally/en général — referred to

Commercial Concentration Tax Act/L'impôt sur les concentrations commerciales, Loi de, R.S.O./L.R.O. 1990, c. C.16

s. 15(10) — referred to

Criminal Code/Code criminel, R.S.C./L.R.C. 1970, c. C-34

s. 305.1 [en./aj. 1980-81-82-83, c. 43, s. 9] — referred to

Criminal Code/Code criminel, R.S.C./L.R.C. 1985, c. C-46

s. 347 — considered

s. 347(1)(a) — considered

s. 347(1)(b) — considered

s. 347(1)(c) — referred to

s. 347(1)(d) — referred to

s. 347(2) "credit advanced/capital prêté" — considered

s. 347(2) "criminal rate/taux criminel" — considered

s. 347(2) "interest/intérêt" — considered

s. 347(3) — referred to

s. 347(4) — referred to

Excise Tax Act/Taxe d'accise, Loi sur la, R.S.C./L.R.C. 1985, c. E-15

s. 7(1) — referred to

Income Tax Act/L'impôt sur le revenu, Loi sur le, R.S.C./L.R.C. 1985, c. 1 (5th Supp./5e suppl.)

Generally/en général — referred to

s. 163.1 — referred to

s. 227(9) — referred to

Interest Act/L'intérêt, Loi sur le, R.S.C./L.R.C. 1985, c. I-15

Generally/en général — referred to

Law Society Act/Barreau, Loi sur le, R.S.O./L.R.O. 1990, c. L.8

s. 59.2 [en./aj. 1992, c. 7, s. 3] — referred to

s. 59.4 [en./aj. 1992, c. 7, s. 3] — considered

s. 59.4(1) [en./aj. 1992, c. 7, s. 3] — considered

s. 59.4(3) [en./aj. 1992, c. 7, s. 3] — considered

Municipal Franchises Act/Concessions municipales, Loi sur les, R.S.O./L.R.O. 1990, c. M.55

Generally/en général — referred to

Ontario Energy Board Act/Comission de l'énergie de l'Ontario, Loi sur la, R.S.O./L.R.O. 1990, c. O.13

Generally/en général — referred to

Small Loans Act/Petits prêts, Loi sur les, R.S.C./L.R.C. 1970, c. S-11

Generally/en général — referred to

s. 2 "cost/coût de prêt" — referred to

s. 3 — referred to

Statutes considered by/Législation citée par *Bastarache J.* (dissenting):

Criminal Code/Code criminel, R.S.C./L.R.C. 1985, c. C-46

s. 347 — considered

s. 347(2) "interest/intérêt" — considered

APPEAL from judgment reported at (1996), 30 O.R. (3d) 414, 93 O.A.C. 155, 28 B.L.R. (2d) 278, 155 D.L.R. (4th) 671 (Ont. C.A.) , regarding interpretation and application of s. 347 of *Criminal Code* to late payment penalties charged by the respondent gas utility.

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

POURVOI à l'encontre d'un jugement publié à (1996), 30 O.R. (3d) 414, 93 O.A.C. 155, 28 B.L.R. (2d) 278, 155 D.L.R. (4th) 671 (Ont. C.A.) , portant sur l'interprétation et l'application de l'art. 347 du *Code criminel* à l'égard de pénalités pour paiement en retard imposées par l'entreprise de distribution de gaz naturel intimée.

***Major J.* (*L'Heureux-Dubé, McLachlin, Iacobucci* and *Binnie JJ.* concurring):**

1 This appeal concerns the interpretation and application of s. 347 of the *Criminal Code* , R.S.C., 1985, c. C-46 -- the "Criminal Interest Rate" provision. Section 347 makes it an offence to enter into an agreement for, or to receive, interest at a rate exceeding 60 percent per year. The respondent sells natural gas to Ontario residents. Customers who do not pay their bills on or before a specified date each month are subject to a five percent penalty for late payment. The main issue is whether that penalty, depending on when it is paid, may be said to constitute "interest at a criminal rate" within the meaning of s. 347 of the *Code* .

2 A subsidiary issue is whether the trial judge erred in awarding $500 in costs against the appellant personally in connection with a procedural motion. The appellant submits that because this putative class action has been approved for support by the Ontario Class Proceedings Committee, any award of costs must be assessed against the Class Proceedings Fund and may not be awarded against him in his personal capacity.

I. Facts

3 The respondent, Consumers' Gas Company Limited ("Consumers' Gas" or "CG"), is a regulated utility which provides natural gas to commercial and residential customers throughout Ontario. Its rates and payment policies are governed by the Ontario Energy Board ("OEB" or "Board") pursuant to the *Ontario Energy Board Act* , R.S.O. 1990, c. O.13, and the *Municipal Franchises Act* , R.S.O. 1990, c. M.55. The respondent cannot sell gas or charge for gas-related services except in accordance with rate orders issued by the Board.

4 Consumers' Gas bills its customers on a monthly basis, and each bill includes a "due date" for the payment of current charges. The due date normally falls on the 10th day (for commercial customers) or the 16th day (for residential customers) after the bill is issued. Customers who do not pay by the due date incur a late payment penalty ("LPP") calculated at five percent of the unpaid charges for that month. The LPP is a one-time penalty, and does not compound or increase over time. Customers can avoid the LPP by participating in a pre-authorized payment system, whereby the amount of their monthly bill is deducted automatically on the due date from a designated bank account.

5 Consumers' Gas offers its customers two billing plans. Under the normal plan, customers are simply billed for the cost of goods and services which they consume each month. Under the "Equal Billing Plan", CG estimates the customer's yearly consumption, bills an equal amount each month for 10 months, settles any balance in the 11th month, and bills for actual use in the 12th. About half of CG's customers subscribe to each type of plan. Late-paying customers are subject to the LPP regardless of which plan is used.

6 The LPP was implemented in 1975 following a series of rate hearings conducted by the OEB. In granting CG's application to impose the penalty, the Board noted that the primary purpose of the LPP is to encourage customers to pay their bills promptly, thereby reducing the cost to CG of carrying accounts receivable. The Board also held that such costs, along with any special collection costs arising from late payments, should be borne by the customers who cause them to be incurred, rather than by the customer base as a whole. In approving a flat penalty of five percent, the OEB rejected the alternative course of imposing a daily interest charge on overdue accounts. The Board reasoned that an interest charge would not provide sufficient incentive to pay by a named

date, would give little weight to collection costs, and might seem overly complicated. The Board recognized that if a bill is paid very soon after the due date, the penalty can, if calculated as an interest charge, be shown to represent a very high rate of interest. However, it noted that customers could avoid such a charge by paying their bills on time, and that in any event in the case of the average bill the dollar amount of the penalty would not be very large.

7 On several occasions since its adoption, the LPP has been reviewed and re-approved by the OEB in essentially the same form. From 1981 until 1989, rate orders issued by the Board with regard to Consumers' Gas incorporated the following provision (applicable to residential customers):

> **Penalty for Late Payment:**
>
> When payment in full is not made within sixteen (16) days of the date of mailing, or the hand delivery of the bill, a penalty of five per cent (5%) of the current amount billed shall be levied....

Beginning in 1989, CG rate orders incorporated this statement from the respondent's Handbook of Rates and Distribution Services (applicable to all customers):

> **Section F - Payment Conditions**
>
> Payment in full should be received by the Company ... on or before the due date specified in the monthly bill, which date is at least ten (10) days (sixteen (16) days in the case of Rates 1, 2, 6 and 9), after the date of rendering the bill. A penalty of five (5) percent of the unpaid portion of the current amount billed shall be added to the amount due if payment is not received as outlined above....

The record indicates that every rate order of the OEB regarding the respondent issued between 1981 and the filing of this action has incorporated the LPP as a component of the respondent's rate structure.

8 Customers are made aware of the LPP in several ways. The due date for payment of current charges appears at the top of every residential bill, and is defined on the reverse as "the date that your account must be paid to avoid a late payment penalty". The significance of the due date is also conveyed by the fact that two different amounts payable appear on the face of the bill: one amount is "payable by due date" while the other, somewhat higher, is "payable after due date". In addition, a variety of informational brochures are provided by CG to its customers. The pamphlet entitled "Getting to Know Us" includes the following definitions of terms contained in the monthly bill:

> 6. Payable by due date -- This is the total amount payable on or before the due date in order to avoid a late payment penalty charge. ...
>
> 7. Due date -- The date on which your account must be paid in full in order to avoid a late payment penalty charge.
>
> 8. Payable after due date -- The total amount payable after the due date. This amount includes the late payment penalty charge.

Elsewhere in the same brochure, it is explained that:

> You should pay your gas bill on or before the due date shown on the bill, in order to avoid late payment

charges. These charges are designed to encourage late-paying customers to pay their accounts promptly, thus minimizing the cost of carrying outstanding accounts. ...

If you do not pay your account by the due date, you must pay the amount "payable after due date" that includes a late payment penalty.

9 The appellant, Gordon Garland, is a resident of Ontario and has been a Consumers' Gas customer since 1983. He and his wife paid approximately $75 in LPP charges between 1983 and 1995. Garland asserts that the LPP violates s. 347 of the *Criminal Code* because -- for a significant number of customers each month -- it constitutes interest at a rate exceeding 60 percent per year. He commenced an action on behalf of over 500,000 Consumers' Gas customers seeking restitution of LPP charges received by the respondent in violation of s. 347 of the *Code* .

10 Garland contends that because the LPP is a one-time charge, the effective rate of interest arising from it depends on when a customer actually pays his or her overdue bill. Actuarial evidence submitted by Garland shows that, under the normal billing plan, the LPP gives rise to an interest rate exceeding 60 percent per annum for customers who pay within 37 days after the due date. It is only on the 38th day after the due date that the interest rate falls below 60 percent and so within the legal limit. It thereafter decreases gradually from 60 percent until paid. Under the Equal Billing Plan, the calculation is more complex -- Garland's actuarial evidence indicates that for such customers, the point at which the interest rate falls below 60 percent is between 24 and 90 days after the due date, depending on the month. For the purpose of this appeal, these calculations are presumed to be accurate.

11 Garland has also submitted statistical evidence indicating that while many of the respondent's customers pay late, most pay only a few days late. Specifically, the evidence shows that between 1981 and 1991, an average of 34.3 percent of customers failed to pay by the due date on at least one of their bills, but 81 percent of those customers paid within 10 days thereafter. Thus, overall during that period, 27.9 percent of CG's customers paid an LPP charge within 10 days after the due date, i.e., well within the time period during which the rate of interest arising from that charge is alleged to have exceeded 60 percent. Again, these figures are presumed to be true for the purposes of this appeal.

12 Finally, Garland has submitted documentary evidence showing that for budgeting purposes, Consumers' Gas makes and relies on forecasts of the revenue it will receive from LPP charges each year. For 1994, the estimate was $7.1 million, and for 1995, the budget forecast was $7.4 million. Garland has also submitted evidence showing that the total of LPP charges received by CG between 1981 and 1993 was $71.2 million.

13 In support of this action, Garland applied for and received financial assistance from the Ontario Class Proceedings Committee, pursuant to s. 59.2 of the *Law Society Act* , R.S.O 1990, c. L.8. Garland also moved, pursuant to the *Class Proceedings Act, 1992* , S.O. 1992, c. 6, for certification of a class proceeding on behalf of all customers who paid LPP charges after April 1, 1981, when s. 347 of the *Code* came into force. Prior to the disposition of that motion, both Garland and Consumers' Gas moved for summary judgment on various grounds. Summary judgment was granted in favour of Consumers' Gas and the action was dismissed. Garland's appeal was dismissed by the Ontario Court of Appeal. This appeal follows.

II. Relevant Statutory Provisions

14 *Criminal Code* , R.S.C. 1985, c. C-46

Criminal Interest Rate

347 .(1) Notwithstanding any Act of Parliament, every one who

(*a*) enters into an agreement or arrangement to receive interest at a criminal rate, or

(*b*) receives a payment or partial payment of interest at a criminal rate,

is guilty of

(*c*) an indictable offence and is liable to imprisonment for a term not exceeding five years, or

(*d*) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.

(2) In this section,

"credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

"criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

. . . . .

"interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

. . . . .

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

(4) In any proceedings under this section, a certificate of a Fellow of the Canadian Institute of Actuaries stating that he has calculated the effective annual rate of interest on any credit advanced under an agreement or arrangement and setting out the calculations and the information on which they are based is, in the absence of evidence to the contrary, proof of the effective annual rate without proof of the signature or official character of the person appearing to have signed the certificate.

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

III. Judicial History

A. Ontario Court (General Division) (1995), 22 O.R. (3d) 451 (Ont. Gen. Div.)

15 As noted, cross-motions for summary judgment were filed by Garland and Consumers' Gas before this action was certified as a class proceeding. By agreement of the parties, a hearing was held before Winkler J. on the threshold question raised in CG's motion, i.e., whether s. 347 has any application to the circumstances of this case.

16 Consumers' Gas raised three arguments to support its contention that s. 347 does not apply and that Garland's action should be dismissed. First, it asserted that the purpose of the LPP is to encourage timely payment, not to achieve a rate of return on an advancement of credit, and therefore the LPP is not "interest" within the meaning of s. 347. In particular, CG pointed out that unlike an interest charge, the LPP is a one-time penalty which does not increase over time. Second, CG argued that s. 347 is intended to cover loans of money, and does not apply where, as here, the alleged "credit" consists solely of the value of goods, services or benefits advanced. Finally, CG relied on the decision in *Nelson v. C.T.C. Mortgage Corp.* (1984), 16 D.L.R. (4th) 139 (B.C. C.A.) , aff'd [1986] 1 S.C.R. 749 (S.C.C.) , to argue that even if the LPP is a charge for the advancement of credit, it cannot violate s. 347 because the payment of the penalty and the interest rate arising from it are determined by voluntary acts of the customer, not by any agreement between the parties.

17 In response, Garland argued that "credit advanced" need not involve a loan of money. He asserted that the arrangement between CG and its customers, which allows for the deferral of payment for goods and services, is a credit arrangement within the meaning of s. 347. Garland further contended that the LPP is, in substance, an interest charge payable for the advancement of such credit. Finally, Garland asserted that the decision in *Nelson* is distinguishable from this action, because incurring and paying the LPP are not "voluntary" acts of the customer within the meaning of *Nelson* . In his submission, the actual receipt of interest at a criminal rate by CG constitutes a violation of para. (*b*) of s. 347(1), even if such an interest rate is not necessarily required on the face of the arrangement between the parties.

18 Winkler J. focused his analysis largely on the significance of the *Nelson* decision. In his view, *Nelson* established three principles applicable to the case at bar (at p. 467):

> [F]irst, that whether an agreement or arrangement violates s. 347 must be determined at the time the agreement is entered into; second, that whether the lender is in breach of s. 347 cannot turn on the voluntary conduct of the borrower; and third, that there is no violation of s. 347 where the payment of a criminal interest is not required by the agreement or arrangement.

Applying these principles, Winkler J. concluded that the LPP could never give rise to an offence under s. 347 because the payment of the penalty at a criminal rate of interest turns on the voluntary conduct of the customer. Winkler J. found that, as in *Nelson* , no payment of illegal interest is required under the arrangement between Consumers' Gas and its customers, at the time that arrangement is entered into. If the customer pays on time, no LPP will be levied. Likewise, if the customer misses the due date but then further delays payment of the LPP for a sufficient amount of time (e.g., 38 days), the resulting rate of interest falls below 60 percent. Winkler J. gave no weight to statistical evidence indicating that a consistent percentage of CG's customers every month do in fact pay an LPP at an illegal interest rate. He held that in any given case, it is always the customer who determines whether or not to incur the LPP and whether to pay it during the window of time when it may be considered a criminal rate.

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

19 Despite this conclusion, Winkler J. went on to consider whether the LPP may be said to constitute "interest" payable for the "advancing of credit under an agreement or arrangement" within the meaning of s. 347. He noted that s. 347 is broadly written and covers a wide range of transactions. In particular, he rejected the contention that the provision applies only to lenders and borrowers of money, and held that "credit advanced" can also refer to the deferral of payment for goods or services. However, he did not agree that *any* late payment is necessarily a deferral of payment or an advancement of credit, particularly where, as here, substantial efforts have been made to encourage the customer to pay on time. He stressed the distinction between the situation where a customer simply fails to pay by a stipulated time -- which he held to be the case on the facts before him -- and the situation where a lender agrees to delay its demand for payment in exchange for consideration. He found that s. 347 applies only to the latter situation. Winkler J. emphasized that the LPP is a one-time payment which does not compound over time, and that there are no immediate consequences for failing to pay it by a given date once it has been incurred. He concluded that the LPP is not levied in order to allow customers to take more time in paying their bills, but rather to discourage them from so doing. Accordingly, he found that the LPP is not an interest charge within the scope of s. 347.

20 Winkler J. granted summary judgment in favour of Consumers' Gas and dismissed the action.

B. Ontario Court of Appeal (1996), 30 O.R. (3d) 414 (Ont. C.A.)

21 The Ontario Court of Appeal (Doherty, Abella and Charron JJ.A.) agreed with the conclusion of Winkler J. that *Nelson* is dispositive, and noted in particular that the reasons in *Nelson* were substantially affirmed by this Court. In *obiter dictum* , the Court of Appeal also agreed that s. 347 applies to transactions where the alleged "credit advanced" consists entirely of the value of goods, services, or benefits. However, the court expressed no opinion on the question of whether the LPP can be characterized as "interest" payable for the "advancing of credit under an agreement or arrangement" within the meaning of s. 347. The appeal was dismissed.

IV. Issues

22

(1) Does the late payment penalty charged by Consumers' Gas come within the scope of s. 347 of the *Criminal Code* ?

(2) Did the motions judge err in awarding costs against Garland in his personal capacity?

V. Analysis

A.Does the late payment penalty charged by Consumers' Gas come within the scope of s. 347 of the Criminal Code?

23 Section 347 (formerly s. 305.1) of the *Criminal Code* , which came into effect on April 1, 1981, created Canada's first general anti-usury provision since Confederation. Prior to the adoption of s. 347, lenders and borrowers enjoyed absolute freedom under federal law to agree upon any rate of interest, subject only to the contractual restraints imposed at common or civil law and the special disclosure requirements arising under the *Interest Act* , R.S.C. 1985, c. I-15 (formerly R.S.C. 1970, c. I-18). The main exception to that rule was the *Small Loans Act* , R.S.C. 1970, c. S-11, s. 3, which limited the imposition of interest and other charges on loans of $1,500 or less. That Act, which was designed to protect borrowers seeking small personal loans, was repealed by

the bill which created s. 347. See *William E. Thomson Associates Inc. v. Carpenter* (1989), 69 O.R. (2d) 545 (Ont. C.A.) at pp. 548-49. The current provision goes far beyond the scope of the *Small Loans Act* , both by criminalizing a particular interest rate for the first time, and by imposing a generally applicable ceiling on all types of credit arrangements without regard to the sophistication of the parties or the amount in issue.

24 Under s. 347, an effective annual rate of interest which exceeds 60 percent of the credit advanced under an agreement or arrangement is a criminal interest rate. The statute creates two offences with regard to such interest. Section 347(1)(*a*) makes it illegal to enter into an agreement or arrangement to receive interest at a criminal rate. Section 347(1)(*b*) makes it illegal to receive a payment or partial payment of interest at a criminal rate. The scope of the language in s. 347 is extremely broad. Interest is defined, with the exception of six specific items, as the aggregate of all charges and expenses, in any form, that are paid or payable for the advancing of credit under an agreement or arrangement. The definition of credit is similarly expansive. It includes the aggregate of the money and the monetary value of any goods, services or benefits advanced under an agreement or arrangement, minus any fees, commissions or similar charges incurred by the creditor.

25 The ostensible purpose of s. 347 was to aid in the prosecution of loan sharks. See House of Commons Debates, July 21, 1980, at p. 3146; *Thomson, supra* , at p. 549. However, it is clear from the language of the statute -- e.g., its reference to insurance and overdraft charges, official fees, and property taxes in mortgage transactions -- that s. 347 was designed to have a much wider reach, and in fact the section has most often been applied to commercial transactions which bear no relation to traditional loan-sharking arrangements. Although s. 347 is a criminal provision, the great majority of cases in which it arises are not criminal prosecutions. Rather, like the case at bar, they are civil actions in which a borrower has asserted the common-law doctrine of illegality in an effort to avoid or recover an interest payment, or to render an agreement unenforceable. For this reason, the provision has attracted criticism from some commercial lawyers and academics, and calls have repeatedly been made for its amendment or repeal. See, e.g., J. S. Ziegel, "The Usury Provisions in the Criminal Code: The Chickens Come Home to Roost" (1986), 11 *C.B.L.J* . 233; Editorial (1994), 23 *C.B.L.J* . 321. Nevertheless, it is now well settled that s. 347 applies to a very broad range of commercial and consumer transactions involving the advancement of credit, including secured and unsecured loans, mortgages and commercial financing agreements.

26 The extent of s. 347's scope is the subject of this appeal. At issue is whether the section applies to penalties for late payment, and in particular the five percent LPP imposed by Consumers' Gas on customers who fail to pay their bills by a prescribed due date. The question has two parts. The first is whether the LPP can be said to constitute "interest" under s. 347, as opposed to being simply an incentive for timely payment. The second is whether the principles set forth in the *Nelson* case preclude the application of s. 347 here on the ground that any interest rate arising from the LPP depends on the voluntary conduct of the customer. These issues will be addressed in turn.

1. Is the LPP "interest" within the meaning of s. 347?

27 Pursuant to s. 347(2), "interest" is defined as:

> ...the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement ... but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount

required to be paid on account of property taxes;

It is apparent from this definition that for the purposes of s. 347 "interest" is an extremely comprehensive term, encompassing many types of fixed payments which would not be considered interest proper at common law or under general accounting principles. In particular, charges or expenses "in the form of a ... penalty" are expressly included as interest under s. 347. At common law, interest is a charge for the use or retention of money which accrues day by day; it does not include penalties. See *Tomell Investments Ltd. v. East Markstock Lands Ltd.* (1977), [1978] 1 S.C.R. 974 (S.C.C.) at p. 983; *Immeubles Fournier Inc. v. Construction St. Hilaire Ltée* (1974), [1975] 2 S.C.R. 2 (S.C.C.) at pp. 10-11; *Ontario (Attorney General) v. Barfried Enterprises Ltd.*, [1963] S.C.R. 570 (S.C.C.) .

28 In adopting s. 347, Parliament opted for the more inclusive "cost of the loan" concept derived from the *Small Loans Act* , which s. 347 replaced. Section 2 of that Act provided:

> **2** ....
>
> "cost" of a loan means the whole of the cost of the loan to the borrower whether the same is called interest or is claimed as discount, deduction from an advance, commission, brokerage, chattel mortgage and recording fees, fines, penalties or charges for inquiries, defaults or renewals or otherwise....

The broad language of s. 347 was presumably intended (as it was in the *Small Loans Act*) to prevent creditors from avoiding the statute simply by manipulating the form of payment exacted from their debtors — a practice which has historically undermined the effectiveness of anti-usury laws applying a strict definition of interest: *Thomson, supra* , at pp. 548-49; see also K. Keest, *The Cost of Credit* (1995), at p. 38. It is the substance, and not merely the form, of a charge or expense which determines whether it is governed by s. 347.

29 The LPP at issue in this appeal is a fixed payment, rather than a charge which accrues day by day. The motions judge emphasized that point in concluding that the LPP does not come within the scope of s. 347. At p. 473, he stated in part:

> First, the penalty is not compounded. Although it is expressed as a percentage of the amount owing, it is in fact a lump sum which is charged only if payment is not made by the due date. Second, the penalty is a one-time payment which does not increase over time.

The same argument has been advanced by the respondent in this appeal. To distinguish between fixed and time-sensitive charges is inconsistent with the plain language of s. 347, and to the extent the motions judge relied on such a distinction, such reliance was unfounded. As noted, Parliament expressly expanded the meaning of interest under s. 347 to include one-time charges, whether payable at the outset of a transaction (e.g., fees and commissions) or after repayment is due (e.g., fines and penalties). A time factor, while essential to the definition of common-law interest, is not necessary to bring a payment within the ambit of s. 347, and the LPP cannot be excluded on that ground.

30 It is equally clear, however, that not every charge or expense will be subject to the criminal interest rate provision. In order to constitute "interest" under s. 347, a charge -- whatever its form -- must be "*paid or payable for the advancing of credit under an agreement or arrangement* " (emphasis added). To contend that the LPP comes within the scope of s. 347 simply because it is a "penalty" is a formalistic and unpersuasive argument. The issue is whether that penalty constitutes, in substance, a cost incurred by customers to receive credit

under an arrangement with Consumers' Gas.

31 There is a basic disagreement in this case about how the LPP should properly be characterized for the purposes of s. 347. The appellant asserts that the LPP is a price paid by customers for the privilege of retaining money that is owed to Consumers' Gas beyond a certain date. As such, he submits, it is in essence a charge for credit under a standing arrangement between the parties. The respondent submits that the LPP is merely an incentive for timely payment and has nothing to do with credit. It asserts that because it lends no money to its customers, but merely bills them for goods and services, there is no extension of credit within the meaning of s. 347. Furthermore, it submits that even if the deferral of payment for those goods and services is in fact a form of credit, such credit is unilaterally taken by late-paying customers, not advanced under any agreement or arrangement between the parties.

32 The dispositive question, therefore, is whether the LPP may be said to constitute a charge or expense "paid or payable for the advancing of credit under an agreement or arrangement". In answering that question, the Court should look to the substance, not merely the form, of the payment relationship which exists between Consumers' Gas and its customers. The basic features of that relationship are not in dispute and may be briefly stated: Consumers' Gas provides goods and services to its customers, but does not bill them immediately upon delivery or performance. Instead, it issues a bill each month for the total charges incurred in the preceding service period. The amount owing on the bill is due by a specified date. Customers who do not pay by that date must pay the amount owing plus an additional five percent penalty.

"Credit Advanced"

33 As a first step, it is necessary to determine whether the relationship between Consumers' Gas and its customers involves any advancement of credit within the meaning of s. 347. Although s. 347 is not confined to loan-sharking, in general the section arises in transactions which involve an advance of money in some form, whether in a conventional loan, a mortgage, a commercial financing agreement or otherwise. This case presents a more unusual situation, since it is clear that Consumers' Gas does not actually lend any money to its customers.

34 In keeping with the thrust of the section in general, "credit advanced" is broadly defined in s. 347(2):

> "credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

Notably, this definition encompasses not only "the money" advanced under an agreement or arrangement, but also "the monetary value of any goods, services or benefits" which may be so advanced. The scope of s. 347 therefore is not confined exclusively to loans of money. The respondent submits, however, that the reach of s. 347 is limited to cases in which at least *some* money has been advanced. This argument is based on a grammatical analysis of s. 347(2), since "money" is preceded by the definite article "the", whereas the phrase "goods, services or benefits" is modified by the indefinite article "any". Both the motions judge and the Court of Appeal rejected that contention as overly formalistic, and I agree. Section 347 applies to arrangements involving the monetary value of goods, services or benefits even in the absence of an outright advance of money.

35 The most plausible interpretation of s. 347(2) is that an "advance" of "the monetary value of any goods,

services or benefits" means a *deferral of payment* for such items. A debt is deferred -- and credit extended -- when an agreement or arrangement permits a debtor to pay later than the time at which payment would otherwise have been due. See R. M. Goode, *Consumer Credit Law* (1989), at p. 109. The substance of such "credit" is a determined amount of money which is payable over time. Unlike the principal of a loan, however, such credit is not initially paid out to the debtor in the form of money, but arises when a debt is incurred for goods, services or benefits, and that debt is then deferred in full or in part by agreement of the parties.

36 An example is a credit sale. Such transactions are analogous to loans even though no money actually changes hands. In place of borrowing funds to pay for goods or services which have been provided, the debtor retains possession of his or her own money and the vendor assumes the position of a creditor by virtue of deferring the debt. Ordinarily in such circumstances, a premium is charged on the deferred amount, reflecting the value of the money which is now owed to the creditor but remains in the control of the party who has been permitted to delay payment. Under this interpretation of s. 347, the retailer who provides financing on a sale at an interest rate exceeding 60 percent per year is subject to the same criminal sanctions as the loan shark who lends money directly at such a rate.

37 It is crucial to bear in mind that the "credit advanced" in such situations consists of "monetary value" — a specific amount of money that is owed for goods, services or benefits pursuant to an agreement or arrangement — and not the goods, services or benefits themselves. If every sale, performance of services or conveyance of benefits were understood to be an advance of "credit", there would be virtually no limit to the application of s. 347. That section, despite its broad scope, is essentially concerned with regulating the relationship between creditors and debtors, not the relationship between commercial actors in the ordinary course of business.

38 This distinction can be illustrated with an example. Assume the purchase of a car for $1,000. Payment of the purchase price will normally be due at a date specified in the sale agreement or when the car is tendered. No credit exists in such a situation, regardless of whether the seller is in fact paid on time, because the car is not advanced to the purchaser as "credit". However, if the seller and purchaser enter into an arrangement to delay payment of the purchase price for one month, then credit has been advanced and any premium charged by the seller for that extension of time must comply with the requirements of s. 347. The "monetary value" of the car is now a fixed amount — $1,000 — under their agreement, and the advancement of that credit begins at the moment when payment would otherwise have been due.

39 The car itself, which may in reality be worth more or less than $1,000, is not the "credit advanced" and is not relevant for the purposes of s. 347. If the opposite were true, it would be virtually impossible to calculate an interest rate arising from such a transaction, since the value of the credit would be undefined. In addition, and more importantly, any transaction involving an "advance" of goods, services or benefits — such as a rental or leasing agreement — would be swept within the ambit of s. 347, and many such transactions would undoubtedly give rise to "interest" exceeding the legal limit. Assume that instead of being purchased, the car is rented for a day at a price of $50. If the car were to constitute credit advanced under s. 347(2), then the return of the car to the rental agency would presumably be a repayment of principal, and the charge paid for the advancing of that credit — $50 for one day — would give rise to an astronomical interest rate based on the value of the car. Such an absurd result could not have been intended by Parliament when it adopted s. 347. For the deferral of a debt to constitute "credit advanced" under s. 347, there must be a specified amount owing, and that amount must actually be due in the absence of an arrangement permitting later payment.

40 In the case at bar, Consumers' Gas provides goods and services to its customers, for which a specified

amount of money is payable each month on a certain date. In light of the principles stated above, the deferral of that payment past the due date constitutes "credit advanced" within the meaning of s. 347(2), assuming that such deferral is permitted under the payment relationship which exists between the parties. The remaining question, therefore, is whether credit is advanced by Consumers' Gas to its customers "under an agreement or arrangement".

"Agreement or Arrangement"

41 As noted at the outset, "interest" under s. 347 is a charge which is "paid or payable for the advancing of credit under an agreement or arrangement". Consumers' Gas contends that even if credit may be said to include the deferral of payment for goods or services, no "agreement or arrangement" for the advancing of such credit exists where a customer simply fails or refuses to pay a bill on time and thereby takes such "credit" unilaterally. In the respondent's view, an agreement or arrangement for credit only arises when the creditor *agrees* to delay its demand for payment, normally in exchange for some form of consideration.

42 The respondent submits that in the case at bar there is no such consensual arrangement — the LPP is imposed not as compensation for credit but as a means to deter customers from paying late. The respondent emphasized, as it did in the courts below, that the LPP does not have the "characteristics which one would expect" of a charge for credit, since it is a one-time payment which does not repeat, compound or increase over time, and no additional penalties accrue if a customer fails to pay it by any particular date. It is contended that the LPP is more akin to the late payment penalties which are authorized under federal and provincial statutes, such as the *Excise Tax Act* , R.S.C., 1985, c. E-15, s. 7(1), the *Income Tax Act* , R.S.C., 1985, c. 1 (5th Supp.), ss. 163.1 and 227(9), and the *Commercial Concentration Tax Act* , R.S.O. 1990, c. C.16, s. 15(10). The respondent submits that Parliament could not have intended for those provisions to constitute agreements or arrangement for the advancing of credit with the meaning of s. 347.

43 The respondent also relies on decisions of the OEB to support its argument regarding the purpose of the LPP. In particular, it cites the original order of the OEB approving the implementation of the penalty. In that decision, the Board emphasized the deterrent effect of such penalties, and specifically rejected the option of imposing a conventional interest charge on overdue accounts. See Reasons for Decision, E.B.R.O. 302-II (September 4, 1975). The Board held at pp. 116-18:

> The primary objective of this charge is to encourage customers to pay promptly and thus minimize the growing cost of carrying accounts receivable.... The Applicant [Consumers' Gas] submits that these costs as well as extra-ordinary collection costs should be borne by the customers who cause them to be incurred.
>
> . . . . .
>
> The late payment penalty charge is a well established and practical device in widespread use in Ontario and elsewhere to encourage prompt payment of utility bills....
>
> The Board recognizes that a few regulatory Boards and text-book writers have been critical of a penalty charge of the kind used by the Applicant. However, the Board does not think that a monetary incentive for prompt payment is wrong in principle. Interest charged on over-due accounts on a daily basis has an appeal on theoretical grounds, but it gives little incentive to pay by a named date, gives little weight to collection costs and seems complicated.

Similarly, in 1988 the OEB reviewed the fairness of the LPP and concluded that it should be maintained in its existing form. See Reasons for Decision, E.B.R.O. 452 (December 21, 1988). In so finding, the Board noted at p. 330 that "the late payment penalty should be large enough to deter those customers who otherwise might be tempted to defer payment." Consumers' Gas submits that the Board's characterization of the LPP should be accorded curial deference by this Court.

44 The respondent's arguments on this point were accepted by the motions judge, who held as follows at pp. 469-71:

> From the foregoing [OEB] decisions, it is apparent that the OEB does not view the LPP charged by Consumers' Gas as an interest charge for the advancing of credit. Instead, as the defendant submits, the OEB considers it to be an incentive for timely payment....
>
> .....
>
> ... I accept the plaintiff's argument that a deferral of payment constitutes credit. However, I do not agree that just because a customer does not pay on time means that there has been a deferral of payment or that credit has been advanced, particularly where the company has done what it could to encourage the customer to pay on time. A distinction must be drawn between the situation in which a customer fails to pay within a stipulated time, because of inadvertence, choice or because he does not have the money, and the situation in which an agreement is entered into whereby the lender of money or issuer of goods agrees to delay its demand for payment, in exchange for the consideration of an additional charge. In my view, s. 347 is applicable only to the latter situation. The facts before me reveal the former situation.

The Court of Appeal dismissed Garland's appeal on separate grounds and declined to reach the issue of whether the LPP is a charge "payable for the advancing of credit under an agreement or arrangement".

45 It is true that there is an important difference between the consensual granting of credit and the unilateral taking of it. See., e.g., Goode, *supra* , at p. 108. As noted, s. 347 does not apply to situations in which a buyer or consumer fails to pay on time, without the consent of the other party, for goods, services or benefits provided. The facts in this case, however, present a different situation. The payment relationship which exists between Consumers' Gas and its customers is defined by a standing arrangement. The terms of that arrangement are imposed by Consumers' Gas, after approval by the OEB. They are clearly conveyed to every customer and do not change from month to month. Those terms provide, in plain language, that a customer's gas bill may be paid either before or after the due date. As the motions judge observed at p. 466:

> [T]he bill received by the customer states the amount "payable by due date", the "due date" and the amount "payable after due date". The bill does not indicate that payment must be made by the due date and I question the ability of Consumers' to sue as soon as the due date has passed.

It is also made clear, however, that Consumers' Gas prefers to receive payment by the due date, and that customers who, for whatever reason, fail to meet that deadline must pay a price of five percent on top of the amount owing for that month.

46 In short, the arrangement between the parties creates two payment options: a short-term option, which costs nothing, and a longer-term option, which involves an additional charge. The motions judge recognized this as well in the closing words of his decision, when he observed (at pp. 473-74) that the transaction between the

parties "is a two-price system by which customers can opt to pay one price by the due date or another price thereafter". He concluded that such an arrangement "represents a discount which is forfeited if payment is not made by the due date" (p. 474). It can just as easily be said that the LPP represents a premium imposed when payment is made over the longer period. Customers who do not like these terms presumably may end their relationship with the respondent; by continuing to subscribe to its services they accept the terms of the prevailing arrangement, including the imposition of the LPP. It cannot properly be contended that Consumers' Gas, having designed those terms itself, does not consent to the customer acting in accordance with them.

