Court File No.: CV-11-9283-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF UNIQUE BROADBAND SYSTEMS, INC.

BOOK OF AUTHORITIES OF THE APPLICANTS (RESPONDING PARTIES), UNIQUE BROADBAND SYSTEMS, INC. AND UBS WIRELESS SERVICES INC.

January 29, 2013

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Blair J.

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(28 pp.)

[Ed. note: Supplementary reasons released August 19, 1998. See [1998] O.J. No. 3307. Further supplementary reasons also released August 19, 1998. See [1998] O.J. No. 3513.]

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Justin R. Fogarty, for the Raytheon Engineers.
Nancy Spies, for the Central Hospital et al (Co-D).
M. Thomson, for the various physicians.
C.H. Freeman, for the Blood Trac Systems.

BLAIR J. (endorsement):--

Background and Genesis of the Proceedings

1 The Canadian Red Cross Society/La Société Canadienne de la Croix Rouge has sought and obtained the insolvency protection and supervision of the Court under the Companies' Creditors Arrangement Act ("CCAA'). It has done so with a view to putting forward a Plan to compromise its obligations to creditors and also as part of a national process in which responsibility for the Canadian blood supply is to be transferred from the Red Cross to two new agencies which are to form a new national blood authority to take control of the Canadian Blood Program.

2 The Red Cross finds itself in this predicament primarily as a result of some $8 billion of tort claims being asserted against it (and others, including governments and hospitals) by a large number of people who have suffered tragic harm from diseases contacted as a result of a blood contamination problem that has haunted the Canadian blood system since at least the early 1980's. Following upon the revelations forthcoming from the wide-ranging and seminal Krever Commission Inquiry on the Blood System in Canada, and the concern about the safety of that system - and indeed alarm - in the general population as a result of those revelations, the federal, provincial and territorial governments decided to transfer responsibility for the Canadian Blood Supply to a new national authority. This new national authority consists of two agencies, the Canadian Blood Service and Héma-Québec.

The Motions

3 The primary matters for consideration in these Reasons deal with a Motion by the Red Cross for approval of the sale and transfer of its blood supply assets and operations to the two agencies and a cross-Motion on behalf of one of the Groups of Transfusion Claimants for an order dismissing that Motion and directing the holding of a meeting of creditors to consider a counter-proposal which

would see the Red Cross continue to operate the blood system for a period of time and attempt to generate sufficient revenues on a fee-for-blood-service basis to create a compensation fund for victims.

4 There are other Motions as well, dealing with such things as the appointment of additional Representative Counsel and their funding, and with certain procedural matters pertaining generally to the CCAA proceedings. I will return to these less central motions at the end of these Reasons.

Operation of the Canadian Blood System and Evolution of the Acquisition Agreement

5 Transfer of responsibility for the operation of the Canadian blood supply system to a new authority will mark the first time that responsibility for a nationally co-ordinated blood system has not been in the hands of the Canadian Red Cross. Its first blood donor clinic was held in January, 1940 - when a national approach to the provision of a blood supply was first developed. Since 1977, the Red Cross has operated the Blood Program furnishing the Canadian health system with a variety of blood and blood products, with funding from the provincial and territorial governments. In 1981, the Canadian Blood Committee, composed of representatives of the governments, was created to oversee the Blood Program on behalf of the Governments. In 1991 this Committee was replaced by the Canadian Blood Agency - whose members are the Ministers of Health for the provinces and territories - as funder and co-ordinator of the Blood Program. The Canadian Blood Agency, together with the federal government's regulatory agency known as BBR (The Bureau of Biologics and Radiopharmaceuticals) and the Red Cross, are the principal components of the organizational structure of the current Blood Supply System.

6 In the contemplated new regime, The Canadian Blood Service has been designated as the vehicle by which the Governments in Canada will deliver to Canadians (in all provinces and territories except Quebec) a new fully integrated and accountable Blood Supply System. Quebec has established Héma-Québec as its own blood service within its own health care system, but subject to federal standards and regulations. The two agencies have agreed to work together, and are working in a co-ordinated fashion, to ensure all Canadians have access to safe, secure and adequate supplies of blood, blood products and their alternatives. The scheduled date for the transfer of the Canadian blood supply operations from the Red Cross to the new agencies was originally September 1, 1998. Following the adjournment of these proceedings on July 31st to today's date, the closing has been postponed. It is presently contemplated to take place shortly after September 18, 1998 if the transaction is approved by the Court.

7 The assets owned and controlled by the Red Cross are important to the continued viability of the blood supply operations, and to the seamless transfer of those operations in the interests of public health and safety. They also have value. In fact, they are the source of the principal value in the Red Cross's assets which might be available to satisfy the claims of creditors. Their sale was therefore seen by those involved in attempting to structure a resolution to all of these political, social and personal problems, as providing the main opportunity to develop a pool of funds to go towards satisfying the Red Cross's obligations regarding the claims of what are generally referred to in these proceedings as the "Transfusion Claimants". It appears, though, that the Transfusion Claimants did not have much, if any, involvement in the structuring of the proposed resolution.

8 Everyone recognizes, I think, that the projected pool of funds will not be sufficient to satisfy such claims in full, but it is thought - by the Red Cross and the Governments, in any event - that the proceeds of sale from the transfer of the Society's blood supply assets represent the best hope of

maximizing the return on the Society's assets and thus of maximizing the funds available from it to meet its obligations to the Transfusion Claimants.

9 This umbrella approach - namely, that the blood supply operations must be transferred to a new authority, but that the proceeds generated from that transfer should provide the pool of funds from which the Transfusion Claimants can, and should, be satisfied, so that the Red Cross may avoid bankruptcy and continue its other humanitarian operations - is what led to the marriage of these CCAA proceedings and the transfer of responsibility for the Blood System. The Acquisition Agreement which has been carefully and hotly negotiated over the past 9 months, and the sale from the Red Cross to the new agencies is - at the insistence of the Governments - subject to the approval of the Court, and they are as well conditional upon the Red Cross making an application to restructure pursuant to the CCAA.

10 The Initial Order was made in these proceedings under the CCAA on July 20th.

The Sale and Transfer Transaction

11 The Acquisition Agreement provides for the transfer of the operation of the Blood Program from the Red Cross to the Canadian Blood Service and Héma-Québec, together with employees, donor and patient records and assets relating to the operation of the Program on September 1, 1998. Court approval of the Agreement, together with certain orders to ensure the transfer of clear title to the Purchasers, are conditions of closing.

12 The sale is expected to generate about $169 million in all, before various deductions. That sum is comprised of a purchase price for the blood supply assets of $132.9 million plus an estimated $36 million to be paid for inventory. Significant portions of these funds are to be held in escrow pending the resolution of different issues; but, in the end, after payment of the balance of the outstanding indebtedness to the T-D Bank (which has advanced a secured line of credit to fund the transfer and re-structuring) and the payment of certain creditors, it is anticipated that a pool of funds amounting to between $70 million and $100 million may be available to be applied against the Transfusion Claims.

13 In substance, the new agencies are to acquire all fixed assets, inventory, equipment, contracts and leases associated with the Red Cross Blood Program, including intellectual property, information systems, data, software, licences, operating procedures and the very important donor and patient records. There is no doubt that the sale represents the transfer of the bulk of the significant and valuable assets of the Red Cross.

14 A vesting order is sought as part of the relief to be granted. Such an order, if made, will have the effect of extinguishing realty encumbrances against and security interest in those assets. I am satisfied for these purposes that appropriate notification has been given to registered encumbrancers and other security interest holders to permit such an order to be made. I am also satisfied, for purposes of notification warranting a vesting order, that adequate notification of a direct and public nature has been given to all of those who may have a claim against the assets. The CCAA proceedings themselves, and the general nature of the Plan to be advanced by the Red Cross - including the prior sale of the blood supply assets - has received wide coverage in the media. Specific notification has been published in principal newspapers across the country. A document room containing relevant information regarding the proposed transaction, and relevant financial information, was set up in Toronto and most, if not all, claimants have taken advantage of access to that room. Richter & Partners were appointed by the Court to provide independent financial advice to the Transfusion

Claimants, and they have done so. Accordingly, I am satisfied in terms of notification and service that the proper foundation for the granting of the Order sought has been laid.

15 What is proposed, to satisfy the need to protect encumbrancers and holders of personal security interests is,

a) that generally speaking, prior registered interests and encumbrances against the Red Cross's lands and buildings will not be affected - i.e., the transfer and sale will take place subject to those interests, or they will be paid off on closing; and,
b) that registered personal property interests will either be assumed by the Purchasers or paid off from the proceeds of closing in accordance with their legal entitlement.

Whether the Purchase Price is Fair and Reasonable

16 The central question for determination on this Motion is whether the proposed Purchase Price for the Red Cross's blood supply related assets is fair and reasonable in the circumstances, and a price that is as close to the maximum as is reasonably likely to be obtained for such assets. If the answer to this question is "Yes", then there can be little quarrel - it seems to me - with the conversion of those assets into cash and their replacement with that cash as the asset source available to satisfy the claims of creditors, including the Transfusion Claimants. It matters not to creditors and Claimants whether the source of their recovery is a pool of cash or a pool of real/personal/intangible assets. Indeed, it may well be advantageous to have the assets already crystallised into a cash fund, readily available and earning interest. What is important is that the value of that recovery pool is as high as possible.

17 On behalf of the 1986-1990 Québec Hepatitis C Claimants Mr. Lavigne and Mr. Bennett argue, however, that the purchase price is not high enough. Mr. Lavigne has put forward a counter-proposal which he submits will enhance the value of the Red Cross's blood supply assets by giving greater play to the value of its exclusive licence to be the national supplier of blood, and which will accordingly result in a much greater return for Claimants. This proposal has been referred to as the "Lavigne Proposal" or the "No-Fault Plan of Arrangement". I shall return to it shortly; but first I propose to deal with the submissions of the Red Cross and of those who support its Motion for approval, that the proposed price is fair and reasonable. Those parties include the Governments, the proposed Purchasers - the Canadian Blood Service and Héma-Québec - and several (but not all) of the other Transfusion Claimant Groups.

18 As I have indicated, the gross purchase price under the Acquisition Agreement is $132.9 million, plus an additional amount to be paid for inventory on closing which will generate a total purchase price of approximately $169 million. Out of that amount, the Bank indebtedness is to be paid and the claims of certain other creditors defrayed. It is estimated that a fund of between $70 million and $100 million will be available to constitute the trust fund to be set aside to satisfy Transfusion Claims.

19 This price is based upon a Valuation prepared jointly by Deloitte & Touche (financial advisor to the Governments) and Ernst & Young (financial advisor to the Red Cross and the present Monitor appointed under the Initial CCAA Order). These two financial advisors retained and relied upon independent appraisal experts to appraise the realty (Royal LePage), the machinery and

equipment and intangible assets (American Appraisal Canada Inc.) and the laboratories (Pellemon Inc.). The experience, expertise and qualifications of these various experts to conduct such appraisals cannot be questioned. At the same time, it must be acknowledged that neither Deloitte & Touche nor Ernst & Young are completely "independent" in this exercise, given the source of their retainers. It was at least partly for this reason that the Court was open to the suggestion that Richter & Partners be appointed to advise the 1986-1990 Ontario Class Action Claimants (and through them to provide independent advice and information to the other groups of Transfusion Claimants). The evidence and submissions indicate that Richter & Partners have met with the Monitor and with representatives of Deloitte & Touche, and that all enquiries have been responded to.

20 Richter & Partners were appointed at the instance of the 1986-1990 Ontario Hepatitis C Claimants Richter & Partners, with a mandate to share their information and recommendations with the other Groups of Transfusion Claimants. Mr. Pitch advises on behalf of that Group that as a result of their due diligence enquiries his clients are prepared to agree to the approval of the Acquisition Agreement, and, indeed urge that it be approved quickly. A significant number of the other Transfusion Claimant groups but by no means all - have taken similar positions, although subject in some cases to certain caveats, none of which pertain to the adequacy of the purchase price. On behalf of the 1986-1990 Hemophiliac Claimants, for instance, Ms. Huff does not oppose the transfer approval, although she raises certain concerns about certain terms of the Acquisition Agreement which may impinge upon the amount of monies that will be available to Claimants on closing, and she would like to see these issues addressed in any Order, if approval is granted. Mr. Lemer, on behalf of the British Columbia 1986-1990 Hepatitis C Class Action Claimants, takes the same position as Ms. Huff, but advises that his clients' further due diligence has satisfied them that the price is fair and reasonable. While Mr. Kaufman, on behalf of Pre 86/Post 90 Hepatitis C Claimants, advances a number of jurisdictional arguments against approval, his clients do not otherwise oppose the transfer (but they would like certain caveats applied) and they do not question the price which has been negotiated for the Red Cross's blood supply assets. Mr. Kainer for the Service Employees Union (which represents approximately 1,000 Red Cross employees) also supports the Red Cross Motion, as does, very eloquently, Ms. Donna Ring who is counsel for Ms. Janet Conners and other secondarily infected spouses and children with HIV.

21 Thus, there is broad support amongst a large segment of the Transfusion Claimants for approval of the sale and transfer of the blood supply assets as proposed.

22 Some of these supporting Claimants, at least, have relied upon the due diligence information received through Richter & Partners, in assessing their rights and determining what position to take. This independent source of due diligence therefore provides some comfort as to the adequacy of the purchase price. It does not necessarily carry the day, however, if the Lavigne Proposal offers a solution that may reasonably practically generate a higher value for the blood supply assets in particular and the Red Cross assets in general. I turn to that Proposal now.