47 The respondent does not deny that the LPP is imposed under an arrangement, but disputes the nature of that arrangement. As noted, it argues that the *intended purpose* of the LPP is not to exact a price for credit but to discourage the taking of credit in the first place. That assertion is not entirely supported by the record. The OEB found that deterrence of late payments is the "primary objective" of the LPP. However, it also held that when such deterrence is not effective, another purpose of the penalty is to ensure that the "cost of carrying accounts receivable" is recovered from customers who, by delaying payment, cause such costs to be incurred (Reasons for Decision, E.B.R.O. 302-II, *supra* , at p. 116). Before approving the respondent's request to implement the LPP in 1975, the OEB held a series of hearings, during which the Associate Comptroller of the respondent was examined with regard to the purpose of the LPP. He stated in part:

> Q: The cost of money is a real problem is it?
>
> A: Yes, sir.
>
> Q: You don't want the customers to be sitting with lots of the company's money for long periods of time. You require cash flow. Is that fair?
>
> A: Yes, sir, that is correct.
>
> Q: It costs the company money to borrow money?
>
> A: Yes, sir.
>
> . . . . .
>
> Q: Isn't this late payment charge then a charge to the customer for keeping the money past a certain time period, for keeping the money for a certain length of time?
>
> A: Partly that and partly to recover our collection costs.

Transcript of Examination of D.C. Morton, January 24, 1975 (Case on Appeal at pp. 376-77). Similarly, in one of its informational brochures ("Some Special Billing Charges"), Consumers' Gas explains the purpose of the LPP to its customers as follows (Case on Appeal, at p. 680):

> The primary purpose of this charge is to encourage our customers to pay on or before the due date and thereby maintain the company's cash flow. Revenue from this penalty helps to offset our costs of carrying outstanding gas accounts receivable and collecting delinquent accounts.

Compensation for the cost of payment deferred is the hallmark of a credit arrangement.

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

48 Even if deterrence were the only intended purpose of the LPP, that would not be determinative of the issue before the Court. The nature of the arrangement between Consumers' Gas and its customers is a question of law. That question turns on how the LPP operates in substance, not on what the respondent hopes to achieve by imposing it. Nor does the Court owe curial deference to the OEB with regard to the characterization of the penalty. It is clear that Consumers' Gas neither encourages late payments nor seeks to profit from them. The issue, however, is not what the company would prefer but what it has consented to. Under the terms prevailing between the parties, customers are permitted to defer their payment, albeit for a price. That is an arrangement for the advancing of credit under the broad language adopted in s. 347. As the OEB recognized, a five percent penalty is an effective deterrent precisely because it constitutes a high cost, in economic terms, for the retention of money. It is the severity of that cost which, in the view of the appellant, runs afoul of s. 347.

49 This conclusion is not affected by the fact that late payment penalties exist in certain federal and provincial statutes. Such penalties are readily distinguishable from the LPP at issue here. The contractual relationship between a public utility and its customers regarding the payment of monthly charges is not comparable to the political relationship between a government and its citizens regarding the payment of taxes. There is no agreement or arrangement between the latter parties governing the imposition of taxes, let alone permitting the payment of one amount by a due date and another amount thereafter. In any event, for the purposes of s. 347, tax is not the monetary value of goods, services, or benefits provided by the government, and the deferral of tax, even if such deferral were permitted, would not constitute "credit" within the meaning of s. 347(2). See *Delta (Municipality) v. Active Chemicals Ltd.* (1984), 57 B.C.L.R. 213 (B.C. C.A.) at p. 217.

50 For these reasons, I conclude that the LPP imposed by Consumers' Gas is a "charge[] in the form of ... a penalty ... payable for the advancing of credit under an agreement or arrangement". As such it is an interest charge for the purposes of s. 347.

51 The conclusions reached in this appeal may not follow intuitively from the concepts of "credit" and "interest" as those terms are employed at common law and in everyday life. The result here is mandated by the extremely broad compass given to those terms by Parliament under s. 347. As Huddart L.J.S.C. observed in *Mira Design Co. v. Seascape Holdings Ltd.* (1981), 34 B.C.L.R. 55 (B.C. S.C.) at p. 60:

> The thrust of the definitions of "credit advanced" and "interest" is to cover all possible aspects of any transaction to ensure that the cost of using someone else's money never exceeds the criminal rate. Thus, they focus on the actual benefit given to the borrower and the real cost of borrowing. The actual benefit is the real amount in the borrower's hands minus all the penalties, commissions and other costs incurred. The cost of borrowing is also widely defined. Clearly the intention of the legislature was to concentrate on the substance of the transaction, not on its mechanics or form.

52 It should be noted however that s. 347 is a deeply problematic law. Some of its terms are most comfortably understood in the narrow context of street-level loan sharking, while others compel a much broader application. The two facets of the statute do not comfortably co-exist. The Court is aware that the present decision may have the effect of increasing the importance of s. 347 in some consumer and commercial transactions. Given the interpretive difficulties inherent in the provision and the volume of civil litigation which it has already spawned, it is with some reluctance that we are legally driven to this conclusion. However, the plain terms of s. 347 must govern its application. If the section is to be given a more directed focus, it lies with Parliament, not the courts, to take the required remedial action.

53 In any event, the result reached in this appeal is limited. On the facts of this case, a penalty incurred, pursuant to the terms of a standing arrangement between the parties, for the deferral of payment of a specified amount of money owing for goods, services or benefits is an "interest" charge within the meaning of s. 347 and is subject to that law's prohibitions against requiring or receiving interest at a criminal rate.

2. Is the Application of s. 347 Precluded by the Principles Set Forth in Nelson v. C.T.C. Mortgage Corp.?

54 As noted, s. 347 creates two separate offences. Section 347(1)(a) makes it illegal to *enter into an agreement or arrangement* to receive interest at a criminal rate. Section 347(1)(*b*) makes it illegal to *receive a payment or partial payment* of interest at a criminal rate. The relationship between these two provisions has been the subject of much comment in the courts below and in academic writings. In particular, controversy exists about whether an agreement which does not expressly require the payment of criminal interest at the time it is entered into may nevertheless give rise to an actual payment of interest at an illegal rate. Such cases can arise if an additional charge is incurred while credit is outstanding, or if the actual period for repayment is shortened by the occurrence of a determining event or an act by one of the parties. See, e.g., *Mira Design, supra; Aectra Refining & Marketing Inc. v. Lincoln Capital Funding Corp.* (1991), 6 O.R. (3d) 146 (Ont. Gen. Div.) ; S. Antle, "A Practical Guide to Section 347 of the Criminal Code — Criminal Rates of Interest" (1994), 23 *C.B.L.J* . 323, at p. 334; Ziegel, "The usury Provisions in the Criminal Code: The Chickens Come Home to Roost", *supra* , at p. 240; M. Feldman, "Criminal Interest Rates in the Context of Early Payment of a Debt Obligation" (1985), 2 *Bus* . & *L* . 70.

55 The leading decision on this issue is *Nelson* , *supra* . The facts and judgments in *Nelson* are set forth in detail in the companion case to this appeal, *Degelder Construction Co. v. Dancorp Developments Ltd.* (October 30, 1998), Doc. 25355 (S.C.C.) , and need not be fully repeated. Briefly, the Nelsons were guarantors of a mortgage on which a number of fixed fees were payable in addition to conventional interest. Had the mortgage been repaid when it was due, the fees and interest would have produced an effective interest rate of 52.49 percent per annum. However, the mortgage contained a right of prepayment which was exercised by the debtor early in the life of the agreement. When the interest rate was calculated over the term during which the mortgage was actually outstanding, it was 84.1 percent per annum. The Nelsons sued the lender alleging that the mortgage agreement was void and unenforceable under s. 305.1 (now s. 347).

56 The issue at trial and on appeal was whether the rate of interest should be calculated over the full term of the mortgage as stated in the agreement, or over the shorter period that the mortgage was actually outstanding. The British Columbia Court of Appeal split on the question. Hutcheon J.A., dissenting, held that the case turned on the distinction between ss. 347(1)(*a*) and 347(1)(*b*). In his view, subs. (1)(*a*) prohibits entering into an agreement which, on its face, requires the payment of illegal interest; he found that such a situation was not before him. However, he held that subs. (1)(*b*) prohibits the actual receipt of an illegal interest payment, and the rate in such situations must be based on the time elapsed since the money was advanced, even if that period differs from the term foreseen in the agreement. The majority, *per* Seaton J.A., found that such an approach would produce an absurd result in a situation where the period of repayment is within the exclusive control of the debtor. As Seaton J.A. held at pp. 144-45, Parliament cannot have intended that "an innocent mortgagee who has entered into a perfectly lawful agreement should as the result of the voluntary act of the mortgagor in prepaying the mortgage become guilty of an offence under [s. 347(1)(*b*)]". The majority recognized that the same might not be true if a mortgage were payable on the demand of the creditor rather than at the debtor's option. The reasons of the majority were agreed to in substance by this Court.

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

57 The gravamen of *Nelson* is that an agreement or arrangement for credit which is legal on its face cannot become illegal under s. 347 through the voluntary act of the debtor. Consumers' Gas contends that this principle precludes the application of s. 347 in the case at bar, because incurring and paying the LPP are voluntary acts of the customer. The motions judge accepted the argument that *Nelson* is dispositive of this case and dismissed the action on that basis. The Ontario Court of Appeal agreed. In particular, the Court of Appeal noted that the decision in *Nelson* was affirmed by this Court.

58 The reasons in *Dancorp* , which are being released simultaneously with this decision, revisit *Nelson* and set forth the following general principles governing the interpretation of s. 347:

> (1) Section 347(1)(*a*) should be narrowly construed. Whether an agreement or arrangement for credit violates s. 347(1)(*a*) is determined as of the time the transaction is entered into. If the agreement or arrangement permits the payment of interest at a criminal rate but does not require it, there is no violation of s. 347(1)(*a*), although s. 374(1)(*b*) might be engaged.
>
> (2) Section 347(1)(*b*) should be broadly construed. Whether an interest payment violates s. 347(1)(*b*) is determined as of the time the payment is received. For the purposes of s. 347(1)(*b*), the effective annual rate of interest arising from a payment is calculated over the period during which credit is actually outstanding.
>
> (3) There is no violation of s. 347(1)(*b*) where a payment of interest at a criminal rate arises from a voluntary act of the debtor, that is, an act wholly within the control of the debtor and not compelled by the lender or by the occurrence of a determining event set out in the agreement.

59 Applying the first principle stated above, it is clear that there is no violation of s. 347(1)(*a*) in this case. The arrangement between Consumers' Gas and its customers does not, on its face, require the payment of interest at a criminal rate. The payment of such interest depends on the occurrence of subsequent events.

60 With regard to s. 347(1)(*b*), Consumers' Gas makes two arguments. First, it contends that a customer can avoid the LPP entirely by paying on time, and therefore any customer who incurs the penalty does so voluntarily. Second, it contends that the amount of time which 14passes between the due date and the actual payment of the LPP --and therefore the effective rate of interest arising from the penalty -- is entirely within the control of the customer. Consumer Gas submits that under the third principle stated above, receipt of the LPP cannot constitute a violation of s. 347(1)(*b*).

61 The respondent's assertion that customers "voluntarily" pay the LPP is unpersuasive. The prepayment of the mortgage in *Nelson* was a voluntary act because it was wholly at the debtor's initiative and was not compelled by the lender's demand or by a determining event set out in the agreement. A customer's failure to pay the LPP by a named date is not voluntary in the same sense. The LPP is automatically triggered by an event specified in the arrangement between the parties, i.e. the passage of time. The fact that the respondent consents to the possibility of late payment, and thereby presents its customers with the option of paying before or after the due date, does not mean that a customer "voluntarily" incurs the LPP when he or she fails to pay on time. A penalty is not "voluntary" simply because it could conceivably be avoided through prompt payment. If that were the case, then all penalties could be considered voluntary, and the inclusion of the term "penalty" in s. 347(2) would become meaningless. When a penalty is specified in an agreement or arrangement for credit, the lender bears the risk that the payment of that penalty might give rise to a violation of s. 347(1)(*b*).

62 It is unnecessary, in the context of this appeal, to create a general rule regarding which kinds of payments are "voluntary" within the meaning of *Nelson* . It bears noting in particular that the "voluntariness" of certain automatic payment terms, such as acceleration clauses triggered by the debtor's default or insolvency, remains an open question. Some writers have suggested that a distinction should be drawn between clauses which accelerate repayment automatically, and those which give the lender the option of demanding repayment upon the occurrence of a stated event. In the latter case, it would be the lender's demand which attracts s. 347, and the lender could avoid liability by declining to accelerate repayment. See, e.g., Antle, *supra* , at p. 327. In my view, such a distinction is not required in this case, since the issue presented here concerns a penalty -- which is provided for explicitly in s. 347 -- and not an acceleration clause.

63 The respondent's second argument with regard to "voluntariness" presents a closer question. The actuarial evidence submitted in this case shows that if a regular billing customer pays the LPP within 38 days of incurring it, the five percent charge represents an annual interest rate exceeding 60 percent per annum. If the customer waits 38 days or longer to pay, the rate drops below the criminal threshold. The respondent submits that because the LPP does not compound or increase over time, and because no further sanctions are imposed by the company for late payment once the due date has passed, it is open to the customer to pay the LPP at any time after it has been incurred, including after the date when the interest rate arising from the penalty would no longer be illegal. It is claimed that to find liability under s. 347 in such circumstances would offend the principle of "voluntariness" set forth in *Nelson* .

64 This case is unlike *Nelson* in several important respects. In *Nelson* , the mortgage was not yet due when the debtor chose to repay it and he was presumably under no pressure from the lender to pay early. Here, by contrast, payment of the monthly bill is overdue and the LPP is already owing at the time the customer actually pays Consumers' Gas; the question is not whether to pay early, but rather how late is too late. Because there is no specific contractual term governing the time for payment after the imposition of the LPP, technically it may be argued that there is an *indefinite* extension of credit. It is obvious, however, that that is not really the case -- the customer does not have the option of *never* paying his or her bill. There is an implied limit to the term for which credit is extended, after which the respondent will undertake to recover the money that is owed to it. The record does not disclose if or when Consumers' Gas would actually sue a customer for non-payment or discontinue service. However, in one of its informational brochures ("To Your Credit"), the respondent explains to its customers the procedures which it employs for "collecting past due bills" (Case on Appeal, at p. 687):

> We send out a broad range of bill messages and notices to remind customers to pay past due bills. The sequence of bill messages and notices depends upon a customer's credit rating and the particular circumstances surrounding the account.

The respondent gives examples of "what happens if bills are not paid on time", including the following (Case on Appeal, at p. 688):

> Probability of the gas supply being cut off to severely overdue accounts. This will result in personal inconvenience, a service reconnection charge and a security deposit payment.

65 Strictly speaking, it is true that customers may delay their payment of the LPP beyond 38 days, but there is clearly no invitation to do so, and it would be disingenuous to conclude that customers actually perceive themselves to be at liberty to wait that long. Statistical evidence submitted by the appellant strongly supports the opposite conclusion. Approximately 81 percent of late payers pay the penalty within 10 days of incurring it, that is,

at an effective rate of interest far beyond the criminal limit. Consumers' Gas and the OEB have been aware of such statistics since at least 1988. See E.B.R.O. 452, at pp. 325-26. Indeed, the respondent tracks such statistics carefully for the purpose of budgeting revenue collected under the LPP as a component of its cash flow. In light of these facts, it cannot be said that payment of the LPP within 38 days is a "voluntary" act within the meaning of *Nelson* .

66 For the foregoing reasons, the LPP charged by Consumers' Gas comes within the scope of s. 347 of the *Criminal Code* .

B. Did the motions judge err in awarding costs against Garland in his personal capacity?

67 On September 13, 1995, Consumers' Gas moved for an order amending the formal judgment of the motions judge. Garland refused to consent to that motion. The motion was granted, and the judge assessed $500 in costs "payable to the defendant ... by the plaintiff personally, forthwith". Garland asserted that that award contravenes s. 59.4 of the *Law Society Act* , which was added by s. 3 of the *Law Society Amendment Act* (*Class Proceedings Funding*), *1992* , S.O. 1992, c. 7.

68 Section 59.4 provides:

> **59.4** — (1) A defendant to a proceeding may apply to the board for payment from the Class Proceedings Fund in respect of a cost award made in the proceeding in the defendant's favour against a plaintiff who has received financial support from the Class Proceedings Fund in respect of the proceeding.
>
> . . . . .
>
> (3) A defendant who has the right to apply for payment from the Class Proceedings Fund in respect of a costs award against a plaintiff may not recover any part of the award from the plaintiff.

The purpose of this provision is to protect class representatives from personal exposure to costs in actions where financial support has been granted by the Class Proceedings Fund. Such protection is important for promoting the purposes of the *Class Proceedings Act, 1992* . Garland has successfully applied for support from the Class Proceedings Fund. Accordingly, he should not be exposed to personal liability for any costs arising in this action, including costs incurred in the context of procedural motions. The award of personal costs against Garland is set aside.

VI. Conclusions and Disposition

69 The appeal is allowed with costs in the cause. (i) Section 347 of the *Criminal Code* applies to the LPP imposed by the respondent. The LPP is an interest charge within the meaning of s. 347(2), and the law's application is not precluded by the principles set forth in the *Nelson* decision. Summary judgment is set aside, and this action is remitted to the Ontario Court (General Division) for proceedings in accordance with the *Class Proceedings Act, 1992* . (ii) The award of costs in the amount of $500 against the appellant in his personal capacity is set aside.

Bastarache J. **(dissenting):**

70 The late payment policy of the Consumers Gas Company Limited provides that bills rendered to residential customers which are not paid on the due date will be subject to a penalty of five (5) percent of the unpaid

amount.

71 Between 1981 and 1989, the late payment penalty policy clause contained in Consumers' rate schedules for residential customers read:

> **Penalty for Late Payment:**
>
> When payment in full is not made within sixteen (16) days of the date of mailing, or the hand delivery of the bill, a penalty of five per cent (5%) of the current amount billed shall be levied. Where payment is made by mail, payment will be deemed to be made on the date postmarked.

72 Commencing in 1989, the provision for late payment penalties was contained in Consumers' Handbook of Rates and Distribution Services as follows:

> **Section F - Payment Conditions**
>
> Payment in full should be received by the Company, or by an institution authorized by the Company to accept payments on its behalf, on or before the due date specified in the monthly bill, which date is at least ten (10) days (sixteen (16) days in the case of Rates 1, 2, 6 and 9), after the date of rendering the bill. A penalty of five (5) percent of the unpaid portion of the current amount billed shall be added to the amount due if payment is not received as outlined above. When payment is mailed, the penalty will be added if the postmark on the envelope containing such payment is later than the specified due date.

73 It is the appellant's position that Consumers' Gas offers two payment options to its customers, the no-credit option and the credit option. By the appellant's reasoning, all customers who pay their bills on time adhere to the no-credit option. By contrast, customers who do not pay on time receive credit commencing on the due date and ending when the bill is paid. In my view, no such option exists. Customers have only one option, which is to pay on time. The only question remaining is then the characterization of the late payment policy.

74 Section 347(2) of the *Criminal Code* , R.S.C. 1985, c. C-46, defines "interest" in these terms:

> "interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

75 The definition of interest includes the notion of "penalty". However, the application of s. 347 is also predicated upon the existence of an "agreement or arrangement" for the advancement of credit. The term "agreement" is defined in the *Oxford English Dictionary* (2nd ed. 1989), as "an arrangement between two or more persons as to a course of action". The term "arrangement" is defined as a "settlement of mutual relations or claims between parties".

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

76 The application of s. 347 is then predicated upon a consensual extension of credit. There is a critical difference between, on the one hand, a unilateral taking of credit and, on the other hand, an extension of credit by mutual consent between the debtor and the creditor. As R. M. Goode, in his book *Consumer Credit Law* (1989), states, at p. 108:

> If a person takes credit without having been granted it — as where he is slow in paying his dentist's bill or his solicitor's account — there is no extension of credit within the Consumer Credit Act.... [I]f a person allows delay in settlement of a debt without binding himself to grant time to the debtor, there is no agreement for credit. This is so whether the delay in the demand for payment arises from inadvertence or inactivity — as where the supplier is simply dilatory in sending out his accounts — or is an intentional indulgence, as where the supplier agrees to allow further time to pay or to accept payment by instalments. Only where this deferment is not just an indulgence but contractual is there an agreement for credit....

77 On the facts of this case, there is no such consensual extension of credit. I believe that Consumers' Gas has not entered into an agreement or arrangement to give credit to the appellant or to any other customers who have paid the late payment penalty. Indeed, far from being a consensual extension of credit, the respondent's late payment penalty represents an effort to prevent or deter customers from unilaterally taking credit. It is simply a penalty exacted by the respondent because the appellant has not paid his bills on a timely basis. To illustrate my view, here is a statement from an American case: *Coffelt v. Arkansas Power & Light Co.* , 451 S.W.2d 881 (U.S. Ark. 1970), *per* Smith J., at p. 884:

> The late charge, far from being an exaction of excessive interest for the loan or forbearance of money, is in fact a device by which consumers are automatically classified to avoid discrimination. Its effect is to require delinquent ratepayers to bear, as nearly as can be determined, the exact collection costs that result from their tardiness in paying their bills. The appellant's argument actually means in substance not that the utility company be prevented from collecting excessive interest but that its customers who pay their bills promptly be penalized by sharing the burden of collecting costs not of their making.

See also *State ex rel. Utilities Commission v. North Carolina Consumers Council Inc.* , 198 S.E.2d 98 (U.S. N.C. Ct. App. 1973).

78 In the present case, there is no agreement whereby the customers of Consumers' Gas are permitted or even encouraged to pay late. Rather, customers are encouraged to pay on time by the imposition of a penalty to be added to payments which are overdue.

79 The decisions of the Ontario Energy Board approving the late payment penalty confirm that the penalty is not "paid or payable for the advancing of credit". Instead, the Ontario Energy Board considers it to be an incentive for timely payment. In fact, the Board specifically rejected the credit option in its decision on the rate application in these terms (E.B.R.O. 302-II, September 4, 1975, at pp. 118-19):

> ...the Board does not think that a monetary incentive for prompt payment is wrong in principle. Interest charged on over-due accounts on a daily basis has an appeal on theoretical grounds, but it gives little incentive to pay by a named date, gives little weight to collection costs and seems complicated. If interest is charged on a monthly basis, it is subject to the same criticism....

1998 CarswellOnt 4053, 231 N.R. 1, 40 O.R. (3d) 479 (headnote only), 165 D.L.R. (4th) 385, 129 C.C.C. (3d) 97, 114 O.A.C. 1, 20 C.R. (5th) 44, 49 M.P.L.R. (2d) 77, [1998] 3 S.C.R. 112, 1998 CarswellOnt 4054, 40 W.C.B. (2d) 49

80 While this is not determinative of the issue, it is one of several indicia to be considered in characterizing the late payment penalty. Winkler J., of the trial court, also considered the fact that the penalty is not compounded; the penalty is a one-time payment which does not increase over time; there is no sanction for the non-payment of the penalty; the penalty triggers contemporaneously with the account becoming overdue.

81 Because in this case there is no consensual extension of credit, it follows that the late payment penalty is not "paid or payable for the advancing of credit under an agreement or arrangement" within the definition of "interest". Section 347 of the *Criminal Code* is not applicable and therefore the action should be dismissed. I adopt Winkler J.'s conclusion on this issue, (1995), 22 O.R. (3d) 451 (Ont. Gen. Div.) , at p. 471:

> I accept the plaintiff's argument that a deferral of payment constitutes credit. However, I do not agree that just because a customer does not pay on time [this] means that there has been a deferral of payment or that credit has been advanced, particularly where the company has done what it could to encourage the customer to pay on time. A distinction must be drawn between the situation in which a customer fails to pay within a stipulated time, because of inadvertence, choice or because he does not have the money, and the situation in which an agreement is entered into whereby the lender of money or issuer of goods agrees to delay its demand for payment, in exchange for the consideration of an additional charge. In my view, s. 347 is applicable only to the latter situation. The facts before me reveal the former situation.

82 Section 347 of the *Criminal Code* cannot be interpreted as a complete code for consumers. The protection of consumers against such penalty clauses cannot be done by way of an undue extension of these terms. Other options, such as to invalidate abusive penalty clauses, are available to protect consumers. I do not believe that a contract for the extension of credit should be implied in every case where there is late payment pursuant to a sale of goods. This implication, in my view, is an interference with the freedom to contract. I would also note that in the present case, we are dealing with a regulated industry and that a rate approval scheme has been established with the specific purpose of protecting consumer interests. To limit the choice of means of the regulator by resorting to the criminal law power is inappropriate and unwarranted.

83 For the above reasons, I would dismiss the appeal.

Appeal allowed.

Pourvoi accueilli.

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TAB 11

1998 CarswellBC 2246, 231 N.R. 122, 165 D.L.R. (4th) 417, 113 B.C.A.C. 1, 184 W.A.C. 1, 129 C.C.C. (3d) 129, 20 C.R. (5th) 77, 20 R.P.R. (3d) 165, 5 C.B.R. (4th) 1, [1998] 3 S.C.R. 90, 58 B.C.L.R. (3d) 1, [1999] 5 W.W.R. 797, 1998 CarswellBC 2247

1998 CarswellBC 2246, 231 N.R. 122, 165 D.L.R. (4th) 417, 113 B.C.A.C. 1, 184 W.A.C. 1, 129 C.C.C. (3d) 129, 20 C.R. (5th) 77, 20 R.P.R. (3d) 165, 5 C.B.R. (4th) 1, [1998] 3 S.C.R. 90, 58 B.C.L.R. (3d) 1, [1999] 5 W.W.R. 797, 1998 CarswellBC 2247

Degelder Construction Co. v. Dancorp Developments Ltd.

Dancorp Developments Ltd., Appellant v. Metropolitan Trust Company of Canada and Dunwoody Limited, Respondents and Degelder Construction Co. Ltd., Respondent and Seaboard Life Insurance Company, Respondent and Mike Degelder and William Little, Defendants by Counterclaim and Metropolitan Trust Company of Canada, Owen Bird, Seaboard Life Insurance Company, Co-operators Life Insurance Company, Confederation Life Insurance Company and Dunwoody Limited, Respondents

Supreme Court of Canada

L'Heureux-Dubé, Cory, McLachlin, Iacobucci, Major, Bastarache, Binnie JJ.

Heard: March 23, 1998
Judgment: October 30, 1998
Docket: 25355

Proceedings: affirming (1996), 21 B.C.L.R. (3d) 112 (C.A.); reversing in part (1996), 16 B.L.R. (2d) 188 (B.C.S.C.); additional reasons at (May 3, 1995), Doc. New Westminster A910895 (B.C.S.C.)

Counsel: *Gary A. Nelson*, for the appellant.

William C. Kaplan and *Francis L. Lamer*, for the respondent Metropolitan Trust Company of Canada.

Robert Sewell, for the respondents Seaboard Life Insurance Company, Co-operators Life Insurance Company and Confederation Life Insurance Company.

Subject: Insolvency; Criminal; Property; Corporate and Commercial

Criminal law --- Offences against rights of property — Criminal interest rate — Miscellaneous issues

Developer received mortgage loan from trust company — Loan agreement required payment of substantial fees and bonuses — Term of loan was 11 months but developer took over three years to repay loan — Developer brought action claiming that trust company received criminal rate of interest — Claim was dismissed and dismissal affirmed by court of appeal — Developer's appeal to Supreme Court of Canada dismissed — Relevant time frame for calculating interest rate under s. 347(1)(b) of Criminal Code is period over which credit is actually repaid — Interest payments made by developer, calculated over a period of three years, did not constitute

interest at criminal rate — Criminal Code, R.S.C. 1985, c. C-46, s. 347(1)(b).

Droit criminel --- Infractions contre les droits de propriété — Taux d'intérêt criminel — Sujets divers

Promoteur a obtenu un prêt hypothécaire d'une société de fiducie — Convention de prêt prévoyait le paiement de frais et de primes considérables — Durée du prêt était de 11 mois, mais le remboursement s'est étalé sur trois ans — Promoteur a intenté une action pour contester le prêt, soutenant que la compagnie de fiducie lui avait imposé un taux d'intérêt criminel — Action a été rejetée et le jugement de première instance a été confirmé en appel — Pourvoi du promoteur à la Cour suprême du Canada a été rejeté — Date pertinente pour calculer le taux d'intérêt était la date à laquelle le remboursement avait réellement été complété — Intérêts payés par le promoteur, calculés sur une période de trois ans, n'équivalaient pas à un taux d'intérêt criminel — Code criminel, L.R.C. 1985, c. C-46, art. 347(1)b).

A developer received a mortgage loan for a trust company to finance the completion of a construction project. The loan agreement required the developer to pay substantial fees and bonuses in addition to a conventional interest rate. The fees and bonuses were deducted from the loan advances and were deemed to have been advanced to the developer before being deducted. The term of the loan agreement was for 11 months, but the developer did not repay the loan for over three years. The developer subsequently brought an action claiming that the trust company had received payments of interest at a criminal rate of 75 per cent per annum, contrary to s. 347(1)(b) of the *Criminal Code*. The developer's claim was dismissed. The trial judge held that the appropriate repayment date to be used for calculating the interest rate of the loan was the date on which repayment was actually completed. Receipt of the interest did not occur until the date on which repayment was actually completed. Interest calculated on that basis was not criminal. The developer appealed the decision to the Court of Appeal and the dismissal of the claim was affirmed. The court confirmed that the appropriate time frame to be used to calculate the interest rate was the period during which credit was outstanding. The developer brought an appeal to the Supreme Court of Canada, arguing that the interest rate should have been calculated using the term of repayment set out in the loan agreement.

Held: The appeal was dismissed.

An interest rate is a "criminal rate" of interest under s. 347 of the *Code* if it exceeds 60 per cent per annum. Section 347(1)(a) of the *Code* makes it illegal to enter into an agreement or arrangement to receive interest at a criminal rate and s. 347(1)(b) of the *Code* makes it illegal to receive a payment or partial payment of interest at a criminal rate. The developer based its claim exclusively on the offence created by s. 347(1)(b) of the *Code*. Interest under s. 347 of the *Code* is defined broadly to include any fees, commissions or penalties incurred by a borrower for the advancing of credit. As a result, the term of the loan was key to determining the rate of interest received by the trust company in the circumstances.

The basic purpose of s. 347 of the *Code* is to prohibit the imposition of usurious interest rates without regard to the form of the transaction. If the rate of interest is calculated under both ss. 347(1)(a) and 347(1)(b) of the *Code* by reference to the contractual term of the loan, it would render s. 347(1)(b) of the *Code* virtually meaningless. It would also invite lenders to manipulate loan transactions to escape the reach of s. 347 of the *Code* entirely, thus defeating the basic purpose of the section.

Section 347(1)(a) of the *Code* should be narrowly construed. The offence is complete upon the formation of an agreement and provable by its terms. Section 347(1)(a) of the *Code* is only violated if the agreement on its face imposes an annual rate of interest above 60 per cent. If the agreement permits the payment of interest at a crim-

inal rate but does not require it, there is no violation of s. 347(1)(a) of the *Code*. Section 347(1)(b) of the *Code* functions to catch those situations where the agreement did not require criminal interest to be paid, but a criminal rate of interest was in fact received by the lender. A payment of interest therefore may be illegal under s. 347(1)(b) of the *Code* even if the loan agreement itself does not violate s. 347(1)(a) of the *Code*. Section 347(1)(b) of the *Code* must be construed broadly enough to account for interest payments that are actually received by the lender at a criminal rate. Whether an interest payment violates s. 347(1)(b) of the *Code* is determined as of the time the payment is received. The relevant time frame for calculating the interest rate is the period over which credit is actually repaid. The interest payments made by the developer, calculated over a period of three years, did not constitute interest at a criminal rate.

Un promoteur immobilier a obtenu un prêt hypothécaire auprès d'une société de fiducie afin de compléter un projet de construction. La convention de prêt prévoyait le paiement de frais et de primes considérables en plus de l'intérêt de base à un taux normal. Les frais et les primes ont été déduits des avances de fonds et ils étaient réputés avancés au promoteur avant même d'être déduits. La durée du prêt était de 11 mois, mais le remboursement s'est étalé sur trois ans. Le promoteur a intenté une action pour contester le prêt, prétendant que la société de fiducie avait perçu des intérêts criminels, soit un taux de 75 pour cent par année, en contravention de l'art. 347(1)b) du *Code criminel*. L'action du promoteur a été rejetée. Le juge du procès a conclu que la date servant au calcul du taux d'intérêt était la date du remboursement complet. La perception de l'intérêt a eu lieu seulement à la date du remboursement complet. L'intérêt calculé sur cette période n'était pas criminel. Le promoteur a formé un pourvoi à la Cour d'appel, mais cette dernière a confirmé le jugement de première instance. La Cour d'appel a confirmé que la date pertinente pour calculer le taux d'intérêt était la date à laquelle le remboursement avait réellement été complété. Le promoteur a formé un pourvoi à la Cour suprême du Canada, soutenant que l'intérêt aurait dû être calculé en fonction du terme fixé dans la convention de prêt.

Arrêt: Le pourvoi a été rejeté.

Un taux d'intérêt constitue un taux « criminel » au sens de l'art. 347 du Code s'il excède 60 pour cent par année. L'article 347(1)a) du Code prévoit qu'il est illégal de conclure une convention ou une entente pour percevoir des intérêts à un taux criminel, alors que l'art. 347(1)b) prévoit qu'il est illégal de percevoir, même partiellement, des intérêts à un taux criminel. Le promoteur a fondé son action exclusivement sur l'infraction prévue à l'art. 347(1)b). L'intérêt selon l'art. 347 est défini de manière très large et comprend: les frais de tout genre, les agios, commissions, pénalités et indemnités. De ce fait, la date de remboursement était la question déterminante pour calculer le taux d'intérêt perçu par la société de fiducie.

L'objet de l'art. 347 du Code est d'interdire l'imposition de taux d'intérêt usuraires sans rapport avec la nature de la transaction. Si le taux d'intérêt était calculé aux fins des art. 347(1)a) et 347(1)b) en fonction du terme fixé dans la convention, ces deux articles s'en trouveraient vidés de leur sens. Cela inciterait les prêteurs à jouer sur les transactions afin d'échapper à l'application de l'art. 347 du Code, éliminant du coup l'objet même de cette disposition. L'article 347(1)a) devrait être interprété restrictivement. L'infraction est commise au moment de la formation de la convention de prêt, et se prouve par ses stipulations.

L'article 347 est violé seulement si la convention comporte à sa face même un taux d'intérêt de 60 pour cent par an. Si la convention prévoit l'imposition d'un intérêt à un taux criminel, mais ne le requiert pas, il n'y a pas de violation à l'art. 347(1)a) du Code. L'article 347(1)b) vise les situations où la convention ne prévoyait pas un intérêt à un taux criminel, mais où un intérêt criminel a effectivement été perçu par le prêteur. Un paiement d'intérêt peut donc être illégal selon l'art. 347(1)b), et ce, même si la convention en soi ne viole pas l'art.

347(1)a). L'article 347(1)b) doit être interprété de façon suffisamment large pour englober des paiements d'intérêt qui sont réellement perçus par le prêteur à un taux criminel. La date pertinente pour calculer le taux d'intérêt est la date à laquelle le remboursement a été complété. Les paiements d'intérêt faits par le promoteur, calculés sur une période de trois, ne constituaient pas de l'intérêt à un taux criminel.

Cases considered by/Jurisprudence citée par *Major J.*:

Aectra Refining & Marketing Inc. v. Lincoln Capital Funding Corp. (1991), 6 O.R. (3d) 146, 85 D.L.R. (4th) 595, 4 B.L.R. (2d) 45 (Ont. Gen. Div.) — applied

Garland v. Consumers' Gas Co. (October 30, 1998), Doc. 25644 (S.C.C.) — applied

Nelson v. C.T.C. Mortgage Corp. (1984), [1985] 2 W.W.R. 560, 59 B.C.L.R. 221, 16 D.L.R. (4th) 139, 67 N.R. 162 (B.C. C.A.) — considered

Nelson v. C.T.C. Mortgage Corp., [1986] 4 W.W.R. 481, [1986] 1 S.C.R. 749, 67 N.R. 161, 29 D.L.R. (4th) 159, 32 B.C.L.R. (2d) xxx (note) (S.C.C.) — considered

R. v. Duzan (1993), 79 C.C.C. (3d) 552, 105 Sask. R. 295, 32 W.A.C. 295 (Sask. C.A.) — applied

William E. Thomson Associates Inc. v. Carpenter (1989), 61 D.L.R. (4th) 1, 44 B.L.R. 125, 34 O.A.C. 365, 69 O.R. (2d) 545 (Ont. C.A.) — applied

Statutes considered/Législation citée:

Criminal Code/Code criminel, R.S.C./L.R.C. 1970, c. C-34

s. 305.1 [en. 1980-81-82-83, c. 43, s. 9] — referred to

Criminal Code/Code criminel, R.S.C./L.R.C. 1985, c. C-46

s. 347 — considered

s. 347(1)(a) — considered

s. 347(1)(b) — considered

s. 347(2) "capital prêté" — considered

s. 347(2) "credit advanced" — considered

s. 347(2) "criminal rate" — considered

s. 347(2) "intérêt" — considered

s. 347(2) "interest" — considered

s. 347(2) "taux criminel" — considered

s. 347(3) — considered

1998 CarswellBC 2246, 231 N.R. 122, 165 D.L.R. (4th) 417, 113 B.C.A.C. 1, 184 W.A.C. 1, 129 C.C.C. (3d) 129, 20 C.R. (5th) 77, 20 R.P.R. (3d) 165, 5 C.B.R. (4th) 1, [1998] 3 S.C.R. 90, 58 B.C.L.R. (3d) 1, [1999] 5 W.W.R. 797, 1998 CarswellBC 2247

s. 347(4) — considered

Rules considered/Règles citées:

Rules of Court, 1990, B.C. Reg. 221/90

R. 18A — referred to

APPEAL by developer from judgment reported at (1996), 21 B.C.L.R. (3d) 112, 73 B.C.A.C. 45, 120 W.A.C. 45 (B.C. C.A.), affirming judgment reported at (1994), 16 B.L.R. (2d) 188 (B.C. S.C. [In Chambers]), dismissing developer's claim.

POURVOI d'un promoteur à l'encontre d'un jugement publié à (1996), 21 B.C.L.R. (3d) 112, 73 B.C.A.C. 45, 120 W.A.C. 45 (B.C. C.A.), confirmant un jugement publié à (1994), 16 B.L.R. (2d) 188 (B.C. S.C. [In Chambers]), rejetant l'action du promoteur.

The judgment of the court was delivered by *Major J.*:

1 This appeal accompanies *Garland v. Consumers' Gas Co.* (October 30, 1998), Doc. 25644 (S.C.C.), and raises the interpretation of the "Criminal Interest Rate" provision in s. 347 of the *Criminal Code*, R.S.C. 1985, c. C-46.

2 The appellant obtained a mortgage loan from the respondent Metropolitan Trust Company of Canada ("Metropolitan") to finance the completion of a construction project. The loan agreement required the appellant to pay substantial fees and bonuses in addition to a conventional interest rate. The term of the agreement was for eleven months, but the loan was not in fact repaid for more than three years.

3 The appellant subsequently challenged the validity of the loan, claiming the respondent had received payments of interest at a criminal rate, contrary to s. 347(1)(*b*) of the *Code*. The issue is whether the effective annual rate of interest arising from the payments should be calculated on the basis of the contractual term of the loan, or the period during which credit was actually outstanding.

I. Factual Background

4 The appellant, Dancorp Developments Ltd. ("Dancorp"), owned and developed a condominium project in Coquitlam, British Columbia. The project was initially financed by a mortgage obtained from Metropolitan for $16,689,000. On the date of that agreement, May 1, 1989, virtually all of the condominium units had been presold to offshore buyers. The presale contracts stipulated that construction would be completed, and title transferred to the purchasers, by December 31, 1990.

5 Construction began in mid-1989 to be finished by October 20, 1990. During the summer of 1989, a design defect was discovered which required the partially completed project to be demolished and rebuilt. This setback increased construction costs and forced Dancorp to seek additional financing. Metropolitan initially refused to provide the extra money, particularly in light of the increased risk that the project would not be completed by the deadline contained in the presale agreements. Dancorp did not obtain alternative financing from other sources.

6 On January 10, 1990, following lengthy negotiations, Metropolitan agreed to provide the additional funds to Dancorp to cover remedial costs and the completion of the project. The agreement between the parties con-

tained the following terms:

(1) Metropolitan agreed to advance up to $2.5 million to Dancorp. Dancorp was entitled to draw down all, some or none of those funds, according to its needs.

(2) The $2.5 million loan was secured by a second mortgage with a face value of $3.25 million. The difference between the two amounts represented a 30 percent bonus to Metropolitan, to be deducted from the gross amount of each loan advance. That is, for every dollar of principal drawn down by Dancorp, $1.30 of debt would be incurred against the mortgage.

(3) An additional bonus of 5 percent was payable on any principal advanced in excess of $1.55 million, again to be deducted from gross advances.

(4) Interest on all principal advanced was to be calculated at the Bank of Nova Scotia prime rate plus 2 percent per annum, compounded and payable monthly in arrears on the first day of each month.

(5) Dancorp agreed to pay a one-time "placement and processing fee" of $77,500.

(6) Dancorp agreed to pay the fees of Metropolitan's solicitors relating to the mortgage.

(7) The mortgage was repayable in full on December 31, 1990.

7 Between January 17 and December 10, 1990, Dancorp received loan advances more or less on a monthly basis. Metropolitan deducted interest, bonuses and legal fees from each gross advance. Under the terms of the loan agreement, those amounts were deemed to have been advanced to Dancorp before being deducted, and were included in Dancorp's debt under the mortgage. Dancorp did not, however, make any direct payments to Metropolitan during this period.

8 On December 27, 1990, for reasons which are not relevant to this appeal, a receiver was appointed by Metropolitan to take over the project, and construction was completed under the receiver's control. Proceeds from the sale of the condominium units were used to pay the debt which had accrued under the second mortgage loan. The first of those payments was received by Metropolitan on April 10, 1992, and the loan was fully repaid on January 29, 1993, more than two years after the contractual maturity date.

9 Dancorp subsequently challenged the validity of the second mortgage loan, alleging that the amounts which Metropolitan had deducted from the loan advances were illegal interest payments under s. 347(1)(*b*) of the *Criminal Code*. In support of that contention, Dancorp filed a certificate stating the annual rate of interest, by Ian Karp, a Fellow of the Canadian Institute of Actuaries. Mr. Karp took into account the actual amounts drawn down, and based his calculations on the contractual term of the loan --i.e., he assumed a hypothetical repayment of the entire debt on December 31, 1990, as contemplated in the loan agreement. Based on that assumption, he concluded that the bonuses, fees and interest received under the second mortgage loan produced an effective rate of interest exceeding 75 percent per annum. The respondent submitted evidence establishing that when interest was calculated over the period during which credit was actually outstanding, the effective rate fell below 20 percent per annum. For the purposes of this appeal, those figures are presumed to be accurate.

10 Dancorp's claim under s. 347 of the *Code* was dismissed following a summary trial. The British Columbia Court of Appeal dismissed Dancorp's appeal.

1998 CarswellBC 2246, 231 N.R. 122, 165 D.L.R. (4th) 417, 113 B.C.A.C. 1, 184 W.A.C. 1, 129 C.C.C. (3d) 129, 20 C.R. (5th) 77, 20 R.P.R. (3d) 165, 5 C.B.R. (4th) 1, [1998] 3 S.C.R. 90, 58 B.C.L.R. (3d) 1, [1999] 5 W.W.R. 797, 1998 CarswellBC 2247

II. Relevant Statutory Provisions

11 *Criminal Code*, R.S.C. 1985, c. C-46

Criminal Interest Rate

347.(1) Notwithstanding any Act of Parliament, every one who

(a) enters into an agreement or arrangement to receive interest at a criminal rate, or

(b) receives a payment or partial payment of interest at a criminal rate,

is guilty of

(c) an indictable offence and is liable to imprisonment for a term not exceeding five years, or

(d) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.

(2) In this section,

"credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;

"criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;

. . . . .

"interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

. . . . .

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

(4) In any proceedings under this section, a certificate of a Fellow of the Canadian Institute of Actuaries stating that he has calculated the effective annual rate of interest on any credit advanced under an agreement

> or arrangement and setting out the calculations and the information on which they are based is, in the absence of evidence to the contrary, proof of the effective annual rate without proof of the signature or official character of the person appearing to have signed the certificate.

III. Judicial History

A. British Columbia Supreme Court (1994), 16 B.L.R. (2d) 188 (B.C. S.C. [In Chambers])

12 A summary trial was held before Preston J. in accordance with R. 18A of the British Columbia Supreme Court Rules. In the context of those proceedings, Dancorp raised the claim that Metropolitan had violated s. 347(1)(*b*) of the *Criminal Code* by receiving payments of interest at a criminal rate under the second mortgage loan. The crucial question before the trial judge was whether, for the purposes of s. 347(1)(*b*), the appropriate repayment date to be used for calculating the interest rate of the loan was the payment date contemplated in the agreement (December 31, 1990) or the date on which repayment was actually completed (January 29, 1993).

13 Preston J. considered *Nelson v. C.T.C. Mortgage Corp.* (1984), 16 D.L.R. (4th) 139 (B.C. C.A.), aff'd [1986] 1 S.C.R. 749 (S.C.C.), a case in which a debtor had exercised a prepayment option on a mortgage, thereby shortening the actual term of the loan and increasing the effective annual interest rate. The court in *Nelson* found that the rate of interest should be calculated over the contractual term of the mortgage, not the period during which credit was actually outstanding. In addition, he noted that the criminal rate of interest in that case resulted from the unilateral act of the debtor in paying out the mortgage before it was due.

14 Preston J. held that ss. 347(1)(*a*) and (*b*) created two separate offences, one of entering into an agreement to receive interest at a criminal rate, and the other of actually receiving interest at that rate. He found that the first offence is complete upon the entering into the agreement and is provable by the terms of the agreement itself. The *actus reus* of the second offence, by contrast, is the actual receipt of payment or partial payment of interest at a criminal rate. The trial judge noted that no claim for breach of subs. (1)(*a*) had been advanced by Dancorp, and that it was unclear in any event whether the mortgage violated that provision, since the amounts to be drawn down were not defined in advance. With regard to subs. (1)(*b*), the trial judge found that "receipt" of interest did not occur until January 29, 1993. He stated at p. 210:

> [Counsel for Metropolitan] contends that receipt by Metropolitan of interest payments is shown by the accounting entries which credit Metropolitan with interest payments as the funds are advanced to Dancorp. That cannot be so. Receipt of a payment or partial payment of interest in subs. (*b*) must be given its normal meaning, that is: a payment of interest by Dancorp to Metropolitan.

and concluded that in the circumstances of this case, the period to be used for calculating the interest rate under s. 347(1)(*b*) was the period during which credit was actually outstanding. Calculated on that basis, he held that Metropolitan had not received interest at a criminal rate. Dancorp's claim under s. 347 was dismissed.

B. British Columbia Court of Appeal (1996), 21 B.C.L.R. (3d) 112 (B.C. C.A.)

15 The British Columbia Court of Appeal dismissed the appeal. Newbury J.A., writing for the court, assumed without deciding that the amounts deducted by Metropolitan from the loan advances were interest payments within the meaning of s. 347(1)(*b*). She then considered what period of time should be used to calculate the interest rate at which those payments were received, and concluded that the appropriate time frame was the period during which credit was outstanding. She agreed with the trial judge that Metropolitan had not received

interest at a criminal rate.

IV. Issue

16 (1) For the purposes of s. 347(1)(*b*) of the *Criminal Code*, should the calculation of the effective annual rate of interest arising from a loan be based on the contractual term of the loan or the period during which credit was actually outstanding?

V. Analysis

17 A general discussion of s. 347 of the *Criminal Code* is included in *Garland*, *supra*, which was released with this decision. Section 347 provides that an interest rate exceeding 60 percent per annum is a "criminal rate" of interest. The statute defines two offences with regard to such interest: s. 347(1)(*a*) makes it illegal to *enter into an agreement or arrangement* to receive interest at a criminal rate, while s. 347(1)(*b*) makes it illegal to *receive a payment or partial payment* of interest at a criminal rate. The claim in this appeal relates exclusively to the latter offence. The issue is whether the Court of Appeal erred in finding that a "criminal rate of interest" for the purposes of subs. (1)(*b*) should be calculated by reference to the period over which credit was actually repaid, as opposed to the contractual term of the loan.

18 The importance of the period of repayment results in part from the broad definition of "interest" contained in s. 347. As discussed in *Garland*, that definition includes not only common-law interest -- i.e., a price for money which accrues day by day -- but also fixed payments, such as fees, commissions and penalties, which may be incurred by a borrower for the advancing of credit. The effective annual interest rate which arises from such payments is intrinsically related to the period of time during which credit is actually extended. A fee or commission paid over a short term will yield a much higher rate of interest than the same amount paid over a longer period. The same holds true for an annual interest rate arising from a bonus or flat percentage charge.

19 For the purposes of s. 347(1)(*a*), the appropriate time period for calculating an interest rate is the term of repayment set forth in the loan agreement. If that period produces a criminal rate of interest, then the entire agreement is illegal on its face under subs. (1)(*a*).

20 Ascribing an interest rate to a "payment or partial payment of interest" under subs. (1)(*b*), however, is more complicated. In some cases, the period over which a loan will actually be repaid is not clearly defined in advance, for instance where the agreement grants a right of prepayment or acceleration, or where the period of repayment simply differs in fact from what was contemplated by the parties. In either case, the period during which credit is actually extended -- and therefore the rate at which an interest payment is actually received -- may vary from the rate which appears on the face of the agreement, particularly where, as here, the transaction involves substantial fees, commissions, penalties, or flat percentage charges such as bonuses. The question is whether liability under subs. (1)(*b*) should reflect that variation in rates, or whether, as a matter of law, a "criminal rate" of interest under subs. (1)(*b*) should be grounded in the same contractual terms which govern liability under subs. (1)(*a*).

A. The Nelson Decision

21 The interpretation of s. 347 was addressed by the British Columbia Court of Appeal in *Nelson*, *supra*. The Nelsons were guarantors of a commercial mortgage under which a number of fixed fees were payable in addition to a conventional interest rate. The mortgage was due after six months, subject to the borrower's right to

prepay the entire loan at any time prior to maturity. Taken together, the fees and interest would have produced an effective interest rate of 52.5 percent per annum had the mortgage been repaid at the end of its full six-month term. In fact, however, the borrower exercised its prepayment option early in the life of the agreement, and the resulting shorter term gave rise to an effective interest rate of 84.1 percent per annum.

The Nelsons and the borrower subsequently sued the lender, alleging that the mortgage exacted a criminal rate of interest contrary to s. 305.1 (now s. 347) of the *Criminal Code*.

22 The issue in *Nelson*, as in the present appeal, was whether the "effective annual rate of interest" arising from a mortgage should be based on the contractual repayment date of the loan or the actual repayment date. The Court of Appeal dismissed the appeal but were divided on the question. The majority, *per* Seaton J.A., held that the appropriate time frame was the full term of the loan as set forth in the agreement. In reaching that result, the majority placed special emphasis on the fact that the actual period of repayment in *Nelson* was within the control of the borrower. Seaton J.A. stated at p. 143:

> (1) Any other interpretation would lead to an absurd result. For example, in a mortgage containing a prepayment option in favour of the mortgagor, if the mortgage were paid off at an early date, the amount of the legal fees alone, would in many cases exceed 60%. Parliament could not have intended that a mortgagee in such circumstances would be guilty of an indictable offence.
>
> (2) It seems more consonant with reason that the interest rate (including all the items spelled out in the definition of interest) should be calculated over the term of the mortgage. In other words, the interest rate should be determined by the terms of the document and not by the act of the borrower in paying off the mortgage.

The majority held that in the context of a prepayment by the debtor, the calculation of an interest rate should be the same under subss. (1)(*a*) or (1)(*b*) of the statute. Seaton J.A. wrote at pp. 144-45:

> (4) The construction proposed by the appellants that the "effective annual rate of interest" be calculated over the period of time that the mortgage is outstanding would mean that the meaning of "criminal rate" in [s. 347(1)(*a*)] would be different from the meaning of "criminal rate" in [s. 347(1)(*b*)]. The "agreement or arrangement" in [s. 347(1)(*a*)] was to receive interest at a legal rate (interest over the term of the mortgage). If, however, the mortgage was prepaid prior to the end of the term, as here, the respondent would be receiving a "payment of interest at a criminal rate". Parliament cannot have intended that the words "criminal rate" have two different meanings within the same section or that an innocent mortgagee who has entered into a perfectly lawful agreement should as the result of the voluntary act of the mortgagor in prepaying the mortgage become guilty of an offence under [s. 347(1)(*b*)].
>
> The purpose of [s. 347] was to make unlawful agreements or arrangements which *require* the borrower to pay interest at a "criminal" rate. The mortgage here does not *require* payment of interest at an unlawful rate. The exercise of an option by a borrower does not, therefore, fall within [s. 347(1)(*a*) or (*b*)].
>
> Section [347(1)(*b*)] was intended to catch those persons receiving "interest at a criminal rate" where the agreement *required* the borrower to pay "interest at a criminal rate" and thus the words "criminal rate" have the same meaning in both paragraphs. [Emphasis in original.]

The majority recognized that the same conclusion might not follow in the case of a mortgage payable "on de-

mand or at the instance of the mortgagee on the happening of a stated condition", rather than at the debtor's option.

23 In dissent, Hutcheon J.A. emphasized the distinction between subss. (1)(*a*) and (1)(*b*) of s. 347. In his view, subs. (1)(*a*) prohibits entering into an agreement which, on its face, requires the payment of illegal interest. He agreed that such a situation was not before them. However, he parted company with the majority with respect to the purpose and operation of subs. (1)(*b*). He stated at p. 150:

> [W]hen the right of prepayment is exercised by payment, as it was in this case, or a demand for payment is made, I think that [s. 347(1)(*b*)] is applicable. The question is: did the mortgagee receive a payment of interest at a criminal rate? That question is to be answered by an analysis of what has been received in fact and a calculation based upon the period that has elapsed since the money was advanced.

Hutcheon J.A. concluded that the lender had violated subs. (1)(*b*) by receiving interest at a rate exceeding 60 percent.

B. Revisiting Nelson: A Framework for Interpreting Section 347

24 The reasons of the majority in *Nelson* were affirmed in substance by this Court. In the appellant's submission, *Nelson* stands for the principle that a "criminal rate" of interest under s. 347 must always be calculated by reference to the contractual term of the loan. Accordingly, it submits that *Nelson* is dispositive of this appeal. The appellant's interpretation is overly broad. The holding of *Nelson* was that a transaction which was legal when entered into cannot become illegal under s. 347 *through a voluntary act of the debtor*. That conclusion was affirmed by this Court. *Nelson* does not exclude the possibility of a criminal interest rate arising during the course of a loan at the initiative of the lender or for other reasons. Indeed, the majority in *Nelson* expressly recognized such a possibility in the context of a demand mortgage.

25 The *Nelson* decision is not a comprehensive framework for interpreting s. 347. In particular, it did not consider those credit agreements which, though legal in form, may become usurious in practice. A complete understanding of s. 347 must address the operation of the law as a whole, and in particular should recognize the different purposes served by subss. (1)(*a*) and (1)(*b*). As noted in *Garland* at para. 54:

> The relationship between these two provisions has been the subject of much comment in the courts below and in academic writings. In particular, controversy exists about whether an agreement which does not expressly require the payment of criminal interest at the time it is entered into may nevertheless give rise to an actual payment of interest at an illegal rate. Such cases can arise if an additional charge is incurred while credit is outstanding, or if the actual period for repayment is shortened by the occurrence of a determining event or an act by one of the parties.

26 The appellant contends that subs. (1)(*b*) prohibits the receipt of interest if the loan agreement, on its face, *requires* such interest to be paid at a criminal rate. In its view, subss. (1)(*a*) and (1)(*b*) define two parts of a single offence, namely, creating an illegal agreement and then collecting its fruits. The appellant maintains that the "criminal rate" of interest underlying those two acts must be calculated in the same way under subss. (1)(*a*) and (1)(*b*) -- i.e., by reference to the contractual term of the loan. The appellant's approach would have the advantage of promoting clarity and consistency in the application of s. 347. A legal credit transaction would remain legal regardless of subsequent events, thus permitting lenders to predict and avoid criminal liability with confidence. At the same time, a transaction which violates subs. (1)(*a*) would remain illegal throughout its dura-

tion, and the receipt of any interest under it would immediately trigger liability under subs. (1)(*b*) as well. The appellant submits that it would be anomalous to have to await the full repayment of a loan before an interest payment could be identified as illegal under subs. (1)(*b*).

27 The flaw in such an approach is that it would render subs. (1)(*b*) virtually meaningless, as it would be impossible for a lender to violate that provision without first having violated subs. (1)(*a*). In effect, the act of entering into an illegal credit agreement would be the *sine qua non* of both crimes. In such circumstances, lenders would inevitably be encouraged to draft credit agreements with open or ambiguous terms, so as to accelerate repayment or trigger the bulk of interest charges during the course of the loan. Unless such transactions could somehow be brought within the scope of subs. (1)(*a*), they would escape the reach of s. 347 entirely. Such a result would defeat the basic purpose of the statute, which is to prohibit the imposition of usurious interest rates without regard to the form of the transaction. See *Garland, supra*, at para. 28; *William E. Thomson Associates Inc. v. Carpenter* (1989), 69 O.R. (2d) 545 (Ont. C.A.), at pp. 548-49. For that reason, the appellant's interpretation fails.

28 The respondent submits that subss. (1)(*a*) and (1)(*b*) are separate and independent provisions: the first targets transactions that are inherently illegal, and the second catches transactions that are illegal in their operation. In the respondent's submission, subs. (1)(*b*) may be violated even if the "criminal rate" at which an interest payment is received is not ascertainable as such on the face of the loan agreement. This interpretation was adopted by the trial judge, who held (at pp. 209-10):

> [Section] 347(1) creates two offences:
>
> 1. The offence of entering into an agreement or arrangement to receive interest at a criminal rate. The actus reus of this offence is the entering into the agreement or arrangement....
>
> 2. The receipt of a payment or partial payment of interest at a criminal rate. The actus reus of this offence is receiving the payment or partial payment.

This approach provides a coherent framework for the interpretation of s. 347. For the purposes of subs. (1)(*a*), the relevant question is: "what rate of interest does the agreement *require*?" For subs. (1)(*b*), the question is: "at what rate of interest has a payment actually been received?" As the respondent contends, a payment of interest may be illegal under subs. (1)(*b*) even if the loan agreement under which it is made did not itself violate subs. (1)(*a*) at the time it was entered into.

29 It follows from the foregoing that s. 347(1)(*a*) should be narrowly construed. That offence is complete upon the formation of an agreement or arrangement for credit, and provable by its terms. As Borins J., then of the Ontario Court (General Division), observed in *Aectra Refining & Marketing Inc. v. Lincoln Capital Funding Corp.* (1991), 6 O.R. (3d) 146 (Ont. Gen. Div.), at p. 150:

> ...the critical time at which a lender commits an offence contrary to s. 347(1)(*a*) ... is when the lender "enters into an agreement ... to receive interest". It is at that time that the court must determine whether the rate of "interest", which is very broadly defined in s. 347(2), provided for by the agreement constitutes the "criminal rate" which is also defined in s. 347(2).

Subsection (1)(*a*) is violated if a credit agreement expressly imposes an annual rate of interest above 60 percent, or if the agreement requires payment of interest charges over a period which necessarily gives rise to an annual

rate exceeding the legal limit. See, e.g., *R. v. Duzan* (1993), 79 C.C.C. (3d) 552 (Sask. C.A.). However, if there is merely a *possibility* that the rate of interest could become illegal under the agreement, subs. (1)(*a*) is not violated. That case can arise where the period of repayment is subject to change, or where a substantial interest charge is payable on demand or upon the occurrence of a named event. On the face of the agreement, there is no *requirement* of criminal interest in such cases; the effective annual rate of interest remains speculative until the actual amount of interest and the actual period of repayment are known.

30 It is the function of subs. (1)(*b*) to catch violations of s. 347 in those circumstances. The provision must be construed broadly enough to account for interest payments that are actually received by the lender at a criminal rate. The relevant time frame for calculating the interest rate at this stage in the analysis is the period over which credit is actually repaid. As Newbury J.A. stated for the Court of Appeal at p. 133:

> On balance ... I am persuaded that since the essence of [subs. (1)(*b*)] is the receipt of interest -- a matter of *fact* -- it would not be sensible to employ, in calculating the interest rate under that subparagraph, a period that was *not in fact* the period during which the credit was outstanding. No authority has been cited for a "hybrid" construction of the provision that would combine the factual aspect of receipt with the hypothetical aspect of the repayment date stated in the loan documents. [Emphasis in original.]

It is true that in some cases, this interpretation will require a wait-and-see approach to determining the lender's liability. The appellant contended that such a result would be inconsistent with basic principles of criminal law. I disagree. A lender who enters into an agreement to receive interest under ambiguous terms bears the risk that the agreement, in its operation, may in fact give rise to a violation of s. 347. The principle in *Nelson* protects the lender from incurring such liability in circumstances that are beyond its control. As previously noted, to tailor subs. (1)(*b*) to the form, rather than the substance, of a credit transaction could invite manipulation by lenders and would defeat the basic purpose of s. 347.

31 Subsections 347(1)(*a*) and (1)(*b*) create separate but complementary offences. The provisions are not mutually exclusive. An agreement which is illegal under subs. (1)(*a*) may in many cases also give rise to liability under subs. (1)(*b*). This will always be the case where the interest rate does not depend on the actual term of the loan. The receipt of any "payment" or "partial payment" of interest in such cases would immediately constitute a violation of subs. (1)(*b*).

32 Where a time factor is present, it is not possible to calculate a "criminal rate" of interest under subs. (1)(*b*) until the lender has been fully repaid and the actual term of the loan has then been defined. In those cases, subss. (1)(*a*) and (1)(*b*) operate independently. A loan which violates subs. (1)(*a*) will also violate subs. (1)(*b*) if payments are received as contemplated in the agreement; if the actual period of repayment is sufficiently prolonged, however, the transaction -- though still illegal under subs. (1)(*a*) -- will not give rise to additional liability under subs. (1)(*b*).

33 If a loan agreement permits but does not require the payment of illegal interest, there is no breach of subs. (1)(*a*), and the analysis shifts to whether a payment of illegal interest was in fact received by the lender. Liability under subs. (1)(*b*) may arise during the course of the loan, so long as it does not result from the voluntary act of the borrower. By the same token, the lender may be released from liability entirely in cases where a charge has been paid over such a long period of time that the resulting interest rate does not exceed the criminal limit.

C. Summary of Applicable Principles

34 For the foregoing reasons, s. 347 should be interpreted according to the following general principles:

(1) Section 347(1)(*a*) should be narrowly construed. Whether an agreement or arrangement for credit violates s. 347(1)(*a*) is determined as of the time the transaction is entered into. If the agreement or arrangement permits the payment of interest at a criminal rate but does not require it, there is no violation of s. 347(1)(*a*), although s. 347(1)(*b*) might be engaged.

(2) Section 347(1)(*b*) should be broadly construed. Whether an interest payment violates s. 347(1)(*b*) is determined as of the time the payment is received. For the purposes of s. 347(1)(*b*), the effective annual rate of interest arising from a payment is calculated over the period during which credit is actually outstanding.

(3) There is no violation of s. 347(1)(*b*) where a payment of interest at a criminal rate arises from a voluntary act of the debtor, that is, an act wholly within the control of the debtor and not compelled by the lender or by the occurrence of a determining event set out in the agreement.

D. Application to the Case at Bar

35 As noted, s. 347(1)(*a*) was not raised in this appeal, and there is no need to assess whether the mortgage, on its face, would have violated that provision. Dancorp's claim is that Metropolitan violated s. 347(1)(*b*) by actually receiving payments of interest at a criminal rate under the second mortgage loan. Assuming, as the Court of Appeal did, that the amounts deducted by Metropolitan from its loan advances to Dancorp were in fact "payments of interest" within the meaning of subs. (1)(*b*), it is common ground that the interest rate arising from them would exceed the criminal limit only if calculated over the contractual term of the loan, and not when based on the actual period of repayment. The appropriate time frame for calculating the rate of interest under subs. (1)(*b*) is the period during which credit is actually outstanding. Calculated over that period -- i.e., more than three years -- the interest payments received by Metropolitan from Dancorp do not constitute interest at a criminal rate.

36 The "voluntariness" principle enunciated in *Nelson* has no application in this appeal. It is true that, as in *Nelson*, the effective annual rate of interest here was changed by the voluntary act of the borrower. However, that is where the similarity ends. The rationale of *Nelson* was that a lender who has entered into a lawful agreement should not, as the result of the voluntary act of the debtor, be guilty of a criminal offence. That danger is not present in this case. On the contrary, the effect of the debtor's voluntary act here was to *release* the lender from liability where an illegal rate of interest might otherwise have arisen under subs. (1)(*b*). Any attempt to apply the *Nelson*rule in this case would require turning that rule on its head.

37 For these reasons, we agree with the decision of the British Columbia Court of Appeal and the appeal is dismissed with costs.

Appeal dismissed.

Pourvoi accueilli.

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TAB 12

2004 CarswellOnt 512, 2004 SCC 7, 40 B.L.R. (3d) 18, 316 N.R. 84, 235 D.L.R. (4th) 385, [2004] 1 S.C.R. 249, 183 O.A.C. 342, 18 C.R. (6th) 1, 17 R.P.R. (4th) 1, 70 O.R. (3d) 255 (note), REJB 2004-53611, J.E. 2004-446

2004 CarswellOnt 512, 2004 SCC 7, 40 B.L.R. (3d) 18, 316 N.R. 84, 235 D.L.R. (4th) 385, [2004] 1 S.C.R. 249, 183 O.A.C. 342, 18 C.R. (6th) 1, 17 R.P.R. (4th) 1, 70 O.R. (3d) 255 (note), REJB 2004-53611, J.E. 2004-446

Transport North American Express Inc. v. New Solutions Financial Corp.

New Solutions Financial Corporation (Appellant) and Transport North American Express Inc. (Respondent)

Supreme Court of Canada

Iacobucci, Major, Bastarache, Arbour, LeBel, Deschamps, Fish JJ.

Heard: October 16, 2003
Judgment: February 12, 2004[FN*]
Docket: 29355

Proceedings: reversing (2002), 27 B.L.R. (3d) 163 (Ont. C.A.); reversing in part (2001), 16 B.L.R. (3d) 148 (Ont. S.C.J.)

Counsel: Peter J. Cavanagh, Eric N. Hoffstein for Appellant

Robert G. Ackerman for Respondent

Subject: Criminal; Property; Corporate and Commercial; Contracts

Criminal law --- Offences — Criminal interest rate — General

Notional severance is available as remedy in cases arising under s. 347 of Criminal Code — Judges are permitted to exercise remedial discretion to enforce in part a contract contravening s. 347 by reading down interest rate provisions to avoid what would otherwise be illegality.

Creditors and debtors --- Interest — Usury — Excessive rate of interest — General

Notional severance is available as remedy in cases arising under s. 347 of Criminal Code — Judges are permitted to exercise remedial discretion to enforce in part a contract contravening s. 347 by reading down interest rate provisions to avoid what would otherwise be illegality.

Contracts --- Illegal contracts (substantive validity) — Severability of illegal provisions

Notional severance is available as remedy in cases arising under s. 347 of Criminal Code — Judges are permitted to exercise remedial discretion to enforce in part a contract contravening s. 347 by reading down, rather than striking out in their entirety, interest rate provisions to avoid what would otherwise be illegality.

Droit criminel --- Infractions — Taux d'intérêt criminel — En général

Divisibilité fictive peut être utilisée comme réparation dans les litiges découlant de l'art. 347 du Code criminel — Juges peuvent exercer leur pouvoir discrétionnaire de réparation et donner partiellement effet à un contrat contraire à l'art. 347 en réduisant le taux d'intérêt prévu par les clauses relatives au taux d'intérêt afin d'éliminer l'illégalité dont serait autrement entaché le contrat.

Créanciers et débiteurs --- Intérêt — Usuraire — Taux d'intérêt excessif — En général

Divisibilité fictive peut être utilisée comme réparation dans les litiges découlant de l'art. 347 du Code criminel — Juges peuvent exercer leur pouvoir discrétionnaire de réparation et donner partiellement effet à un contrat contraire à l'art. 347 en réduisant le taux d'intérêt prévu par les clauses relatives au taux d'intérêt afin d'éliminer l'illégalité dont serait autrement entaché le contrat.

Contrats --- Contrats illégaux (validité au fond) — Divisibilité des dispositions illégales

Divisibilité fictive peut être utilisée comme réparation dans les litiges découlant de l'art. 347 du Code criminel — Juges peuvent exercer leur pouvoir discrétionnaire de réparation et donner partiellement effet à un contrat contraire à l'art. 347 non pas en retranchant les clauses relatives aux taux d'intérêt mais en réduisant le taux d'intérêt prévu par celles-ci, afin d'éliminer l'illégalité dont serait autrement entaché le contrat.

A debtor and creditor entered into a loan agreement for a $500,000 financing. The agreement provided for interest at the rate of four per cent per month calculated daily and payable monthly in arrears. The agreement also provided for a "royalty payment" of $160,000 to be paid in eight quarterly installments; a monitoring fee of $750 per month; a commitment fee of $5,000; and other legal and administrative fees payable at the time of the advance.

The parties were under the mistaken impression that the effective annual interest rate under the agreement was 48 per cent. In fact, the effective annual interest rate worked out to 60.1 per cent. In addition, the other payments, though not described as interest, amounted to an effective annual interest rate of 30.8 per cent. In effect, the cumulative effective interest rate was 90.9 per cent per annum.

The debtor brought an application for a declaration that the loan agreement contained a rate of interest in excess of 60 per cent in contravention of s. 347 of the Criminal Code.

The debtor's application was granted. Rather than severing the provisions of the agreement dealing with interest, the application judge reduced the effective annual interest rate to 60 per cent on the basis that all other payments under the agreement were enforceable. Had the application judge severed the interest provisions of the agreement, leaving only the royalties and other fees, the effective annual rate of interest would have been 30.8 per cent.

The debtor appealed. The appeal was allowed in part. The majority of the Court of Appeal found that the application judge erred in notionally severing or reading down the terms of the loan agreement to bring the effective rate of interest to 60 per cent per annum. The majority of the Court of Appeal held that the appropriate remedy was to strike out or "blue pencil" the portion of the agreement calling for the payment of interest at the rate of four per cent per month calculated daily, payable monthly in arrears, leaving the balance of the agreement to be enforced in accordance with its terms.

The creditor appealed.

Held: The appeal was allowed.

Per Arbour J. (Iacobucci, Major and LeBel JJ. concurring): Notional severance is available as a remedy in cases arising under s. 347 of the Code. The application of notional severance was appropriate in this case because the agreement only inadvertently violated s. 347; the parties were experienced in commercial matters and had negotiated at arm's length; there was no evidence that the parties did not have equal bargaining power; and the parties had the benefit of independent legal advice. The creditor should be repaid the principal together with the highest amount of interest legally allowable, being 60 per cent. This notional severance did not rewrite the contract any more than enforcing only the other payments, which amounted to "interest" at 30.8 per cent.

All forms of severance alter the terms of the original agreement, and when a court employs the "blue pencil" test, it is making a new agreement for the parties. The preferred severance technique is the one that, in light of the particular contractual context, most appropriately cures the illegality while remaining otherwise as close as possible to the intentions of the parties expressed in the agreement. The appropriate approach is to vest the greatest possible amount of remedial discretion in judges of courts of first instance. The spectrum of available remedies runs from a court holding contracts in violation of s. 347 to be void ab initio, in the most egregious and abusive cases, to notional severance. In determining where along the spectrum a particular contract lies, the following factors should be considered: whether the purpose or policy of s. 347 would be subverted by severance, whether the parties entered into the agreement for an illegal purpose or with an evil intention, the relative bargaining position of the parties and their conduct in reaching the agreement, and the potential for the debtor to enjoy an unjustified windfall.