The Lavigne Proposal

23 Mr. Lavigne is Representative Counsel for the 1986-1990 Québec Hepatitis C Claimants. His cross-motion asks for various types of relief, including for the purposes of the main Motion,

a) an order dismissing the Red Cross motion for court approval of the sale of the blood supply assets;

b) an order directing the Monitor to review the feasibility of the Lavigne Proposal's plan of arrangement (the "No-Fault Plan of Arrangement") which has now been filed with the Court of behalf of his group of "creditors"; and,

c) an order scheduling a meeting of creditors within 6 weeks of the end of this month for the purpose of voting on the No-Fault Plan of Arrangement.

24 This cross-motion is supported by a group of British Columbia Pre 86/Post 90 Hepatitis C Claimants who are formally represented at the moment by Mr. Kaufman but for whom Mr. Klein now seeks to be appointed Representative Counsel. It is also supported by Mr. Lauzon who seeks to be appointed Representative Counsel for a group of Québec Pre 86/Post 90 Hepatitis C Claimants. I shall return to these "Representation" Motions at the end of these Reasons. Suffice it to say at this stage that counsel strongly endorsed the Lavigne Proposal.

25 The Lavigne Proposal can be summarized in essence in the following four principals, namely:

1. Court approval of a no-fault plan of compensation for all Transfusion Claimants, known or unknown;
2. Immediate termination by the Court of the Master Agreement presently governing the relationship between the Red Cross and the Canadian Blood Agency, and the funding of the former, which Agreement requires a one year notice period for termination;
3. Payment in full of the claims of all creditors of the Red Cross; and,
4. No disruption of the Canadian Blood Supply.

26 The key assumptions and premises underlying these notions are,

* that the Red Cross has a form of monopoly in the sense that it is the only blood supplier licensed by Government in Canada to supply blood to hospitals;
* that, accordingly, this license has "value", which has not been recognized in the Valuation prepared by Deloitte & Touche and by Ernst & Young, and which can be exploited and enhanced by the Red Cross continuing to operate the Blood Supply and charging hospitals directly on a fully funded cost recovery basis for its blood services;
* that Government will not remove this monopoly from the Red Cross for fear of disrupting the Blood Supply in Canada;
* that the Red Cross would be able to charge hospitals sufficient amounts not only to cover its costs of operation (without any public funding such as that now coming from the Canadian Blood Agency under the Master Agreement), but also to pay all of its creditors and to establish a fund which would allow for compensation over time to all of the Transfusion Claimants; and, finally,
* that the no-fault proposal is simply an introduction of the Krever Commission recommendations for a scheme of no-fault compensation for all transfusion claimants, for the funding of the blood supply program through

direct cost recovery from hospitals, and for the inclusion of a component for a compensation fund in the fee for service delivery charge.

27 In his careful argument in support of his proposal Mr. Lavigne was more inclined to couch his rationale for the No-Fault Plan in political terms rather than in terms of the potential value created by the Red Cross monopoly licence and arising from the prospect of utilizing that monopoly licence to raise revenue on a fee-for-blood-service basis, thus leading - arguably - to an enhanced "value" of the blood supply operations and assets. He seemed to me to be suggesting, in essence, that because there are significant Transfusion Claims outstanding against the Red Cross, Government as the indirect purchaser of the assets should recognize this and incorporate into the purchase price an element reflecting the value of those claims. It was submitted that because the Red Cross has (or, at least, will have had) a monopoly licence regarding the supply of blood products in Canada, and because it could charge a fee-for-blood-service to hospitals for those services and products, and because other regimes M other countries employ such a fee for service system and build in an insurance or compensation element for claims, and because the Red Cross might be able to recover such an element in the regime he proposes for it, then the purchase price must reflect the value of those outstanding claims in some fashion. I am not able to understand, in market terms, however, why the value of a debtor's assets is necessarily reflective in any way of the value of the claims against those assets. In fact, it is the stuff of the everyday insolvency world that exactly the opposite is the case. In my view, the argument is more appropriately put - for the purposes of the commercial and restructuring considerations which are what govern the Court's decisions in these types of CCAA proceedings - on the basis of the potential increase in value from the revenue generating capacity of the monopoly licence itself. In fairness, that is the way in which Mr. Lavigne's Proposal is developed and justified in the written materials filed.

28 After careful consideration of it, however, I have concluded that the Lavigne Proposal cannot withstand scrutiny, in the context of these present proceedings.

29 Farley Cohen - a forensic a principal in the expert forensic investigative and accounting firm of Linquist Avery Macdonald Baskerville Company - has testified that in his opinion the Red Cross operating licence "provides the potential opportunity and ability for the Red Cross to satisfy its current and future liabilities as discussed below". Mr. Cohen then proceeds in his affidavit to set out the basis and underlying assumptions for that opinion in the following paragraphs, which I quote in their entirety:

1. In my opinion, if the Red Cross can continue as a sole and exclusive operator of the Blood Supply Program and can amend its funding arrangements to provide for full cost recovery, including the cost of proven claims of Transfusion Claimants, and whereby the Red Cross would charge hospitals directly for the Blood Safety Program, then there is a substantial value to the Red Cross to satisfy all the claims against it.
2. In my opinion, such value to the Red Cross is not reflected in the Joint Valuation Report.
3. My opinion is based on the following assumptions: (i) the Federal Government, while having the power to issue additional licences to other Blood System operators, would not do so in the interest of public safety; (ii) the Red Cross can terminate the current funding arrangement pursuant to the terms of the Master Agreement; and (iii) the cost of blood charged to

> the hospitals would not be cost-prohibitive compared to alternative blood suppliers. (highlighting in original)

30 On his cross-examination, Mr. Cohen acknowledged that he did not know whether his assumptions could come true or not. That difficulty, it seems to me, is an indicia of the central weakness in the Lavigne Proposal. The reality of the present situation is that all 13 Governments in Canada have determined unequivocally that the Red Cross will no longer be responsible for or involved in the operation of the national blood supply in this country. That is the evidentiary bedrock underlying these proceedings. If that is the case, there is simply no realistic likelihood that any of the assumptions made by Mr. Cohen will occur. His opinion is only as sound as the assumptions on which it is based.

31 Like all counsel - even those for the Transfusion Claimants who do not support his position - I commend Mr. Lavigne for his ingenuity and for his sincerity and perseverence in pursing his clients' general goals in relation to the blood supply program. However, after giving it careful consideration as I have said, I have come to the conclusion that the Lavigne Proposal - whatever commendation it my deserve in other contexts - does not offer a workable or practical alternative solution in the context of these CCAA proceedings. I question whether it can even be said to constitute a "Plan of Compromise and Arrangement" within the meaning of the CCAA, because it is not something which either the debtor (the Red Cross) or the creditors (the Transfusion Claimants amongst them) have control over to make happen. It is, in reality, a political and social solution which must be effected by Governments. It is not something which can be imposed by the Court in the context of a restructuring. Without deciding that issue, however, I am satisfied that the Proposal is not one which in the circumstances warrants the Court in exercising its discretion under sections 4 and 5 of the CCAA to call a meeting of creditors to vote on it.

32 Mr. Justice Krever recommended that the Red Cross not continue in the operation of the Blood Supply System and, while he did recommend the introduction of a no-fault scheme to compensate all blood victims, it was not a scheme that would be centred around the continued involvement of the Red Cross. It was a government established statutory no-fault scheme. He said (Final Report, Vol. 3, p. 1045):

> The provinces and territories of Canada should devise statutory no-fault schemes that compensate all blood-injured persons promptly and adequately, so they do not suffer impoverishment or illness without treatment. I therefore recommend that, without delay, the provinces and territories devise statutory no-fault schemes for compensating persons who suffer serious adverse consequences as a result of the administration of blood components or blood products.

33 Governments - which are required to make difficult choices - have chosen, for their own particular reasons, not to go down this particular socio-political road. While this may continue to be a very live issue in the social and political arena, it is not one which, as I have said, is a solution that can be imposed by the Court in proceedings such as these.

34 I am satisfied, as well, that the Lavigne Proposal ought not to impede the present process on the basis that it is unworkable and impractical, in the present circumstances, and given the determined political decision to transfer the blood supply from the Red Cross to the new agencies, might possibly result in a disruption of the supply and raise concerns for the safety of the public if that were the case. The reasons why this is so, from an evidentiary perspective, are well articulated in

the affidavit of the Secretary General of the Canadian Red Cross, Pierre Duplessis, in his affidavit sworn on August 17, 1998. I accept that evidence and the reasons articulated therein. In substance Dr. Duplessis states that the assumptions underlying the Lavigne Proposal are "unrealistic, impractical and unachievable for the Red Cross in the current environment" because,

a) the political and factual reality is that Governments have clearly decided - following the recommendation of Mr. Justice Krever - that the Red Cross will not continue to be involved in the National Blood Program, and at least with respect to Quebec have indicated that they are prepared to resort to their powers of expropriation if necessary to effect a transfer;
b) the delays and confusion which would result from a postponement to test the Lavigne Proposal could have detrimental effects on the blood system itself and on employees, hospitals, and other health care providers involved in it;
c) the Master Agreement between the Red Cross and the Canadian Blood Agency, under which the Society currently obtains its funding, cannot be cancelled except on one year's notice, and even if it could there would be great risks in denuding the Red Cross of all of its existing funding in exchange for the prospect of replacing that funding with fee for service revenues; and,
d) it is very unlikely that over 900 hospitals across Canada - which have hitherto not paid for their blood supply, which have no budgets contemplating that they will do so, and which are underfunded in event will be able to pay sufficient sums to enable the Red Cross not only to cover its operating costs and to pay current bills, but also to repay the present Bank indebtedness of approximately $35 million in full, and to repay existing unsecured creditors in full, and to generate a compensation fund that will pay existing Transfusion Claimants (it is suggested) in full for their $8 billion in claims.

35 Dr. Duplessis summarizes the risks inherent in further delays in the following passages from paragraph 17 of his affidavit sworn on August 17, 1998:

> The Lavigne Proposal that the purchase price could be renegotiated to a higher price because of Red Cross' ability to operate on the terms the Lavigne Proposal envisions is not realistic, because Red Cross does not have the ability to operate on those terms. Accordingly, there is no reason to expect that CBS and H-Q would pay a higher amount than they have already agreed to pay under the Acquisition Agreement. Indeed, there is a serious risk that delays or attempts to renegotiate would result in lower amounts being paid. Delaying approval of the Acquisition Agreement to permit an experiment with the Lavigne Proposal exposes Red Cross and its stakeholders, including all Transfusion Claimants, to the following risks:
>
> (a) continued losses in operating the National Blood Program which will reduce the amounts ultimately available to all stakeholders;
> (b) Red Cross' ability to continue to operate its other activities being jeopardized;

(c) the Bank refusing to continue to support even the current level of funding and demanding repayment, thereby jeopardizing Red Cross and all of Red Cross' activities including the National Blood Program;

(d) CBS and H-Q becoming unprepared to complete an acquisition on the same financial terms given, among other things, the costs which they will incur in adjusting for later transfer dates, raising the risks of exproporiation or some other, less favourable taking of Red Cross' assets, or the Governments simply proceeding to set up the means to operate the National Blood Program without paying the Red Cross for its assets.

36 These conclusions, and the evidentiary base underlying them, are in my view irrefutable in the context of these proceedings.

37 Those supporting the Lavigne Proposal argued vigorously that approval of the proposed sale transaction in advance of a creditors' vote on the Red Cross Plan of Arrangement (which has not yet been filed) would strip the Lavigne Proposal of its underpinnings and, accordingly, would deprive those "creditor" Transfusion Claimants from their statutory right under the Act to put forward a Plan and to have a vote on their proposed Plan. In my opinion, however, Mr. Zarnett's response to that submission is the correct one in law. Sections 4 and 5 of the CCAA do not give the creditors a right to a meeting or a right to put forward a Plan and to insist on that Plan being put to a vote; they have a right to request the Court to order a meeting, and the Court will do so if it is in the best interests of the debtor company and the stakeholders to do so. In this case I accept the submission that the Court ought not to order a meeting for consideration of the Lavigne Proposal because the reality is that the Proposal is unworkable and unrealistic in the circumstances and I see nothing to be gained by the creditors being called to consider it. In addition, as I have pointed out earlier in these Reasons, a large number of the creditors and of the Transfusion Claimants oppose such a development. The existence of a statutory provision permitting creditors to apply for an order for the calling of a meeting does not detract from the Court's power to approve a sale of assets, assuming that the Court otherwise has that power in the circumstances.

38 The only alternative to the sale and transfer, on the one hand, and the Lavigne Proposal, on the other hand, is a liquidation scenario for the Red Cross, and a cessation of its operations altogether. This is not in the interests of anyone, if it can reasonably be avoided. The opinion of the valuation experts is that on a liquidation basis, rather than on a "going concern" basis, as is contemplated in the sale transaction, the value of the Red Cross blood supply operations and assets varies between the mid - $30 million and about $74 million. This is quite considerable less than the $169 million (+/-) which will be generated by the sale transaction.

39 Having rejected the Lavigne Proposal in this context, it follows from what I have earlier said that I conclude the purchase price under the Acquisition Agreement is fair and reasonable, and a price that is as close to the maximum as is reasonably likely to be obtained for the assets.

Jurisdiction Issue

40 The issue of whether the Court has jurisdiction to make an order approving the sale of substantial assets of the debtor company before a Plan has been put forward and placed before the creditors for approval, has been raised by Mr. Bennett. I turn now to a consideration of that question.

41 Mr. Bennett argues that the Court does not have the jurisdiction under the CCAA to make an order approving the sale of substantial assets by the Applicant Company before a Plan has even been filed and the creditors have had an opportunity to consider and vote on it. He submits that section 11 of the Act permits the Court to extend to a debtor the protection of the Court pending a restructuring attempt but only in the form of a stay of proceedings against the debtor or in the form of an order restraining or prohibiting new proceedings. There is no jurisdiction to approve a sale of assets in advance he submits, or otherwise than in the context of the sanctioning of a Plan already approved by the creditors.

42 While Mr. Kaufman does not take the same approach to a jurisdictional argument, he submits nonetheless that although he does not oppose the transfer and approval of the sale, the Court cannot grant its approval at this stage if it involves "sanitizing" the transaction. By this, as I understand it, he means that the Court can "permit" the sale to go through - and presumably the purchase price to be paid - but that it cannot shield the assets conveyed from claims that may subsequently arise - such as fraudulent preference claims or oppression remedy claims in relation to the transaction. Apart from the fact that there is no evidence of the existence of any such claims, it seems to me that the argument is not one of "jurisdiction" but rather one of "appropriateness". The submission is that the assets should not be freed up from further claims until at least the Red Cross has filed its Plan and the creditors have had a chance to vote on it. In other words, the approval of the sale transaction and the transfer of the blood supply assets and operations should have been made a part and parcel of the Plan of Arrangement put forward by the debtor, and the question of whether or not it is appropriate and supportable in that context debated and fought out on the voting floor, and not separately before-the-fact. These sentiments were echoed by Mr. Klein and by Mr. Thompson as well. In my view, however, the assets either have to be sold free and clear of claims against them - for a fair and reasonable price - or not sold. A purchaser cannot be expected to pay the fair and reasonable purchase price but at the same time leave it open for the assets purchased to be later attacked and, perhaps, taken back. In the context of the transfer of the Canadian blood supply operations, the prospect of such a claw back of assets sold, at a later time, has very troubling implications for the integrity and safety of that system. I do not think, firstly, that the argument is a jurisdictional one, and secondly, that it can prevail in any event.

43 I cannot accept the submission that the Court has no jurisdiction to make the order sought. The source of the authority is twofold: it is to be found in the power of the Court to impose terms and conditions on the granting of a stay under section 11; and it may be grounded upon the inherent jurisdiction of the Court, not to make orders which contradict a statute, but to "fill in the gaps in legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan": Re Dylex Limited and Others, (1995), 31 C.B.R. (3d) 106, per Farley J., at p. 110.

44 As Mr. Zarnett pointed out, paragraph 20 of the Initial Order granted in these proceedings on July 20, 1998, makes it a condition of the protection and stay given to the Red Cross that it not be permitted to sale or dispose of assets valued at more than $1 million without the approval of the Court. Clearly this is a condition which the Court has the jurisdiction to impose under section 11 of the Act. It is a necessary conjunction to such a condition that the debtor be entitled to come back to the Court and seek approval of a sale of such assets, if it can show it is in the best interests of the Company and its creditors as a whole that such approval be given. That is what it has done.

45 It is very common in CCAA restructurings for the Court to approve the sale and disposition of assets during the process and before the Plan if formally tendered and voted upon. There are many examples where this has occurred, the recent Eaton's restructuring being only one of them. The CCAA is designed to be a flexible instrument, and it is that very flexibility which gives it its efficacy. As Farley J. said in Dylex, supra (p. 111), "the history of CCAA law has been an evolution of judicial interpretation". It is not infrequently that judges are told, by those opposing a particular initiative at a particular time, that if they make a particular order that is requested it will be the first time in Canadian jurisprudence (sometimes in global jurisprudence, depending upon the level of the rhetoric) that such an order has made! Nonetheless, the orders are made, if the circumstances are appropriate and the orders can be made within the framework and in the spirit of the CCAA legislation. Mr. Justice Farley has well summarized this approach in the following passage from his decision in Re Lehndorff General Partner (1993), 17 C.B.R. (3d) 24, at p. 31, which I adopt:

> The CCAA is intended to facilitate compromises and arrangements between companies and their creditors as an alternative to bankruptcy and, as such, is remedial legislation entitled to a liberal interpretation. It seems to me that the purpose of the statute is to enable insolvent companies to carry on business in the ordinary course or otherwise deal with their assets so as to enable plan of compromise or arrangement to be prepared, filed and considered by their creditors for the proposed compromise or arrangement which will be to the benefit of both the company and its creditors. See the preamble to and sections 4, 5, 7, 8 and 11 of the CCAA (a lengthy list of authorities cited here is omitted).
>
> The CCAA is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA (citations omitted)
>
> (emphasis added)

46 In the spirit of that approach, and having regard to the circumstances of this case, I am satisfied not only that the Court has the jurisdiction to make the approval and related orders sought, but also that it should do so. There is no realistic alternative to the sale and transfer that is proposed, and the alternative is a liquidation/bankruptcy scenario which, on the evidence would yield an average of about 44% of the purchase price which the two agencies will pay. To forego that purchase price - supported as it is by reliable expert evidence - would in the circumstances be folly, not only for the ordinary creditors but also for the Transfusion Claimants, in my view.

47 While the authorities as to exactly what considerations a court should have in mind in approving a transaction such as this are scarce, I agree with Mr. Zarnett that an appropriate analogy may be found in cases dealing with the approval of a sale by a court-appointed receiver. In those circumstances, as the Ontario Court of Appeal has indicated in Royal Bank v. Soundair Corp. (1991), 7 C.B.R. (3d) 1, at p. 6 the Court's duties are,

(i) to consider whether the receiver has made a sufficient effort to get the best price and has not acted improvidently;
(ii) to consider the interests of the parties;

(iii)to consider the efficacy and integrity of the process by which offers are obtained; and,

(iv) to consider whether there has been unfairness in the working out of the process.

48 I am satisfied on all such counts in the circumstances of this case.

49 Some argument was directed towards the matter of an order under the Bulk Sales Act. Because of the nature and extent of the Red Cross assets being disposed of, the provisions of that Act must either be complied with, or an exemption from compliance obtained under s. 3 thereof. The circumstances warrant the granting of such an exemption in my view. While there were submissions about whether or not the sale would impair the Society's ability to pay its creditors in full, I do not believe that the sale will impair that ability. In fact, it may well enhance it. Even if one accepts the argument that the emphasis should be placed upon the language regarding payment "in full" rather than on "impair", the case qualifies for an exemption. It is conceded that the Transfusion claimants do not qualify as "creditors" as that term is defined under the Bulk Sales Act; and if the claims of the Transfusion Claimants are removed from the equation, it seems evident that other creditors could be paid from the proceeds in full.

Conclusion and Treatment of Other Motions

50 I conclude that the Red Cross is entitled to the relief it seeks at this stage, and orders will go accordingly. In the end, I come to these conclusions having regard in particular to the public interest imperative which requires a Canadian Blood Supply with integrity and a seamless, effective and relatively early transfer of blood supply operations to the new agencies; having regard to the interests in the Red Cross in being able to put forward a Plan that may enable it to avoid bankruptcy and be able to continue on with its non-blood supply humanitarian efforts; and having regard to the interests of the Transfusion Claimants in seeing the value of the blood supply assets maximized.

51 Accordingly an order is granted - subject to the caveat following - approving the sale and authorizing and approving the transactions contemplated in the Acquisition Agreement, granting a vesting order, and declaring that the Bulk Sales Act does not apply to the sale, together with the other related relief claimed in paragraphs (a) through (g) of the Red Cross's Notice of Motion herein. The caveat is that the final terms and settlement of the Order are to be negotiated and approved by the Court before the Order is issued. If the parties cannot agree on the manner in which the "Agreement Content" issues raised by Ms. Huff and Mr. Kaufman in their joint memorandum of comments submitted in argument yesterday, I will hear submissions to resolve those issues.

Other Motions

52 The Motions by Mr. Klein and by W. Lauzon to be appointed Representative Counsel for the British Columbia and Quebec Pre86/Post 90 Hepatitis C Claimants, respectively, are granted. It is true that Mr. Klein had earlier authorized Mr. Kaufman to accept the appointment on behalf of his

British Columbia group of clients, but nonetheless it may be - because of differing settlement proposals emanating to differing groups in differing Provinces - that there are differences in interests between these groups, as well as differences in perspectives in the Canadian way. As I commented earlier, in making the original order appointing Representative Counsel, the Court endeavours to conduct a process which is both fair and perceived to be fair. Having regard to the nature of the claims, the circumstances in which the injuries and diseases inflicting the Transfusion Claimants have been sustained, and the place in Canadian Society at the moment for those concerns, it seems to me that those particular claimants, in those particular Provinces, are entitled if they wish to have their views put forward by those counsel who are already and normally representing them in their respective class proceedings.

53 I accept the concerns expressed by Mr. Zarnett on behalf of the Red Cross, and by Mr. Robertson on behalf of the Bank, about the impact of funding on the Society's cash flow and position. In my earlier endorsement dealing with the appointment of Representative Counsel and funding, I alluded to the fact that if additional funding was required to defray these costs those in a position to provide such funding may have to do so. The reference, of course, was to the Governments and the Purchasers. It is the quite legitimate but nonetheless operative concerns of the Governments to ensure the effective and safe transfer of the blood supply operations to the new agencies which are driving much of what is happening here. Since the previous judicial hint was not responded to, I propose to make it a specific term and condition of the approval Order that the Purchasers, or the Governments, establish a fund - not to exceed $2,000,000 at the present time without further order - to pay the professional costs incurred by Representative Counsel and by Richter & Partners.

54 The other Motions which were pending at the outset of yesterday's Hearing are adjourned to another date to be fixed by the Commercial List Registrar.

55 Orders are to go in accordance with the foregoing.

BLAIR J.

qp/s/aaa/mjb/qlmjb/qlvls

TAB 2

Indexed as:

Fracmaster (Re)

IN THE MATTER OF The Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
AND IN THE MATTER OF Fracmaster Ltd.

[1999] A.J. No. 566

1999 ABQB 379

245 A.R. 102

11 C.B.R. (4th) 204

88 A.C.W.S. (3d) 740

Action No. 9901-05042

Alberta Court of Queen's Bench
Judicial District of Calgary

Paperny J.

Judgment: filed May 17, 1999.

(20 pp.)

Counsel:

G. Brian Davison, for Fracmaster Ltd.
Brian P. O'Leary, for Arthur Andersen Inc.
Howard A. Gorman, for UTI Energy Corp.
Frank R. Dearlove, for Royal Bank of Canada.
Patrick T. McCarthy, Q.C., for the Banking Syndicate.
B.A.R. Smith, Q.C., for the Outside Directors.
V. Phillippe Lalonde, for Alfred Balm.
Charles P. Russell, for Harvard International Resources Ltd.
W.E. Brett Code, for Banque Nationale de Paris (Canada).
Larry B. Robinson and Sean T. Fitzgerald, for TD Asset Finance Corp.
Donald B. Higa, for Cananwill Ltd.

Robert T. Anderson, for TrizecHahn Office Properties Ltd.
Mark G. Damm, for the Employees.
J. Patrick Peacock, Q.C., for 812124 Alberta Ltd.
Anita Walker, for Tuboscope Inc.
Richard Dudelzak, Q.C., for Shareholders/Investors.
Allan G.P. Shewchuk, for Shareholder.

REASONS FOR DECISION

PAPERNY J.:--

I. INTRODUCTION

1 Fracmaster Ltd. ("Fracmaster") is an Alberta corporation. On March 18, 1999, LoVecchio J. granted an order pursuant to the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (CCAA), appointing Arthur Anderson Inc. as the monitor (the "Monitor"). At the same time, he imposed a stay of proceedings, effectively preventing any creditors from realizing on their assets. I later extended that stay to April 30, 1999. Various parties returned before me on April 30, 1999 with several applications. Fracmaster asked me to approve the sale of substantially all of its assets to UTI Energy Corp. ("UTI"). A syndicate of creditors (the "Syndicate") supported that application, but presented an alternate application of lifting the stay and appointing the Monitor as receiver and manager of Fracmaster. The Syndicate is represented by counsel for the Royal Bank of Canada ("Royal Bank") and represents the Royal Bank, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Hongkong Bank of Canada, Banque Nationale de Paris (Canada) and Credit Suisse First Boston Canada. While the Royal Bank has a separate interest as well, I will, for simplicity, refer to these secured creditors, including the Royal Bank in its capacity as operating lender, as the Syndicate. Alfred Balm ("Mr. Balm"), a large shareholder of Fracmaster, requested an adjournment to allow him to develop an alternative to the UTI sale.

2 I granted an adjournment until May 14, 1999, and also extended the stay. In the interim, Mr. Balm was to be given access by Fracmaster to financial information that he might need to prepare his alternative. I also requested the Monitor to prepare a further report, including a report on the valuation of Fracmaster and its subsidiaries, to help me determine if this matter was appropriately under the CCAA. Finally, I asked Fracmaster to consider certain matters, including the existence of a "plan" within the meaning of the CCAA and any provisions for notice to creditors and other interested parties. On May 7, 1999, I granted an application by Harvard International Resources Ltd. ("Harvard") for access to financial information, so that Harvard could consider its interest in presenting an alternative to the UTI sale. I did not agree, however, to entertain the proposal or to allow it to be submitted for consideration by the stakeholders.