Per Bastarache J. (dissenting): There is a fundamental difference between striking out offending sections of a contract and rewriting a central provision of a contract. Although both approaches interfere in some way with the intent of the parties, the added flexibility of the rewriting approach comes at a considerable cost and is not supported by any principle of contract law. The notional severance or rewriting approach is inconsistent with the general objectives expressed in the Criminal Code and is incompatible with the notion of deterrence. To permit a notional severance of the kind ordered by the application judge is to effect a substantial innovation in the common law doctrine of severance to the benefit of those who prima facie stand in violation of the criminal law. The finding that there was no criminal intent in this case should not obscure the analysis. Knowledge is not a requirement under s. 347 of the Code.

Per Fish J. (Deschamps J. concurring) (dissenting): The application judge erred in substituting for the criminal rate of interest charged by the creditor the highest rate that the creditor could otherwise have charged. The effect of the application judge's decision was to stretch the principles of equity in an inappropriate way and to send the wrong message to those who lend money at a criminal rate to "willing" borrowers. Those who do so should not be encouraged to believe that if their illegal arrangement is subjected to judicial scrutiny they will nonetheless recover the highest rate they could legally have charged and thus suffer no pecuniary disadvantage for having violated s. 347 of the Code. Assuming notional severance is available as a remedy in cases arising under s. 347 of the Code, it should be permitted only where it does no violence to public policy interests, where it is found to be warranted as a matter of equity and where "blue pencil" severance is impracticable or would bring about an unjust result. In this case, simple "blue pencil" severance was both possible and fair and did not do violence to the policy purposes of s. 347 of the Code or require a judicial rewriting of the agreement of the parties. The application judge's conclusion that the creditor did not intend to breach s. 347 of the Code should not be misunderstood.

An intent to breach that section is not an essential element of the offence. It was neither artificial nor arbitrary to sever the criminal rate of interest and to leave intact those distinct and separate payments not considered to be interest by the parties. Had there been only an effective interest rate of 60.1 per cent, and not a cumulative effective rate of 90.9 per cent, it might have been desirable not to sever the interest clause entirely. However, that was not the case here.

Un débiteur et un créancier ont conclu une entente de prêt pour un financement de 500 000 $. L'entente prévoyait des intérêts de 4 pour cent par mois, calculés quotidiennement et payables mensuellement à l'échéance. Elle prévoyait également le paiement de « redevances » de 160 000 $, payables en huit versements trimestriels, des frais de surveillance de 750 $ par mois, une commission d'engagement de 5 000 $ et d'autres frais administratifs et légaux payables au moment du prêt.

Les parties croyaient à tort que le taux d'intérêt annuel effectif prévu par l'entente était de 48 pour cent. En fait, le taux d'intérêt annuel effectif équivalait à 60,1 pour cent par année. De plus, même s'ils n'étaient pas décrits comme des intérêts, les autres paiements étaient équivalents à un taux d'intérêt annuel effectif de 30,8 pour cent. Dans les faits, le taux d'intérêt effectif s'élevait à 90,9 pour cent par année.

Le débiteur a présenté une demande afin qu'il soit déclaré que le contrat de prêt prévoyait un taux d'intérêt supérieur à 60 pour cent, contrevenant ainsi à l'art. 347 du Code criminel.

La demande du débiteur a été accordée. Au lieu de diviser les dispositions de l'entente portant sur l'intérêt, le juge saisi de la demande a réduit à 60 pour cent le taux d'intérêt annuel effectif au motif que tous les autres paiements prévus par l'entente étaient valides. Si le juge avait divisé les dispositions de l'entente prévoyant l'intérêt, conservant seulement les redevances et les frais, le taux d'intérêt annuel effectif aurait été de 30,8 pour cent.

Le débiteur a interjeté appel. Le pourvoi a été accueilli en partie. La majorité de la Cour d'appel a conclu que le juge saisi de la demande avait commis une erreur en divisant fictivement ou en interprétant de façon restrictive les termes du contrat de prêt afin de réduire à 60 pour cent par année le taux d'intérêt effectif. Selon elle, la réparation appropriée était de retrancher ou de « rayer au trait de crayon bleu » la clause du contrat qui exigeait le paiement d'intérêts mensuels de 4 pour cent, calculés quotidiennement et payables mensuellement à l'échéance, tout en permettant l'exécution du reste de la convention conformément aux modalités qui y étaient stipulées.

Le créancier a interjeté appel.

Arrêt: Le pourvoi a été accueilli.

Arbour, J. (Iacobucci, Major et LeBel, JJ., souscrivant à l'opinion d'Arbour, J.): La divisibilité fictive peut être utilisée comme réparation dans les litiges découlant de l'art. 347 du Code. En l'espèce, la décision d'appliquer la divisibilité fictive à la convention était appropriée, étant donné que: c'était par inadvertance que la convention contrevenait à l'art. 347; les parties avaient de l'expérience des affaires et avaient négocié sans lien de dépendance; aucune preuve n'indiquait qu'elles n'avaient pas négocié d'égale à égale; chacune avait consulté son propre conseiller juridique. Le créancier devait se voir rembourser le montant du prêt ainsi que le taux d'intérêt légal le plus élevé, soit 60 pour cent. La divisibilité fictive ne réécrivait pas plus le contrat que ne le faisait la décision d'obliger seulement le paiement des autres frais, équivalant à des intérêts de 30,8 pour cent.

Toutes les formes de divisibilité modifient les termes du contrat initial et, lorsque le tribunal utilise la méthode

du trait de crayon bleu, il crée une nouvelle entente entre les parties. La technique de division préférable est celle qui, en fonction du contexte contractuel particulier, permet de mieux remédier à l'illégalité tout en demeurant le plus fidèle aux intentions des parties qui sont exprimées dans l'entente. La meilleure approche est de conférer aux tribunaux de première instance un pouvoir discrétionnaire de réparation le plus large possible. L'éventail des réparations possibles va de la décision du tribunal de déclarer nuls ab initio les contrats contrevenant à l'art. 347, dans les cas les plus graves et les plus abusifs, à la divisibilité fictive. Pour déterminer où se situe un contrat en particulier dans ce spectre, il faux examiner les facteurs suivants: la question de savoir si l'application de la divisibilité compromettait l'objectif ou la politique générale visé par l'art. 347; la question de savoir si les parties ont conclu la convention dans un but illégal ou dans une intention malveillante; le pouvoir de négociation relatif des parties et leur conduite au cours des négociations; la possibilité que le débiteur tire un profit injustifié de la solution choisie.

Bastarache, J. (dissident): Il existe une différence fondamentale entre le fait de retrancher des clauses illégales d'un contrat et celui de reformuler une clause cruciale d'un contrat. Même si les deux approches modifient d'une certaine manière l'intention des parties, la souplesse accrue que permet la reformulation s'accompagne toutefois d'un coût considérable et n'est étayée par aucun principe du droit des contrats. La divisibilité fictive, ou reformulation, est incompatible avec les objectifs généraux exprimés dans le Code criminel et avec la notion de dissuasion. Autoriser la sorte de divisibilité fictive ordonnée par le juge saisi de la demande revient à apporter à la doctrine de la divisibilité prévue par la common law une innovation substantielle en faveur de personnes qui, à première vue, contreviennent au droit criminel. La conclusion selon laquelle il y avait absence d'intention criminelle ne doit pas influencer l'analyse. L'article 347 n'exige pas que l'infraction ait été commise sciemment.

Fish, J., dissident (Deschamps, J., souscrivant à l'opinion de Fish, J.): Le juge saisi de la demande a commis une erreur en remplaçant le taux d'intérêt criminel demandé par le créancier au débiteur par le taux le plus élevé que le créancier aurait par ailleurs pu exiger. La décision du juge du procès a eu pour effet de forcer indûment les principes d'equity et d'envoyer un message inapproprié à ceux qui prêtent de l'argent, à un taux interdit par le droit criminel, à des emprunteurs « consentants ». Il ne faudrait pas laisser croire aux prêteurs que, même si leurs arrangements illégaux sont contrôlés par les tribunaux, ils pourront néanmoins obtenir le taux le plus élevé qu'ils auraient pu légalement imposer et éviter, en conséquence, tout désavantage financier susceptible de découler de leur contravention à l'art. 347 du Code criminel. Même en présumant que l'on pouvait utiliser la divisibilité fictive à titre de réparation dans les litiges découlant de l'art. 347 du Code, l'utilisation de celle-ci ne devrait être permise que lorsqu'elle ne fait pas violence à des considérations d'ordre public, qu'elle est justifiée par les principes d'equity et que la divisibilité au moyen du trait du crayon bleu est irréalisable ou produit un résultat injuste. En l'espèce, la divisibilité au moyen du trait de crayon bleu est une solution à la fois possible et juste; elle ne fait pas violence aux objectifs d'intérêt général visés par l'art. 347 du Code ni ne requiert du tribunal qu'il réécrive l'entente entre les parties. Il ne fallait pas mal interpréter la conclusion du juge selon laquelle le créancier n'avait pas eu l'intention d'enfreindre les dispositions de l'art. 347. L'intention d'enfreindre cette disposition ne constitue pas un élément essentiel de l'infraction. Il n'apparaissait ni artificiel ni arbitraire de retrancher le taux d'intérêt criminel et de maintenir les frais distincts non considérés comme de l'intérêt par les parties. Si on avait été en présence d'un taux d'intérêt effectif de 60,1 pour 100, et non d'un taux d'intérêt effectif cumulatif de 90,9 pour 100, il aurait pu être souhaitable de ne pas retrancher en entier la clause relative à l'intérêt. Mais tel n'était pas le cas en l'espèce.

Annotation

The essential dispute between the three decisions in this case is the amount of trust the Supreme Court judges are willing to place in the decisions of trial judges. The majority create the flexible remedy of "notional severance". They do so on the basis that the greater flexibility inherent in allowing trial judges to read in terms to a private contract, rather than simply strike down provisions, can result in fairer results in many cases. That proposition is certainly true. Bastarache J., on the other hand, argues that if notional severance is available there will be greater uncertainty in the law, because illegal provisions will be open to judicial redrafting. Even if the concept is restricted to s. 347 of the *Criminal Code*, and not applied elsewhere as Bastarache J. fears, the proposition that there will be greater uncertainty is equally true. "Greater remedial flexibility" and "greater uncertainty" are (like "judicial independence" and "judicial activism") simply two ways of describing the same situation. Fish J.'s judgment fits in the middle, attempting to structure any discretion that is given to trial judges: he argues that it should be a specific requirement that notional severance only be available where blue pencil severance is impractical or unjust.

The trend in many areas of the law has recently been to provide greater flexibility rather than strict rules: one need only think of the principled exception to the hearsay rule, for example. The majority here are quite conscious of the trust they are placing, noting specifically at para. 39 that "there is little danger that abuses of this remedial flexibility would surreptitiously creep past trial judges". It is often difficult to anticipate, however, all the potential applications of a rule that counsel can persuade a judge are appropriate in individual cases. It will be interesting to see whether in a few years the Court feels the need to revisit the issue, imposing structure similar to that Fish J. suggests here.

Steve Coughlan[FN*]

The *New Solutions* decision is a landmark decision of the Supreme Court of Canada addressing the calculation of interest for the purposes of the usury provisions embodied in Section 347 of the *Criminal Code*, R.S.C. 1985, c. C-46. The decision so radically transforms the methodology of the courts in Section 347 cases that to do the case justice would require significantly more time and pages than this annotation affords. These annotators are not shying away from the task of a thorough consideration of *New Solutions*. In fact, such a piece is currently in the making. Alas, failings on the part of the elder annotator of this case means that such works-in-progress sometimes have a shelf life as works-in-progress that are perhaps more enduring than publishers appreciate. Since this decision is simply too important to leave un-annotated in the *Real Property Reports* pending publication of a more detailed analysis, this annotation will serve merely to alert readers of *Real Property Reports* to the near-paradigm-shift in this area of the law, and to provide some random preliminary observations on the case.

The relevant facts in the *New Solutions* case are relatively simple. A lender charged a borrower a rate of interest, together with an assortment of fixed fees, the aggregation of which resulted in an effective annual interest rate on the loan in excess of the 60% per annum criminal usury threshold prescribed by Section 347 of the *Interest Act*, R.S.C. 1985, c. I-15. At trial, Mr. Justice Cullity of the Superior Court of Ontario (*Transport North American Express Inc. v. New Solutions Financial Corp.*, 2001 CarswellOnt 1758, 200 D.L.R. (4th) 560, 54 O.R. (3d) 144, 16 B.L.R. (3d) 148 (Ont. S.C.J.), applied a concept of "notional severance", in effect reducing the rate of interest from just above the 60% threshold to just below the 60% threshold, without reference to specific subcategories of interest that could or could not be independently declared severable.

This approach contrasted markedly from the "blue pencil" approach adopted by the Ontario Court of Appeal (*Transport North American Express Inc. v. New Solutions Financial Corp.*, 2002 CarswellOnt 1935, 6 R.P.R. (4th) 1, 214 D.L.R. (4th) 44, 160 O.A.C. 381, 60 O.R. (3d) 97, 27 B.L.R. (3d) 163 (Ont. C.A.). The blue pencil

approach, being the traditional and accepted Canadian approach to the severability of provisions in what would otherwise be illegal contracts, requires the court to identify and separate illegal provisions from the balance of the contract and enforcing the balance of the contract to the extent still reasonably possible under the circumstances. As applied to the various components to of the interest formula in *New Solutions*, the Ontario Court of Appeal, in overturning the Ontario Superior Court's decision, struck out some of the block fees while enforcing the remaining components of interest for a resulting effective annual interest rate on the loan equal to approximately 31% per annum.

On appeal, the Supreme Court of Canada reversed the Ontario Court of Appeal's blue pencil approach and vindicated Mr. Justice Cullity's proposed notional severance approach.

The decision of the Supreme Court, delivered by Madam Justice Arbour (with Iacobucci, Major, and Lebel JJ concurring), gives rise to certain random observations, presented here in no particular order of significance:

1 Legal historians will no doubt note that *New Solutions* is among the very last decisions of Madam Justice Arbour and Mr. Justice Iacobucci, both of whom will be retiring from the bench shortly after this decision is published in the *Real Property Reports*.

2. The decision invites a distinction between the true "loan sharking" (the evil sought to be addressed by Section 347), on the one hand, and less egregious technical breaches of the statute that might fairly be characterized as "ordinary" commercial conduct, on the other hand. The Court describes the former as conduct entered into with the intent of an "illegal purpose" or with "evil intent", and concludes that notional severance should be available only in cases of the latter.

3. As a direct consequence of such a distinction, the court also admonishes against the possibility (inherent in a blue pencil approach) of a "windfall" for the borrower, where the blue pencil mark-up yields an unusually low effective annual interest (an ironic policy concern given that the borrower is the supposed victim in cases of usury!).

4. The Court also introduces the suggestion that relatively bargaining power may be relevant to the entitlement to notional severance relief. The Supreme Court's insistence on disparate bargaining power as a precondition for notional severance is surprising. One might have thought that disparate bargaining power was merely a indicia of the loan sharking arm of Section 347 and would not itself be a precondition to notional severance.

5. There were vigorous and well-written dissents by both Mr. Justice Fish and Mr. Justice Bastarache. Mr. Justice Fish warns (quite rightly it is submitted) that the adoption of a notional severance paradigm leads to potential moral hazard. If lenders are now confident that the consequence of usurious interest rates is merely the inability to enforce the collection of that usurious interest (if and whenever challenged), then there will be nothing to deter lenders from exceeding the 60% per annum maximum interest in the first place. In contrast, a blue pencil approach can result in significant reductions in the interest actually collectable by the lender (on the same *New Solutions* facts, the legal recovery under the blue pencil approach was almost half of what would have been realized through the application of the notional severance formula), and the very potential for non-marginal loss would constitute an incentive not to exceed the usury limits in the first place.

6. Mr. Justice Bastarache dissents from the majority distinction between loan sharking and ordinary high-interest commercial lending. He notes that there is nothing in Section 347 that calls for an assessment of "illegal purpose" or "evil intent" before assessing culpability, and suggests that the Court ought not read-in such a require-

ment for the purposes of assessing the enforceability of the otherwise illegal contract.

7. It should be noted that the Supreme Court was only assessing whether public policy should allow an otherwise illegal contract to be enforced. The criteria introduced by the Supreme Court in making this determination is relevant only to this civil analysis of contract law, and cannot be interpreted as an amendment of the constituent elements of the actual crime itself. That is, Section 347 of the *Criminal Code* presumably does not, as a result of the Supreme Court majority reasons in *New Solutions*, now enjoy a "no illegal purpose/no evil intent" or a "relative bargaining position" defence.

8. It is curious to see that none of the three courts that considered the case adopted an ultra hard-line, zero-tolerance, all-or-nothing approach to technical usury. That is, none of the courts sought to make all of the interest under the loan unenforceable or, worse, make the whole of the loan unenforceable.

9. Extrapolating the Supreme Court's holding in *New Solutions* to other areas of commercial law can, depending on one's perspective, be most liberating or invite a second coming of Pandora's Box. Arguably, notional severance, especially coupled with the normative assessment of the relative evil of the parties, is nothing more than unbridled purposive interpretation. Applied judiciously, it can prevent holdings that are legally absurd, but technically compliant. Applied otherwise, notional severance (like all "purposive" approaches to statutory construction) can lead, in worse case scenarios, to an erosion of legal stability and increased commercial transaction costs.

10. The Supreme Court's decision in *New Solutions* is conceptually consistent with the Court's recent decision in National Trust Co. v. H & R Block Canada Inc., 2003 CarswellOnt 4443, 2003 CarswellOnt 4444, 14 R.P.R. (4th) 1, [2003] S.C.J. No. 70, 2003 SCC 66, 44 C.B.R. (4th) 249, 38 B.L.R. (3d) 1, 232 D.L.R. (4th) 193, 312 N.R. 91, 180 O.A.C. 1 (S.C.C.) . In that case, the Ontario Court of Appeal had applied the Ontario *Bulk Sales Act*, R.S.O. 1990, c. B.14, literally, effectively imposing penal sanctions on the parties for having conducted a sale in bulk without compliance with the terms of the *Bulk Sales Act* (even though, ironically, strict compliance would not have ultimately made any difference to the "victims" of the illegal bulk sale since all of the sale proceeds would have been paid to the same secured lender either way). The Supreme Court overturned the Ontario Court of Appeal in that case as well, imposing a commercially reasonable solution by a very purposive construction of the legislation.

11. For excellent but unpublished commentaries on the Superior Court and Court of Appeal treatments of *New Solutions*, see Paul Perell's articles, "Criminal Rate of Interest" (The Six Minute Real Estate Lawyer, The Law Society of Upper Canada, 5 December 2001) and "Interesting Developments About Interest" (The Six Minute Real Estate Lawyer, The Law Society of Upper Canada, 27 November 2002), and A. Paul Mahaffy's article, "Getting All, Nothing, or Something in Between: A Look at Criminal Rates of Interest, Loan Recovery and the *Transport North* decision" (January 2003) 13 Ontario Bar Association, *Business Beat*.

Jeffrey W. Lem

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William E. Thomson Associates Inc. v. Carpenter (1989), 61 D.L.R. (4th) 1, 44 B.L.R. 125, 34 O.A.C. 365, 69 O.R. (2d) 545, 1989 CarswellOnt 128 (Ont. C.A.) — considered

Statutes considered by *Arbour J.*:

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s. 305.1 [en. 1980-81-82-83, c. 43, s. 9] — referred to

Criminal Code, R.S.C. 1985, c. C-46

Generally — referred to

s. 347(1)(a) — referred to

s. 347(2) "credit advanced" — considered

s. 347(2) "criminal rate" — considered

s. 347(2) "interest" — considered

s. 347(3) — considered

s. 347(7) — considered

Statutes considered by *Bastarache J.*:

Criminal Code, R.S.C. 1985, c. C-46

Generally — referred to

s. 347 — considered

Statutes considered by *Fish J.*:

Criminal Code, R.S.C. 1985, c. C-46

Generally — referred to

s. 347 — referred to

s. 347(1) — considered

s. 347(2) "criminal rate" — considered

s. 347(2) "interest" — referred to

APPEAL by creditor from judgment reported at 2002 CarswellOnt 1935, 214 D.L.R. (4th) 44, 160 O.A.C. 381, 60 O.R. (3d) 97, 27 B.L.R. (3d) 163, 6 R.P.R. (4th) 1 (Ont. C.A.) allowing in part debtor's appeal from judgment granting application for declaration that loan agreement contained criminal rate of interest.

POURVOI du créancier à l'encontre de l'arrêt publié à 2002 CarswellOnt 1935, 214 D.L.R. (4th) 44, 160 O.A.C. 381, 60 O.R. (3d) 97, 27 B.L.R. (3d) 163, 6 R.P.R. (4th) 1 (Ont. C.A.), qui a accueilli en partie le pourvoi du débiteur à l'encontre du jugement qui avait accueilli la demande visant à obtenir une déclaration que le contrat de prêt prévoyait un taux d'intérêt criminel.

***Arbour J.*:**

I. Overview

1 In March of 2000, the appellant, New Solutions Financial Corp. ("New Solutions"), and the respondent, Transport North American Express Inc. ("TNAE") entered into a credit agreement pursuant to which New Solutions advanced TNAE the sum of $500,000. In addition to various other fees and charges, the agreement provided for interest to be paid at the rate of four percent per month, calculated daily and payable monthly in arrears. By all accounts, the various payments called for by the agreement constituted a "criminal rate" of interest as defined in s. 347 of the *Criminal Code*, R.S.C. 1985, c. C-46 (hereinafter the "*Code*"). The payments soon became too onerous for TNAE to meet, and the company applied to the Ontario Superior Court of Justice for a declaration that the agreement contained an illegally high rate of interest and should not be enforced.

2 The application judge, Cullity J., ruled that he was not confined to the so-called "blue-pencil" approach to severance in dealing with the statutory illegality of the contract, whereby only discrete illegal promises could be excised. Using "notional severance", he read down the offending interest rate so the contract provided for the maximum legal rate of interest: (2001), 54 O.R. (3d) 144 (Ont. S.C.J.).

3 Upon appeal to the Court of Appeal for Ontario, Rosenberg J.A., for the majority, concluded that the doctrine of severance only permits the striking of distinct promises from a contract. He reversed the application judge's finding that notional severance was an available remedial instrument. Rosenberg J.A. found that it was appropriate to strike out or blue-pencil the provision calling for interest at four percent per month, calculated daily and payable monthly in arrears, leaving the balance of the agreement to be enforced in accordance with its

terms. Sharpe J.A., agreeing with the reasons of Cullity J., dissented: (2002), 60 O.R. (3d) 97 (Ont. C.A.).

4 There is broad consensus that the traditional rule that contracts in violation of statutory enactments are void *ab initio* is not the approach courts should necessarily take in cases of statutory illegality involving s. 347 of the *Code*. Instead, judicial discretion should be employed in cases in which s. 347 has been violated in order to provide remedies that are tailored to the contractual context involved. The primary issue in this appeal by New Solutions is whether notional severance, as formulated and applied by Cullity J., is valid in Canadian law and applicable here.

5 Given the desirability of remedial flexibility in cases of statutory illegality arising in connection with s. 347 of the *Code*, the evolving nature of the law regarding statutory illegality generally and the sound policy basis in which the concept is rooted, I find that notional severance is available as a matter of law as a remedy in cases arising under s. 347.

6 A spectrum of remedies is available to judges in dealing with contracts that violate s. 347 of the *Code*. The remedial discretion this spectrum affords is necessary to cope with the various contexts in which s. 347 illegality can arise. At one end of the spectrum are contracts so objectionable that their illegality will taint the entire contract. For example, exploitive loan-sharking arrangements and contracts that have a criminal object should be declared void *ab initio*. At the other end of the spectrum are contracts that, although they do contravene a statutory enactment, are otherwise unobjectionable. Contracts of this nature will often attract the application of the doctrine of severance. The agreement in this case is an example of such a contract. In each case, the determination of where along the spectrum a given case lies, and the remedial consequences flowing therefrom, will hinge on a careful consideration of the specific contractual context and the illegality involved.

7 The application judge in this case found that (i) the agreement between New Solutions and TNAE only inadvertently violated s. 347; (ii) the parties were experienced in commercial matters and negotiated at arm's length; (iii) there was no evidence that they did not have equal bargaining power; and (iv) they each had the benefit of independent legal advice in the course of the negotiations leading to the agreement. Consequently, the application of notional severance to the agreement between New Solutions and TNAE in this case by Cullity J. was appropriate. I would allow the appeal.

II. Facts

8 For the relevant time period, TNAE was in the business of expedited freight trucking. Ken and Karen Dragosits were shareholders in TNAE and actively involved in the operation of its business. Prior to the end of 1999, other shareholders held a 50 percent interest in TNAE. A corporation connected to these other shareholders provided TNAE the funds needed for the firm's working capital. A demand was made by this other corporation for the repayment of the funds owed to it by TNAE. The Dragosits and TNAE decided to search out a source for the means to repay the indebtedness.

9 The Dragosits sought financing from BDO Capital, now the appellant, New Solutions, to enable TNAE to repay its indebtedness and for the other shareholders in TNAE to be bought out. The parties eventually entered into an agreement that contained a high rate of interest and also significant other fees and charges. The costly nature of the loan for TNAE no doubt reflected the high risk New Solutions was taking on in making the funds available.

10 Before arriving at their agreement, New Solutions expressed interest in acquiring a 30 percent equity in-

terest in TNAE in conjunction with the contemplated credit facility. The Dragosits resisted this as they wished to be the sole shareholders of TNAE. In lieu of surrendering an equity interest, they agreed that New Solutions would receive a "royalty payment" of $160,000, payable in eight quarterly installments, to reflect the approximate value of a 30 percent equity interest in TNAE.

11 In the negotiations leading up to the agreement, each party had the benefit of independent legal advice. On March 6, 2000, a commitment letter in respect of the proposed credit facility was signed by the Dragosits and provided for the following payments:

(a) interest at four percent per month calculated daily, payable monthly in arrears;

(b) a monthly monitoring fee of $750;

(c) a one percent standby fee;

(d) royalty payments of $160,000 in eight quarterly installments;

(e) payment of legal and other fees; and

(f) a commitment fee of $5,000.

With the exception of the standby fee, all these payments were found by Cullity J. and by Rosenberg J.A. to constitute "interest" under s. 347(2) of the *Code*. Presumably, the standby fee was not included in the calculation of the effective interest rate because no standby fees were charged since the full credit facility of $500,000 was drawn upon.

12 By March 30, 2000, the parties had, in addition to the commitment letter, executed an accounts receivable factoring agreement, a promissory note and a general security agreement. The Dragosits also each executed personal guarantees of the indebtedness for up to $500,000 plus interest at the rate of 30 percent per annum. From the outset, the parties had agreed to depart from the terms of the accounts receivable factoring agreement. On March 28, 2000, the solicitor for New Solutions wrote to the solicitor for TNAE and the Dragosits, confirming that the parties had agreed on March 27 that they would not strictly follow the terms of the accounts receivable factoring agreement unless New Solutions elected to exercise its rights under it. Instead, the understanding was that TNAE would borrow the full $500,000 from New Solutions and pay the interest, fees and royalties as set out in the commitment letter. According to Cullity J., "the concept of a factoring of receivables was put aside and replaced by a revolving credit facility" (para. 5).

13 The principal amount of $500,000 was advanced by New Solutions. At the outset, TNAE paid interest at the rate of four percent per month, calculated daily and payable monthly in arrears, as well as the other fees and charges, in general accordance with the terms of the commitment letter.

14 The various payments eventually became onerous, and TNAE sought legal advice regarding the repayment of the borrowed funds. TNAE then applied to the Ontario Superior Court of Justice for a declaration that the agreement contained an interest component that contravened s. 347 of the *Code*. It also sought an order that interest previously paid be returned.

15 On the basis of actuarial evidence, Cullity J. found that the effective interest rate on the loan, if it was repaid in full within two years, was 90.9 percent per annum. In itself, the promise to pay interest at four percent

per month calculated daily, payable monthly in arrears, amounted to an effective annual interest rate of 60.1 percent. The remaining payments amounted to an effective annual interest rate of 30.8 percent.

16 New Solutions originally denied that the agreement violated the *Code* but sought severance and rectification if it did. Cullity J. found that the agreement was in contravention of s. 347(1)(*a*) and applied "notional severance" to reduce the effective annual interest rate to 60 percent so the agreement would comply with s. 347. The Court of Appeal allowed TNAE's appeal; it struck out the clause providing for interest at a rate of four percent per month calculated daily and payable monthly in arrears, and left in place the other payments, which amounted to an effective annual rate of 30.8 percent when computed as interest as *per* s. 347(2). New Solutions seeks the restoration of the decision of the application judge.

III. Relevant Statutory Provisions

17 The pertinent text of the relevant provision of the *Criminal Code*, R.S.C. 1985, c. C-46, is:

> **347.** (1) Notwithstanding any Act of Parliament, every one who
>
> (*a*) enters into an agreement or arrangement to receive interest at a criminal rate, or
>
> (*b*) receives a payment or partial payment of interest at a criminal rate,
>
> is guilty of
>
> (*c*) an indictable offence and is liable to imprisonment for a term not exceeding five years, or
>
> (*d*) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.
>
> (2) In this section,
>
> "credit advanced" means the aggregate of the money and the monetary value of any goods, services or benefits actually advanced or to be advanced under an agreement or arrangement minus the aggregate of any required deposit balance and any fee, fine, penalty, commission and other similar charge or expense directly or indirectly incurred under the original or any collateral agreement or arrangement;
>
> "criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty per cent on the credit advanced under an agreement or arrangement;
>
> . . . . .
>
> "interest" means the aggregate of all charges and expenses, whether in the form of a fee, fine, penalty, commission or other similar charge or expense or in any other form, paid or payable for the advancing of credit under an agreement or arrangement, by or on behalf of the person to whom the credit is or is to be advanced, irrespective of the person to whom any such charges and expenses are or are to be paid or payable, but does not include any repayment of credit advanced or any insurance charge, official fee, overdraft charge, required deposit balance or, in the case of a mortgage transaction, any amount required to be paid on account of property taxes;

. . . . .

(3) Where a person receives a payment or partial payment of interest at a criminal rate, he shall, in the absence of evidence to the contrary, be deemed to have knowledge of the nature of the payment and that it was received at a criminal rate.

. . . . .

(7) No proceedings shall be commenced under this section without the consent of the Attorney General.

IV. Issue

18 Are judges in Canada permitted by law to exercise remedial discretion to partially enforce a contract contravening s. 347 of the *Code* by reading down interest rate provisions to avoid what would otherwise be illegality?

V. Analysis

A. Illegality of the Contract

19 The definition of "interest" in s. 347(2) is broad: see *Garland v. Consumers' Gas Co.*, [1998] 3 S.C.R. 112 (S.C.C.), at para. 28. The various payments made by TNAE, with the exception of any portion of the payments relating to the repayment of principal, satisfy the definition of "interest" as defined in s. 347(2). This includes the "royalty payments". I agree with the courts below that the payments made by TNAE to New Solutions cumulatively amount to an interest rate in excess of that permitted by the *Code*.

B. The Doctrine of Illegality

20 The Federal Court of Appeal's decision in *Still v. Minister of National Revenue* (1997), [1998] 1 F.C. 549 (Fed. C.A.), provides a useful summary of the development of the doctrine of illegality, including a discussion of the development and evolution of the doctrine's common law and statutory branches. In addressing the current state of the doctrine of illegality, Robertson J.A. remarked, at para. 12:

> Law reform agencies have been quick to conclude that the law of illegality is in an unsatisfactory state . . . There is a plethora of conflicting decisions and great uncertainty as to the principles which should be guiding the courts. Arguably, so many exceptions have been grafted on to the common law rule that illegal contracts are void *ab initio* that the validity of the rule itself is brought into question.

In light of the excellent treatment of the doctrine's history by Robertson J.A. in *Still v. Minister of National Revenue*, *supra*, there would be little benefit to fully retracing the doctrine's history here. Instead, given the evolving nature of this area of law, a very brief survey of some of the existing case law on the application of the doctrine of illegality will provide sufficient context for the finding in this case that notional severance is available as a discretionary remedy in cases where s. 347 has been violated.

21 The historical common law approach to contractual illegality is reflected in the following passage of Parke B. in *Cope v. Rowlands* (1836), 2 M. & W. 149, 150 E.R. 707 (Eng. Exch.), at p. 710:

> [W]here the contract which the plaintiff seeks to enforce, be it express or implied, is expressly or by implic-

> ation forbidden by the common or statute law, no court will lend its assistance to give it effect. It is equally clear that a contract is void if prohibited by a statute, though the statute inflicts a penalty only, because such a penalty implies a prohibition.

In *Cope v. Rowlands*, *supra*, the question surrounded whether an unlicensed broker could recover for the work that he had done for the defendant. The court concluded that the legal requirement (under threat of penalty) that brokers be licensed by the city of London implied a prohibition on work being done by unlicenced brokers. As a consequence, the contract was held to be void *ab initio* and the unlicensed broker was unable to enforce his claim for payment for the work that had been done. The Court of Appeal for Ontario denied recovery in a similar case involving an electrician seeking to recover for work done without possessing the appropriate class of licence: see *Kocotis v. D'Angelo* (1957), 13 D.L.R. (2d) 69 (Ont. C.A.).

22 The historical common law approach that contracts illegal under statute are void *ab initio* has been applied by this Court: see, e.g., *Bank of Toronto v. Perkins* (1883), 8 S.C.R. 603 (S.C.C.), and more recently, *Neider v. Carda of Peace River District Ltd.*, [1972] S.C.R. 678 (S.C.C.). However, some time ago Canadian courts began to develop a more flexible approach to statutory illegality in contract, often severing the illegal provisions and enforcing the remainder. For example, in one of the earliest cases dealing with the application of s. 347 of the *Code*, *Mira Design Co. v. Seascape Holdings Ltd.*, [1982] 4 W.W.R. 97 (B.C. S.C.), Huddart L.J.S.C. held that although the interest provisions of a mortgage were unenforceable, exceeding as they did the maximum effective interest rate permitted under s. 305.1 of the *Code* (the predecessor to s. 347), the contract as a whole should not be held to be void *ab initio*. Her reasoning, at p. 104, was that although the section makes it an offence to receive interest at an illegal rate, the section did not seek to make associated collateral agreements (such as for the transfer of the real estate or the payment of the principal amount owing on the mortgage) void *ab initio*:

> Most Canadians would agree that the purpose of the Criminal Code is to protect the public by providing for the punishment of behaviour that Parliament considers to be against the public interest. The purpose of s. 305.1 [now s. 347] is to punish everyone who enters into an agreement or arrangement to receive interest at a criminal rate. It does not expressly prohibit such behaviour, nor does it declare such an agreement or arrangement to be void. The penalty is severe, and designed to deter persons from making such agreements. It replaces the Small Loans Act, which included a prohibition of such agreements and gave the court the power to reconstruct them. It is designed to protect borrowers. There is no penalty imposed on a person who makes an agreement to pay, or pays, interest at a criminal rate. It is not designed to prevent persons from entering into lending transactions per se.

23 The same approach was taken by the Court of Appeal for Ontario in *William E. Thomson Associates Inc. v. Carpenter* (1989), 61 D.L.R. (4th) 1 (Ont. C.A.). Having considered s. 347 of the *Code*, the court in that case concluded that where an interest rate provided for in an agreement exceeds the 60 percent statutory maximum, the interest rate provision of the contract may be severed without declaring the whole contract void.

24 In *Thomson*, *supra*, at p. 8, Blair J.A. considered the following four factors in deciding between partial enforcement and declaring a contract void *ab initio*: (i) whether the purpose or the policy of s. 347 would be subverted by severance; (ii) whether the parties entered into the agreement for an illegal purpose or with an evil intention; (iii) the relative bargaining positions of the parties and their conduct in reaching the agreement; and (iv) whether the debtor would be given an unjustified windfall. He did not foreclose the possibility of applying other considerations in other cases, however, and remarked (at p. 12) that whether "a contract tainted by illegal-

ity is completely unenforceable depends upon all the circumstances surrounding the contract and the balancing of the considerations discussed above and, in appropriate cases, other considerations".