3 I now have six applications before me. First, Fracmaster applies to have the UTI sale approved. Second, the Syndicate (although supporting Fracmaster's application) applies, as an alternative to Fracmaster's application, to lift the stay, appoint a receiver, direct the receiver to approve the UTI sale, and allow the Syndicate to begin steps to realize on its security. Third, Mr. Balm and the Janus Corporation ("Janus") apply to continue the stay, adjourn the other applications, appoint an

interim receiver, and have the court direct the calling of meetings for consideration of its proposal by the secured creditors, the unsecured creditors and the shareholders. Fourth, the previously unheard-from party Calfrac Ltd., formerly 812124 Alberta Ltd. ("Calfrac") applies for approval and acceptance of the proposal which it purports to put forward. Fifth, Cananwill Canada Limited ("Cananwill") applies for a declaration that it has a valid assignment of certain sums in priority to all security interests granted by Fracmaster, including those granted to the Syndicate. Sixth, TD Asset Finance Corp. seeks an order lifting the stay. Harvard has indicated it does not intend to seek the court's leave to put forward a proposal.

II. FACTS

A. Background

4 Fracmaster applied for protection under the CCAA, proposing to file a compromise or arrangement with its creditors and, if appropriate, an arrangement with its shareholders.

5 In his affidavit sworn in support of the initial application, Gary Sherkey, Fracmaster's chief financial officer, deposed that for the year ending December 31, 1998 Fracmaster had a net loss of approximately $11 million before charges of $126 million were taken to reduce the carrying value of the company's Russian related assets. At March 15, 1999 Fracmaster had claims owing to trade creditors in excess of $17 million. At March 15, 1999 Fracmaster's indebtedness included a revolving demand operating facility in the amount of $32,672,000, advances under a credit facility of a subsidiary company in the amount of $12 million U.S. and a revolving demand loan of another subsidiary in the amount of $2,045,000 U.S. In addition, at March 15, 1999, Fracmaster had a term loan facility with the Syndicate of banks in the amount of $63,200,000. The loan was repayable in three annual payments of approximately $21,100,000, with the initial payment due on April 30, 1999. On March 15, 1999 Fracmaster's operating facility was almost fully drawn and a payment of $7.5 million was due on March 18, 1999. Fracmaster was unable to make that payment. Fracmaster at the time had been unable to arrange for additional operating funds from its banks or elsewhere. Justice LoVecchio granted the application, including the stay requested.

6 The Monitor's April 12, 1999 report shows that Fracmaster's liabilities were:

-operating line of credit	$32,972,000.00
-term loan, long term debt	$63,590,000.00
-BNPI (contingent) (approximate)	$18,000,000.00
-accounts payable, pre-CCAA	$19,703,000.00

TOTAL	$134,265,000.00 Cdn.

The total owed to the Syndicate at that time was approximately $96,562,000.

7 According to the April 30 affidavit of Douglas Paul, a Senior Account Manager at the Royal Bank, Fracmaster and the Syndicate agreed to continue earlier efforts to sell Fracmaster. In consideration for the Syndicate allowing this CCAA process to be undertaken, Fracmaster provided the Syndicate with a consent order to lift the stay and a consent order to appoint a receiver.

8 On April 27, 1999, Fracmaster and the Syndicate entered into an asset purchase agreement with UTI. The purchase price is $60.7 million for the assets, plus an equity participation for the

Syndicate. UTI wishes to close the transaction. Counsel for UTI states that UTI would prefer to complete the sale under the CCAA, but that it would still be possible under receivership. If court approval is not received for its offer, or the offer is not extended beyond May 17, 1999, UTI may terminate the offer. As is evident from the figures set out above, the UTI purchase price is significantly less than the total of the secured debt owing to the Syndicate.

9 The Syndicate supports the sale to UTI under the CCAA. The Syndicate is contractually obliged to support the sale. However, as mentioned, if the court declines to approve the UTI sale under the CCAA, the Syndicate wishes the stay lifted and a receiver appointed, so that the Syndicate can proceed to enforce its security. Notwithstanding its earlier notice of motion, the Syndicate submitted at the hearing it would seek the court to direct the receiver to complete the UTI sale.

10 Mr. Balm has been involved with Fracmaster in some capacity since its inception. Mr. Balm sold all of his Fracmaster shares (approximately 67 per cent of the outstanding shares) on September 9, 1997. The shares were sold through an instalment receipt structure. When the second instalment was due on September 9, 1998, buyers representing approximately 43 per cent of the Fracmaster shares defaulted on the payment because the share price had substantially decreased. Mr. Balm announced his intention to re-sell those shares; Fracmaster announced it was willing to cooperate with that sale. Apparently, Mr. Balm still holds approximately 43 per cent of Fracmaster's shares, giving him a substantial stake in Fracmaster.

11 In a May 11 affidavit, Mr. Margetak, President and CEO of Fracmaster, deposes that Fracmaster conducted a sales process from September 1998 to April 27, 1999. He opines that this was a full and effective canvassing of the market for parties interested in investing in or buying the assets of Fracmaster. Fracmaster's brief describes the sales process in two stages. First, there was the attempt from September 16, 1998 to March 9, 1999 to sell the shares of Fracmaster in conjunction with Mr. Balm. Second, there was the attempt from March 18, 1999 to April 27, 1999 during which certain steps were taken: (i) Fracmaster solicited and received expressions of interest from various parties; (ii) the parties were requested to file proposals by April19 - five were received; and (iii) proposals were reviewed and negotiations occurred - the UTI sale was considered the best proposal.

12 There is a dispute over Mr. Balm's commitment to reinvesting in Fracmaster. Mr. Balm deposes that he never foreclosed the possibility of coming up with an alternative arrangement to any sale; Fracmaster's representatives depose that he indicated he was no longer interested. However, on April 30, 1999, I granted Mr. Balm access to the financial information to decide if he wished to put forward a proposal. I did not at the time agree to entertain such a proposal, or allow it to be submitted to the various stakeholders, reserving that issue for consideration today.

B. UTI's Offer

13 UTI's offer is for all, or substantially all, of Fracmaster's assets. The purchase price is $60.7 million cash, plus warrants for up to five per cent of the outstanding shares of Newco, the purchaser, a "single-purpose corporation". Through a scheme of puts and calls, the value of the warrants is effectively capped at $20 million. The result is there is no provision for unsecured creditors or shareholders. The Syndicate supports the UTI proposal and is contractually obliged to do so. The offer does not come before the court in the form of a plan, nor does it contemplate a plan being put forward post-closing.

C. Balm/Janus Plan of Arrangement

14 This is the only true plan put forward as contemplated by the terms and spirit of the CCAA. This proposal offers the secured creditors $66 million, plus 720,000 warrants at an exercise price of $5 per consolidated share. The unsecured creditors would have a choice of (i) the lesser of their claim amount and $500; or (ii) an unsecured note for a maximum of 20 per cent of their claim, which appears to be payable in instalments over several years, presumably if Fracmaster is solvent at the time the payments come due. Some unsecured creditors are excluded from the plan, and will be paid in full. There would be a consolidation of the shares on a 25 for 1 basis. Shareholders would be able to purchase some of the new shares at $5 per share, although the mechanics in the proposal are unclear. The plan contemplates approval by the secured creditors as a class, the unsecured creditors as a class and the shareholders as a class. It anticipates meetings being held and a hearing to obtain court approval on July 19, 1999.

D. Calfrac Offer

15 Calfrac's purported proposal, which emerged almost literally at the last minute, is very similar to the UTI sale. Calfrac would pay a maximum of $65 million total. The Syndicate would receive $61 million, plus equity participation similar to that in the UTI sale. The unsecured creditors would receive ten cents on the dollar, to a maximum of $3 million among all the unsecured creditors. The shareholders would receive two cents per common share, to a maximum of $1 million.

E. Value of Fracmaster

16 It would have been of assistance to the Court to have an independent opinion as to the fairness of the sale process and the consideration to all stakeholders. Instead, I have Fracmaster's submission that the UTI offer represents the best available value for Fracmaster, based on the extensive sales process that was undertaken over several months.

17 I also have the valuation which the Monitor prepared at my request. However, the Monitor has requested, and I have agreed, that it be kept sealed and confidential, first, because of the expressions of interest by other parties, and, second, because releasing the valuation may prejudice Fracmaster's ability to negotiate sales of the subsidiaries and their assets. This report is limited due to time constraints, and the court recognizes that, because the valuation is sealed, it is not capable of being challenged.

18 The Monitor states in its second report (May 12, 1999) that: "The valuation evidence provided to the Court by the Monitor...indicates that the liquidation value of Fracmaster and its subsidiaries will not generate sufficient funds to satisfy the Lending Syndicate's claim." (at para. 44). The valuation clearly supports that conclusion. That valuation underscores that in a best-case scenario, the Syndicate will not be paid in full and will be left with a loss. The Monitor has not put forward a valuation scenario that would result in any recovery by the unsecured creditors, let alone the shareholders.

III. ANALYSIS

A. Structure and Purpose of the CCAA

19 The formal title of the CCAA states that it is an "Act to facilitate compromises and arrangements between companies and their creditors". A wealth of case law has developed from this broad wording. As stated by L.W. Houlden and G.B. Morawetz in Bankruptcy and Insolvency Law of Canada, 3d ed. (Carswell, looseleaf), volume 3 at 10A-2:

> The C.C.A.A. has a broad remedial purpose giving a debtor an opportunity to find a way out of financial difficulties short of bankruptcy, foreclosure or the seizure of assets through receivership proceedings. It allows the debtor to find a plan that will enable him to meet the demands of his creditors through refinancing with new lending, equity financing or the sale of the business as a going concern....

20 Therefore, the objective of the CCAA is to help businesses restructure or reach some other kind of arrangement with their creditors. It is generally accepted that the CCAA is not to be used to wind-up or liquidate a company, although there are some circumstances in which the CCAA can be used in such a way (Houlden and Morawetz at 10A-3).

21 For example, the court in Re Associated Investors of Canada Ltd. (1987), 67 C.B.R. (N.S.) 237 (Alta. Q.B.) (reversed on different grounds) dealt with plans of arrangement that contemplated liquidation of the companies rather than their survival (at 240-41). The trial court held that the CCAA "is not restricted in its application to companies which are to be kept in business.... (at 245).

22 Similarly, Farley J. has held that the CCAA "need not be employed to revitalize a corporation but can also involve a liquidation scenario" (Re Olympia & York Developments Ltd. (1995), 34 C.B.R. (3d) 93 (Ont. Gen. Div.) at 104), and that an orderly distribution of the company's affairs "may involve a winding-up or liquidation of a company or simply a substantial downsizing of its business operations, provided the same is proposed in the best interests of the creditors generally." (Re Lehndorff General Partner Ltd. (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.) at 32).

23 I accept those statements. However, I note that the court in Olympia & York was dealing with an arrangement which had been approved in accordance with the CCAA provisions (i.e., it had been approved by the creditors and sanctioned by the court). In Lehndorff, the court explicitly required that the action (e.g., liquidation) be "in the best interests of the creditors generally". The court went on to conclude that each of the applicants, who wished CCAA protection in order to present a plan, had a "realistic possibility of being able to continue operating" (at 32).

24 I also note the principle that even where a plan is proposed, the court need not order a meeting of the creditors or class of creditors. That is because ss. 4 and 5 of the CCAA, which provide for such meetings, are permissive, not mandatory. As Houlden and Morawetz state at 10A-11: "If the court believes that the proposed plan or arrangement is not in the best interests of creditors, it may refuse to make the order...[I]f the plan lacks economic reality, the court will also refuse to make the order".

25 The latter point of "economic reality" is well illustrated in the recent decision of Blair J. in Re Canadian Red Cross Society, [1998] O.J. No. 3306 (Gen. Div.). In that case, the Canadian Red Cross Society (the "Red Cross") sought CCAA protection with a view to putting forth a plan. The purpose of the plan was both to deal with its creditors and as part of the government-mandated process for transferring responsibility for the Canadian blood supply to two new agencies. The Red Cross was faced with approximately $8 billion of tort claims arising from contaminated blood products. The Red Cross asked the court to approve the sale of its principal assets to the two new agencies. One group of tort claimants asked the court to direct a meeting of creditors to consider a counter-proposal.

26 Even though the proceeds of sale would be far too low to satisfy the tort claims, the Red Cross and the governments involved thought the amount was the best that could be obtained, considering the urgency of transferring the blood supply services system. The central question was whether the proposed price for the asset purchase was "fair and reasonable in the circumstances, and a price that is as close to the maximum as is reasonably likely to be obtained for such assets." (at 4). The price was supported by many tort claimants. After payment of the secured line of credit and certain other unspecified creditors, there would be a $70 million to $100 million pool of funds for the tort claimants.

27 The price in Red Cross was reached by the governments' and the Red Cross' financial advisers. The two financial advisers had retained independent appraisal experts. Another adviser reviewed the price and the process. This independent due diligence gave the court "some comfort as to the adequacy of the purchase price" (at 5).

28 The court was also faced with the "Lavigne Proposal", which would see the assets stay with the Red Cross. However, the court held that national policy decisions precluded the Lavigne Proposal from having any "realistic likelihood" of success (at 7). The court concluded that the Lavigne Proposal:

> ...does not offer a workable or practical alternative solution in the context of these CCAA proceedings. I question whether it can even be said to constitute a Plan of Compromise and Arrangement' within the meaning of the CCAA, because it is not something which either the debtor (the Red Cross) or the creditors (the Transfusion Claimants amongst them) have control over to make happen.

Because it was not a realistic plan in the circumstances, the court refused to order a meeting under ss. 4 and 5 of the CCAA.

29 I accept and support the broad statement made by Blair J. in Red Cross (at 10):

> I cannot accept the submission that the Court has no jurisdiction to make the order sought. The source of the authority is twofold: it is to be found in the power of the Court to impose terms and conditions on the granting of a stay under section11; and it may be grounded upon the inherent jurisdiction of the Court, not to make orders which contradict a statute, but to 'fill in the gaps in the legislation so as to give effect to the objects of the CCAA, including the survival program of a debtor until it can present a plan.'

This statement must be read in light of the following wording (at 10):

> It is very common in CCAA restructurings for the Court to approve the sale and disposition of assets during the process and before the Plan is formally tendered and voted upon.

30 Apart from the sale of assets or the Lavigne Proposal, the only alternative was liquidation. The experts opined that the value on liquidation basis would be $95-139 million less than the value of the proposed sale. Therefore, the court determined that the proposed sale price was fair and reasonable, and as close as possible to a maximum price under the circumstances (at 9). While commenting that it is not uncommon for courts to approve sales before a plan is filed or voted on (su-

pra), the Court said the circumstances must be "appropriate" and the orders must be able to be made "within the framework and in the spirit of the CCAA legislation." (at 11).

B. Appropriate Remedy in this Situation

31 I do not have the benefit of an independent full appraisal of Fracmaster. I wish to emphasize that this is not the Monitor's fault. In the circumstances of this case, including time pressures and other factors, I believe that the Monitor has performed to the best of its ability.

32 However, I do have enough valuation information to determine that there is no value in Fracmaster greater than the amount owed to the secured creditors. In other words, there is insufficient value in Fracmaster to provide anything for the unsecured creditors or shareholders. While I appreciate that the Balm/Janus and the Calfrac proposals attempt to make a provision for the unsecured creditors and shareholders, even the total value of those proposals appears to be considerably less than the amount owed to the Syndicate of secured creditors. Both those proposals on their face offer only an incremental increase to the secured creditors but are marginally better for the unsecured creditors and, possibly, for the shareholders. While the Balm/Janus proposal has potential "upside" for all classes, I have no way of determining the economic reality of such an upside.

33 I commend Mr. Balm for the effort he has gone to in formulating his proposal and seeking financial backing. As noted earlier, it is the only option before me that fits conventionally within the CCAA structure. He has also gone to great lengths to address concerns that could arise, such as the BNPI secured interest and his offer to provide unsecured DIP financing. Mr. Balm's proposal theoretically leaves a life for Fracmaster and for the shareholders.

34 However, I cannot ignore the commercial and practical realities of Fracmaster's situation. The valuation evidence before me clearly indicates that there is no equity in Fracmaster. Notwithstanding the court's broad powers under the CCAA, the Balm/Janus proposal, and the CCAA itself, specifically require the approval of the secured lenders - here, the Syndicate. Regardless of whether the court could compel the Syndicate to consider and vote on the Balm/Janus proposal, I recognize and accept that the Syndicate has commercial concerns with the proposal.

35 The delay until July 19 contemplated by the Balm/Janus proposal is significant in the circumstances. The Syndicate is currently faced with a loss of approximately $35 million under the UTI sale. The Balm/Janus proposal puts the Syndicate, in the Syndicate's view, at risk to lose even more. The unsecured creditors and the shareholders face no such risk if there is delay - they have only the possibility of recovering some amount greater than zero.

36 This fundamental concept - that the Syndicate would be further risking its recovery after already accepting the reality of a $35 million loss - speaks to why these proposals do not fit within the CCAA. The spirit of the CCAA contemplates a restructuring, or at least an attempt at restructuring, for the general benefit of all stakeholders. Fracmaster's current financial situation precludes that, absent the secured creditors' agreement to accept a substantial commercial risk.

37 The Calfrac proposal is no more a plan than is the UTI proposal. Although it slightly betters UTI's pricing structure, it fails to contemplate practical procedures, including a provision for consultations with the stakeholders or a method of determining claims.

38 As with the Balm/Janus proposal, the Calfrac proposal ignores the fundamental reality that the Syndicate is not agreeable to it. Again, this is a business decision of the Syndicate, notwithstanding its contractual obligation to support the UTI sale.

39 Accordingly, neither the Balm/Janus nor the Calfrac proposals are "workable or practical", to use the language from Red Cross. The Syndicate has indicated it will not approve either proposal in the circumstances, and that it is contractually bound to support the UTI sale. However, more persuasive than its contractual obligation is the fact that it has valid commercial reasons for refusing to take the risk those offers present. It has been submitted, that under the broad power conferred by the CCAA I can require the Syndicate to consider the proposals and direct the calling of meetings for that purpose. However, to exercise my discretion in that fashion would substitute the Court's commercial view and ignore the Syndicate's business concerns, hoping it will have a change of heart, where it has the only realistic remaining financial interest in Fracmaster. I decline to do so. Given the Syndicate's refusal to consent, it would be pointless to order meetings of the creditors and shareholders to consider either proposal.

40 It may well be that the UTI proposal is a commercially provident deal. The fact that it is not in the form of a plan is not in and of itself fatal in CCAA proceedings. However, the proposed transaction does not create a pool of cash in which unsecured creditors or shareholders can ultimately participate for their general benefit. It does not provide for the opportunity to consult with those stakeholders because it does not contemplate their receipt of any benefit. The court does not have the comfort of an independent opinion as to the fairness of the transaction or the process leading up to it. It has only a limited opportunity to evaluate the proposal. However reasonable the proposal may be, its purpose is to facilitate a sale for the benefit of the Syndicate. That can be accomplished in a different fashion without distorting the spirit of the CCAA. These concerns, cumulatively, lead me to no other conclusion than this proposed sale ought not to be approved under the CCAA.

41 I reach this conclusion with great reluctance, as I respect the purpose of the CCAA and recognize the losses that are being suffered by the unsecured creditors and the shareholders. However, inappropriate use of the Act can only weaken such a valuable piece of legislation.

42 The Syndicate has applied to this Court for the lifting of the stay to allow them to enforce their security. Fracmaster has acknowledged it is indebted to the Syndicate pursuant to the terms of two general security agreements dated April 28, 1998 as supplemented and amended, that it is in default under each part of the security, that all sums owing under the security have become due and payable and that the security has become enforceable.

43 I am prepared to lift the stay for that purpose and to grant the requested order appointing Arthur Andersen Inc. ("Arthur Andersen") as receiver and manager (the "Receiver") of the present and future undertaking, property and assets of Fracmaster on certain terms and conditions. I find it just and convenient to do so. Arthur Andersen has been the Monitor since the commencement of these proceedings and has fulfilled its role independently. It is well informed and alert to the precarious financial situation of Fracmaster.

44 The Syndicate and UTI wish me to direct that the Receiver proceed to close the UTI sale. In my view the purpose of the appointment of the Receiver would be largely defeated were I to fetter his discretion in that regard. The Monitor in his submissions made it abundantly clear that he is conscious of "the absolute need to resolve this". As such, I am confident, given his prior involvement in this matter, that he will be able to take whatever immediate action he deems necessary and to report to the Court as required.

45 The Court is very much alive to the concern regarding delay in the process and the need for finality. To that end I seek advice from the Receiver as to how quickly he can report as to its recommendations with respect to a sale of assets or such other immediate action he deems appropriate for the benefit of all claimants, including the secured creditors.

46 The terms of the appointment are to include, but are not limited to, the following:

> The Receiver shall be authorized and empowered to take all steps it deems necessary to preserve and protect the undertaking, property and assets of Fracmaster for the benefit of all claimants, including the secured creditors.
>
> The Receiver shall report to this Court at the earliest opportunity, and in any event no later than May 21, 1999, as to its recommendation with respect to a sale of Fracmaster's assets, or such other immediate action as it may deem appropriate for the benefit of all claimants, including the secured creditors.
>
> The Receiver may from time to time apply to this Court for advice and direction in the discharge of its powers and duties upon notice to all parties who made submissions to the Court with respect to this order, and such other parties as the Court may direct.

47 I request the assistance of counsel in preparing a proposed form of order for my review, incorporating the above and including the necessary powers anticipated. The order is also to reflect the Court's request for aid and recognition of any court or judicial body within and outside Canada.

48 I ask counsel to re-attend before me today with the proposed form of order.

IV. DISPOSITION

49 The Syndicate's application is granted on the terms set out above. The applications of Fracmaster, Mr. Balm/Janus and Calfrac are dismissed. The applications of Cananwill, TD Asset Finance Corp. and TrizecHahn Office Properties Ltd. are all adjourned sine die, to be dealt with by the Receiver or further Court order.

PAPERNY J.

cp/i/kjm

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Indexed as:

Royal Bank of Canada v. Fracmaster Ltd.

IN THE MATTER OF The Companies' Creditors Arrangement Act
R.S.C. 1985, c. C-36 as amended
AND IN THE MATTER OF Fracmaster Ltd.
Between
Uti Energy Corp., respondent (plaintiff), and
Fracmaster Ltd., respondent (defendant)
And between
Royal Bank of Canada, and
Royal Bank of Canada, as agent for Royal Bank of Canada, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Hong Kong Bank of Canada, Banque Nationale de Paris (Canada) and Credit Suisse First Boston Canada, respondents (plaintiffs), and
Fracmaster Ltd., respondent (defendant), and
Uti Energy Corp., appellant
And between
The Janus Corporation, appellant (plaintiff), and
Fracmaster Ltd., respondent (defendant)
And between
Royal Bank of Canada, and Royal Bank of Canada, as agent for Royal Bank of Canada, Canadian Imperial Bank of Commerce, Bank of Nova Scotia, Hong Kong Bank of Canada, Banque Nationale de Paris (Canada) and Credit Suisse First Boston Canada, respondents (plaintiffs), and
Fracmaster Ltd., respondent (defendant), and
Uti Energy Corp., appellant, and
Calfrac Limited, appellant

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89 A.C.W.S. (3d) 9

Dockets: 99-18326, 99-18327, 99-18331 and 99-18335

Alberta Court of Appeal
Calgary, Alberta

Conrad, O'Leary and Fruman JJ.A.

Heard: June 4 and 7, 1999.
Oral judgment: June 7, 1999. Filed: June 9, 1999.

(10 pp.)

Appeal from the entire order of Paperny J. made May 17, 1999 and entered on May 19, 1999. Appeal from the entire order of Paperny J. made May 21, 1999 and entered on May 25, 1999.

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T.J. Mallett and A.D. Little, for BJ Services Company.
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R. Dudelzak, Q.C., for Global Securities Ltd.
W.E.B. Code, for BNPI.
G.B. Davison, for Fracmaster (for the Corporation).
S.T. Fitzgerald, for TD Asset Finance.

MEMORANDUM OF JUDGMENT
DELIVERED FROM THE BENCH

The judgment of the Court was delivered by Fruman J.A.

1 CONRAD J.A.:-- The decision of the Court is unanimous and will be delivered by Madam Justice Fruman.

2 FRUMAN J.A. (orally):-- Fracmaster Ltd., an oil and gas services company with world-wide operations, encountered serious financial difficulties. With liabilities that greatly exceeded its assets, its inevitable insolvency gave rise to hurried attempts to restructure the company. A series of court proceedings and a court-authorized tender process, all conducted at break neck speed, resulted in a court order approving the sale of Fracmaster's assets to BJ Services Company for $80 million. That order, and the events which led up to it, are the subject of four appeals by prospective purchasers whose bids for Fracmaster were unsuccessful.

3 We make two preliminary observations. First, this is a court of review. It is not our task to reconsider the merits of the various offers and decide which proposal might be best. The decisions made by the chambers judge involve a good measure of discretion, and are owed considerable deference. Whether or not we agree, we will only interfere if we conclude that she acted unreasonably, erred in principle or made a manifest error.

4 Our second observation is that events unfolded rapidly, with short time periods and offers arriving, literally, at the last minute. Parties did not always have time to prepare and file affidavits. On occasion representations of fact were mixed with submissions of law made by counsel to the chambers judge. As a result, our record is not as complete as we might have wished. We imply no criticism. We understand Fracmaster's serious financial jeopardy, the need for haste, and the accommodation by the parties and the court to conclude matters quickly. However, the frailties of the record require that we give considerable deference to fact findings made by the chambers judge and further illustrate why leave is and should be required to appeal proceedings under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 (section 13). I will refer to that statute as the "CCAA".

FACTS

5 Fracmaster is an Alberta company. Beginning in the fall of 1998, when its financial condition was precarious, it unsuccessfully attempted to restructure its financial affairs. With the indulgence of a lending syndicate to whom Fracmaster owed $96 million, and whose debt was registered as a first charge on its assets, it subsequently filed a petition under the CCAA. On March 18, 1999, Fracmaster was granted an order imposing a stay of proceedings and appointing Arthur Andersen Inc. as the monitor. Fracmaster then conducted another sale process, in order to restructure the company, inject equity or sell its assets. The sale process was neither supervised nor controlled by the monitor. Several companies submitted offers or proposals, including UTI Energy Corp., Calfrac Limited and The Janus Corporation together with its principal, Alfred H. Balm.