25 In *Trillium Computer Resources Inc. v. Taiwan Connection Inc.* (1993), 11 B.L.R. (2d) 1, aff'd (1994), 11 B.L.R. (2d) 1 (Ont. Div. Ct.), Conant J. entered summary judgment in favour of the plaintiff who had paid $8,000 interest in consideration of credit extended by the defendant for eight days. In a brief judgment and without addressing the authorities on this point, Conant J. stated, at p. 2:

> I am satisfied that an interest rate of over 3,000% per annum, whether it be for credit and/or compensation for damages and other matters suffered by the Defendant, is a flagrant breach of s. 347 of the *Criminal Code* of Canada. This, in my view, is illegal and shall be returned to the Plaintiff less the maximum rate of 60% per annum allowed under the Code. [Emphasis added.]

This approach is similar to the one applied by Cullity J. and endorsed by Sharpe J.A. (in dissent at the Court of Appeal) in the present case.

26 In *Milani v. Banks* (1997), 145 D.L.R. (4th) 55 (Ont. C.A.), the Court of Appeal for Ontario applied the contextual approach endorsed by Blair J.A. in *Thomson, supra*. This case involved a $35,000 loan with a term of 30 days. The contract provided for $3,000 to be kept by the creditor in respect of the costs associated with the loan, and an 18 percent annualized interest rate to be paid on the full principal amount. McKinlay J.A. for the court held, at pp. 59-60 that:

> In this case, the appellant takes the position that the only offensive part of the loan was the $3,000 charge for "fees", and that if the agreement were left intact apart from that provision, the result would be a fair one in the circumstances. I am inclined to agree with that position . . .
>
> I consider this case to be one strongly favouring the position of the appellant. She is clearly not entitled to the $3,000 fee, but I would strike only that provision, and leave the loan otherwise intact as a $32,000 loan with interest at 18% per annum for a thirty day term.

The approach taken by McKinlay J.A. in *Milani v. Banks, supra*, is reflected in the path taken by Rosenberg J.A. at the Court of Appeal for Ontario in the case at bar. McKinlay J.A. severed one of the "interest" terms (actually attributable to "costs") from the loan so that the interest rate would be legal, just as Rosenberg J.A. in this case severed the promise to pay interest at four percent per month, calculated daily, payable monthly in arrears, thereby leaving the other charges to amount, cumulatively, to a permissible rate of interest under s. 347.

C. The Problematic Nature of the Blue-Pencil Test

27 The blue-pencil approach is understood both as a test of the availability of severance to remedy contractual illegality and also as a technique for effecting severance. The blue-pencil approach as a *test* of the appropriateness of severance requires a consideration of whether an illegal contract can be rendered legal by striking out (*i.e.*, by drawing a line through) the illegal promises in the agreement. The resulting set of legal terms should retain the core of the agreement. If the nature or core of the agreement is disturbed, then on this test the illegal clause in the contract is not a candidate for severance and the entire contract is void. The blue-pencil approach as a *technique* of effecting severance involves the actual excision of the provisions leading to the illegality, leaving those promises untainted by the illegality to be enforced.

28 The use of the blue-pencil approach to sever one or more provisions from a contract alters the terms of the agreement between the parties. The only agreement that one can say with certainty the parties would have agreed to is the one that they actually entered into. The insistence in the case law that the blue-pencil test derives its validity from refusing to change or add words or provisions to the contract is unconvincing. It is doubtful, for example, that the lenders in cases such as *Thomson*, *supra*, or *Mira Design Co.*, *supra*, would have entered into the agreements at issue had they been aware *ex ante* that they would only be entitled to the return of the principal advanced. The change effected by the blue-pencil technique will often fundamentally alter the consideration associated with the bargain and do violence to the intention of the parties. Indeed, in many cases, the application of the blue-pencil approach will provide for an interest-free loan where the parties demonstrated in the agreement a clear intention to charge and pay considerable interest.

29 The blue-pencil test was developed in cases where the courts were considering instruments under seal, where the form of the deed governed and where the intention of the parties was irrelevant. It was therefore important that what remained after severance would be a valid deed:

> In the deed form was everything; the actual intention of the parties was immaterial. It was, therefore, natural that in considering the possibility of severance of promises in a deed, the court should be concerned to see that what was left remained a valid deed; there could be no question of implying a promise to take effect if part of the original bargain was illegal. This is the historical origin of what was later called the 'blue-pencil test'.
>
> (Norman S. Marsh, "The Severance of Illegality in Contract" (1948), 64 *Law Q. Rev.* 230 and 347, at pp. 351-52)

Historically, courts were not concerned with the intention of the parties. The artificiality of the blue-pencil test arises from the common law constraints imposed on courts unaided by principles of equity.

30 Courts inescapably make a new bargain for the parties when they use the blue-pencil approach. As Cullity J. remarked, at paras. 35-36:

> The blue-pencil test is, I believe, a relic of a bygone era when the attitude of courts of common law — unassisted by principles of equity — towards the interpretation and enforcement of contracts was more rigid than is the case at the present time. At an early stage in the development of the law relating to illegal promises, severance was held to be justified on the basis of the blue-pencil test alone. As the reasoning in *Milani* and *William E. Thomson* demonstrates, we have moved a long way beyond that mechanical approach. Enforcement may be refused in the exercise of the kind of discretionary judgment I have mentioned even where blue-pencil severance is possible.
>
> Despite repeated statements in the cases that the court will not make a new agreement for the parties, that is, of course, exactly what it does whenever severance is permitted in cases like *William E. Thomson* and *Milani*. [Emphasis added.]

I am in complete agreement with the conclusion that when a court employs the blue-pencil test, it is making a new agreement for the parties. Indeed, all forms of severance alter the terms of the original agreement.

31 I also agree with the view of Rosenberg J.A. at the Court of Appeal in the present case, at para. 33, that severance lies along a spectrum of available remedies. Depending on the circumstances, the court may exercise

its discretion to find the whole agreement unenforceable or sever only the provision(s) that put the effective interest rate over 60 percent:

> [A] judge has discretion to apply the doctrine of severance to an agreement that offends the criminal interest rate provisions of the Code. This discretion gives rise to a spectrum of available remedies. Where the loan transaction resembles a traditional loan sharking arrangement, the court may refuse to apply the doctrine of severance and hold the entire loan agreement unenforceable, including the obligation to repay the principal. While this remedy leaves the borrower with a windfall, this result may be justified in some cases by the need to denounce such usurious practices. See *C.A.P.S. International Inc. v. Kotello*, [2002] M.J. No. 205 [(QL)] (Q.B.). At the other end of the spectrum, in the case of a good faith commercial transaction where the equities favour the lender and severance does not undermine the policy of the legislation, the court may sever only those provisions of the loan agreement that put the effective interest rate over 60 per cent, leaving intact the borrower's obligation to repay the principal and pay some interest. See *e.g., Milani, supra.* Closer to the centre of the spectrum lies a case like *TerraCan* [*TerraCan Capital Corp. v. Pine Projects Ltd.* (1993), 100 D.L.R. (4th) 431 (B.C.C.A.)], where the court severed all the interest provisions but upheld the debtor's obligation to repay the principal. [Emphasis added.]

This statement of the remedial discretion of a judge in a case involving a violation of s. 347 of the *Code* takes into account the seriousness of the illegality involved in any given case, the identity and nature of the parties and the broader contractual context.

32 If the case is an appropriate one for the court to sever only those provisions of the loan agreement that put the effective interest rate over 60 percent, and if it is conceded, as it must be, that such a rewording alters the agreement of the parties, the question becomes only a choice of the appropriate technique of severance. The preferred severance technique is the one that, in light of the particular contractual context involved, would most appropriately cure the illegality while remaining otherwise as close as possible to the intentions of the parties expressed in the agreement. The blue-pencil technique may not necessarily achieve that result.

33 The blue-pencil test is imperfect because it involves mechanically removing illegal provisions from a contract, the effects of which are apt to be somewhat arbitrary. The results may be arbitrary in the sense that they will be dependent upon accidents of drafting and the form of expression of the agreement, rather than the substance of the bargain or consideration involved. For example, if the effective interest rate of the total interest obligation (as defined in s. 347(2)) in the agreement between New Solutions and TNAE were only 0.1 percent lower, then the excision of the various charges, fees and royalty payment provisions using the blue-pencil technique would have resulted in a legally valid agreement bearing an effective annual rate of interest of 60 percent. Although the results obtained from the blue-pencil approach will in many cases be sensible and may often be desirable, due to its artificiality, the application of the blue-pencil approach will sometimes be inappropriate.

34 Section 347 of the *Code* invites difficulties with arbitrariness by imposing a bright line of 60 percent as demarcating legal interest from illegal interest. This legislatively mandated bright line distinguishes s. 347 cases from those involving provisions, for example, in restraint of trade, where there is no bright line. The interaction of the blue-pencil test with the bright line separating illegal interest from legal interest leads to erratic results. Consider the following three substantively equivalent contracts. Assume for each contract that each party was commercially sophisticated, of equivalent bargaining power and in receipt of independent legal advice. Assume also that neither party was aware the interest payable was prohibited by the *Code*. The three contracts lead to dramatically different results when the blue-pencil test is applied.

35 First, consider the result obtained using the blue-pencil approach in the case at bar. Accepted actuarial evidence showed that the contract between TNAE and New Solutions providing for interest at four percent per month, calculated daily, payable monthly in arrears, represented an effective interest rate of 60.1 percent per annum; other fees and charges reflected a further 30.8 percent interest per annum, resulting in a total rate of 90.9 percent. The application of the blue-pencil test required that, at the very least, the 60.1 percent interest provision be struck from the contract since, standing alone, it violated s. 347. After considering the equities of the contractual context, Rosenberg J.A. concluded that TNAE should have to repay the principal and at least some interest. Consequently, the provision calling for 60.1 percent effective annual interest was struck from the contract, and TNAE was held accountable for repaying the principal plus the other fees and charges, amounting to an effective annual interest rate of 30.8 percent.

36 Second, consider a contract that provides for 60.0 percent interest in one provision and 30.9 percent interest in the remaining provisions. This contract would result in the same 90.9 percent per annum rate of interest payable overall. Given the equities of the contractual context as found in the courts below, the application of the blue-pencil test would result in the other fees and charges being struck from the contract and the 60.0 percent interest payment obligation surviving.

37 Finally, consider what the result would be under the blue-pencil approach if there were only one interest provision, and that this provision called for an effective annual interest rate of 90.9 percent, which would also involve exactly the same amount of consideration passing from borrower to the lender as under the previous two contracts. The blue-pencil test would require that the entire interest obligation be severed from the contract, since it alone would violate s. 347. This would result in no interest being payable under the contract. It is possible, in this last example, that the illegality of the rate would be so apparent that courts would be justified in reducing to zero such a blatantly illegal rate. On the other hand, if the criminal rate was arrived at inadvertently — or under a misapprehension of the law — as assumed for the comparison of these three contracts, the obligation to repay at least some interest should be upheld. In that case, the maximum permissible rate would best reflect the intention of the parties, while curing the illegality.

38 This demonstrates that, at least in the case of contracts in violation of s. 347 of the *Code*, the results associated with the application of the blue-pencil approach are overly dependent upon the form of the contract, rather than its substance. In these three similar contracts, the borrower must pay 30.8 percent interest, 60.0 percent interest, or no interest, depending on otherwise insignificant differences in drafting. Results this erratic and sensitive to the form of contractual expression are undesirable, and can be avoided through the use of notional severance in cases where considerations flowing from the broad contractual context favour the lender.

39 There is little danger that abuses of this remedial flexibility would surreptitiously creep past trial judges. On the contrary, judges are apt to be quite suspicious, and rightly so, of credit arrangements which provide for effective annual rates of interest in excess of 60 percent per annum. Using notional severance to read down interest provisions to be just within the legal limit would not find application in traditional loan-sharking transactions. It would be available as a remedy where a court recognizes the commercial sophistication and professional advice received by both parties, concludes that the violation of s. 347 by the parties was unintentional, and considers it equitable to give effect to the highest legal interest obligation available. In such cases, there is no reason, in my view, to prefer the blue-pencil approach as more likely to deter criminal interest rates. I will return to this point below.

40 Thus, the appropriate approach is to vest the greatest possible amount of remedial discretion in judges in

courts of first instance. The spectrum of available remedies runs from a court holding contracts in violation of s. 347 void *ab initio*, in the most egregious and abusive cases, according to the criteria identified in *Thomson, supra*, to notional severance. In the determination of where along the spectrum a particular contract lies, the considerations identified in *Thomson, supra*, by Blair J.A. should be referred to and analysed carefully. Although Blair J.A. was considering the desirability of severing illegal interest from principal, the same factors are helpful in determining whether to reduce illegal interest to a legal level.

D. Application of the Revised Approach

41 Finding, as I do, that the maximum level of remedial flexibility should be vested in judges and available for application by them subject to a careful analysis of the factors identified in *Thomson, supra*, I will apply this approach to the facts of the case at bar.

42 As outlined above, in *Thomson, supra*, Blair J.A. identified four considerations relevant to the determination of whether public policy ought to allow an otherwise illegal agreement to be partially enforced rather than being declared void *ab initio* in the face of illegality in the contract:

1. whether the purpose or policy of s. 347 would be subverted by severance;

2. whether the parties entered into the agreement for an illegal purpose or with an evil intention;

3. the relative bargaining position of the parties and their conduct in reaching the agreement;

4 the potential for the debtor to enjoy an unjustified windfall.

43 The first factor — whether the policy behind s. 347 would be subverted here by partial enforcement — is related to the concerns expressed by Rosenberg J.A. in this case that civil remedies should not frustrate the deterrence purpose of the criminal prohibition. In this regard, it is important to identify the policy purpose underlying s. 347. Ostensibly, it was intended to curb loan-sharking activity. It is difficult to pinpoint the precise rationale behind the provision, however, because the legislative record yields few clues. According to Professor Jacob Ziegel:

> On July 22nd, 1980, only a day after its first reading, the House of Commons gave second and third reading to Bill C-44, "An Act to Amend the Small Loans Act and to provide for its repeal and to amend the Criminal Code". The Bill was not debated and its adoption had the unanimous support of all three political parties. Any public discussion of the merits of the Bill was effectively forestalled by the haste with which it was rushed through the House. This failure to give interested parties an opportunity to study and comment on the Bill would be serious enough if the Bill only dealt with minor technical matters. But it does not. The Bill deals with questions of major social, economic, and legal importance which warranted careful examination. Even if one accepts the soundness of the objectives of the Bill, it does not follow that its technical implementation is equally unobjectionable or that the same goals could not have been realized in a less controversial manner. In the writer's view, the Bill is open to objections on both counts and may generate as many new problems as it was designed to resolve.
>
> (J.S. Ziegel, "Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law" (1981), 59 *Can. Bar Rev.* 188, at p. 188)

As was stated by this Court in *Garland, supra*, at para. 25:

> The ostensible purpose of s. 347 was to aid in the prosecution of loan sharks. See *House of Commons Debates*, 1st Sess., 32nd Parl., vol. III, July 21, 1980, at p. 3146; *Thomson, supra*, at p. 549. However, it is clear from the language of the statute — e.g., its reference to insurance and overdraft charges, official fees, and property taxes in mortgage transactions — that s. 347 was designed to have a much wider reach, and in fact the section has most often been applied to commercial transactions which bear no relation to traditional loan-sharking arrangements. Although s. 347 is a criminal provision, the great majority of cases in which it arises are not criminal prosecutions. Rather, like the case at bar, they are civil actions in which a borrower has asserted the common-law doctrine of illegality in an effort to avoid or recover an interest payment, or to render an agreement unenforceable. For this reason, the provision has attracted criticism from some commercial lawyers and academics, and calls have repeatedly been made for its amendment or repeal . . . Nevertheless, it is now well settled that s. 347 applies to a very broad range of commercial and consumer transactions involving the advancement of credit, including secured and unsecured loans, mortgages and commercial financing agreements.

Since it is very difficult to identify the policy objective behind s. 347 of the *Code* beyond the prevention of loan-sharking, violations of the section that clearly do not involve loan-sharking should be approached cautiously, keeping in mind that there is no need to deter, through the criminal law, effective interest rates of up to 60 percent per year. Given that this was a commercial transaction engaged in by experienced and independently advised commercial parties, it is difficult to see why the choice of a 30.8 percent rather than 60 percent rate better fosters compliance with s. 347(1)(*a*) of the *Code*.

44 The second factor is whether the agreement was entered into for an illegal purpose or with an evil intention. There is no evidence on the record to suggest that New Solutions has been charged with violating s. 347(1)(*a*). Absent a criminal conviction, New Solutions has the benefit of the presumption of innocence. Concerns with specific and general deterrence are best addressed by the criminal law. A prosecution under s. 347 of the *Code* cannot be initiated without the consent of the Attorney General. This suggests that even a criminal remedy is not always appropriate for an infringement of s. 347, let alone a civil remedy seeking to promote the criminal law objective of deterrence. Cullity J. found that the parties were unaware that the agreement contravened s. 347, their intent being only to provide the means by which TNAE could buy out its remaining shareholders and acquire commercially necessary working capital. It was a contract entered into for ordinary commercial purposes. There was nothing inherently illegal or evil about this intention. The worst that could be said is that TNAE was a high-risk debtor for New Solutions to lend to (even with the personal guarantees of the Dragosits), the corporation's needs were high relative to its value, and it needed the money on relatively short notice. This second consideration militates in favour of a flexible remedy.

45 The third factor concerns the relative bargaining position of the parties and their conduct in reaching the agreement. Each party had independent legal advice. Each party was commercially experienced. The Dragosits and TNAE knew what they were getting into, as did New Solutions. The one failing seems to be that neither side realized that their agreement would contravene s. 347 of the *Code*. This third consideration, too, favours a flexible remedy.

46 Finally, any potential for an unjustified windfall in this case arises from TNAE possibly not having to repay the principal and interest, or from TNAE possibly not having to pay a commercially appropriate rate of interest on the loan. Given that each party had independent advice and knew precisely the obligations that they were taking on, my conclusion is that the equities of the situation favour New Solutions. This is in accord with the findings by both the lower courts in this case.

47 New Solutions should be repaid the principal, with the highest amount of interest legally allowable, namely 60 percent. This represents a reduction from the interest rate of 90.9 percent that the contract provided for, but, given s. 347 of the *Code*, is the most that New Solutions can legally receive. This no more rewrites the contract than enforcing only the other obligations, which cumulatively amount to "interest" at 30.8 percent.

48 My colleague, Bastarache J., refers to clause 9.1 of the Accounts Receivable Factoring Agreement (para. 68), arguing it supports the blue-pencil approach to severance. I agree that by clause 9.1 the parties expressed a preference for the use of severance to give full effect to the valid provisions of that agreement. I have two responses to the view, however, that the clause calls for the use of the blue-pencil approach to severance rather than notional severance. First, from the outset the parties agreed not to strictly abide by the terms of the Accounts Receivable Factoring Agreement. Therefore, I question whether it is appropriate to refer to clause 9.1 of this agreement. Second, accepting for the sake of argument that the factoring agreement is relevant, the use of notional severance is not foreclosed by the intent underlying the inclusion of clause 9.1 in the factoring agreement. The genuine intent underlying clause 9.1 was to preserve as much of the agreement as possible should any part of it be deemed to be invalid. In light of the analysis above, the part of the agreement that is invalid is the obligation to pay an effective interest rate in excess of 60 percent per annum. Therefore, notional severance is the most appropriate remedy to apply here, since it gives the greatest possible legal effect to the valid aspects of the agreement, which is in concert with the intention underlying clause 9.1.

VI. Conclusion

49 For the foregoing reasons I would allow the appeal, set aside the order of the Court of Appeal and restore the order of Cullity J. I would award costs to the appellant in this Court and in the Court of Appeal.

***Bastarache J.*:**

50 I have read the reasons of Arbour J. and respectfully disagree. I would not make available the remedy of "notional severance", whereby judges are permitted to rewrite offending provisions in a contract so as to make them conform with the law. Instead, I would restrict the remedy available under such circumstances to severance, in the traditional sense, whereby judges are permitted to strike out offending provisions in a contract provided they represent separate promises.

51 My dissent is based on three major considerations.

52 First, like Rosenberg J.A., I think there is a fundamental difference between striking out offending sections of a contract and rewriting a central provision of a contract. Although both approaches admittedly interfere in some way with the intent of the parties, the added flexibility of the rewriting approach comes at a considerable cost. Furthermore, it is not supported by any principle of contract law. On the contrary, the severance doctrine is a long-standing one. A useful survey of the history and development of severance for illegality can be found in *Still v. Minister of National Revenue* (1997), [1998] 1 F.C. 549 (Fed. C.A.).

53 Historically, courts held that illegality in contract rendered the entire agreement unenforceable and refused to order the return of money or property transferred under the agreement. This classic approach to contractual illegality was articulated by Parke B. in *Cope v. Rowlands* (1836), 2 M. & W. 149, 150 E.R. 707 (Eng. Exch.), at p. 710:

> [W]here the contract which the plaintiff seeks to enforce, be it express or implied, is expressly or by implication forbidden by the common or statute law, no court will lend its assistance to give it effect. It is equally clear that a contract is void if prohibited by a statute, though the statute inflicts a penalty only, because such a penalty implies a prohibition.

54 This Court has also endorsed the traditional doctrine of statutory illegality. In *Bank of Toronto v. Perkins* (1883), 8 S.C.R. 603 (S.C.C.), Ritchie C.J. stated, at p. 610:

> It would be a curious state of the law if, after the Legislature had prohibited a transaction, parties could enter into it, and, in defiance of the law, compel courts to enforce and give effect to their illegal transactions.

At p. 613, Strong J. added:

> Whenever the doing of any act is expressly forbidden by statute, whether on grounds of public policy or otherwise, the English courts hold the act, if done, to be void, though no express words of avoidance are contained in the enactment itself.

See also *Steinberg v. Cohen* (1929), [1930] 2 D.L.R. 916 (Ont. C.A.); *Hasiuk v. Oshanek* (1935), [1936] 1 D.L.R. 232 (Man. C.A.).

55 Over time, the lower courts in Canada moved away from this strict approach because it was viewed as harsh and inequitable in some cases and could result in a windfall to one party. Courts have come to apply a modern approach when faced with a contract that contains an illegal provision. Under the modern approach to illegality, a contract that violates a statute may be enforceable, but not in its entirety. In *Carney v. Herbert*, [1985] 1 All E.R. 438, [1984] 3 W.L.R. 1303 (Eng. C.A.), the Privy Council succinctly summarized the principles to be applied. At p. 443 of the decision, their Lordships quoted with approval the following statements made in an Australian case, *McFarlane v. Daniell* (1938), 38 SR(NSW) 337 (N.W.T. S.C.), at p. 345:

> When valid promises supported by legal consideration are associated with, but separate in form from, invalid promises, the test of whether they are severable is whether they are in substance so connected with the others as to form an indivisible whole which cannot be taken to pieces without altering its nature . . . If the elimination of the invalid promises changes the extent only but not the kind of the contract, the valid promises are severable . . . If the substantial promises were all illegal or void, merely ancillary promises would be inseverable.

Accordingly, the illegal promise may be severed from the rest of the contract, leaving the remaining promises to be enforced by the court. See G.H.L. Fridman, *The Law of Contract in Canada* (4th ed. 1999), at pp. 441 - 45; S.M. Waddams, *The Law of Contracts* (4th ed. 1999), at p. 421. This has been referred to as the "blue-pencil" test, a label first used in the case of *Attwood v. Lamont*, [1920] 3 K.B. 571 (Eng. C.A.).

56 In my opinion, the "blue-pencil" test is nothing more than an expression to describe the application of the severance principle. In *Canadian American Financial Corp. (Canada) v. King* (1989), 60 D.L.R. (4th) 293 (B.C. C.A.) at pp. 299-300, Hinkson J.A. referred to *Attwood v. Lamont*, *supra*, in which Lord Sterndale M.R. captured the essence of the applicable principle, at pp. 577-78:

> I think, therefore, that it is still the law that a contract can be severed if the severed parts are independent of one another and can be severed without the severance affecting the meaning of the part remaining.
>
> This is sometimes expressed, as in this case by the Divisional Court, by saying that the severance can be effected when the part severed can be removed by running a blue pencil through it.

57 Under the blue-pencil test, severance is only possible if the judge can strike out, by drawing a line through, the portion of the contract they want to remove, leaving the portions that are not tainted by illegality, without affecting the meaning of the part remaining. In other words, the offending provision must constitute a separate promise, and one that is not part of the main purport and substance of the contract. The provision must appear severable. See Fridman, *supra*, at p. 443.

58 The blue-pencil test has been applied several times in the context of violations of s. 347 of the *Criminal Code* to strike out offending interest provisions. For example, in an earlier dealing with the application of s. 347, *Mira Design Co. v. Seascape Holdings Ltd.*, [1982] 4 W.W.R. 97 (B.C. S.C.), at p. 105, Huddart L.J.S.C. held:

> In these circumstances, and considering that the offending provisions can be deleted by striking the first proviso on p. 2 of the mortgage, the words "in the event it is paid to the Mortgagee", and "together with interest at the aforesaid rate on the principal sum of EIGHTY THOUSAND ($80,000) DOLLARS" from the second proviso, the entire following paragraph and the words "and interest" from the covenant contained in para. A on the same page, I have concluded that the offending portions are severable in fact.

At p. 104, Huddart L.J.S.C. also described the scope and application of s. 305.1 [now s. 347] of the *Criminal Code* as follows:

> Most Canadians would agree that the purpose of the Criminal Code is to protect the public by providing for the punishment of behaviour that Parliament considers to be against the public interest. The purpose of s. 305.1 [now s. 347] is to punish everyone who enters into an agreement or arrangement to receive interest at a criminal rate. It does not expressly prohibit such behaviour, nor does it declare such an agreement or arrangement to be void. The penalty is severe, and designed to deter persons from making such agreements. It replaces the Small Loans Act, which included a prohibition of such agreements and gave the court the power to reconstruct them. It is designed to protect borrowers. There is no penalty imposed on a person who makes an agreement to pay, or pays, interest at a criminal rate. It is not designed to prevent persons from entering into lending transactions per se. As regards subject matter, its scope and application are limited to agreements regarding interest. Moreover, to find that s. 305.1 [now s. 347] necessarily prohibits the entering into of agreements or arrangements to receive interest at a criminal rate would be to accomplish that which Parliament has chosen not to do, or cannot do, directly.

59 Second, there is no legal or other principled reason to limit the application of the new approach endorsed by my colleague, that is notional severance, to the application of the criminal rate of interest. This means that other illegal provisions would be open to judicial redrafting. In my opinion, the availability of "notional severance" as a remedy creates greater uncertainty in the law. It is clear that both severance and notional severance alter the parties' agreement in some way. However, under the traditional severance approach, courts continue to work with the words of the parties themselves, removing only those portions of the contract that render it illegal. In stark contrast, under notional severance, courts will be permitted to literally add new words to the parties'

agreement. By doing so, courts will be substituting their intentions for those of the parties. Notional severance would extend the judicial role in what I consider to be an unfortunate way. One instance, in particular, comes to mind.

60 In *Canadian American Financial Corp. (Canada) Ltd. v. King*, *supra*, Hinkson, Lambert and Southin JJ.A. wrote three sets of concurring reasons refusing to grant an interlocutory injunction to enforce a covenant in restraint of trade. The provision of the contract in question was a non-competition clause that restrained competition in Canada and Bermuda. All three judges held that the covenant was overly broad. They refused to substitute a covenant with reasonable terms for the unreasonable provision. Lambert J.A. concluded that the authorities were clear that courts may not make contracts for parties that they have not made themselves. In his opinion, substituting the words "British Columbia and Alberta" for "Canada and Bermuda" would have rendered the term enforceable (at p. 307), but that was something for the parties, not the court, to do. Under the new approach, would judges be permitted to make such substitutions in order to render the contract enforceable?

61 It is important to note that Lambert J.A. found, at p. 307, that the blue-pencil rule would have made no difference to his decision as he would not have been any more willing to sever a portion of the clause had it named all the provinces and territories of Canada separately, and so been amenable to the application of the blue-pencil rule. [I am not convinced under traditional severance that a court would not be permitted to strike out a number of offending provisions, or a number of provinces within a list, in order to render the contract compliant with the law. As the majority's decision preserves traditional severance as one of the remedies within the trial judge's discretion, this issue will likely be considered in a more appropriate case in the future.]

62 Furthermore, Lambert J.A. held that a clause, where one alternative encompasses another, would be, in his opinion, void for uncertainty and should not be made valid by severance. For example, a contract containing a covenant not to compete: (1) in Ottawa, and (2) in the rest of Ontario, might be valid as to Ottawa, but overbroad, and therefore wholly invalid, as to Ontario. Including the two promises within the same contract renders the whole clause invalid. In Lambert J.A.'s opinion, the only point on which the covenant is clear is that the covenant is to cover at least Ottawa. But the parties could have simply stated that. Again, under the approach adopted by my colleague, could a court rewrite the second clause to read, for example, "in the rest of *northeastern* Ontario", so that it no longer constitutes an illegal restraint of trade?

63 Third, in my view, the approach taken by the majority in this case is inconsistent with that taken in *Garland v. Consumers' Gas Co.*, [1998] 3 S.C.R. 112 (S.C.C.). In *Garland*, *supra*, this Court interpreted the definition of interest broadly in order to prevent creditors from avoiding the statute by manipulating the form in which payments are to be made. At paras. 27 - 28, Major J. wrote:

> It is apparent from this definition that for the purposes of s. 347 "interest" is an extremely comprehensive term, encompassing many types of fixed payments which would not be considered interest proper at common law or under general accounting principles.
>
> . . . . .
>
> The broad language of s. 347 was presumably intended . . . to prevent creditors from avoiding the statute simply by manipulating the form of payment exacted from their debtors . . . . It is the substance, and not merely the form, of a charge or expense which determines whether it is governed by s. 347.

64 Under my colleague's approach, a creditor would be permitted to escape the consequences of its avoidance measures by simply reducing the rate applied to the maximum permitted under the *Criminal Code*. In my opinion, this approach is inconsistent with the general objectives expressed in the *Criminal Code* and incompatible with the notion of deterrence. It is a criminal offence for any lender, even a commercial creditor, to enter into a loan agreement providing for an effective interest rate greater than 60% per annum. And, as Rosenberg J.A. remarked, at para. 31, of the majority reasons of the Court of Appeal ((2002), 60 O.R. (3d) 97 (Ont. C.A.)) to permit a notional severance of the kind ordered by the application judge is to effect a substantial innovation in the common law doctrine of severance to the benefit of those who *prima facie* stand in violation of the criminal law.

65 It is also important to note that this Court has developed a method for determining whether, as a matter of principle, a departure from well-established precedent is warranted. I canvassed the relevant factors in *Friedmann Equity Developments Inc. v. Final Note Ltd.*, [2000] 1 S.C.R. 842, 2000 SCC 34 (S.C.C.), at para. 43, as follows:

> In the recent case of *Robinson* [*R. v. Robinson*, [1996] 1 S.C.R. 683] Lamer C.J., for a majority of the Court, relied on five factors to justify the reversal of an earlier decision of the Court in *MacAskill v. The King*, [1931] S.C.R. 330. These factors were the existence of previous dissenting opinions in this Court, a trend in the provincial appellate courts to depart from the principles adopted in the original decision, criticism of the case or the adoption of a contrary rule in other jurisdictions, doctrinal criticism of the case and its foundations, and inconsistency of the case with other decisions. While they are not prerequisites for a change in the common law, these factors help to identify compelling reasons for reform. On the other hand, courts will not intervene where the proposed change will have complex and far-reaching effects, setting the law on an unknown course whose ramifications cannot be accurately measured: see *Bow Valley* [*Husky (Bermuda) Ltd. v. Saint John Shipbuilding Ltd.*, [1997] 3 S.C.R. 1210], at para. 93.

In my opinion, there do not appear to be compelling reasons to depart from the lower courts' and Privy Council's well-established precedent.

66 My colleague has provided a comprehensive summary of the facts in issue. In my opinion, the finding by the trial judge that there was no criminal intent should not cloud our analysis. Knowledge is not a requirement under the provision. Indeed, as noted by Rosenberg J.A., at para. 15 of the majority reasons of the Court of Appeal, the typical case is one where the parties do not intend to violate the criminal law and occupy relatively equal bargaining positions.

67 Also, while legal advice will almost certainly be helpful, parties cannot rely on such advice to excuse themselves from non-compliance with the law. Here, advice was given on the specific interest clause only, that the interest was 48 percent, and that advice was wrong. Neither party was advised by its solicitor of the scope of s. 347 of the *Criminal Code* (see Appellant's Factum para. 5, Respondent's Factum para. 1). Contracting parties should consider all of the provisions in the agreement when determining the total interest charged.

68 I would like to conclude by drawing attention to clause 9.1 of the Accounts Receivable Factoring Agreement which reflects the parties' own intentions as to remedy (see tab 4 of the Respondent's Record). Clause 9.1 reads as follows:

> 9.1 Severability. If any provision of this Agreement is deemed by a court having jurisdiction to be wholly or partially invalid, this Agreement shall be interpreted as if such provision had not been part of this Agreement, and so that the validity of such provision shall not affect the validity of the remainder of this Agreement which shall be construed as if this Agreement had been executed without such provision.

69 At the hearing of the appeal in this Court, counsel for the appellant submitted that "this severance provision really doesn't apply to the interest rate provision that is in effect in this case which is found in a separate document which was in the commitment letter". Counsel conceded however that clause 9.1 "reflects an intention that if, to the extent that a provision is tainted by illegality, it will not render the contract invalid, and this clause applies *to the extent that notional severance is not effected*" (emphasis added). The underlined caveat is, of course, incompatible with the plain meaning of clause 9.1 and unsupported by the record.

70 In any event, the commitment letter referred to by counsel is dated *March 6, 2000*, and the factoring agreement that contains clause 9.1 indicates that it was executed as of *March 30, 2000*. And, significantly, the commitment letter and the factoring agreement provide for *the same royalty payment of $160,000, the same monitoring fee of $750 per month, and the same standby fee of 1 percent per month.*

71 A letter sent from the appellant's solicitor to the respondent is instructive in this regard. As the trial judge explains, at paras 4 - 5 of his reasons ((2001), 54 O.R. (3d) 144 (Ont. S.C.J.)):

> Although a factoring agreement, promissory note and general security agreement were executed on or as of March 30, 2000, the parties had already agreed to depart from the provisions of the first of these documents. On March 28, 2000, the respondent's solicitor wrote to the solicitor acting for the applicant and the Dragositis:
>
> > Further to our conversation of March 27, 2000, I confirm on behalf of my client that as an economic accommodation to your client, the administration of the factoring facility will not strictly follow the provisions of the factoring agreement, unless my client elects to exercise its rights under that agreement. It is anticipated that your client will draw the full amount of the facility and pay interest, fees and royalties as they are set out in the commitment letter. Please note that the interest rate in [sic] 48 [per cent] per annum.
>
> In consequence, the concept of a factoring of receivables was put aside and replaced by a revolving credit facility secured on the current assets of the applicant including its accounts receivable. Each of the Dragositis signed a personal guarantee for the entire $500,000. [Emphasis added.]

72 In these circumstances, I am not persuaded that clause 9.1 of the factoring agreement was in any way overtaken by the commitment letter dated earlier. While certain aspects of the financial arrangement were governed by the commitment letter alone, it is apparent from the letter sent by appellant's solicitor that the provisions of the factoring agreement were still very much alive.

73 A plain reading of the clause indicates that, should a term of the agreement between the parties be "deemed . . . wholly or partially invalid", the parties intended their agreement to be "construed as if this Agreement had been executed without [the offending] provision". I cannot see how the wording of the clause can be said to anticipate — still less, to provide for — notional severance.