6 When the matter returned to court in May of 1999 four applications were heard:

> First, Fracmaster applied for approval of the sale of its assets to UTI. The members of the lending syndicate supported that application, in accordance with a contractual commitment they had made to UTI.
>
> Second, that same lending syndicate, as an alternative to Fracmaster's application, applied to lift the stay, appoint Arthur Andersen as receiver, direct the receiver to approve the UTI sale and permit the lending syndicate to begin to realize on its security.
>
> Third, Balm/Janus applied to continue the stay, adjourn the other applications, appoint an interim receiver and have the court direct the calling of meetings of secured creditors, unsecured creditors and shareholders, to consider the Balm/Janus plan of arrangement.
>
> Fourth, Calfrac applied for approval and acceptance of its proposal to purchase Fracmaster's assets.

7 In reasons dated May 17, 1999, the chambers judge dismissed the Fracmaster, Balm/Janus and Calfrac applications. She appointed Arthur Andersen as the receiver/manager on certain terms

and conditions, including the power to sell the assets of Fracmaster subject to court approval. She denied the lending syndicate's application to direct the receiver to sell the assets to UTI. Alive to concerns about delay, she asked the receiver to quickly report its recommendations about a sale of assets or other immediate action that the receiver considered appropriate for the benefit of all claimants, including the secured creditors (CCAA A.B. 333). The May 17 order in the CCAA proceedings is the subject of appeals by Balm/Janus and UTI.

8 The next day, May 18, the receiver returned to court with a notice of motion seeking directions for approval of a sale process by way of sealed bids. The process was designed to respond to the principles and objectives established by the chambers judge for a sale of assets. As there had been no independent valuations, the proposed tender process would test the market to determine whether offers were available in excess of the amount of the lending syndicate's secured debt. The process was also designed to maximize the value to the creditors; respond to concerns about delay and the need for finality; provide a process for the benefit of all creditors; and be fundamentally fair by establishing a level playing field for all participants.

9 The proposal was not greeted with unanimous approval by the prospective purchasers, and its terms were the subject of heated debate in court. At the conclusion of the May 18 proceedings, the chambers judge ordered a tender process. The order set out the terms and conditions of offers that would be considered, with final offers to be submitted by 2:00 p.m. on May 20, 1999, by way of sealed bids. The receiver would advise the interested parties of its recommendation by 8:00 p.m. on May 20, and make its recommendation to the court at 10:00 a.m. on May 21. The tender process established in the May 18 order has not been appealed.

10 Offers were submitted by UTI, Calfrac and BJ Services, a company which had previously shown interest in acquiring Fracmaster, but had not participated in the CCAA company-conducted sale process. Balm/Janus did not submit an offer. The lending syndicate continued to support the UTI offer, in accordance with a contractual commitment its members had made to UTI. The receiver recommended acceptance of the BJ Services offer, for a number of reasons, including the fact that it provided the highest cash purchase price, exceeding the Calfrac offer by $13 million and the UTI offer by $19.3 million. The chambers judge, in reasons dated May 21, 1999, approved the BJ Services offer recommended by the receiver. UTI and Calfrac appeal that decision.

THE CCAA APPEALS

11 Balm/Janus appeal the chambers judge's decision in the CCAA proceedings, declining to order a meeting of creditors and shareholders of Fracmaster to consider and implement Balm/Janus' proposed plan of arrangement. The appeal is supported by certain shareholders of Fracmaster and by Banque Nationale de Paris, a subordinated lender.

12 The chambers judge acknowledged that the restructuring proposed by Balm/Janus was a true plan which fit within the CCAA, leaving an after-life for Fracmaster and its shareholders. However, she noted the commercial reality that there was no equity left in Fracmaster, and that the lending syndicate had the only realistic remaining financial interest (CCAA A.B. 329-330). Under the terms of the CCAA and the Balm/Janus proposal, the plan would require the approval of the lending syndicate, which had indicated that it would not support the proposal. The chambers judge found as a fact that the lending syndicate had valid commercial reasons for its refusal (CCAA A.B. 331). She decided that it would be pointless to order meetings of creditors and shareholders and dismissed the Balm/Janus application.

13 There is no requirement under the CCAA that all proposed plans of arrangement be put to meetings of creditors and shareholders for their consideration. Sections 4 and 5 specifically employ the word "may", giving the court discretion. In exercising its discretion, the court must consider whether the proposed plan of arrangement has a reasonable chance of success: Bargain Harold's Discount Ltd. v. Paribas Bank of Canada (1992), 10 C.B.R. (3d) 23 (Ont. Gen. Div.), or instead, is doomed to failure: Re Inducon Development Corp. (1991), 8 C.B.R. (3d) 306 (Ont. Gen. Div.). Here it was clear that the lending syndicate did not support the plan. They would be entitled to vote as a class at the meeting and defeat the plan. It was also clear that the Fracmaster situation was urgent, requiring rapid resolution, and that the delays that would be occasioned by calling the meetings would further jeopardize Fracmaster's financial condition and the value of its assets. The chambers judge did not err in concluding that the Balm/Janus plan was doomed to failure. We grant leave to appeal to Balm/Janus, but dismiss their appeal.

14 We wish to make a further observation. Under the CCAA the court has no discretion to sanction a plan unless it has been approved by a vote of a 2/3 majority in value of each class of creditors (section 6). To that extent, each class of creditors has a veto. This procedure is quite different from a court-appointed receivership. In a receivership the desires of the creditors are a significant factor, but the approval by a specific majority of creditors is not a pre-condition to court sanction, and creditors do not have an absolute veto. The difference in the procedures gives rise to different tests and considerations to be applied in each type of proceeding. While in this case the lending syndicate's desires in the CCAA and receivership proceedings were consistent, the chambers judge was not required to give the same weight to their wishes in each proceeding.

15 UTI also appeals the May 17, 1999 order denying Fracmaster's application to approve the sale of its assets to UTI under the CCAA. The chambers judge noted that the proposed sale of assets to UTI did not create any monetary return for the unsecured creditors or shareholders of Fracmaster, nor did it contemplate that they would receive any benefit. The transaction was effectively a sale of assets for the benefit of the lending syndicate, a transaction which she concluded could be accomplished in a manner that did not require the use of the CCAA (CCAA A.B. 331-332). Without deciding whether the UTI offer was commercially provident, she concluded that the sale should not be approved under the CCAA, and dismissed Fracmaster's application.

16 Although there are infrequent situations in which a liquidation of a company's assets has been concluded under the CCAA, the proposed transaction must be in the best interest of the creditors generally: Re Lehndorff General Partner Ltd. (1993), 17 CBR (3d) 24 at 31 (Ont. Gen. Div.). There must be an ongoing business entity that will survive the asset sale. See, for example, Re Canadian Red Cross Society, [1998] O.J. No. 3306 (Ont. Gen. Div.), online: QL (OJ); Re Solv-Ex Corporation and Solv-Ex Canada Limited, (19 November, 1997), (Calgary), 9701-10022 (Alta. Q.B.). A sale of all or substantially all the assets of a company to an entirely different entity, with no continued involvement by former creditors and shareholders, does not meet this requirement. While we do not intend to limit the flexibility of the CCAA, we are concerned about its use to liquidate assets of insolvent companies which are not part of a plan or compromise among creditors and shareholders, resulting in some continuation of a company as a going concern. Generally, such liquidations are inconsistent with the intent of the CCAA and should not be carried out under its protective umbrella. The chambers judge did not err in concluding that the sale of assets to UTI would be an inappropriate use of the CCAA. We grant leave to appeal to UTI, but dismiss its appeal.

RECEIVERSHIP APPEALS

17 Calfrac appeals the May 21 order which approved the sale of Fracmaster's assets to BJ Services. Its primary complaint is that the receiver failed to administer the sale process in strict compliance with the May 18 court ordered procedure. Calfrac's complaints about the process were considered by the chambers judge, and dealt with in her May 21 reasons (Receivership A.B. 119 to 122). She concluded that the terms of the May 18 order had to be read in light of the commercial realities of the business world and the bidding process. She viewed the variations as minor and not problematic and decided that the BJ Services offer was in substantially the same form as the offer proposed by the receiver.

18 A review of Calfrac's offer indicates that it too was not in strict complaince with the terms of the May 18 order. This is not entirely unexpected as the order, tender process and submission of offers came about quickly, without time to contemplate all the intricacies of fine legal drafting. Amendments to the form of agreement were contemplated in paragraph 4. c of the May 18 order. The other paragraphs of section 4, setting out other terms and conditions, did not specifically mention amendments.

19 The tender process in this case was not a distinct and final process designed to provide a complete set of bid documents to the bidders, with no possibility of negotiation or variation, as might be the case in a construction bid. See, for example, M.J.B. Enterprises Ltd. v. Defence Construction (1951) Ltd., [1999] S.C.J. No. 17 (S.C.C.), online: QL (SCJ). Time did not permit the creation of such definitive conditions. Instead the process was designed to be court supervised. The amendment provisions contained in paragraph 4. c illustrate the intent to build flexibility into the process, rather than requiring strict compliance with the order. All parties were entitled to be present and make representations at the court proceedings to approve an offer, with the court to have ultimate discretion to determine whether the principles and objectives of the sale process had been met. The chambers judge did not act unreasonably in considering the commercial realities and the nature of the variations, and in accepting the form of BJ Services offer. This ground of appeal fails.

20 A second ground of appeal advanced by both Calfrac and UTI, is that the receiver and the chambers judge failed to properly consider the closing risks associated with the BJ Services offer. The chambers judge considered the closing risks in her reasons (Receivership A.B. 112 to 113) and accepted the receiver's conclusion that the closing risks associated with the BJ Services offer were more than the Calfrac offer, no greater than the UTI offer, and more than offset by the BJ Services purchase price.

21 Calfrac is critical of the summary manner in which the receiver communicated its risk assessment, and the lack of detail to back up its analysis. The receiver had 6 hours in which to analyze the offers and indicate its recommendation to the parties. The expedited procedure was set out in the May 18 order which has not been appealed. With the benefit of more time, the receiver undoubtedly would have proffered a more detailed analysis. But one cannot be overly critical of the receiver's work product, given the time constraints.

22 Both UTI and Calfrac contend that the chambers judge erred in her assessment of the closing risks. UTI suggests that she erred in concluding that the closing risks of the BJ Services offer were no greater than the UTI offer. Even if that were so, the chambers judge also concluded that the BJ Services closing risks were more than offset by the greater purchase price. If that was the case for the Calfrac offer, which involved fewer closing risks and a higher purchase price than the UTI

offer, it would certainly be the case for the UTI offer, which involved greater closing risks and the lowest purchase price. We are not satisfied that the chambers judge's conclusions on risks were unreasonable. We defer to her findings and dismiss this ground of appeal.

THE LENDING SYNDICATE'S WISHES

23 UTI's principal ground of appeal is that the chambers judge erred in acting upon the receiver's recommendation and approving the sale of Fracmaster's assets to BJ Services. UTI submits that the prevailing consideration for the receiver should have been the wishes and business decision of the lending syndicate, which supported the UTI offer. UTI's appeal is supported by the lending syndicate and, if the Balm/Janus appeal does not succeed, by Banque Nationale de Paris, the subordinated lender.

24 The facts in this case are unique. After the preliminary stay and CCAA order, Fracmaster conducted a company supervised sale process, which resulted in offers or proposals from several companies, including Balm/Janus, Calfrac and UTI. The lending syndicate considered the proposals, preferred the UTI offer and contractually agreed to support it. An acknowledgment to the April 26 UTI offer, signed by the lending syndicate, stated: "The above Offer is hereby acknowledged by each of the undersigned and each of them agree to support the Offer at the CCAA Proceedings."

25 On April 27, 1999 the lending syndicate signed a side letter which contemplated that the sale of assets might not be completed under the CCAA, but under an alternate transaction, such as the appointment of a receiver and conveyance of assets by the receiver to UTI. The letter stated: "It is agreed that the Term Lenders and the Operating Lender will use their reasonable best efforts to conclude any such alternate transaction so long as they receive the same consideration as they would have received under the Offer."

26 Fracmaster applied for an order approving the sale of its assets to UTI under the provisions of the CCAA. Although the lending syndicate supported that application, in the same proceeding the lending syndicate applied for an alternate order appointing a receiver and directing the receiver to sell the assets to UTI. The chambers judge dismissed Fracmaster's application under the CCAA. She appointed a receiver but refused to direct the receiver to transfer the assets to UTI, concluding that this would fetter the receiver's discretion and largely defeat the purposes of its appointment (CCAA A.B. 333). Although the chambers judge noted that the receiver could have recommended a sale to UTI if it felt comfortable doing so, the receiver instead recommended a new sale process, involving sealed tenders. Both UTI and Calfrac participated in the sealed tender process, repeating their earlier offers. BJ Services, which had not made an offer in the CCAA proceedings, put in a new bid. It offered cash consideration to the lending syndicate of $80 million for Fracmaster's assets, compared to $60.7 million plus warrants offered by UTI and $66 million plus warrants offered by Calfrac. The lending syndicate, which had agreed to support the UTI offer before the BJ Services offer was made, stuck by their commitment and continued to support the UTI offer.

27 In accordance with the May 18 order, the receiver was required to make a recommendation to the court, bearing in mind the interests of all claimants, including the secured creditors. The bid process confirmed that the lending syndicate had the only remaining financial stake in the company. The amount of its secured debt was $96 million, which exceeded the bids. The receiver was aware that the lending syndicate supported UTI's offer, and was also aware of the letter agreement. Nevertheless, the receiver concluded that the BJ Services offer was the best offer, and recommended its acceptance.