74 Bearing in mind the plain meaning of clause 9.1, counsel's concession as to the intention of the parties

and the letter sent by the appellant's solicitor to the respondent on March 28, 2000 — three weeks after the commitment letter, on which the appellant relies, was signed, I feel bound to conclude that the blue-pencil approach adopted by the Court of Appeal is entirely consistent with the parties' own intentions and that notional severance is not.

75 In light of this consideration, I respectfully disagree with my colleague that reducing, or effectively rewriting, the rate of interest to the legally prescribed rate of 60 percent would show more respect for the sanctity of the bargain between the parties. It appears from clause 9.1 that the parties turned their minds to this very issue and agreed that, in the event of a court declaring a provision in the contract invalid, the Agreement shall be interpreted, not redrafted, as if that provision was not part of the contract.

76 For these reasons, I would dismiss the appeal with costs.

***Fish J.*:**

77 With respect for the contrary view of Justice Arbour, I would, like Justice Bastarache and for the reasons that follow, dismiss the appeal with costs.

I

78 We are concerned in this case with the civil consequences of a serious violation of the criminal law of Canada.

79 Section 347 of the *Criminal Code*, R.S.C. 1985, c. C-46, provides that it is a criminal offence to charge or agree to receive "interest at a criminal rate", which is defined as interest that exceeds 60 percent per annum. I consider the violation in this case to be serious because the appellant charged the respondent an effective interest rate of *more than 90 percent*.

80 I recognize that the law of equity is not a closed-end list of off-the-shelf remedies. Like the majority in the Court of Appeal, however, I do not believe this case required a new and novel prescription to ensure a fair and reasonable solution. The well-established "blue-pencil" remedy described by my colleagues and applied in the Court of Appeal respects the trial judge's findings of fact, as it must, and achieves an equitable result consistent with established principle.

81 Finally, I agree with the majority in the Court of Appeal that the trial judge erred in straining the recognized rules of equity by resorting to what he described as "notional severance". In different circumstances, his fresh and creative approach might well prove appropriate. That would be so where notional severance is necessary to resolve a private dispute fairly and in a manner that is not incompatible with the social and legal objectives of the criminal law — which, in my respectful view, is not the case here.

II

82 The appellant made a commercial loan to the respondent at a "criminal rate" within the meaning of s. 347 of the *Criminal Code*. Pursuant to that provision, as I have mentioned, anything over 60 percent per annum is, as a matter of law, a "criminal rate".

83 The loan in this case was made at an effective annual rate of 90.9 percent, or 150 percent of the legal

maximum.

84 There were two components to the interest charged.

85 The first provided for interest at four percent per month, calculated daily, payable monthly in arrears. Appellant's solicitor, without intending to mislead, erroneously advised respondent's solicitor "that the interest rate [was] 48 percent per annum". It was in fact 60.1 percent, a criminal rate in itself.

86 The second component consisted in various charges that, taken together, increased the effective annual interest rate from 60.1 percent to 90.9 percent.

87 These facts are not in dispute.

88 Moreover, the appellant, though it did so at the outset, no longer contests: (1) that the rate stipulated as interest was a "criminal rate" within the meaning of s. 347 of the *Criminal Code*; and (2) that the additional charges I have mentioned fall within the definition of "interest" in s. 347. And it is common ground that s. 347 applies to the kind of commercial loan that concerns us here.

89 Two defining features of the impugned loan agreement must therefore be borne in mind from the outset. First, that we are not dealing in this case with a contract that violates civil, commercial or regulatory legislation, but rather with an agreement that violates the *Criminal Code* of Canada; and second, that the effective interest rate under that contract amounts to more than *one-and-a-half times the threshold criminal rate*, and does not exceed it *barely, slightly*, or by only 0.1 percent.

90 The trial judge found that the appellant did not intend to breach s. 347 of the *Criminal Code*. This was therefore, in his view, a case for severance of the illegal provisions in the contract.

91 It is important to remember that only one provision of the contract was *illegal in itself*: the provision which charges interest at the criminally prohibited rate of 60.1 percent. The other charges, included in the definition of interest set out in s. 347, were separately set out in the agreement and not stipulated as interest.

92 Had the trial judge severed the interest clause and left the other charges intact, his decision would have fallen within the bounds of his discretion.

93 He declined, however, to do so.

94 Instead, he applied a new and novel remedy that he described as "notional severance", rewriting the interest clause so as to yield, when added to the other charges, a cumulative, effective interest rate of 60 percent — the very threshold of the criminal rate prohibited by s. 347 of the *Code*.

95 In the Court of Appeal for Ontario, the majority found that the trial judge had erred in "straining" the law in this way. The appellant had charged the respondent a criminal rate of interest far exceeding the limit established by Parliament, and the Court of Appeal found it inappropriate, as a matter of legal principle and judicial policy, to bend or extend the equitable remedy of severance in order to secure for the appellant the maximum rate of interest it could have recovered had it *not* violated the law.

96 Bearing in mind the trial judge's findings of fact and applying the recognized blue-pencil approach, the court instead severed the criminal rate agreed to by the parties *as interest* and permitted the appellant to recover

the separately stipulated charges, which left in place an effective interest rate of just over 30 percent.

97 The decisive question in this Court is whether the Court of Appeal erred in law in concluding as it did.

98 I would answer that question in the negative.

III

99 Without so deciding, I am prepared for present purposes to agree with Arbour J., at para. 5 of her reasons, that "notional severance is available as a matter of law as a remedy in cases arising under s. 347" of the *Criminal Code*.

100 Even on that assumption, however, I would permit notional severance only where: (1) public policy does not require that the entire agreement be declared unenforceable; (2) severance is found to be warranted; and (3) severance *simpliciter* — or "blue-pencil severance" — is impracticable or would occasion an unjust result.

101 Here, on the facts as found by the trial judge, the first two criteria are satisfied but the third is not: blue-pencil severance is both possible and fair. And, unlike notional severance as applied by the trial judge, blue-pencil severance does not do violence to the policy purposes of s. 347 of the *Criminal Code* or require a judicial rewriting of the interest clause agreed to, as such, by the parties.

102 Section 347(1) of the *Code* provides that everyone who

> (a) enters into an agreement or arrangement to receive interest at a criminal rate, or
>
> (b) receives a payment or partial payment of interest at a criminal rate,

is guilty of

> (c) an indictable offence and is liable to imprisonment for a term not exceeding five years, or
>
> (d) an offence punishable on summary conviction and is liable to a fine not exceeding twenty-five thousand dollars or to imprisonment for a term not exceeding six months or to both.

103 And s. 347(2) provides:

> (2) In this section,
>
> "criminal rate" means an effective annual rate of interest calculated in accordance with generally accepted actuarial practices and principles that exceeds sixty percent on the credit advanced under an agreement or arrangement;

104 As consideration for its loan to the respondent, in addition to the interest stipulated as interest, the appellant, as already mentioned, charged various other amounts that constituted interest called by another name. As noted by Arbour J., it is undisputed that those charges fall squarely with the definition of "interest" set out in s. 347(2) of the *Criminal Code*. Together, they added 30.8 percent to the 60.1 percent expressly contemplated by the agreement.

105 The trial judge found as a fact that the appellant, in charging the respondent an effective interest rate of

90.9 percent per annum, did not intend to breach the provisions of s. 347. His conclusion in this regard should not be misunderstood: an intent to breach the section is not an essential element of the offence.

106 There is no doubt, moreover, that the appellant was perfectly aware of the stipulated rate of interest (though perhaps not of its actuarial quantification) and was aware of all the other charges that, as a matter of law, constitute interest as well.

107 As I said earlier, I am prepared to assume for present purposes that notional severance is a remedy known to law, but would permit its application in cases involving a breach of the criminal law only where severance is nonetheless warranted as a matter of equity and severance *simpliciter* is impracticable or would create an unjust result.

108 The question, then, is whether this is such a case.

109 With the greatest of respect, I am persuaded that it is not, essentially for the reasons set out by Rosenberg J.A., speaking for the majority in the Ontario Court of Appeal ((2002), 60 O.R. (3d) 97 (Ont. C.A.)), at paras. 31-35:

> It is a criminal offence for any lender, even a commercial creditor, to enter into a loan agreement providing for an effective interest rate greater than 60 percent per annum. And to permit a notional severance of the kind ordered by the application judge is to effect a substantial innovation in the common law doctrine of severance. While the common law develops over time, it would be inconsistent with the aims of deterrence for the courts to make such a major innovation at the behest of those who *prima facie* stand in violation of the criminal law. As Huddart J. [now J.A.] said in *Pacific National Developments [Ltd. v. Standard Trust Co.* (1991), 53 B.C.L.R. (2d) 158 (S.C.),] at p. 163: "It is not for the courts either to strain to find ways in which to avoid the application of the *Criminal Code*, or to assist those who strain to do so, although it is for the courts to interpret strictly penal provisions of statutes".
>
> . . . . .
>
> I agree with the British Columbia Court of Appeal in *Terracan, supra,* that a judge has discretion to apply the doctrine of severance to an agreement that offends the criminal interest rate provisions of the Code. This discretion gives rise to a spectrum of available remedies. Where the loan transaction resembles a traditional loan sharking arrangement, the court may refuse to apply the doctrine of severance and hold the entire loan agreement unenforceable, including the obligation to repay the principal. While this remedy leaves the borrower with a windfall, this result may be justified in some cases by the need to denounce such usurious practices. See *C.A.P.S. International Inc. v. Kotello*, [2002] M.J. No. 205 (Q.B.). At the other end of the spectrum, in the case of a good faith commercial transaction where the equities favour the lender and severance does not undermine the policy of the legislation, the court may sever only those provisions of the loan agreement that put the effective interest rate over 60 percent, leaving intact the borrower's obligation to repay the principal and pay some interest. See *e.g., Milani, supra*. Closer to the center of the spectrum lies a case like *Terracan*, where the court severed all the interest provisions but upheld the debtor's obligation to repay the principal.
>
> Where does the present case fit on the spectrum? The application judge concluded, and I have accepted, that the equities favour the lender. His reasons make it clear that if he had concluded that notional severance was not available, he would have severed the provision calling for payment of an interest rate of 4 percent per

month calculated daily, payable monthly in arrears. I agree that this is the appropriate remedy.

In this case there are at least two distinct covenants that can be traced back to the negotiations leading to the agreement. As indicated, the respondent initially wanted an equity interest in the appellant's business. This is the source of the royalty payments. The other covenant was the more conventional agreement with respect to interest. In my view, it is possible to sever one or both in a manner consistent with the established principles respecting severance. The 4 percent per month interest provision must be severed because it violates s. 347 of the *Criminal Code*. I see no justification for trying to save that provision simply because it only barely exceeds 60 percent. The respondent is an experienced commercial lender. It misled the appellant, albeit unintentionally, when its solicitor referred to the interest rate as merely 48 percent. The appellant has not shown that the other fees and charges such as the commitment fee and monitoring fee are clearly part of the interest rate payment and accordingly they should not be severed.

110 I agree with Rosenberg J.A.'s analysis and would add these additional considerations.

111 The first relates to the appellant's purported good faith. As I understand it, this refers to:

(1) the trial judge's finding that the appellant did not intend to breach s. 347, in the sense that the appellant appears not to have realized that its otherwise well-understood charges violated the *Criminal Code*; and

(2) the fact that the separate and distinct charges which added just over 30 percent per annum to the stipulated rate of interest were not known by the appellant to constitute interest within the meaning of s. 347(2) of the *Code*.

112 I accept that neither the appellant nor the respondent thought of the added charges as interest.

113 On this assumption, it appears to me neither "artificial" nor "arbitrary" to sever the criminal rate of interest *agreed to as interest* and to leave intact the distinct and separate charges *not agreed to as interest*, and *not considered to be interest by either party*.

114 This solution responds adequately to the policy concerns expressed by the majority in the Court of Appeal. Unlike notional severance, it requires no judicial rewriting of the interest clause agreed to as such by the parties. And it still leaves the appellant with a return of slightly more than 30 percent per annum.

IV

115 Arbour J. concludes that the four factors set out by Blair J.A. in *William E. Thomson Associates Inc. v. Carpenter* (1989), 61 D.L.R. (4th) 1 (Ont. C.A.), favour severance in this case. I agree. That is why I would affirm the judgment of the Court of Appeal.

116 But the more difficult question is whether these four factors favour notional severance *as opposed to* the established blue-pencil form of severance contemplated by Blair J.A. in *Thomson*. In my respectful view, they do not.

117 The first consideration or factor is whether the purpose and policy of s. 347 of the *Criminal Code* would be better served by severance *simpliciter* or by notional severance.

118 In support of her conclusion, on this branch of the matter, Arbour J. cites at para. 43, an article in which

Professor Jacob Ziegel explains his objections to s. 347 (J.S. Ziegel, "Bill C-44: Repeal of the Small Loans Act and Enactment of a New Usury Law" (1981), 59 *Can. Bar Rev.* 188). On the issue that concerns us here, however, Professor Ziegel elsewhere states:

> So far as the interest component is concerned, obviously the lender cannot recover that part of it which exceeds 60%. But can he recover the first 60%? In my view, the answer should be no, and this on two grounds. First, it is unlikely that the contract itself will distinguish between the two interest components. There is therefore no basis on which to apply the doctrine of severance. The second reason is that severance would undermine the policy of s. 305.1 [now s. 347] (even if one believes, as the writer does, that it is a bad policy) and encourage lenders to run calculated risks, secure in the knowledge that they would only lose that part of the interest which exceeds 60%. [Emphasis added.]
>
> (J.S. Ziegel, "The Usury Provisions in the Criminal Code: The Chickens Come Home to Roost" (1986), 11 *Can. Bus. L.J.* 233, at p. 242)

119 Professor Ziegel's first reason is of limited application here, since the parties *did* distinguish between the two components of the illegal interest rate. Moreover, there is a sound basis for distinguishing between them: the first, agreed to by the parties as interest, itself exceeds the limit, albeit narrowly, while the second was not considered by the parties to be part of the interest rate, though s. 347 gives it that effect.

120 Professor Ziegel's second reason, which I share, clearly militates *in favour of blue-pencil severance*, the solution adopted by the majority in the Court of Appeal, and *against* "*notional severance*", which the trial judge applied in awarding the appellant interest at the threshold of the criminal rate.

121 I agree with Arbour J. that the second consideration — whether the parties entered into the agreement for an illegal purpose or with an evil intention — in this case favours a flexible remedy. That objective, however, is satisfied by severing the interest clause and leaving the other charges intact, since this requires the respondent to pay, and allows the appellant to receive, an effective interest rate of more than 30 percent on the commercial loan that was the object of their agreement.

122 This remedy certainly differs from — but is no less "flexible" — than the remedy conceived by the trial judge.

123 Had there been only an effective interest rate of 60.1 percent — and not a cumulative effective rate of 90.9 percent — it might have been desirable, I concede, not to sever the interest clause entirely. But that was not the case here.

124 The third consideration relates to the relative bargaining positions of the parties and their conduct in reaching the agreement.

125 In this regard, it is true that the respondent had the advice of a solicitor and does not appear to have been a naive or inexperienced victim of misunderstanding. But a commercial borrower who agrees, for lack of an alternative source of financing, to pay an effective interest rate of 90.9 percent per annum — many times the normal commercial rate — and to provide personal guarantees for the loan, can hardly be said to have bargaining power equal to that of the lender.

126 I turn now to the fourth consideration, relating to the potential for unjust enrichment or, in the words of

Arbour J., "an unjustified windfall" (para. 42).

127 Unlike Justice Arbour, I do not consider that the respondent can be said to be unjustly enriched if it is relieved by a court of law of its contractual undertaking to pay a criminal rate of interest where, as here, it is required at the same time to pay an effective annual rate of more than 30 percent and to repay the principal as well — in full.

128 In short, it appears to me that all four considerations identified by Blair J.A. in *Thomson*, *supra*, examined individually and weighed together, militate here in favour of the remedy applied by the Court of Appeal and against the remedy adopted by the trial judge.

129 Accordingly, I agree with the Court of Appeal that the trial judge erred in substituting for the criminal rate of interest charged by the appellant to the respondent the highest rate the appellant could otherwise have charged.

130 And, like the Court of Appeal, I see no basis in the established rules of equity that would permit the trial judge to rewrite the illegal interest clause agreed to by the parties in this way. It should simply have been struck out on the accepted blue-pencil approach.

131 The effect of the trial judge's decision was to stretch the principles of equity in an inappropriate way and to send the wrong message to those who lend money at a criminally prohibited rate to "willing" borrowers who cannot otherwise obtain a loan.

132 They should not be encouraged to believe that if their illegal arrangement is subjected to judicial scrutiny, they will nonetheless recover the highest rate they could legally have charged — and thus suffer no pecuniary disadvantage for having violated s. 347 of the *Criminal Code*.

V

133 As mentioned at the outset, I have assumed for the purposes of this appeal the correctness of Justice Arbour's premise that "notional severance is available as a matter of law as a remedy in cases arising under s. 347" of the *Criminal Code*.

134 On this assumption, I would apply notional severance to cases involving a breach of the *Criminal Code* only where severance does no violence to public policy interests, is found to be warranted as a matter of equity, and severance *simpliciter* is impracticable or, though possible, would create an unjust result.

135 For all of these reasons and, to the extent that they are not incompatible, the reasons of Bastarache J., I would dismiss the appeal with costs.

Appeal allowed.

Pourvoi accueilli.

FN* A corrigendum issued by the court March 31, 2004 has been incorporated herein.

FN* Faculty of Law, Dalhousie University.

2004 CarswellOnt 512, 2004 SCC 7, 40 B.L.R. (3d) 18, 316 N.R. 84, 235 D.L.R. (4th) 385, [2004] 1 S.C.R. 249, 183 O.A.C. 342, 18 C.R. (6th) 1, 17 R.P.R. (4th) 1, 70 O.R. (3d) 255 (note), REJB 2004-53611, J.E. 2004-446

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TAB 13

C

2012 CarswellOnt 1263, 2012 ONSC 506

Timminco Ltd., Re

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

In the Matter of a Plan of Compromise or Arrangement of Timminco Limited and Bécancour Silicon Inc., Applicants

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: January 12, 2012
Judgment: February 2, 2012
Docket: CV-12-9539-00CL

Counsel: A.J. Taylor, M. Konyukhova, K. Esaw, for Applicants

D.W. Ellickson, for Communications, Energy and Paperworkers' Union of Canada

C. Sinclair, for United Steelworkers' Union

K. Peters, for AMG Advance Metallurgical Group NV

M. Bailey, for Superintendent of Financial Services (Ontario)

S. Weisz, for FTI Consulting Canada Inc.

A. Kauffman, for Investissement Quebec

Subject: Corporate and Commercial; Insolvency; Labour and Employment; Public

Business associations.

Debtors and creditors.

Labour and employment law.

Pensions.

Cases considered by *Morawetz J.*:

AbitibiBowater inc., Re (2009), 74 C.C.P.B. 254, D.T.E. 2009T-434, 57 C.B.R. (5th) 285, 2009 QCCS 2028, 2009 CarswellQue 4329, [2009] R.J.Q. 1415 (Que. S.C.) — referred to

ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp. (2008), 2008 ONCA 587, 2008 CarswellOnt 4811, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 240 O.A.C. 245, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 296 D.L.R. (4th) 135, (sub nom. *Metcalfe & Mansfield Alternative Investments II Corp., Re)* 92 O.R. (3d) 513, 45 C.B.R. (5th) 163, 47 B.L.R. (4th) 123 (Ont. C.A.) — considered

Canwest Global Communications Corp., Re (2009), 2009 CarswellOnt 6184, 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]) — considered

Collins & Aikman Automotive Canada Inc., Re (2007), 37 C.B.R. (5th) 282, 2007 CarswellOnt 7014, 63 C.C.P.B. 125 (Ont. S.C.J.) — referred to

Fraser Papers Inc., Re (2009), 2009 CarswellOnt 4469, 55 C.B.R. (5th) 217, 2009 C.E.B. & P.G.R. 8350, 76 C.C.P.B. 254 (Ont. S.C.J. [Commercial List]) — referred to

Grant Forest Products Inc., Re (2009), 2009 CarswellOnt 4699, 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]) — considered

Indalex Ltd., Re (2011), 2011 CarswellOnt 2458, 2011 ONCA 265, 2011 C.E.B. & P.G.R. 8433, 104 O.R. (3d) 641, 75 C.B.R. (5th) 19, 17 P.P.S.A.C. (3d) 194, 331 D.L.R. (4th) 352, 276 O.A.C. 347, 89 C.C.P.B. 39 (Ont. C.A.) — followed

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 1330 (Ont. S.C.J. [Commercial List]) — considered

Nortel Networks Corp., Re (2009), 2009 CarswellOnt 4467, 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]) — followed

Nortel Networks Corp., Re (2009), 256 O.A.C. 131, 2009 CarswellOnt 7383, 2009 ONCA 833, 59 C.B.R. (5th) 23, 77 C.C.P.B. 161, (sub nom. *Sproule v. Nortel Networks Corp.)* 2010 C.L.L.C. 210-005, (sub nom. *Sproule v. Nortel Networks Corp., Re)* 99 O.R. (3d) 708 (Ont. C.A.) — considered

Sierra Club of Canada v. Canada (Minister of Finance) (2002), 287 N.R. 203, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 18 C.P.R. (4th) 1, 44 C.E.L.R. (N.S.) 161, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 211 D.L.R. (4th) 193, 223 F.T.R. 137 (note), 20 C.P.C. (5th) 1, 40 Admin. L.R. (3d) 1, 2002 SCC 41, 2002 CarswellNat 822, 2002 CarswellNat 823, (sub nom. *Atomic Energy of Canada Ltd. v. Sierra Club of Canada)* 93 C.R.R. (2d) 219, [2002] 2 S.C.R. 522 (S.C.C.) — followed

Stelco Inc., Re (2005), 253 D.L.R. (4th) 109, 75 O.R. (3d) 5, 2 B.L.R. (4th) 238, 9 C.B.R. (5th) 135, 2005 CarswellOnt 1188, 196 O.A.C. 142 (Ont. C.A.) — followed

Timminco Ltd., Re (2012), 2012 ONSC 106, 2012 CarswellOnt 1059 (Ont. S.C.J. [Commercial List]) — referred to

Statutes considered:

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

Generally — referred to

s. 11.51 [en. 2005, c. 47, s. 128] — considered

s. 11.52(1) [en. 2007, c. 36, s. 66] — considered

s. 11.52(2) [en. 2007, c. 36, s. 66] — considered

Pension Benefits Act, R.S.O. 1990, c. P.8

Generally — referred to

Régimes complémentaires de retraite, Loi sur les, L.R.Q., c. R-15.1

en général — referred to

Rules considered:

Federal Courts Rules, SOR/98-106

R. 151 — considered

Morawetz J.:

1 This motion was heard on January 12, 2012. On January 16, 2012, the following endorsement was released:

> Motion granted. Reasons will follow. Order to go subject to proviso that the Sealing Order is subject to modification, if necessary, after reasons provided.

2 These are those reasons.

Background

3 On January 3, 2012, Timminco Limited ("Timminco") and Bécancour Silicon Inc. ("BSI") (collectively, the "Timminco Entities") applied for and obtained relief under the *Companies' Creditors Arrangement Act* (the "CCAA").

4 In my endorsement of January 3, 2012, (*Timminco Ltd., Re*, 2012 ONSC 106 (Ont. S.C.J. [Commercial List])), I stated at [11]: "I am satisfied that the record establishes that the Timminco Entities are insolvent and are 'debtor companies' to which the CCAA applies".

5 On the initial motion, the Applicants also requested an "Administration Charge" and a "Directors. and Officers. Charge" ("D&O Charge"), both of which were granted.

6 The Timminco Entities requested that the Administration Charge rank ahead of the existing security interest of Investissement Quebec ("IQ") but behind all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise, including any deemed trust created under the *Ontario Pension Benefit Act* (the "PBA") or the *Quebec Supplemental Pensions Plans Act* (the "QSPPA") (collectively, the "Encumbrances") in favour of any persons that have not been served with this application.

7 IQ had been served and did not object to the Administration Charge and the D&O Charge.

8 At [35] of my endorsement, I noted that the Timminco Entities had indicated their intention to return to court to seek an order granting super priority ranking for both the Administration Charge and the D&O Charge ahead of the Encumbrances.

9 The Timminco Entities now bring this motion for an order:

(a) suspending the Timminco Entities. obligations to make special payments with respect to the pension plans (as defined in the Notice of Motion);

(b) granting super priority to the Administration Charge and the D&O Charge;

(c) approving key employee retention plans (the "KERPs") offered by the Timminco Entities to certain employees deemed critical to a successful restructuring and a charge on the current and future assets, undertakings and properties of the Timminco Entities to secure the Timminco Entities. obligations under the KERPs (the "KERP Charge"); and

(d) sealing the confidential supplement (the "Confidential Supplement") to the First Report of FTI Consulting Canada Inc. (the "Monitor").

10 If granted, the effect of the proposed Court-ordered charges in relation to each other would be:

- first, the Administration Charge to the maximum amount of $1 million;
- second, the KERP Charge (in the maximum amount of $269,000); and
- third, the D&O Charge (in the maximum amount of $400,000).

11 The requested relief was recommended and supported by the Monitor. IQ also supported the requested relief. It was, however, opposed by the Communications, Energy and Paperworkers. Union of Canada ("CEP"). The position put forth by counsel to CEP was supported by counsel for the United Steelworkers. Union ("USW").

12 The motion materials were served on all personal property security registrants in Ontario and in Quebec: the members of the Pension Plan Committees for the Bécancour Union Pension Plan and the Bécancour Non-Union Pension Plan; the Financial Services Commission of Ontario; the Regie de Rentes du Quebec; the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Works International Union; and La Section Locale 184 de Syndicat Canadien des Communications, De L.Energie et du Papier; and various government entities, including Ontario and Quebec environmental agencies and federal and provincial taxing authorities.

13 Counsel to the Applicants identified the issues on the motion as follows:

(a) Should this court grant increased priority to the Administration Charge and the D&O Charge?

(b) Should this court grant an order suspending the Timminco Entities. obligations to make the pension contributions with respect to the pension plans?

(c) Should this court approve the KERPs and grant the KERPs Charge?

(d) Should this court seal the Confidential Supplement?

14 It was not disputed that the court has the jurisdiction and discretion to order a super priority charge in the context of a CCAA proceeding. However, counsel to CEP submits that this is an extraordinary measure, and that the onus is on the party seeking such an order to satisfy the court that such an order ought to be awarded in the circumstances.

15 The affidavit of Peter A.M. Kalins, sworn January 5, 2012, provides information relating to the request to suspend the payment of certain pension contributions. Paragraphs 14-28 read as follows:

14. The Timminco Entities sponsor the following three pension plans (collectively, the "**Pension Plans**"):

(a) the Retirement Pension Plan for The Haley Plant Hourly Employees of Timminco Metals, A Division of Timminco Limited (Ontario Registration Number 0589648) (the "**Haley Pension Plan**");

(b) the Régime de rentes pour les employés non syndiqués de Silicium Bécancour Inc. (Québec Registration Number 26042) (the "**Bécancour Non-Union Pension Plan**"); and

(c) the Régime de rentes pour les employés syndiqués de Silicium Bécancour Inc. (Québec Registration Number 32063) (the "**Bécancour Union Pension Plan**").

Haley Pension Plan

15. The Haley Pension plan, sponsored and administered by Timminco, applies to former hourly employees at Timminco's magnesium facility in Haley, Ontario.

16. The Haley Pension Plan was terminated effective as of August 1, 2008 and accordingly, no normal cost contributions are payable in connection with the Haley Pension Plan. As required by the Ontario *Pension Benefits Act* (the "**PBA**"), a wind-up valuation in respect of the Haley Pension Plan was filed with the Financial Services Commission of Ontario ("**FSCO**") detailing the plan's funded status as of the wind-up date, and each year thereafter. As of August 1, 2008, the Haley Pension Plan was in a deficit position on a wind-up basis of $5,606,700. The PBA requires that the wind-up deficit be paid down in equal annual installments payable annually in advance over a period of no more than five years.

17. As of August 1, 2010, the date of the most recently filed valuation report, the Haley Pension Plan had a wind-up deficit of $3,922,700. Contributions to the Haley Pension Plan are payable annually in advance every August 1. Contributions in respect of the period from August 1, 2008 to July 31, 2011 totalling $4,712,400 were remitted to the plan. Contributions in respect of the period from August 1, 2011 to July 31, 2012 were estimated to be $1,598,500 and have not been remitted to the plan.

18. According to preliminary estimates calculated by the Haley Pension Plan's actuaries, despite Timminco having made contributions of approximately $4,712,400 during the period from August 1, 2008 to July 31, 2011, as of August 1, 2011, the deficit remaining in the Haley Pension Plan is $3,102,900.

Bécancour Non-Union Pension Plan

19. The Bécancour Non-Union Pension Plan, sponsored by BSI, is an on-going pension plan with both defined benefit ("**DB**") and defined contribution provisions. The plan has four active members and 32 retired and deferred vested members (including surviving spouses).

20. The most recently filed actuarial valuation of the Bécancour Non-Union Pension Plan performed for funding purposes was performed as of September 30, 2010. As of September 30, 2010, the solvency deficit in the Bécancour Non-Union Pension Plan was $3,239,600.

21. In 2011, normal cost contributions payable to this plan totaled approximately $9,525 per month (or 16.8% of payroll). Amortization payments owing to this plan totaled approximately $41,710 per month. All contributions in respect of the plan were paid when due in accordance with the Québec *Supplemental Pension Plans Act* (the "**QSPPA**") and regulations.

Bécancour Union Pension Plan

22. The BSI-sponsored Bécancour Union Pension Plan is an on-going DB pension plan with two active members and 98 retired and deferred vested members (including surviving spouses).

23. The most recently filed actuarial valuation performed for funding purposes was performed as of September 30, 2010. As of September 30, 2010, the solvency deficit in the Bécancour Union Pension Plan was $7,939,500.

24. In 2011, normal cost contributions payable to the plan totaled approximately $7,083 per month (or 14.7% of payroll). Amortization payments owing to this plan totaled approximately $95,300 per month. All contributions in respect of the plan were paid when due in accordance with the QSPPA and regulations.

25. BSI unionized employees have the option to transfer their employment to QSLP, under the form of the existing collective bargaining agreement. In the event of such transfer, their pension membership in the Bécancour Union Pension Plan will be transferred to the Quebec Silicon Union Pension Plan (as defined and described in greater detail in the Initial Order Affidavit). Also, in the event that any BSI non-union employees transfer employment to QSLP, their pension membership in the Bécancour Non-Union Pension Plan would be transferred to the Quebec Silicon Non-Union Pension Plan (as defined and described in greater detail in the Initial Order Affidavit). I am advised by Andrea Boctor of Stikeman Elliott LLP, counsel to the Timminco Entities, and do verily believe that if all of the active members of the Bécancour Union Pension Plan and the Bécancour Non-Union Pension Plan transfer their employment to QSLP, the Régie des rentes du Québec would have the authority to order that the plans be wound up.

Pension Plan Deficiencies and the Timminco Entities' CCAA Proceedings

26. The assets of the Pension Plans have been severely impacted by market volatility and decreasing long-term interest rates in recent years, resulting in increased deficiencies in the Pension Plans. As a result, the special payments payable with respect to the Haley Plan also increased. As at 2010, total annual special

payments for the final three years of the wind-up of the Haley Pension Plan were $1,598,500 for 2010, $1,397,000 for 2011 and $1,162,000 for 2012, payable in advance annually every August 1. By contrast, in 2011 total annual special payments to the Haley Pension Plan for the remaining two years of the wind-up increased to $1,728,700 for each of 2011 and 2012.

Suspension of Certain Pension Contributions

27. As is evident from the Cashflow Forecast, the Timminco Entities do not have the funds necessary to make any contributions to the Pension Plans other than (a) contributions in respect of normal cost, (b) contributions to the defined contribution provision of the BSI Non-Union Pension Plan, and (c) employee contributions deducted from pay (together, the "**Normal Cost Contributions**"). Timminco currently owes approximately $1.6 million in respect of special payments to the Haley Pension Plan. In addition, assuming the Bécancour Non-Union Pension Plan and the Bécancour Union Pension Plan are not terminated, as at January 31, 2012, the Timminco Entities will owe approximately $140,000 in respect of amortization payments under those plans. If the Timminco Entities are required to make the pension contributions other than Normal Cost Contributions (the "**Pension Contributions**"), they will not have sufficient funds to continue operating and will be forced to cease operating to the detriment of their stakeholders, including their employees and pensioners.

28. The Timminco Entities intend to make all normal cost contributions when due. However, management of the Timminco Entities does not anticipate an improvement in their cashflows that would permit the making of Pension Contributions with respect to the Pension Plans during these CCAA proceedings.

The Position of CEP and USW

16 Counsel to CEP submits that the super priority charge sought by the Timminco Entities would have the effect of subordinating the rights of, *inter alia*, the pension plans, including the statutory trusts that are created pursuant to the QSPPA. In considering this matter, I have proceeded on the basis that this submission extends to the PBA as well.

17 In order to grant a super priority charge, counsel to CEP, supported by USW, submits that the Timminco Entities must show that the application of provincial legislation "would frustrate the company's ability to restructure and avoid bankruptcy". (See *Indalex Ltd., Re*, 2011 ONCA 265 (Ont. C.A.) at para. 181.)

18 Counsel to CEP takes the position that the evidence provided by the Timminco Entities falls short of showing the necessity of the super priority charge. Presently, counsel contends that the Applicants have not provided any plan for the purpose of restructuring the Timminco Entities and, absent a restructuring proposal, the affected creditors, including the pension plans, have no reason to believe that their interests will be protected through the issuance of the orders being sought.

19 Counsel to CEP takes the position that the Timminco Entities are requesting extraordinary relief without providing the necessary facts to justify same. Counsel further contends that the Timminco Entities must "wear two hats" and act both in their corporate interest and in the best interest of the pension plan and cannot simply ignore their obligations to the pension plans in favour of the corporation. (See *Indalex Ltd., Re*, *supra*, at para. 129.)

20 Counsel to CEP goes on to submit that, where the "two hats" gives rise to a conflict of interest, if a cor-

poration favours its corporate interest rather than its obligations to its fiduciaries, there will be consequences. In *Indalex Ltd., Re, supra*, the court found that the corporation seeking CCAA protection had acted in a manner that revealed a conflict with the duties it owed the beneficiaries of pension plans and ordered the corporation to pay the special payments it owed the plans (See *Indalex Ltd., Re, supra*, at paras. 140 and 207.)

21 In this case, counsel to CEP submits that, given the lack of evidentiary support for the super priority charge, the risk of conflicting interests and the importance of the Timminco Entities. fiduciary duties to the pension plans, the super priority charge ought not to be granted.

22 Although counsel to CEP acknowledges that the court has the discretion in the context of the CCAA to make orders that override provincial legislation, such discretion must be exercised through a careful weighing of the facts before the court. Only where the applicant proves it is necessary in the context and consistent with the objects of the CCAA may a judge make an order overriding provincial legislation. (See *Indalex Ltd., Re, supra*, at paras. 179 and 189.)

23 In the circumstances of this case, counsel to CEP argues that the position of any super priority charge ordered by the court should rank after the pension plans.

24 CEP also takes the position that the Timminco Entities. obligations to the pension plans should not be suspended. Counsel notes that the Timminco Entities have contractual obligations through the collective agreement and pension plan documents to make contributions to the pension plans and, as well, the Timminco Entities owe statutory duties to the beneficiaries of the pension funds pursuant to the QSPPA. Counsel further points out that s. 49 of the QSPPA provides that any contributions and accrued interest not paid into the pension fund are deemed to be held in trust for the employer.

25 In addition, counsel takes the position that the Court of Appeal for Ontario in *Indalex Ltd., Re, supra*, confirmed that, in the context of Ontario legislation, all of the contributions an employee owes a pension fund, including the special payments, are subject to the deemed trust provision of the PBA.

26 In this case, counsel to CEP points out that the special payments the Timminco Entities seek to suspend in the amount of $95,300 per month to the Bécancour Union Pension Plan, and of $47,743 to the Silicium Union Pension Plan, are payments that are to be held in trust for the beneficiaries of the pension plans. Thus, they argue that the Timminco Entities have a fiduciary obligation to the beneficiaries of the pension plans to hold the funds in trust. Further, the Timminco Entities. request to suspend the special payments to the Bécancour Union Pension Plan and the Quebec Silicon Union Pension Plan reveals that its interests are in conflict.