28 The chambers judge followed that recommendation and approved the BJ Services offer. There is no suggestion that the BJ Services offer was prejudicial to the lending syndicate. The chambers judge considered the case law and concluded that although the creditors' interests were an important consideration, they were not the only consideration (Receivership A.B. 117). Accepting the principle that the creditors' views should be very seriously considered, she indicated that if she were satisfied that the receiver acted properly and providently, she would be reluctant to withhold approval of a transaction recommended by the receiver. (Receivership A.B. 118)

29 UTI concedes that had the bid process resulted in a bid which exceeded the lending syndicate's secured claim of $96 million, parties other than the lending syndicate would have had a financial interest in the outcome, and different considerations would apply. Because none of the bids exceeded $96 million, only the lending syndicate had a financial interest in the proceeds of sale of assets. UTI submits that the lending syndicate made a bargain with UTI, and that bargain should be the paramount consideration. The thrust of UTI's argument is that its offer should be accepted so long as no one else offered more than $96 million. In effect, it would have a reserve bid.

30 The narrow issue raised in the appeal is the weight to be given to the lending syndicate's wishes to accept the UTI offer. But this appeal raises a competing issue, the integrity of the bid process.

31 Lenders have the ability to appoint private receivers and deal with assets without court approval. In the circumstances of this case, where Fracmaster has many offshore assets, we are told that a private receivership without court involvement would not be expedient. Once a creditor embarks upon a court appointed receivership, the creditor loses an element of control, including the power to dictate the terms of the disposition of assets. Although the lending syndicate's preferences are an important factor to be considered by the court, its preferences do not fetter the court's discretion and are not necessarily determinative.

32 The receiver's role in a liquidation of assets is clear and well defined. Its obligation is to make a sufficient effort to obtain the highest possible sale price for the assets: Salima Investments Ltd. v. Bank of Montreal (1985), 21 D.L.R. (4th) 473 at 476 (Alta. C.A.). In Royal Bank of Canada v. Soundair Corp. (1991), 83 D.L.R. (4th) 76 at 93 (Ont. C.A.), Galligan J.A. set out the principles which govern the function of the court and the exercise of its discretion when considering an application by a receiver for court approval of a sale:

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

The chambers judge considered each of these principles in turn, then accepted the receiver's recommendation.

33 Only in rare cases will the receiver's recommendation diverge from the wishes of the only stakeholder, and those cases must be carefully scrutinized by a judge who is asked to approve that recommendation. But we cannot say that the chambers judge acted unreasonably by following the

recommendation of the receiver in this case, because of the unique facts and manner in which events unfolded.

34 After the court learned of the existence of the lending syndicate's contractual commitment to support the UTI offer in a receivership, it nevertheless ordered a sealed tender process. The receiver asked for the sale process in order to determine whether offers might be made which would exceed the amount of the lending syndicate's debt. The receiver also submitted that only a sale process would satisfy the court that it had fulfilled its mandate to maximize recovery and "give everyone a fair and reasonable attempt at bidding on the assets of the company" (Receivership A.B. 56). Once the sale process was engaged, it had to be fundamentally fair, with a level playing field for all participants.

35 The receiver contacted all parties who had previously made an offer for Fracmaster's assets or expressed an interest in making an offer. The receiver also issued a press release outlining the terms of the sale. It was therefore clearly contemplated that the bidding process would not be confined to previous bidders.

36 Some reference to a reserve bid could have been incorporated into the May 18 order indicating, for example, that UTI's offer was to be accepted unless a bid exceeded $96 million. The order was silent. Under the order, UTI was not required to repeat its earlier offer and could have changed the consideration. In fact, it could have made no offer at all. Anyone entering the bidding process might well know, as BJ Services did, that the lending syndicate supported UTI's offer and that this could create some impediments. But they could not know that UTI's offer would have the effect of a reserve bid up to $96 million. To default to the UTI bid without prior notice to the other bidders would undermine the integrity of the independent bidding process.

37 UTI chose to resubmit its earlier offer, but must have been mindful of the risks. Clause 6. (b) of UTI's offer specifically stated that the offer was conditional on court approval.

38 While neither the receiver nor the court had an obligation to sweeten the lending syndicate's negotiated deal, the fact that the effect of the recommended bid was to increase the lending syndicate's cash consideration was not itself a reason to dismiss the receiver's recommendation. Once the court embarked upon a sealed tender process other interests were engaged. The chambers judge considered the interests and desires of the lending syndicate. She also considered the other factors set out in Soundair, including fairness and the efficacy and integrity of the process. She balanced the competing interests, as she was required to do, and we cannot say that her conclusion was unreasonable or that she erred in principle. This ground of appeal fails.

SUMMARY

39 We grant leave to appeal the CCAA orders to Balm/Janus and UTI. The Balm/Janus appeal, Calfrac appeal and two appeals by UTI are dismissed.

FRUMAN J.A.

(DISCUSSION AS TO COSTS)

40 CONRAD J.A.:-- We have concluded that there is no reason to depart from the normal rule that costs follow the success of the appeal. Accordingly, we will order one set of costs to BJ Services to be payable in equal amounts by UTI, Calfrac and Balm/Janus. The costs are to be assessed on Column 5.

CONRAD J.A.

cp/i/kjm

TAB 3

Indexed as:

Menegon v. Philip Services Corp.

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36., as amended
AND IN THE MATTER OF the Courts of Justice Act, R.S.O. 1990 c. C-43, as amended
AND IN THE MATTER OF a plan of compromise or arrangement of Philip Services Corp. and the applicants listed on Schedule "A"
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Between
Joseph Menegon, plaintiff, and
Philip Services Corp., Salomon Brothers Canada Inc., Merill Lynch Canada Inc., CIBC Wood Gundy Securities Inc., Midland Walwyn Capital Inc., First Marathon Securities Limited, Gordon Capital Corporation, RBC Dominion Securities Inc., TD Securities Inc., and Deloitte & Touche, defendants

[1999] O.J. No. 4080

11 C.B.R. (4th) 262

39 C.P.C. (4th) 287

Court File Nos. 99-CL-3442 and 4166CP/98

Ontario Superior Court of Justice
Commercial List

Blair J.

August 27, 1999.

(60 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Arrangement, judicial approval -- Practice -- Persons who can sue and be sued -- Individuals and corporations, status or standing -- Class or representative actions -- Conflict of laws -- Bankruptcy.

Motion by the defendant Philip Services for authorization to enter into a proposed settlement under the Class Proceeding Act. Joint motion by the representative plaintiff Menegon and by Philip for certification of class proceedings as against Philip only. Motion by the defendant Deloitte and Touche and by former officers and directors of Philip to declare an insolvency plan unreasonable. Motion by the creditor Royal Bank for a declaration that its claim against Philip under certain leases be determined

under Canadian law. Philip was the parent company of a large network of subsidiaries in Canada and the United States. Publicity regarding inventory discrepancies led to a drop in prices of Philip shares, resulting in various class actions which alleged that Philip's financial disclosure contained material misstatements in violation of United States securities laws. The actions were consolidated and ultimately dismissed, though an appeal was pending. Menegon commenced a class proceeding in Ontario for misrepresentation and rescission relating to purchase of Philip shares. The Royal Bank had a claim against Philip under 57 equipment leases governed by Ontario law with respect to equipment located in Ontario. A memorandum of understanding outlined a proposed settlement between Philip and the class action plaintiffs in both the United States and Canadian proceedings. Philip filed for bankruptcy protection in the United States and for protection in Canada under the Companies' Creditors Arrangement Act. The Canadian plan provided that Canadian claimants were to be governed by and treated in the United States proceedings.

HELD: Class proceedings certified as against Philip for settlement purposes only. Deloitte & Touche, the officers and directors, and the Royal Bank were all entitled to assert claims in the Canadian proceedings. Royal Bank was also entitled to a declaration that its claims under the leases were to be determined in Canadian proceedings. Approval of the settlement was premature. Reasonableness of the plan was an issue to be determined at a sanctioning hearing.

Statutes, Regulations and Rules Cited:

Bankruptcy Code.

Class Proceedings Act, 1992, ss. 5(1), 17.

Companies' Creditors Arrangement Act, ss. 5.1(3), 18.6(2), 18.6(5).

Courts of Justice Act, s. 97.

Counsel:

David R. Byers, Sean Dunphy and Colleen Stanley, for the Philip Services Corp. et al.
John McDonald, for the Class Proceedings plaintiffs.
J.L. McDougall, Q.C., B.R. Leonard, for the defendants Deloitte & Touche.
B. Zarnell, for the defendants Merill Lynch Canada Inc., Midland Walwyn Capital Inc., First Marathon Securities Limited, Gordon Capital Corporation and Salomon Brothers Canada Inc. ("The Underwriters")
Hilary Clarke, for the Royal Bank of Canada.
Pamela Huff and Susan Grundy, for the Lenders under the Credit Agreement.
Joseph Groia and Subrata Bhattacharjee, for the certain Directors.
E.A. Sellars, for the defendant CIBC as Account Intermediary.
Steven Graff, for the PHH Vehicle Leasing.

BLAIR J.:--

I - FACTS

Background

1 The issues raised on these Motions touch upon difficult areas in the burgeoning field of cross-border insolvencies.

2 Philip Services Corp. is the ultimate parent company of a network of approximately 200 directly and indirectly owned subsidiaries in Canada, the United States and elsewhere. The operations of this international conglomerate of companies are service oriented, with a primary focus on what are referred to as "Metals Services" and "Industrial Services". The former involves the collection, processing and recycling of scrap metal for steel mills and for the foundry and automotive industries. The latter entails providing such things as cleaning and maintenance services, waste collection and transportation, emergency response services and tank cleaning for major industries ("outsourcing services"), and providing "by-products recovery services", with heavy emphasis on chemical and fuel and polyurethane recycling, for the same industries.

3 The Philips conglomerate - with consolidated revenues in 1988 of U.S. $2 billion, but a consolidated net loss of U.S. $1.587 billion for the period ending December 31, 1998 - has fallen into insolvent circumstances. On June 25, 1999, Philip Services Corp. and its Canadian subsidiaries sought and obtained the protection of this Court under the provisions of the CCAA to enable them to attempt to restructure their affairs. On the same date, Philip Service Corp. and its primary subsidiary for its U.S. operations, Philip Services (Delaware) Inc., together with other U.S. subsidiaries, filed for Chapter 11 protection under the U.S. Bankruptcy Code in United States Bankruptcy Court (District of Delaware). On July 12, 1999, a "Disclosure Statement and a Plan of Reorganization" was filed in the U.S. Bankruptcy Proceedings ("the U.S. Plan"). On July 15th, a Plan of Compromise and Arrangement was filed in the CCAA Proceedings ("the Canadian Plan").

4 As the parties and counsel have done, I shall refer to Philip Services Corp. as "Philip" and to Philip Services (Delaware) Inc. as "PSI". I shall refer to the conglomerate as a whole as "Consolidated Philip."

5 Philip is an Ontario corporation with head offices in Hamilton, Ontario. It is a public company with stock trading on the Toronto Stock Exchange, the Montreal Exchange, and the New York Stock Exchange. Although trading is suspended at the present time, the bulk of trading occurred on the New York Stock Exchange. Eighty-two percent of Philip's issued and outstanding shares are owned by U.S. residents. Moreover, it appears, the majority of Philip's operating assets, and of its operations, are located in the United States. Consolidated Philip carries on business at more than 260 locations, and employs more than 40,000 industrial and commercial customers world-wide. In Canada, there are 94 locations, about 2,000 employees, and annual revenues in the neighbourhood of U.S. $333 million.

6 Philip expanded very rapidly in the past few years - perhaps too rapidly, as it turns out. Consolidated Philip grew by more than 40 new business acquisitions in 1996 and 1997. Associated with this expansion was the negotiation of a U.S. $1.5 billion Credit Agreement with Philip and PSI as borrowers and a syndicate of more than 40 lenders (the "Lenders"). Under the Credit Agreement Philip guaranteed the borrowings of PSI, and PSI guaranteed the borrowings of Philip. In addition, certain subsidiaries of Philip and PSI guaranteed all of the liabilities of Philip and PSI to the lenders, and the guarantees from the subsidiaries were secured by general agreements and specific assignments of assets. In short, the Lenders have security over virtually all of the assets of Consolidated Philip. Moreover, subject to certain specific exceptions, it is first security.

7 During this same period of expansion, Philip raised about U.S. $362 million through a public offering in the U.S. and Canada. Seventy-five percent of these shares were sold in the U.S. As events transpired, these public offerings have led to a series of class actions against Philip both in the U.S. and in Canada. They arose out of certain discrepancies between copper inventory as shown on the books and records of Philip and actual inventory on hand, which were revealed in audits in early 1998. Publicity

surrounding the discrepancies led to a drop in the price of Philip shares, which led to various class actions. Eventually, it was determined that Philip's liabilities had been understated by approximately U.S. 35 million. As a result, it was required to file an Amended Form 10-K with the U.S. Securities and Exchange Commission restating its financial results for 1997 to show an additional loss of $35 million. It was also required to revise the amount of pre-tax special and non-recurring charges for that same year.

8 It is said that the unsettling effects of the financial irregularities and the class action proceedings, in conjunction with a general uncertainty in the markets serviced by Consolidated Philip, caused Philip's earnings to drop dramatically. It could not refinance its long-term debt under the Credit Agreement. Its trade credit was curtailed. It lost contracts and, because its bonding capacity was impaired, it was further hampered in its ability to win new contracts. In spite of concerted efforts over a period of nearly a year, Philip was not able to re-finance its debt or to restructure its affairs outside of the court restructuring context. Cash conservation measures in late 1998 led to defaults under the Credit Agreement. Debt restructuring negotiations with the Lenders since that time led ultimately to the parallel insolvency proceedings in Canada and the U.S. to which I have referred above.