27 Counsel also submits that the Timminco Entities have not pointed to a particular reason, other than generalized liquidity problems, as to why they are unable to make special payments to their pension plans.

28 With respect to the KERPs, counsel to CEP acknowledges that the court has the power to approve a KERP, but the court must only do so when it is convinced that it is necessary to make such an order. In this case, counsel contends that the Timminco Entities have not presented any meaningful evidence on the propriety of the proposed KERPs. Counsel notes that the Timminco Entities have not named the KERPs recipients, provided any specific information regarding their involvement with the CCAA proceeding, addressed their replaceability, or set out their individual bonuses. In the circumstances, counsel submits that it would be unfair and inequitable for the court to approve the KERPs requested by the Timminco Entities.

29 Counsel to CEP's final submission is that, in the event the KERPs are approved, they should not be sealed, but rather should be treated in the same manner as other CCAA documents through the Monitor. Alternatively, counsel to CEP submits that a copy of the KERPs should be provided to the Respondent, CEP.

The Position of the Timminco Entities

30 At the time of the initial hearing, the Timminco Entities filed evidence establishing that they were facing severe liquidity issues as a result of, among other things, a low profit margin realized on their silicon metal sales due to a high volume, long-term supply contract at below market prices, a decrease in the demand and market price for solar grade silicon, failure to recoup their capital expenditures incurred in connection with the development of their solar grade operations, and the inability to secure additional funding. The Timminco Entities also face significant pension and environmental remediation legacy costs, and financial costs related to large outstanding debts.

31 I accepted submissions to the effect that without the protection of the CCAA, a shutdown of operations was inevitable, which the Timminco Entities submitted would be extremely detrimental to the Timminco Entities. employees, pensioners, suppliers and customers.

32 As at December 31, 2011, the Timminco Entities. cash balance was approximately $2.4 million. The 30-day consolidated cash flow forecast filed at the time of the CCAA application projected that the Timminco Entities would have total receipts of approximately $5.5 million and total operating disbursements of approximately $7.7 million for net cash outflow of approximately $2.2 million, leaving an ending cash position as at February 3, 2012 of an estimated $157,000.

33 The Timminco Entities approached their existing stakeholders and third party lenders in an effort to secure a suitable debtor-in-possession ("DIP") facility. The Timminco Entities existing stakeholders, Bank of America NA, IQ, and AMG Advance Metallurgical Group NV, have declined to advance any funds to the Timminco Entities at this time. In addition, two thirdparty lenders have apparently refused to enter into negotiations regarding the provision of a DIP Facility.[FN1]

34 The Monitor, in its Second Report, dated January 11, 2012, extended the cash forecast through to February 17, 2012. The Second Report provides explanations for the key variances in actual receipts and disbursements as compared to the January 2, 2012 forecast.

35 There are some timing differences but the Monitor concludes that there are no significant changes in the underlying assumptions in the January 10, 2012 forecast as compared to the January 2, 2012 forecast.

36 The January 10 forecast projects that the ending cash position goes from positive to negative in mid-February.

37 Counsel to the Applicants submits that, based on the latest cash flow forecast, the Timminco Entities currently estimate that additional funding will be required by mid-February in order to avoid an interruption in operations.

38 The Timminco Entities submit that this is an appropriate case in which to grant super priority to the Administration Charge. Counsel submits that each of the proposed beneficiaries will play a critical role in the Timminco Entities. restructuring and it is unlikely that the advisors will participate in the CCAA proceedings unless

the Administration Charge is granted to secure their fees and disbursements.

39 Statutory Authority to grant such a charge derives from s. 11.52(1) of the CCAA. Subsection 11.52(2) contains the authority to grant super-priority to such a charge:

> 11.52(1) Court may order security or charge to cover certain costs — On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of
>
> (a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;
>
> (b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and
>
> (c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.
>
> 11.52(2) Priority — This court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

40 Counsel also submits that the Timminco Entities require the continued involvement of their directors and officers in order to pursue a successful restructuring of their business and/or finances and, due to the significant personal exposure associated with the Timminco Entities. liabilities, it is unlikely that the directors and officers will continue their services with the Timminco Entities unless the D&O Charge is granted.

41 Statutory authority for the granting of a D&O charge on a super priority basis derives from s. 11.51 of the CCAA:

> 11.51(1) Security or charge relating to director's indemnification — On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or officer of the company after the commencement of proceedings under this Act.
>
> (2) Priority — The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.
>
> (3) Restriction — indemnification insurance — The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.
>
> (4) Negligence, misconduct or fault — The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negli-

gence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

Analysis

(i) Administration Charge and D&O Charge

42 It seems apparent that the position of the unions. is in direct conflict with the Applicants. positions.

43 The position being put forth by counsel to the CEP and USW is clearly stated and is quite understandable. However, in my view, the position of the CEP and the USW has to be considered in the context of the practical circumstances facing the Timminco Entities. The Timminco Entities are clearly insolvent and do not have sufficient reserves to address the funding requirements of the pension plans.

44 Counsel to the Applicants submits that without the relief requested, the Timminco Entities will be deprived of the services being provided by the beneficiaries of the charges, to the company's detriment. I accept the submissions of counsel to the Applicants that it is unlikely that the advisors will participate in the CCAA proceedings unless the Administration Charge is granted to secure their fees and disbursements. I also accept the evidence of Mr. Kalins that the role of the advisors is critical to the efforts of the Timminco Entities to restructure. To expect that the advisors will take the business risk of participating in these proceedings without the security of the charge is neither reasonable nor realistic.

45 Likewise, I accept the submissions of counsel to the Applicants to the effect that the directors and officers will not continue their service without the D&O Charge. Again, in circumstances such as those facing the Timminco Entities, it is neither reasonable nor realistic to expect directors and officers to continue without the requested form of protection.

46 It logically follows, in my view, that without the assistance of the advisors, and in the anticipated void caused by the lack of a governance structure, the Timmico Entities will be directionless and unable to effectively proceed with any type or form of restructuring under the CCAA.

47 The Applicants argue that the CCAA overrides any conflicting requirements of the QSPPA and the BPA.

48 Counsel submits that the general paramountcy of the CCAA over provincial legislation was confirmed in *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.* (2008), 45 C.B.R. (5th) 163 (Ont. C.A.) at para. 104. In addition, in *Nortel Networks Corp., Re*, the Court of Appeal held that the doctrine of paramountcy applies either where a provincial and a federal statutory position are in conflict and cannot both be complied with, or where complying with the provincial law will have the effect of frustrating the purpose of the federal law and therefore the intent of Parliament. See *Nortel Networks Corp., Re* (2009), 59 C.B.R. (5th) 23 (Ont. C.A.).

49 It has long been stated that the purpose of the CCAA is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors, with the purpose of allowing the business to continue. As the Court of Appeal for Ontario stated in *Stelco Inc., Re* (2005), 75 O.R. (3d) 5 (Ont. C.A.), at para. 36:

> In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will en-

> able it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme...

50 Further, as I indicated in *Nortel Networks Corp., Re* (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J. [Commercial List]), this purpose continues to exist regardless of whether a company is actually restructuring or is continuing operations during a sales process in order to maintain maximum value and achieve the highest price for the benefit of all stakeholders. Based on this reasoning, the fact that Timminco has not provided any plan for restructuring at this time does not change the analysis.

51 The Court of Appeal in *Indalex Ltd., Re* (2011), 75 C.B.R. (5th) 19 (Ont. C.A.) confirmed the CCAA court's ability to override conflicting provisions of provincial statutes where the application of the provincial legislation would frustrate the company's ability to restructure and avoid bankruptcy. The Court stated, *inter alia*, as follows (beginning at paragraph 176):

> The CCAA court has the authority to grant a super-priority charge to DIP lenders in CCAA proceedings. I fully accept that the CCAA judge can make an order granting a super-priority charge that has the effect of overriding provincial legislation, including the PBA. ...
>
> . . .
>
> What of the contention that recognition of the deemed trust will cause DIP lenders to be unwilling to advance funds in CCAA proceedings? It is important to recognize that the conclusion I have reached does not mean that a finding of paramountcy will never be made. That determination must be made on a case by case basis. There may well be situations in which paramountcy is invoked and the record satisfies the CCAA judge that application of the provincial legislation would frustrate the company's ability to restructure and avoid bankruptcy.

52 The Timminco Entities seek approval to suspend Special Payments in order to maintain sufficient liquidity to continue operations for the benefit of all stakeholders, including employees and pensioners. It is clear that based on the January 2 forecast, as modified by the Second Report, the Timminco Entities have insufficient liquidity to make the Special Payments at this time.

53 Counsel to the Timminco Entities submits that where it is necessary to achieve the objective of the CCAA, the court has the jurisdiction to make an order under the CCAA granting, in the present case, super priority over the Encumbrances for the Administration Charge and the D&O Charge, even if such an order conflicts with, or overrides, the QSPPA or the PBA.

54 Further, the Timminco Entities submit that the doctrine of paramountcy is properly invoked in this case and that the court should order that the Administration Charge and the D&O Charge have super priority over the Encumbrances in order to ensure the continued participation of the beneficiaries of these charges in the Timminco Entities. CCAA proceedings.

55 The Timminco Entities also submit that payment of the pension contributions should be suspended. These special (or amortization) payments are required to be made to liquidate a going concern or solvency deficiency in a pension plan as identified in the most recent funding valuation report for the plan that is filed with the applicable pension regulatory authority. The requirement for the employer to make such payments is

provided for under applicable provincial pension minimum standards legislation.

56 The courts have characterized special (or amortization) payments as pre-filing obligations which are stayed upon an initial order being granted under the CCAA. (See *AbitibiBowater inc., Re* (2009), 57 C.B.R. (5th) 285 (Que. S.C.); *Collins & Aikman Automotive Canada Inc., Re* (2007), 37 C.B.R. (5th) 282 (Ont. S.C.J.) and *Fraser Papers Inc., Re* (2009), 55 C.B.R. (5th) 217 (Ont. S.C.J. [Commercial List]).

57 I accept the submission of counsel to the Applicants to the effect that courts in Ontario and Quebec have addressed the issue of suspending special (or amortization) payments in the context of a CCAA restructuring and have ordered the suspension of such payments where the failure to stay the obligation would jeopardize the business of the debtor company and the company's ability to restructure.

58 The Timminco Entities also submit that there should be no director or officer liability incurred as a result of a court-ordered suspension of payment of pension contributions. Counsel references *Fraser Papers*, where Pepall J. stated:

> Given that I am ordering that the special payments need not be made during the stay period pending further order of the Court, the Applicants and the officers and directors should not have any liability for failure to pay them in that same period. The latter should be encouraged to remain during the CCAA process so as to govern and assist with the restructuring effort and should be provided with protection without the need to have recourse to the Director's Charge.

59 Importantly, *Fraser Papers* also notes that there is no priority for special payments in bankruptcy. In my view, it follows that the employees and former employees are not prejudiced by the relief requested since the likely outcome should these proceedings fail is bankruptcy, which would not produce a better result for them. Thus, the "two hats" doctrine from *Indalex Ltd., Re*, *supra*, discussed earlier in these reasons at [20], would not be infringed by the relief requested. Because it would avoid bankruptcy, to the benefit of both the Timminco Entities and beneficiaries of the pension plans, the relief requested would not favour the interests of the corporate entity over its obligations to its fiduciaries.

60 Counsel to the Timminco Entities submits that where it is necessary to achieve the objective of the CCAA, the court has the jurisdiction to make an order under the CCAA suspending the payment of the pension contributions, even if such order conflicts with, or overrides, the QSPPA or the PBA.

61 The evidence has established that the Timminco Entities are in a severe liquidity crisis and, if required to make the pension contributions, will not have sufficient funds to continue operating. The Timminco Entities would then be forced to cease operations to the detriment of their stakeholders, including their employees and pensioners.

62 On the facts before me, I am satisfied that the application of the QSPPA and the PBA would frustrate the Timminco Entities ability to restructure and avoid bankruptcy. Indeed, while the Timminco Entities continue to make Normal Cost Contributions to the pension plans, requiring them to pay what they owe in respect of special and amortization payments for those plans would deprive them of sufficient funds to continue operating, forcing them to cease operations to the detriment of their stakeholders, including their employees and pensioners.

63 In my view, this is exactly the kind of result the CCAA is intended to avoid. Where the facts demonstrate that ordering a company to make special payments in accordance with provincial legislation would have the ef-

fect of forcing the company into bankruptcy, it seems to me that to make such an order would frustrate the rehabilitative purpose of the CCAA. In such circumstances, therefore, the doctrine of paramountcy is properly invoked, and an order suspending the requirement to make special payments is appropriate (see *ATB Financial* and *Nortel Networks Corp., Re*).

64 In my view, the circumstances are such that the position put forth by the Timminco Entities must prevail. I am satisfied that bankruptcy is not the answer and that, in order to ensure that the purpose and objective of the CCAA can be fulfilled, it is necessary to invoke the doctrine of paramountcy such that the provisions of the CCAA override those of QSPPA and the PBA.

65 There is a clear inter-relationship between the granting of the Administration Charge, the granting of the D&O Charge and extension of protection for the directors and officers for the company's failure to pay the pension contributions.

66 In my view, in the absence of the court granting the requested super priority and protection, the objectives of the CCAA would be frustrated. It is not reasonable to expect that professionals will take the risk of not being paid for their services, and that directors and officers will remain if placed in a compromised position should the Timminco Entities continue CCAA proceedings without the requested protection. The outcome of the failure to provide these respective groups with the requested protection would, in my view, result in the overwhelming likelihood that the CCAA proceedings would come to an abrupt halt, followed, in all likelihood, by bankruptcy proceedings.

67 If bankruptcy results, the outcome for employees and pensioners is certain. This alternative will not provide a better result for the employees and pensioners. The lack of a desirable alternative to the relief requested only serves to strengthen my view that the objectives of the CCAA would be frustrated if the relief requested was not granted.

68 For these reasons, I have determined that it is both necessary and appropriate to grant super priority to both the Administrative Charge and D&O Charge.

69 I have also concluded that it is both necessary and appropriate to suspend the Timminco Entities. obligations to make pension contributions with respect to the Pension Plans. In my view, this determination is necessary to allow the Timminco Entities to restructure or sell the business as a going concern for the benefit of all stakeholders.

70 I am also satisfied that, in order to encourage the officers and directors to remain during the CCAA proceedings, an order should be granted relieving them from any liability for the Timminco Entities. failure to make pension contributions during the CCAA proceedings. At this point in the restructuring, the participation of its officers and directors is of vital importance to the Timminco Entities.

(ii) The KERPs

71 Turning now to the issue of the employee retention plans (KERPs), the Timminco Entities seek an order approving the KERPs offered to certain employees who are considered critical to successful proceedings under the CCAA.

72 In this case, the KERPs have been approved by the board of directors of Timminco. The record indicates

that in the opinion of the Chief Executive Officer and the Special Committee of the Board, all of the KERPs participants are critical to the Timminco Entities. CCAA proceedings as they are experienced employees who have played central roles in the restructuring initiatives taken to date and will play critical roles in the steps taken in the future. The total amount of the KERPs in question is $269,000. KERPs have been approved in numerous CCAA proceedings where the retention of certain employees has been deemed critical to a successful restructuring. See *Nortel Networks Corp., Re*, [2009] O.J. No. 1044 (Ont. S.C.J. [Commercial List]), *Grant Forest Products Inc., Re* (2009), 57 C.B.R. (5th) 128 (Ont. S.C.J. [Commercial List]), and *Canwest Global Communications Corp., Re* (2009), 59 C.B.R. (5th) 72 (Ont. S.C.J. [Commercial List]).

73 In *Grant Forest Products*, Newbould J. noted that the business judgment of the board of directors of the debtor company and the monitor should rarely be ignored when it comes to approving a KERP charge.

74 The Monitor also supports the approval of the KERPs and, following review of several court-approved retention plans in CCAA proceedings, is satisfied that the KERPs are consistent with the current practice for retention plans in the context of a CCAA proceeding and that the quantum of the proposed payments under the KERPs are reasonable in the circumstances.

75 I accept the submissions of counsel to the Timminco Entities. I am satisfied that it is necessary, in these circumstances, that the KERPs participants be incentivized to remain in their current positions during the CCAA process. In my view, the continued participation of these experienced and necessary employees will assist the company in its objectives during its restructuring process. If these employees were not to remain with the company, it would be necessary to replace them. It is reasonable to conclude that the replacement of such employees would not provide any substantial economic benefits to the company. The KERPs are approved.

76 The Timminco Entities have also requested that the court seal the Confidential Supplement which contains copies of the unredacted KERPs, taking the position that the KERPs contain sensitive personal compensation information and that the disclosure of such information would compromise the commercial interests of the Timminco Entities and harm the KERPs participants. Further, the KERPs participants have a reasonable expectation that their names and salary information will be kept confidential. Counsel relies on *Sierra Club of Canada v. Canada (Minister of Finance)*, [2002] 2 S.C.R. 522 (S.C.C.) at para. 53 where Iacobucci J. adopted the following test to determine when a sealing order should be made:

> A confidentiality order under Rule 151 should only be granted when:
>
> (a) such an order is necessary in order to prevent serious risk to an important interest, including a commercial interest, in the context of litigation because reasonable alternative measures will not prevent the risk; and
>
> (b) the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh the deleterious effects, including the effects on the right to free expression, which in this context includes the public interest in open and accessible court proceedings.

77 CEP argues that the CCAA process should be open and transparent to the greatest extent possible and that the KERPs should not be sealed but rather should be treated in the same manner as other CCAA documents through the Monitor. In the alternative, counsel to the CEP submits that a copy of the KERPs should be provided to the Respondent, CEP.

78 In my view, at this point in time in the restructuring process, the disclosure of this personal information could compromise the commercial interests of the Timminco Entities and cause harm to the KERP participants. It is both necessary and important for the parties to focus on the restructuring efforts at hand rather than to get, in my view, potentially side-tracked on this issue. In my view, the Confidential Supplement should be and is ordered sealed with the proviso that this issue can be revisited in 45 days.

Disposition

79 In the result, the motion is granted. An order shall issue:

(a) suspending the Timminco Entities. obligation to make special payments with respect to the pension plans (as defined in the Notice of Motion);

(b) granting super priority to the Administrative Charge and the D&O Charge;

(c) approving the KERPs and the grant of the KERP Charge;

(d) authorizing the sealing of the Confidential Supplement to the First Report of the Monitor.

FN1 In a subsequent motion relating to approval of a DIP Facility, the Timminco Entities acknowledged they had reached an agreement with a third-party lender with respect to providing DIP financing, subject to court approval. Further argument on this motion will be heard on February 6, 2012.

END OF DOCUMENT

TAB 14

2012 CarswellOnt 1466, 2012 ONSC 948

Timminco Ltd., Re

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

In the Matter of a Plan of Compromise or Arrangement of Timminco Limited and Bécancour Silicon Inc., Applicants

Ontario Superior Court of Justice [Commercial List]

Morawetz J.

Heard: January 27 - February 6, 2012
Judgment: February 9, 2012
Docket: CV-12-9539-00CL

Counsel: A. J. Taylor, M. Konyukhova, for Applicants

K. Stuebing, D. Wray, for Communications, Energy and Paperworkers' Union of Canada ("CEP")

L. Rogers, for FTI Consulting Canada Inc.

D. Bish, for QSI Partners Ltd.

C. Sinclair, for United Steelworkers' Union ("USW")

S. Scharbach, D. McPhail, for FSCO

H. Meredith, for AMG Advance Metallurgical Group NV

B. Boake, for Dow Corning

A. Kauffman, for Investissement Quebec

J. Orr, M. Spencer, for Class Action Plaintiffs

Subject: Insolvency

Business associations.

***Morawetz J.*:**

1 Timminco Limited and Bécancour Silicon Inc. (together, the "Timminco Entities") brought this motion for an order approving the DIP Facility (defined below) and granting a priority charge on the current and future assets, undertakings and properties of the Timminco Entities in favour of the DIP Lender (defined below).

2 CEP and USW opposed the motion, especially the request to grant super priority to the DIP Lender.

3 By way of background, the Timminco Entities stated that they attempted to secure DIP financing prior to commencing the CCAA proceeding, but were unable to do so. The affidavit of Mr. Kalins sworn January 20, 2012 states that the Timminco Entities had approached their existing stakeholders and third-party financing lenders in order to obtain a suitable DIP facility. Investissement Quebec ("IQ"), Bank of America, N.A. ("Bank of America"), AMG Advanced Metallurgical Group NV ("AMG") and two third-party lenders declined to advance any funds to the Timminco Entities. The affidavit also states that negotiations with another third-party lender failed to result in a DIP facility with mutually agreeable terms.

4 Mr. Kalins went on to state that in light of the Timminco Entities precarious cash position, it was imperative that the Timminco Entities secured DIP financing as soon as possible after commencement of the CCAA proceedings. Following the grant of the stay of proceedings, the Timminco Entities, with the assistance of the Monitor, expanded their efforts to secure DIP financing by contacting parties who could not be contacted in advance of the filing.

5 Mr. Kalins stated that the Timminco Entities pursued the arrangement of a DIP facility with a number of parties and five parties submitted indicative terms for a DIP facility. Following further discussion and negotiations, the Timminco Entities negotiated a DIP Agreement with QSI Partners Ltd. ("QSI" or the "DIP Lender") dated January 18, 2012 (the "DIP Agreement").

6 The DIP Agreement is conditional, among other things, upon the issuance of a court-order approving the DIP Facility and granting the DIP Lender a priority charge in favour of the DIP Lender (the "DIP Lenders' Charge") over all of the assets, property and undertaking of the Timminco Entities (the "Property"), ranking ahead in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise (collectively, the "Encumbrances") in favour of any person, notwithstanding the order of perfection or attachment, including without limitation any deemed trust created under the *Ontario Pension Benefits Act* ("OPBA"), or the *Quebec Supplemental Pension Plans Act* ("QSPPA"), other than the Administration Charge and the KERP Charge (as granted by my order dated January 16, 2012), and any valid purchase money security interests.

7 Mr. Kalins stated that the DIP Lender was specifically asked whether it would advance under the DIP Facility if the DIP Lenders' Charge was not granted priority over the Encumbrances (other than any valid purchase money security interest), including without limitation any deemed trust created under the OPBA or the QSPPA. The DIP Lender indicated that they would not advance under the DIP Facility; and further, the DIP Lenders' Charge is not intended to secure obligations incurred prior to the CCAA proceeding.

8 The DIP Agreement provides for a period of exclusivity during which the Timminco Entities may not negotiate with or accept any proposal of any person other than the DIP Lender for the acquisition of substantially all of the assets of the Timminco Entities until January 31, 2012 (the "Exclusivity Period") in order to provide the DIP Lender with an opportunity to prepare a "stalking horse bid" for consideration by the Timminco Entities.

9 Mr. Kalins went on to state that, if the order approving the DIP Facility was not granted in a form and substance satisfactory to the DIP Lender and the Timminco Entities, or if the DIP obligations are declared to be

immediately due and payable, the Exclusivity period shall immediately terminate.

10 Mr. Kalins also stated that the financial terms of the DIP Agreement are better than or not materially worse than those proposed in the competing term sheets. Some of the other term sheets provided were for an inadequate amount of funding, contained other disadvantageous terms or would not be available in a timely manner. Mr. Kalins states that, in the opinion of management, the DIP Agreement is the best available option. The special committee of the board has approved the execution of the DIP Agreement and the seeking of court approval.

11 The Monitor filed its Third Report which addresses the request for approval of the DIP Agreement and the DIP Lenders' Charge. The Monitor has been providing the Timminco Entities with assistance in their attempts to obtain DIP financing. The Monitor reported that four of the indications of interests with respect to a DIP facility were either for an amount that was insufficient to provide the necessary liquidity, added more onerous financial terms than those contained in the DIP Agreement, or contained terms and conditions that, in the opinion of the Timminco Entities and the Monitor, made it unlikely that a binding agreement could successfully be negotiated within the time frame necessary to be able to access the funding when required, or a combination of these factors.

12 The Monitor reports that the DIP Lender is a Cayman Islands company that the Monitor has been informed is a subsidiary of a major company with a strategic interest in the business and assets of the Timminco Entities. Pursuant to a non-disclosure agreement entered into between the Timminco Entities and the DIP Lender, neither the Timminco Entities nor the Monitor is at liberty to disclose the name of the ultimate parent company of QSI, although that information is known to the Timminco Entities and the Monitor. However, the Monitor does report that the DIP Lender has confirmed that the corporate group of which it is part is neither a shareholder nor a creditor of the Timminco Entities.

13 The Monitor also reports that subject to the terms and conditions of the DIP Agreement, the DIP Lender has agreed to lend up to U.S. $4.25 million (the "Maximum Amount"). The Maximum Amount will be deposited in a segregated interest-bearing account of the Monitor within one business day of the granting of this order, with advances to draw from the Maximum Amount in accordance with the terms of the DIP Agreement.

14 The DIP Facility is to bear interest at the Bank of Canada prime rate plus 5% per annum payable monthly in arrears. A commitment fee of U.S. $100,000 is payable from the first DIP advance. In addition, the Timminco Entities are obligated to pay all reasonable out of pocket expenses.

15 The Timminco Entities' obligations under the DIP Facility (the "DIP Obligations") are repayable in full on the earlier of:

(a) the occurrence of an event of default which is continuing and has not been cured; and

(b) June 20, 2012.

16 The DIP Agreement does provide for the mandatory repayment of the DIP Obligations from the net proceeds of any sale of collateral, subject to the first $1,269,000 of such net proceeds being paid to and held by the Monitor as the Priority Charge reserve.

17 The Monitor is of the view that the DIP Agreement contains affirmative covenants, negative covenants,

events of default and conditions customary for this type of financing, including the granting of the DIP Lenders' Charge having priority over all other Encumbrances against the assets of the Timminco Entities other than the Administration Charge, the KERP charge and purchase money security interests that are permitted Encumbrances.

18 The Monitor specifically notes that the DIP Agreement provides that DIP advances cannot be used to make special payments in respect of pension plans. During the negotiation of the DIP Agreement, the Monitor reports that the DIP Lender was asked whether it would allow DIP advances to be used to pay special payments and whether it would allow DIP advances to be used for claims in respect of pension plans ranked in priority to the DIP Lenders' Charge. The Monitor states that the DIP Lender was not prepared to do so.

19 The revised Cash Flow Forecast filed in the Second Report indicates that the Timminco Entities become cash flow negative during the third week of February 2012. Mr. Kalins states that without additional funding, the Timminco Entities will be forced to cease operating in February.

20 Further, Mr. Kalins states that the DIP Facility is expected to provide sufficient liquidity to conduct an orderly marketing process of the Timminco Entities' business following expiry of the Exclusivity Period, whether or not a "stalking horse bid" is negotiated.

21 The motion materials have been served on, among others:

(a) IQ, Bank of America, Dow Corning, all registrants shown on searches of the personal property security and real property registers in Ontario and in Quebec;

(b) the members of the pension plan committees for the Bécancour Union Pension Plan and the Bécancour Non-Union Pension Plan, Financial Services Commission of Ontario; Régie de rentes du Québec, the USW and the Bécancour Union; and

(c) various government entities, including Ontario and Quebec environmental agencies and federal and provincial taxing authorities.

22 In addition, all of the directors and officers of the Timminco Entities were served with the motion record in connection with the request for the DIP Lenders' Charge to rank ahead of, among other things, the D&O Charge.

23 The Monitor recommended that the requested relief be granted. The motion was not opposed by IQ or any other secured creditor.

24 The motion was opposed by CEP and the USW.

25 The financial positions of the various pension plans for the benefit of members of CEP and USW have been set out in previous decisions and are not repeated here.

26 Mr. Simoneau, President of CEP, Local 184, states in his affidavit that since the commencement of the CCAA proceedings, CEP and the pension committee have been excluded from all aspects of the Applicant's restructuring activities, details of which are contained at paragraphs 7 — 15 of his affidavit.

27 The CEP also takes the position that neither the pension committee nor the CEP were consulted during the negotiation of the DIP Agreement and that the Applicants have not disclosed specific reasons for their electing not to pursue negotiations with any of the other parties that expressed interest in entering into a DIP agreement.

28 The issue on this motion is whether the court should approve the DIP Facility and grant the DIP Lenders' Charge.

29 In respect of this issue, counsel to the Timminco Entities submits that to the extent that the request for the DIP Lenders' Charge is a request for the court to override the provisions of the QSPPA or the OPBA, the court has the jurisdiction to do so. I agree with this submission. This issue was analyzed in *Timminco Limited (Re)* 2012 ONSC 506, which considered the court's jurisdiction to grant super priority to the Administration Charge and D&O Charge, and is incorporated by reference to this decision and attached as Appendix A. The analysis of the court's jurisdiction in that case is also applicable here.

30 The Timminco Entities seek approval of the DIP Facility in the amount of U.S. $4,250,000. The Timminco Entities also seek a granting of the DIP Lenders' Charge securing the DIP Facility ranking immediately behind the Administration Charge and the KERP Charge.

31 Section 11.2 of the CCAA provides the court with the express jurisdiction to grant a DIP financing charge and provides, in part, as follows:

> 11.2(1) Interim Financing — on application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, a court may make an order declaring that all or part of the company's property is subject to a security or charge — in an amount that the court considers appropriate — in favour of a person specified in the order who agrees to lend to the company an amount approved by the court as being required by the company, having regard to its cash-flow statement. The security or charge may not secure an obligation that exists before the order is made.
>
> 11.2(2) Priority — Secured Creditors — the court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

32 Subsection 11.2(4) sets out the factors to be considered by the court in deciding whether to grant a DIP Financing Charge:

> 11.2(4) — Factors to be Considered — in deciding whether to make an order, the court is to consider, among other things:
>
> (a) the period during which the company is expected to be subject to proceedings under the CCAA;
>
> (b) how the company's business and financial affairs are to be managed during the proceedings;
>
> (c) whether the company's management has the confidence of its major creditors;
>
> (d) whether the loan would enhance the prospects of a viable compromise or arrangement being made in respect of the company;

(e) the nature and value of the company's property;

(f) whether any creditor would be materially prejudiced as a result of the security or charge; and

(g) the monitor's report.

33 Counsel to the Timminco Entities referenced *Canwest Global Communications Corp. (Re)* (2009), 59 C.B.R. (5th) 72 (Ont. S.C.J.) (Commercial List)), where Pepall J. stressed the importance of meeting the criteria set out in s. 11.2(1), namely:

(a) whether notice has been given to secured creditors likely to be affected by the security charge or charge;

(b) whether the amount to be granted under the DIP Facility is appropriate and required having regard to the debtor's cash-flow statement; and

(c) whether the DIP Charge secures an obligation that existed before the order was made (which it should not).

34 Counsel to the Timminco Entities submits that a number of factors support the granting of the DIP Lenders' Charge and satisfy the criteria set out in s. 11.2(1) of the CCAA and the factors to be considered as outlined in s. 11.2(4) of the CCAA:

(a) the Timminco Entities expect to continue operating during the term of the DIP Facility and attempt to negotiate a "stalking horse bid" and complete a bidding procedure or, if a "stalking horse bid" cannot be negotiated, complete a stand-alone sales process and return to court for approval, which the Timminco Entities expect to complete before June 2012;

(b) the management of the Timminco Entities' business will be overseen by the Monitor. In this respect, counsel submits that neither IQ nor any other major creditor has expressed any concern in respect of the Timminco Entities' management;

(c) without the DIP Facility, the Timminco Entities will not have the funding necessary to meet their obligations and will have to cease operations by the third week of February. Counsel further submits that the Timminco Entities and the Monitor are of the view that the continuation of operations would likely enhance the prospects of the sales process succeeding and would maximize recoveries for stakeholders;

(d) secured creditors have been given notice of the motion and IQ is not opposed to the granting of the DIP Lenders' Charge;

(e) directors and officers of Timminco, as beneficiaries of the D&O Charge, received notice of the request for an order granting the DIP Lenders' Charge ranking in priority to the D&O Charge;

(f) the Monitor is supportive of the requested relief and is of the view that any potential detriment caused to the Timminco Entities' creditors by the DIP Lenders' Charge should be outweighed by the benefits that it creates;

(g) the DIP Lender indicated that it will not provide the DIP Facility if the DIP Lenders' Charge is not gran-

ted; and

(h) the DIP Lenders' Charge does not secure an obligation that existed before the granting of the Initial Order.

35 Counsel to IQ does not oppose the requested relief, but did make submissions to oppose the outcome sought by CEP, on the basis that such an outcome would provide enhanced priority to CEP and USW, at the expense of IQ.

36 Not surprisingly, counsel for CEP takes a different approach and submits that in order to resolve the issue, consideration must be given to whether the evidentiary record discloses that the DIP Agreement is the result of a negotiation process that was fair and reasonable and that satisfies the statutory and common law obligations to act in the best interests of the union pension plans and their beneficiaries.

37 Counsel to CEP submits that in addition to the listed factors noted above, it is incumbent upon the court to consider whether the Applicants, as members of the pension committee, have satisfied their fiduciary duties to the union pension plans both under the statute and at common law during the negotiation of the DIP Agreement. Counsel submits that a failure of the Timminco Entities in this regard would render the DIP Agreement itself unfair and unreasonable and the product of an unlawful process in which the Timminco Entities breached their duties to the union pension plans.

38 Counsel to CEP submits that the Applicants, as members of the pension committee, are subject to fiduciary obligations in respect of the plan members and beneficiaries and that these obligations arise both at common law and by virtue of the QSPPA.

39 Counsel to CEP contends that at the time the Applicants initiated the CCAA proceedings, the evidence confirmed that the union pension plans and the Haley pension plan were underfunded. The decisions that the Timminco Entities have made since the commencement of the CCAA proceedings have the potential to affect the plan members and beneficiaries at a time when they are peculiarly vulnerable. Counsel contends that the Timminco Entities have failed to consider their fiduciary obligations or consider the best interests of the plan members or beneficiaries and that this includes the negotiation of the DIP Agreement.

40 A key component of the argument is the contention that the Timminco Entities were not at liberty to resolve the conflict by simply ignoring their role as a fiduciary to the pension plan. Counsel argues that when the Applicants' duty to the corporation conflicted with their fiduciary duties, including the negotiation of the DIP Agreement, it was incumbent on the Applicants to take steps to address the conflict and they failed to do so.

41 Counsel to CEP also submits that there was insufficient evidence to justify the requested order.

42 There is no doubt that the position of those represented by CEP and USW is impaired. However, the effect of acceding to the arguments put forth by counsel to CEP and supported by USW will do nothing, in my view, to improve the position of the members they represent.

43 The stark reality of the situation facing the Timminco Entities is that without the approval of the DIP Facility and the granting of the DIP Charge, there simply will be no money available.

44 The uncontradicted evidence is clear:

(i) in the third week of February 2012, the Timminco Entities will become cash flow negative;

(ii) without additional funding, the Timminco Entities will be forced to cease operating;

(iii) the Timminco Entities, with the assistance of the Monitor, have attempted to secure DIP financing, both prior to and after commencement of CCAA proceedings;

(iv) there was insufficient liquidity or unfavourable terms associated with the rejected DIP proposals;

(v) the DIP Lender will not permit DIP advances to be used to pay special payments or for claims in respect of pension plans ranked in priority to the DIP Lenders' Charge;

(vi) the DIP Facility is expected to provide sufficient liquidity to conduct an orderly marketing process of the Timminco Entities' business.

45 I have taken the above findings into consideration, as well as the factors set out at [34] above. A review of these factors leads to the conclusion that the DIP Facility is necessary. The requirements of s. 11.2 of the CCAA have, in my view, been satisfied.

46 It is unrealistic to expect that any commercially motivated DIP Lender will advance funds without receiving the priority that is being requested on this motion. It is also unrealistic to expect that any commercially motivated party would make advances to the Timminco Entities for the purpose of making special payments or other payments under the pension plans.

47 The alternative proposed by CEP — of a DIP Charge without super priority — is not, in my view, realistic, nor is directing the Monitor to investigate alternative financing without providing super priority. If there is going to be any opportunity for the Timminco Entities to put forth a restructuring plan, it seems to me that it is essential and necessary for the DIP Financing to be approved and the DIP Charge granted. The alternative is a failed CCAA process.

48 This underscores the lack of other viable options that was fully considered in the first Timminco endorsement (*Timminco Limited (Re)* 2012 ONSC 506). The situation has not changed. The reality, in my view, is that there is no real alternative. The position being put forth by CEP does not, in my view, satisfactorily present any viable alternative. In this respect, it seems to me that the challenge of the unions to the position being taken by the Timminco Entities is suspect, as the only alternative is a shutdown. It is impossible for me to reach any conclusion other than the fact that there simply is no other viable alternative.

49 In the absence of the court granting the requested super priority, the objectives of the CCAA would be frustrated. It is neither reasonable nor realistic to expect a commercially motivated DIP lender to advance funds in a DIP facility without super priority. The outcome of a failure to grant super priority would, in all likelihood, result in the Timminco Entities having to cease operations, which would likely result in the CCAA proceedings coming to an abrupt halt, followed by bankruptcy proceedings. Such an outcome would be prejudicial to all stakeholders, including CEP and USW.

50 The analysis in the present motion is the same as that set out in *Timminco Limited (Re)*, 2012 ONSC 506. The outcome of this motion is consistent with that analysis. I am satisfied that bankruptcy is not the answer and, in order to ensure that the objectives of the CCAA are fulfilled, it is necessary to invoke the doctrine of paramountcy such that the provisions of the CCAA override those of the QSPPA and the OPBA.

51 On the facts before me, I am satisfied that it is both necessary and appropriate to approve the DIP Facility. It is also, in my view, both necessary and appropriate to grant the D&O Charge and to provide that the D&O Charge has priority over the Encumbrances, including without limitation any deemed trust created under the OPBA or the QSPPA.

52 The motion is, therefore, granted. The DIP Facility is approved and the DIP Charge is granted with the requested super priority.

Appendix A

CITATION: Timminco Limited (Re), 2012 ONSC 506

COURT FILE NO.: CV-12-9539-00CL

DATE: 20120202

SUPERIOR COURT OF JUSTICE — ONTARIO

(COMMERCIAL LIST)

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

RE: IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TIMMINCO LIMITED AND BÉCANCOUR SILICON INC., Applicants

BEFORE: MORAWETZ J.

COUNSEL: A. J. Taylor, M. Konyukhova and K. Esaw, for the Applicants

D.W. Ellickson, for Communications, Energy and Paperworkers' Union of Canada

C. Sinclair, for United Steelworkers' Union

K. Peters, for AMG Advance Metallurgical Group NV

M. Bailey, for Superintendent of Financial Services (Ontario)

S. Weisz, for FTI Consulting Canada Inc.

A. Kauffman, for Investissement Quebec

HEARD: January 12, 2012

RELEASED: January 16, 2012

REASONS: February 2, 2012

Endorsement

This motion was heard on January 12, 2012. On January 16, 2012, the following endorsement was released:

> Motion granted. Reasons will follow. Order to go subject to proviso that the Sealing Order is subject to modification, if necessary, after reasons provided.

These are those reasons.

Background

On January 3, 2012, Timminco Limited ("Timminco") and Bécancour Silicon Inc. ("BSI") (collectively, the "Timminco Entities") applied for and obtained relief under the *Companies' Creditors Arrangement Act* (the "CCAA").

In my endorsement of January 3, 2012, (*Timminco Limited (Re)*, 2012 ONSC 106), I stated at [11]: "I am satisfied that the record establishes that the Timminco Entities are insolvent and are 'debtor companies' to which the CCAA applies".

On the initial motion, the Applicants also requested an "Administration Charge" and a "Directors' and Officers' Charge" ("D&O Charge"), both of which were granted.

The Timminco Entities requested that the Administration Charge rank ahead of the existing security interest of Investissement Quebec ("IQ") but behind all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise, including any deemed trust created under the *Ontario Pension Benefit Act* (the "PBA") or the *Quebec Supplemental Pensions Plans Act* (the "QSPPA") (collectively, the "Encumbrances") in favour of any persons that have not been served with this application.

IQ had been served and did not object to the Administration Charge and the D&O Charge.

At [35] of my endorsement, I noted that the Timminco Entities had indicated their intention to return to court to seek an order granting super priority ranking for both the Administration Charge and the D&O Charge ahead of the Encumbrances.

The Timminco Entities now bring this motion for an order:

> (a) suspending the Timminco Entities' obligations to make special payments with respect to the pension plans (as defined in the Notice of Motion);
>
> (b) granting super priority to the Administration Charge and the D&O Charge;
>
> (c) approving key employee retention plans (the "KERPs") offered by the Timminco Entities to certain employees deemed critical to a successful restructuring and a charge on the current and future assets, undertakings and properties of the Timminco Entities to secure the Timminco Entities' obligations under the KERPs (the "KERP Charge"); and
>
> (d) sealing the confidential supplement (the "Confidential Supplement") to the First Report of FTI Consulting Canada Inc. (the "Monitor").

If granted, the effect of the proposed Court-ordered charges in relation to each other would be:

- first, the Administration Charge to the maximum amount of $1 million;
- second, the KERP Charge (in the maximum amount of $269,000); and
- third, the D&O Charge (in the maximum amount of $400,000).

The requested relief was recommended and supported by the Monitor. IQ also supported the requested relief. It was, however, opposed by the Communications, Energy and Paperworkers' Union of Canada ("CEP"). The position put forth by counsel to CEP was supported by counsel for the United Steelworkers' Union ("USW").

The motion materials were served on all personal property security registrants in Ontario and in Quebec: the members of the Pension Plan Committees for the Bécancour Union Pension Plan and the Bécancour Non-Union Pension Plan; the Financial Services Commission of Ontario; the Regie de Rentes du Quebec; the United Steel, Paper and Forestry, Rubber, Manufacturing, Energy, Allied Industrial and Service Works International Union; and La Section Locale 184 de Syndicat Canadien des Communications, De L'Energie et du Papier; and various government entities, including Ontario and Quebec environmental agencies and federal and provincial taxing authorities.

Counsel to the Applicants identified the issues on the motion as follows:

(a) Should this court grant increased priority to the Administration Charge and the D&O Charge?

(b) Should this court grant an order suspending the Timminco Entities' obligations to make the pension contributions with respect to the pension plans?

(c) Should this court approve the KERPs and grant the KERPs Charge?

(d) Should this court seal the Confidential Supplement?

It was not disputed that the court has the jurisdiction and discretion to order a super priority charge in the context of a CCAA proceeding. However, counsel to CEP submits that this is an extraordinary measure, and that the onus is on the party seeking such an order to satisfy the court that such an order ought to be awarded in the circumstances.

The affidavit of Peter A.M. Kalins, sworn January 5, 2012, provides information relating to the request to suspend the payment of certain pension contributions. Paragraphs 14-28 read as follows:

14. The Timminco Entities sponsor the following three pension plans (collectively, the "**Pension Plans**"):

(a) the Retirement Pension Plan for The Haley Plant Hourly Employees of Timminco Metals, A Division of Timminco Limited (Ontario Registration Number 0589648) (the "**Haley Pension Plan**");

(b) the Régime de rentes pour les employés non syndiqués de Silicium Bécancour Inc. (Québec Registration Number 26042) (the "**Bécancour Non-Union Pension Plan**"); and

(c) the Régime de rentes pour les employés syndiqués de Silicium Bécancour Inc. (Québec Registration Number 32063) (the "**Bécancour Union Pension Plan**").

Haley Pension Plan

15. The Haley Pension plan, sponsored and administered by Timminco, applies to former hourly employees at Timminco's magnesium facility in Haley, Ontario.

16. The Haley Pension Plan was terminated effective as of August 1, 2008 and accordingly, no normal cost contributions are payable in connection with the Haley Pension Plan. As required by the Ontario *Pension Benefits Act* (the "**PBA**"), a wind-up valuation in respect of the Haley Pension Plan was filed with the Financial Services Commission of Ontario ("**FSCO**") detailing the plan's funded status as of the wind-up date, and each year thereafter. As of August 1, 2008, the Haley Pension Plan was in a deficit position on a wind-up basis of $5,606,700. The PBA requires that the wind-up deficit be paid down in equal annual installments payable annually in advance over a period of no more than five years.

17. As of August 1, 2010, the date of the most recently filed valuation report, the Haley Pension Plan had a wind-up deficit of $3,922,700. Contributions to the Haley Pension Plan are payable annually in advance every August 1. Contributions in respect of the period from August 1, 2008 to July 31, 2011 totalling $4,712,400 were remitted to the plan. Contributions in respect of the period from August 1, 2011 to July 31, 2012 were estimated to be $1,598,500 and have not been remitted to the plan.

18. According to preliminary estimates calculated by the Haley Pension Plan's actuaries, despite Timminco having made contributions of approximately $4,712,400 during the period from August 1, 2008 to July 31, 2011, as of August 1, 2011, the deficit remaining in the Haley Pension Plan is $3,102,900.

Bécancour Non-Union Pension Plan

19. The Bécancour Non-Union Pension Plan, sponsored by BSI, is an on-going pension plan with both defined benefit ("**DB**") and defined contribution provisions. The plan has four active membersand 32 retired and deferred vested members (including surviving spouses).

20. The most recently filed actuarial valuation of the Bécancour Non-Union Pension Plan performed for funding purposes was performed as of September 30, 2010. As of September 30, 2010,the solvency deficit in the Bécancour Non-Union Pension Plan was $3,239,600.

21. In 2011, normal cost contributions payable to this plan totaled approximately $9,525 per month (or 16.8% of payroll). Amortization payments owing to this plan totaled approximately $41,710 per month. All contributions in respect of the plan were paid when due in accordance with the Québec *Supplemental Pension Plans Act* (the "**QSPPA**") and regulations.

Bécancour Union Pension Plan

22. The BSI-sponsored Bécancour Union Pension Plan is an on-going DB pension plan with two active membersand 98 retired and deferred vested members (including surviving spouses).

23. The most recently filed actuarial valuation performed for funding purposes was performed as of September 30, 2010. As of September 30, 2010, the solvency deficit in the Bécancour Union Pension Plan was $7,939,500.

24. In 2011, normal cost contributions payable to the plan totaled approximately $7,083 per month (or 14.7% of payroll). Amortization payments owing to this plan totaled approximately $95,300 per month. All contributions in respect of the plan were paid when due in accordance with the QSPPA and regulations.

25. BSI unionized employees have the option to transfer their employment to QSLP, under the form of the existing collective bargaining agreement. In the event of such transfer, their pension membership in the Bécancour Union Pension Plan will be transferred to the Quebec Silicon Union Pension Plan (as defined and described in greater detail in the Initial Order Affidavit). Also, in the event that any BSI non-union employees transfer employment to QSLP, their pension membership in the Bécancour Non-Union Pension Plan would be transferred to the Quebec Silicon Non-Union Pension Plan (as defined and described in greater detail in the Initial Order Affidavit). I am advised by Andrea Boctor of Stikeman Elliott LLP, counsel to the Timminco Entities, and do verily believe that if all of the active members of the Bécancour Union Pension Plan and the Bécancour Non-Union Pension Plan transfer their employment to QSLP, the Régie des rentes du Québec would have the authority to order that the plans be wound up.

Pension Plan Deficiencies and the Timminco Entities' CCAA Proceedings

26. The assets of the Pension Plans have been severely impacted by market volatility and decreasing long-term interest rates in recent years, resulting in increased deficiencies in the Pension Plans. As a result, the special payments payable with respect to the Haley Plan also increased. As at 2010, total annual special payments for the final three years of the wind-up of the Haley Pension Plan were $1,598,500 for 2010, $1,397,000 for 2011 and $1,162,000 for 2012, payable in advance annually every August 1. By contrast, in 2011 total annual special payments to the Haley Pension Plan for the remaining two years of the wind-up increased to $1,728,700 for each of 2011 and 2012.

Suspension of Certain Pension Contributions

27. As is evident from the Cashflow Forecast, the Timminco Entities do not have the funds necessary to make any contributions to the Pension Plans other than (a) contributions in respect of normal cost, (b) contributions to the defined contribution provision of the BSI Non-Union Pension Plan, and (c) employee contributions deducted from pay (together, the "**Normal Cost Contributions**"). Timminco currently owes approximately $1.6 million in respect of special payments to the Haley Pension Plan. In addition, assuming the Bécancour Non-Union Pension Plan and the Bécancour Union Pension Plan are not terminated, as at January 31, 2012, the Timminco Entities will owe approximately $140,000 in respect of amortization payments under those plans. If the Timminco Entities are required to make the pension contributions other than Normal Cost Contributions (the "**Pension Contributions**"), they will not have sufficient funds to continue operating and will be forced to cease operating to the detriment of their stakeholders, including their employees and pensioners.

28. The Timminco Entities intend to make all normal cost contributions when due. However, management of the Timminco Entities does not anticipate an improvement in their cashflows that would permit the making of Pension Contributions with respect to the Pension Plans during these CCAA proceedings.

The Position of CEP and USW

Counsel to CEP submits that the super priority charge sought by the Timminco Entities would have the effect of subordinating the rights of, *inter alia*, the pension plans, including the statutory trusts that are created pursuant to the QSPPA. In considering this matter, I have proceeded on the basis that this submission extends to the PBA as well.

In order to grant a super priority charge, counsel to CEP, supported by USW, submits that the Timminco Entities

must show that the application of provincial legislation "would frustrate the company's ability to restructure and avoid bankruptcy". (See *Indalex (Re)*, 2011 ONCA 265 at para. 181.)

Counsel to CEP takes the position that the evidence provided by the Timminco Entities falls short of showing the necessity of the super priority charge. Presently, counsel contends that the Applicants have not provided any plan for the purpose of restructuring the Timminco Entities and, absent a restructuring proposal, the affected creditors, including the pension plans, have no reason to believe that their interests will be protected through the issuance of the orders being sought.

Counsel to CEP takes the position that the Timminco Entities are requesting extraordinary relief without providing the necessary facts to justify same. Counsel further contends that the Timminco Entities must "wear two hats" and act both in their corporate interest and in the best interest of the pension plan and cannot simply ignore their obligations to the pension plans in favour of the corporation. (See *Indalex (Re)*, *supra*, at para. 129.)

Counsel to CEP goes on to submit that, where the "two hats" gives rise to a conflict of interest, if a corporation favours its corporate interest rather than its obligations to its fiduciaries, there will be consequences. In *Indalex (Re)*, *supra*, the court found that the corporation seeking CCAA protection had acted in a manner that revealed a conflict with the duties it owed the beneficiaries of pension plans and ordered the corporation to pay the special payments it owed the plans (See *Indalex (Re)*, *supra*, at paras. 140 and 207.)

In this case, counsel to CEP submits that, given the lack of evidentiary support for the super priority charge, the risk of conflicting interests and the importance of the Timminco Entities' fiduciary duties to the pension plans, the super priority charge ought not to be granted.

Although counsel to CEP acknowledges that the court has the discretion in the context of the CCAA to make orders that override provincial legislation, such discretion must be exercised through a careful weighing of the facts before the court. Only where the applicant proves it is necessary in the context and consistent with the objects of the CCAA may a judge make an order overriding provincial legislation. (*See Indalex (Re)*, *supra*, at paras. 179 and 189.)

In the circumstances of this case, counsel to CEP argues that the position of any super priority charge ordered by the court should rank after the pension plans.

CEP also takes the position that the Timminco Entities' obligations to the pension plans should not be suspended. Counsel notes that the Timminco Entities have contractual obligations through the collective agreement and pension plan documents to make contributions to the pension plans and, as well, the Timminco Entities owe statutory duties to the beneficiaries of the pension funds pursuant to the QSPPA. Counsel further points out that s. 49 of the QSPPA provides that any contributions and accrued interest not paid into the pension fund are deemed to be held in trust for the employer.

In addition, counsel takes the position that the Court of Appeal for Ontario in *Indalex (Re)*, *supra*, confirmed that, in the context of Ontario legislation, all of the contributions an employee owes a pension fund, including the special payments, are subject to the deemed trust provision of the PBA.

In this case, counsel to CEP points out that the special payments the Timminco Entities seek to suspend in the amount of $95,300 per month to the Bécancour Union Pension Plan, and of $47,743 to the Silicium Union Pension Plan, are payments that are to be held in trust for the beneficiaries of the pension plans. Thus, they argue

that the Timminco Entities have a fiduciary obligation to the beneficiaries of the pension plans to hold the funds in trust. Further, the Timminco Entities' request to suspend the special payments to the Bécancour Union Pension Plan and the Quebec Silicon Union Pension Plan reveals that its interests are in conflict.

Counsel also submits that the Timminco Entities have not pointed to a particular reason, other than generalized liquidity problems, as to why they are unable to make special payments to their pension plans.

With respect to the KERPs, counsel to CEP acknowledges that the court has the power to approve a KERP, but the court must only do so when it is convinced that it is necessary to make such an order. In this case, counsel contends that the Timminco Entities have not presented any meaningful evidence on the propriety of the proposed KERPs. Counsel notes that the Timminco Entities have not named the KERPs recipients, provided any specific information regarding their involvement with the CCAA proceeding, addressed their replaceability, or set out their individual bonuses. In the circumstances, counsel submits that it would be unfair and inequitable for the court to approve the KERPs requested by the Timminco Entities.

Counsel to CEP's final submission is that, in the event the KERPs are approved, they should not be sealed, but rather should be treated in the same manner as other CCAA documents through the Monitor. Alternatively, counsel to CEP submits that a copy of the KERPs should be provided to the Respondent, CEP.

The Position of the Timminco Entities

At the time of the initial hearing, the Timminco Entities filed evidence establishing that they were facing severe liquidity issues as a result of, among other things, a low profit margin realized on their silicon metal sales due to a high volume, long-term supply contract at below market prices, a decrease in the demand and market price for solar grade silicon, failure to recoup their capital expenditures incurred in connection with the development of their solar grade operations, and the inability to secure additional funding. The Timminco Entities also face significant pension and environmental remediation legacy costs, and financial costs related to large outstanding debts.

I accepted submissions to the effect that without the protection of the CCAA, a shutdown of operations was inevitable, which the Timminco Entities submitted would be extremely detrimental to the Timminco Entities' employees, pensioners, suppliers and customers.

As at December 31, 2011, the Timminco Entities' cash balance was approximately $2.4 million. The 30-day consolidated cash flow forecast filed at the time of the CCAA application projected that the Timminco Entities would have total receipts of approximately $5.5 million and total operating disbursements of approximately $7.7 million for net cash outflow of approximately $2.2 million, leaving an ending cash position as at February 3, 2012 of an estimated $157,000.

The Timminco Entities approached their existing stakeholders and third party lenders in an effort to secure a suitable debtor-in-possession ("DIP") facility. The Timminco Entities existing stakeholders, Bank of America NA, IQ, and AMG Advance Metallurgical Group NV, have declined to advance any funds to the Timminco Entities at this time. In addition, two third-party lenders have apparently refused to enter into negotiations regarding the provision of a DIP Facility.[FN1]

The Monitor, in its Second Report, dated January 11, 2012, extended the cash forecast through to February 17, 2012. The Second Report provides explanations for the key variances in actual receipts and disbursements as

compared to the January 2, 2012 forecast.

There are some timing differences but the Monitor concludes that there are no significant changes in the underlying assumptions in the January 10, 2012 forecast as compared to the January 2, 2012 forecast.

The January 10 forecast projects that the ending cash position goes from positive to negative in mid-February.

Counsel to the Applicants submits that, based on the latest cash flow forecast, the Timminco Entities currently estimate that additional funding will be required by mid-February in order to avoid an interruption in operations.

The Timminco Entities submit that this is an appropriate case in which to grant super priority to the Administration Charge. Counsel submits that each of the proposed beneficiaries will play a critical role in the Timminco Entities' restructuring and it is unlikely that the advisors will participate in the CCAA proceedings unless the Administration Charge is granted to secure their fees and disbursements.

Statutory Authority to grant such a charge derives from s. 11.52(1) of the CCAA. Subsection 11.52(2) contains the authority to grant super-priority to such a charge:

> 11.52(1) Court may order security or charge to cover certain costs — On notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of a debtor company is subject to a security or charge — in an amount that the court considers appropriate — in respect of the fees and expenses of
>
> (a) the monitor, including the fees and expenses of any financial, legal or other experts engaged by the monitor in the performance of the monitor's duties;
>
> (b) any financial, legal or other experts engaged by the company for the purpose of proceedings under this Act; and
>
> (c) any financial, legal or other experts engaged by any other interested person if the court is satisfied that the security or charge is necessary for their effective participation in proceedings under this Act.
>
> 11.52(2) Priority — This court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

Counsel also submits that the Timminco Entities require the continued involvement of their directors and officers in order to pursue a successful restructuring of their business and/or finances and, due to the significant personal exposure associated with the Timminco Entities' liabilities, it is unlikely that the directors and officers will continue their services with the Timminco Entities unless the D&O Charge is granted.

Statutory authority for the granting of a D&O charge on a super priority basis derives from s. 11.51 of the CCAA:

> 11.51(1) Security or charge relating to director's indemnification — On application by a debtor company and on notice to the secured creditors who are likely to be affected by the security or charge, the court may make an order declaring that all or part of the property of the company is subject to a security or charge — in an amount that the court considers appropriate — in favour of any director or officer of the company to indemnify the director or officer against obligations and liabilities that they may incur as a director or of-

ficer of the company after the commencement of proceedings under this Act.

(2) Priority — The court may order that the security or charge rank in priority over the claim of any secured creditor of the company.

(3) Restriction — indemnification insurance — The court may not make the order if in its opinion the company could obtain adequate indemnification insurance for the director or officer at a reasonable cost.

(4) Negligence, misconduct or fault — The court shall make an order declaring that the security or charge does not apply in respect of a specific obligation or liability incurred by a director or officer if in its opinion the obligation or liability was incurred as a result of the director's or officer's gross negligence or wilful misconduct or, in Quebec, the director's or officer's gross or intentional fault.

Analysis

(i) Administration Charge and D&O Charge

It seems apparent that the position of the unions' is in direct conflict with the Applicants' positions.

The position being put forth by counsel to the CEP and USW is clearly stated and is quite understandable. However, in my view, the position of the CEP and the USW has to be considered in the context of the practical circumstances facing the Timminco Entities. The Timminco Entities are clearly insolvent and do not have sufficient reserves to address the funding requirements of the pension plans.

Counsel to the Applicants submits that without the relief requested, the Timminco Entities will be deprived of the services being provided by the beneficiaries of the charges, to the company's detriment. I accept the submissions of counsel to the Applicants that it is unlikely that the advisors will participate in the CCAA proceedings unless the Administration Charge is granted to secure their fees and disbursements. I also accept the evidence of Mr. Kalins that the role of the advisors is critical to the efforts of the Timminco Entities to restructure. To expect that the advisors will take the business risk of participating in these proceedings without the security of the charge is neither reasonable nor realistic.

Likewise, I accept the submissions of counsel to the Applicants to the effect that the directors and officers will not continue their service without the D&O Charge. Again, in circumstances such as those facing the Timminco Entities, it is neither reasonable nor realistic to expect directors and officers to continue without the requested form of protection.

It logically follows, in my view, that without the assistance of the advisors, and in the anticipated void caused by the lack of a governance structure, the Timminco Entities will be directionless and unable to effectively proceed with any type or form of restructuring under the CCAA.

The Applicants argue that the CCAA overrides any conflicting requirements of the QSPPA and the BPA.

Counsel submits that the general paramountcy of the CCAA over provincial legislation was confirmed in *ATB Financial v. Metcalf & Mansfield Alternative Investment II Corp.*, (2008), 45 C.B.R. (5th) 163 (Ont. C.A.) at para. 104. In addition, in *Nortel Networks Corporation (Re)*, the Court of Appeal held that the doctrine of paramountcy applies either where a provincial and a federal statutory position are in conflict and cannot both be complied with, or where complying with the provincial law will have the effect of frustrating the purpose of the

federal law and therefore the intent of Parliament. See *Nortel Networks Corporation (Re)*, (2009), 59 C.B.R. (5th) 23 (Ont. C.A.).

It has long been stated that the purpose of the CCAA is to facilitate the making of a compromise or arrangement between an insolvent debtor company and its creditors, with the purpose of allowing the business to continue. As the Court of Appeal for Ontario stated in *Stelco Inc., (Re)* (2005), 75 O.R. (3d) 5, at para. 36:

> In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme...

Further, as I indicated in *Nortel Networks Corporation (Re)*, (2009), 55 C.B.R. (5th) 229 (Ont. S.C.J.), this purpose continues to exist regardless of whether a company is actually restructuring or is continuing operations during a sales process in order to maintain maximum value and achieve the highest price for the benefit of all stakeholders. Based on this reasoning, the fact that Timminco has not provided any plan for restructuring at this time does not change the analysis.

The Court of Appeal in *Indalex Ltd. (Re)* (2011), 75 C.B.R. (5th) 19 (Ont. C.A.) confirmed the CCAA court's ability to override conflicting provisions of provincial statutes where the application of the provincial legislation would frustrate the company's ability to restructure and avoid bankruptcy. The Court stated, *inter alia*, as follows (beginning at paragraph 176):

> The CCAA court has the authority to grant a super-priority charge to DIP lenders in CCAA proceedings. I fully accept that the CCAA judge can make an order granting a super-priority charge that has the effect of overriding provincial legislation, including the PBA. ...
>
> . . .
>
> What of the contention that recognition of the deemed trust will cause DIP lenders to be unwilling to advance funds in CCAA proceedings? It is important to recognize that the conclusion I have reached does not mean that a finding of paramountcy will never be made. That determination must be made on a case by case basis. There may well be situations in which paramountcy is invoked and the record satisfies the CCAA judge that application of the provincial legislation would frustrate the company's ability to restructure and avoid bankruptcy.

The Timminco Entities seek approval to suspend Special Payments in order to maintain sufficient liquidity to continue operations for the benefit of all stakeholders, including employees and pensioners. It is clear that based on the January 2 forecast, as modified by the Second Report, the Timminco Entities have insufficient liquidity to make the Special Payments at this time.

Counsel to the Timminco Entities submits that where it is necessary to achieve the objective of the CCAA, the court has the jurisdiction to make an order under the CCAA granting, in the present case, super priority over the Encumbrances for the Administration Charge and the D&O Charge, even if such an order conflicts with, or overrides, the QSPPA or the PBA.

Further, the Timminco Entities submit that the doctrine of paramountcy is properly invoked in this case and that the court should order that the Administration Charge and the D&O Charge have super priority over the Encumbrances in order to ensure the continued participation of the beneficiaries of these charges in the Timminco Entities' CCAA proceedings.

The Timminco Entities also submit that payment of the pension contributions should be suspended. These special (or amortization) payments are required to be made to liquidate a going concern or solvency deficiency in a pension plan as identified in the most recent funding valuation report for the plan that is filed with the applicable pension regulatory authority. The requirement for the employer to make such payments is provided for under applicable provincial pension minimum standards legislation.

The courts have characterized special (or amortization) payments as pre-filing obligations which are stayed upon an initial order being granted under the CCAA. (See *AbitibiBowater Inc.*, (Re) (2009) 57 C.B.R. (5th) 285 (Q.S.C.); *Collins & Aikman Automotive Canada Inc.* (2007), 37 C.B.R. (5th) 282 (Ont. S.C.J.) and *Fraser Papers Inc. (Re)* (2009), 55 C.B.R. (5th) 217 (Ont. S.C.J.).

I accept the submission of counsel to the Applicants to the effect that courts in Ontario and Quebec have addressed the issue of suspending special (or amortization) payments in the context of a CCAA restructuring and have ordered the suspension of such payments where the failure to stay the obligation would jeopardize the business of the debtor company and the company's ability to restructure.

The Timminco Entities also submit that there should be no director or officer liability incurred as a result of a court-ordered suspension of payment of pension contributions. Counsel references *Fraser Papers*, where Pepall J. stated:

> Given that I am ordering that the special payments need not be made during the stay period pending further order of the Court, the Applicants and the officers and directors should not have any liability for failure to pay them in that same period. The latter should be encouraged to remain during the CCAA process so as to govern and assist with the restructuring effort and should be provided with protection without the need to have recourse to the Director's Charge.

Importantly, *Fraser Papers* also notes that there is no priority for special payments in bankruptcy. In my view, it follows that the employees and former employees are not prejudiced by the relief requested since the likely outcome should these proceedings fail is bankruptcy, which would not produce a better result for them. Thus, the "two hats" doctrine from *Indalex (Re)*, *supra*, discussed earlier in these reasons at [20], would not be infringed by the relief requested. Because it would avoid bankruptcy, to the benefit of both the Timminco Entities and beneficiaries of the pension plans, the relief requested would not favour the interests of the corporate entity over its obligations to its fiduciaries.

Counsel to the Timminco Entities submits that where it is necessary to achieve the objective of the CCAA, the court has the jurisdiction to make an order under the CCAA suspending the payment of the pension contributions, even if such order conflicts with, or overrides, the QSPPA or the PBA.

The evidence has established that the Timminco Entities are in a severe liquidity crisis and, if required to make the pension contributions, will not have sufficient funds to continue operating. The Timminco Entities would then be forced to cease operations to the detriment of their stakeholders, including their employees and pensioners.

On the facts before me, I am satisfied that the application of the QSPPA and the PBA would frustrate the Timminco Entities ability to restructure and avoid bankruptcy. Indeed, while the Timminco Entities continue to make Normal Cost Contributions to the pension plans, requiring them to pay what they owe in respect of special and amortization payments for those plans would deprive them of sufficient funds to continue operating, forcing them to cease operations to the detriment of their stakeholders, including their employees and pensioners.

In my view, this is exactly the kind of result the CCAA is intended to avoid. Where the facts demonstrate that ordering a company to make special payments in accordance with provincial legislation would have the effect of forcing the company into bankruptcy, it seems to me that to make such an order would frustrate the rehabilitative purpose of the CCAA. In such circumstances, therefore, the doctrine of paramountcy is properly invoked, and an order suspending the requirement to make special payments is appropriate (see *ATB Financial* and *Nortel Networks Corporation (Re)*).

In my view, the circumstances are such that the position put forth by the Timminco Entities must prevail. I am satisfied that bankruptcy is not the answer and that, in order to ensure that the purpose and objective of the CCAA can be fulfilled, it is necessary to invoke the doctrine of paramountcy such that the provisions of the CCAA override those of QSPPA and the PBA.

There is a clear inter-relationship between the granting of the Administration Charge, the granting of the D&O Charge and extension of protection for the directors and officers for the company's failure to pay the pension contributions.

In my view, in the absence of the court granting the requested super priority and protection, the objectives of the CCAA would be frustrated. It is not reasonable to expect that professionals will take the risk of not being paid for their services, and that directors and officers will remain if placed in a compromised position should the Timminco Entities continue CCAA proceedings without the requested protection. The outcome of the failure to provide these respective groups with the requested protection would, in my view, result in the overwhelming likelihood that the CCAA proceedings would come to an abrupt halt, followed, in all likelihood, by bankruptcy proceedings.

If bankruptcy results, the outcome for employees and pensioners is certain. This alternative will not provide a better result for the employees and pensioners. The lack of a desirable alternative to the relief requested only serves to strengthen my view that the objectives of the CCAA would be frustrated if the relief requested was not granted.

For these reasons, I have determined that it is both necessary and appropriate to grant super priority to both the Administrative Charge and D&O Charge.

I have also concluded that it is both necessary and appropriate to suspend the Timminco Entities' obligations to make pension contributions with respect to the Pension Plans. In my view, this determination is necessary to allow the Timminco Entities to restructure or sell the business as a going concern for the benefit of all stakeholders.

I am also satisfied that, in order to encourage the officers and directors to remain during the CCAA proceedings, an order should be granted relieving them from any liability for the Timminco Entities' failure to make pension contributions during the CCAA proceedings. At this point in the restructuring, the participation of its officers and directors is of vital importance to the Timminco Entities.

(ii) The KERPs

Turning now to the issue of the employee retention plans (KERPs), the Timminco Entities seek an order approving the KERPs offered to certain employees who are considered critical to successful proceedings under the CCAA.

In this case, the KERPs have been approved by the board of directors of Timminco. The record indicates that in the opinion of the Chief Executive Officer and the Special Committee of the Board, all of the KERPs participants are critical to the Timminco Entities' CCAA proceedings as they are experienced employees who have played central roles in the restructuring initiatives taken to date and will play critical roles in the steps taken in the future. The total amount of the KERPs in question is $269,000. KERPs have been approved in numerous CCAA proceedings where the retention of certain employees has been deemed critical to a successful restructuring. See *Nortel Networks Corporation (Re)*, (2009) O.J. No. 1044 (S.C.J.), *Grant Forest Products Inc. (Re)*, (2009) 57 C.B.R. (5th) 128 (Ont. S.C.J.) [Commercial List], and *Canwest Global Communications Corp. (Re)*, (2009) 59 C.B.R. (5th) 72 (Ont. S.C.J.).

In *Grant Forest Products*, Newbould J. noted that the business judgment of the board of directors of the debtor company and the monitor should rarely be ignored when it comes to approving a KERP charge.

The Monitor also supports the approval of the KERPs and, following review of several court-approved retention plans in CCAA proceedings, is satisfied that the KERPs are consistent with the current practice for retention plans in the context of a CCAA proceeding and that the quantum of the proposed payments under the KERPs are reasonable in the circumstances.

I accept the submissions of counsel to the Timminco Entities. I am satisfied that it is necessary, in these circumstances, that the KERPs participants be incentivized to remain in their current positions during the CCAA process. In my view, the continued participation of these experienced and necessary employees will assist the company in its objectives during its restructuring process. If these employees were not to remain with the company, it would be necessary to replace them. It is reasonable to conclude that the replacement of such employees would not provide any substantial economic benefits to the company. The KERPs are approved.

The Timminco Entities have also requested that the court seal the Confidential Supplement which contains copies of the unredacted KERPs, taking the position that the KERPs contain sensitive personal compensation information and that the disclosure of such information would compromise the commercial interests of the Timminco Entities and harm the KERPs participants. Further, the KERPs participants have a reasonable expectation that their names and salary information will be kept confidential. Counsel relies on *Sierra Club of Canada v. Canada (Minister of Finance)*, [2002] 2 S.C.R. 522 at para. 53 where Iacobucci J. adopted the following test to determine when a sealing order should be made:

> A confidentiality order under Rule 151 should only be granted when:
>
> (a) such an order is necessary in order to prevent serious risk to an important interest, including a commercial interest, in the context of litigation because reasonable alternative measures will not prevent the risk; and
>
> (b) the salutary effects of the confidentiality order, including the effects on the right of civil litigants to a fair trial, outweigh the deleterious effects, including the effects on the right to free expression, which

in this context includes the public interest in open and accessible court proceedings.

CEP argues that the CCAA process should be open and transparent to the greatest extent possible and that the KERPs should not be sealed but rather should be treated in the same manner as other CCAA documents through the Monitor. In the alternative, counsel to the CEP submits that a copy of the KERPs should be provided to the Respondent, CEP.

In my view, at this point in time in the restructuring process, the disclosure of this personal information could compromise the commercial interests of the Timminco Entities and cause harm to the KERP participants. It is both necessary and important for the parties to focus on the restructuring efforts at hand rather than to get, in my view, potentially side-tracked on this issue. In my view, the Confidential Supplement should be and is ordered sealed with the proviso that this issue can be revisited in 45 days.

Disposition

In the result, the motion is granted. An order shall issue:

(a) suspending the Timminco Entities' obligation to make special payments with respect to the pension plans (as defined in the Notice of Motion);

(b) granting super priority to the Administrative Charge and the D&O Charge;

(c) approving the KERPs and the grant of the KERP Charge;

(d) authorizing the sealing of the Confidential Supplement to the First Report of the Monitor.

MORAWETZ J.

Date: February 2, 2012

FN1 In a subsequent motion relating to approval of a DIP Facility, the Timminco Entities acknowledged they had reached an agreement with a third-party lender with respect to providing DIP financing, subject to court approval. Further argument on this motion will be heard on February 6, 2012.

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CCM MASTER QUALIFIED FUND, LTD. Applicants	-and-	BLUTIP POWER TECHNOLOGIES LTD. Respondents	Court File No. CV-12-9622-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

BOOK OF AUTHORITIES
(RETURNABLE MARCH 15, 2015)

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