The Class Proceedings

9 Developments in the class action proceedings are what have led specifically to the Motions which are presently before this Court.

10 In February and March of 1998 various class actions were filed in the United States against Philip, certain of its past and present directors and officers, the underwriters of the Company's November 1997 public offering, and the Company's auditors (Deloitte & Touche).[1] The actions, now consolidated, alleged that Philip's financial disclosure for various time periods between 1995 and 1997 contained material misstatements or omissions in violation of U.S. federal securities laws.

11 In May, 1998, a class proceeding was also commenced in Ontario, under the Class Proceedings Act, 1992 ("the CPA Proceeding"). The plaintiff is Joseph Menegon, a retired school teacher living in Hamilton, who had purchased 300 common shares of Philip on the TSE in November, 1998. The CPA Proceedings is an action for misrepresentation, negligent misrepresentation and rescission relating to the purchase of shares of Philip by people in Canada between February 28 and May 7, 1998. The defendants are Philip, the various Underwriters, and Deloitte & Touche.

12 At the instance of Philip and Deloitte & Touche, however, a motion was brought for an order dismissing the U.S. Class Action on the grounds that the United States Court was not the proper Court for the disposition of the claims, but that the Ontario Court was. This motion was successful and on May 4, 1999 the U.S. Class Action was dismissed. A motion to reconsider was also dismissed. Although the U.S. Class Action plaintiffs have appealed, the present status of those proceedings is that they have been dismissed.

13 Nonetheless, the U.S. claims persist, and there have been negotiations between counsel for the U.S. and Canadian Class Action plaintiffs and Philip since early 1999 with a view to arriving at a settlement of the class action claims against Philip. Because of the nature of these claims, and the potential quantum of any judgments that might be obtained, a resolution of the Class Action proceedings, according to Philip, is an essential element of any successful restructuring. On June 23, 1999, the parties to the negotiations entered into a Memorandum of Understanding which outlined a proposed settlement between Philip and the U.S. Class Action and CPA Proceedings plaintiffs.

14 Philip and the CPA Proceeding plaintiff now seek certification of the CPA Proceeding and approval of the Settlement by the Court. Philip, separately, seeks approval of this Court under the CCAA to enter into the proposed Settlement. These motions have triggered the series of matters that are

now to be disposed of. Deloitte & Touche not only opposes the Motions, but seeks separate declaratory relief on its own part touching upon the Settlement itself and as well the overall "fairness" and "reasonableness" of the proposed Canadian Plan. I shall return to the specifics of the competing Motions and the relief sought shortly. First, however, some brief reference to the controversial aspects of the Canadian and U.S. Plans, and to the terms of the Settlement, is required.

The Controversial Aspects of the Plans, and the Settlement

15 The principle terms and conditions of the U.S. and Canadian Plans, as they presently stand, were hammered out in a "Lock-Up Agreement" entered into in April, 1999 and later amended on June 21st, between Philip (as Canadian Borrower), PSI, (as U.S. borrower), and a Steering Committee representing the Lenders. There were also negotiations with certain of Philip's major unsecured creditors and with counsel for the U.S. and Canadian class action plaintiffs. The Lock-Up Agreement is variously described as the result of "heavy" negotiations and "very hard bargaining". No doubt that is indeed the case.

16 The amended Lock-Up Agreement provides in substance that the Lenders will become the holders of 91% of the equity in the newly restructured Philip, and that they will as well receive U.S. $ 300 million of senior secured debt (now reduced to $250 million through asset sales) and $100 million of secured "payment in kind" notes. Under the U.S. Plan the remaining 9% of the equity in the restructured Philip is to be made available to other stakeholders, on the following basis: 5% (plus U.S. $60 million in junior notes) is to be for the compromised unsecured creditors; 2% for the existing shareholders; 1.5% for the Canadian and U.S. class action plaintiffs; and, 0.5% for the holders of other securities claims. The formula is conditional upon cross-approvals of the U.S. and Canadian Plans.

17 From Philip's perspective the Plans filed in both the U.S. and in Canada are interdependent and form a single Plan from a "business point of view". The general concept of the overall plan is that each class of stakeholders in the Consolidated Philip with similar characteristics are to be treated similarly whether they are located in the U.S. or in Canada. With this in mind, and having regard to the need for a coordinated restructuring of claims and interests against Philip, PSI, and the Canadian and U.S. subsidiaries, the Plans provide that,

a) creditors with claims against Philip's Canadian subsidiaries but not against Philip itself are to file their claims in the CCAA proceedings in Canada, and are to be dealt with in the Canadian Plan; and
b) creditors with claims against Philip or its U.S. subsidiaries are to have their claims processed in the U.S. proceedings and are to be dealt with in the U.S. Plan.

18 The result of this is that the claims of Philip's creditors, whether Canadian or U.S. are to be dealt with under the U.S. Plan and governed by Chapter 11 of the U.S. Bankruptcy Code. This includes the claims of Deloitte & Touche and of the Underwriters, and of certain former officers and directors, for contribution and indemnity in relation to the U.S. and Canadian class proceedings. It also includes the claims of certain creditors, such as Royal Bank of Canada, in relation to personal leases.

19 Not surprisingly, those so affected take umbrage at this treatment. They submit that it contravenes the provisions of the CCAA and their substantive rights under Canadian law, and should not be countenanced. It renders the Canadian Plan unfair and unreasonable, in their submission, and should not be sanctioned. Philip argues, on the other hand, that matters relating to whether or not the Plan is fair and reasonable are matters to be dealt with at the sanctioning hearing, when the Plan is brought before the Court for approval after is has received the earlier approval of the Company's creditors.

The Proposed Settlement

20 Under the proposed Settlement the Canadian and U.S. class action plaintiffs are to receive 1.5% of the common shares of a restructured Philip, as noted above. The shares are to be distributed pro rata amongst the Canadian and U.S. plaintiffs. There is to be, in addition, an amount of up to U.S. $575,000 for costs of counsel for the U.S. and Canadian class action plaintiffs. The Settlement is embodied in the U.S. Plan as "Allowed Class 8B Claims". It includes the right of persons caught by the class proceedings to opt out; however, any member of the class who elects to opt out of the proposed settlement is also to be dealt with in the U.S. Plan as a Class 8B claimant.

21 The proposed Settlement is conditional upon its being approved by the Courts in Canada and in the U.S. and according to Philip, upon the successful implementation of both the Canadian and the U.S. Plan. Philip has made it clear that it and its professional advisors do not believe that a restructuring of Philip can be accomplished without resolution of the class action claims in Canada and the U.S. Philip, counsel in the Canadian class action, and the Lenders all argue that in the event of liquidation, the plaintiffs will get nothing because -- even if they are successful on liability -- they will have no chance of recovering a damage award against the insolvent Philip. The Settlement is also recommended by Ernst & Young, the court appointed Monitor for Philip in the CCAA proceedings.

22 What, then, are the specific issues that the Court is asked to determine on the pending Motions?

II - THE ISSUES RAISED

23 The following Motions, as summarized, are before the Court:

1) A Motion by Philip pursuant to the CCAA for authorization and direction to enter into the proposed Settlement of the proceeding pending against it under the Class Proceeding Act;
2) A joint Motion by Philip and Mr. Menegon, the representative plaintiff in the CPA Proceedings, for certification of the class proceeding as against the defendant Philip only, and for approval of the Settlement Agreement together with directions regarding notification of members of the proposed class;
3) A cross-Motion by Deloitte & Touche - one of Philip's co-defendants in the CPA Proceedings, supported by the other co-defendant Underwriters -- for declaratory relief in the nature of an order:

    a) declaring, pursuant to s. 5.1(3) of the CCAA and s. 97 of the Court of Justice Act that the Canadian Plan is not fair and reasonable in the circumstances, having regard to those provisions in the Canadian Plan which compromise the ability of Deloitte & Touche to claim contribution and indemnity against Philip and certain of its directors, officers and employees;
    b) precluding the compromise of the Deloitte & Touche claims and amending both the Canadian Plan and the U.S. Plan so the Deloitte & Touche's rights are to be determined under the Canadian Plan alone, and in accordance with Canadian law and without unfairly prejudicing its rights.

4) A Motion by Royal Bank of Canada for an order,

a) declaring that the claim of Royal Bank against Philip under certain leases shall be determined with reference to Canadian law and in the Canadian proceedings;
b) declaring that the Canadian Plan is not fair and reasonable because it seeks to compromise the Bank's claims in the U.S. Plan, thus adversely affecting the Bank's rights and circumventing Philip's obligations under Canadian law;
c) amending the Canadian Plan so that the Bank's claim is not dealt with in the U.S. Plan; and
d) amending sub-paragraph 14(d) of the Initial Order granted in the CCAA proceeding on June 25, 1999 -- which presently permits Philip to terminate any and all arrangements entered into by them by providing that the sub-paragraph does not apply to leases of personal property; and, finally,

5) A Motion on behalf of certain former officers and directors of Philip seeking to have the Canadian Plan and the U.S. Plan declared not fair and reasonable in the circumstances, having regard to those provisions,

a) which attempt to compromise or otherwise limit the ability of the Moving Parties to claim contribution and indemnity from Philip without compensation whatsoever;
b) which call for releases to be provided to current directors and officers of Philip, but not to former directors and officers;
c) which deprive the Moving Parties of their rights as creditors to vote on the Canadian Plan.

III - LAW AND ANALYSIS

The Class Proceedings

24 There is little difference is substance between the joint Motion of Philip and the Canadian class action plaintiff under the Class Proceedings Act, and that of Philip alone, under the CCAA. Both ultimately seek approval and implementation of the proposed Settlement. However, the CCAA proceeding provides the context in which this approval is sought and, indeed - as I have already mentioned - Philip and others are of the view that a successful restructuring of Consolidated Philip is not possible without the implementation of the proposed Settlement, and that the converse is also true. Thus, there is a close link between the two, and in my opinion the issue of settlement approval cannot be viewed in isolation from the CCAA/restructuring environment in the context of which it was developed.

Certification

25 I have little hesitation in certifying - and do certify - the CPA Proceeding as a class proceeding pursuant to subsection 5(1) of the Class Proceedings Act, as requested. That is, the proceeding is certified as a class proceeding as against the defendant Philip only and for settlement purposes only. It is without prejudice to any arguments the other defendants to the CPA Proceedings may wish to make in opposition to any element of the plaintiff's claim, including, but not limited to, certification of a class as against them.

26 For those purposes, however, I am satisfied that the tests set out in subsection 5(1) have been met. The statement of claim discloses a cause of action based upon faulty disclosure. There is an identifiable

class, as articulated in the materials, and a common issue, as therein very broadly defined.[2] A class proceeding makes sense, and is the preferable procedure for the resolution of the common issue in the circumstance, and Mr. Menegon constitutes a representative plaintiff as called for in the subsection. An Ontario Court has jurisdiction pursuant to the Class Proceedings Act to certify a Canada-wide opt out class where the action has a "real and substantial" connection to Ontario, as is the case here; see, Carom v. Bre-X Minerals Ltd., 43 O.R. (3d) 441, February 11, 1999, (Ont. Gen. Div.); Nantais et al v. Telectronics Proprietary (Canada) Ltd. et al, (1995), 25 O.R. (3d) 331 (Ont. Gen. Div.), leave to appeal refused [1995] O.J. No. 3069, at p. 347 (Div. Ct.).

Approval and Notice

27 I have concluded, however, that Notice should be given at this time to the members of the class as certified, in accordance with the provisions of section 17 of the Class Proceedings Act, but that the proposed Settlement ought not to be approved at this time and at this stage of the restructuring proceedings.

28 This conclusion is based not so much on the issue of whether notification under the Act may be given jointly for certification and approval, and not so much of the question of the merits of the proposed Settlement as between the class action plaintiffs and Philip. The former issue has not yet been settled, but need not be determined in this case. The latter is supported by the recommendations of the Monitor and seasoned U.S. representative counsel, and by the "reality check" that is there is no settlement it is unlikely that the class action plaintiffs will ever recover anything from Philip.

29 Rather, my conclusion is based upon my sense that it is premature to approve a settlement of the U.S. and Canadian class action proceedings at this stage of the restructuring process. Philip and the Lenders have made it clear that the settlement of those claims forms a central underpinning to the ability of Consolidated Philip to reorganize successfully. But the reverberations of the class actions extend to more than merely the relations between Philip and the class action plaintiffs. They affect the relations between Philip and the co-defendants in the proceedings, and between the class action plaintiffs and the co-defendants as well. The class action plaintiffs and the co-defendants are all unsecured claimants of Philip in the restructuring process - the claim of the co-defendants for contribution and indemnity against Philip and its former officers and directors arise out of the same "nucleus of operative facts"[3] as the claims of the class action plaintiffs against Philip; and one follows from the other. It has frequently been noted that the full name of the CCAA is "An Act to facilitate compromises and arrangements between companies and their creditors". In the bare-knuckled ring of commercial restructuring negotiations, this cannot be accomplished if one group of unsecured claimant is given an unwarranted advantage over another.

30 To grant approval to the proposed Settlement of the class action plaintiffs with Philip at this stage would in effect immunize both those plaintiffs and Philip from the need to have regard to the co-defendants in resolving their dispute. It may well be that a plaintiff in an action with multi-party defendants can settle unilaterally with one of those defendants without creating other repercussions in the lawsuit. It may also be, however, that such a settlement cannot be effected without taking into account some aspects of the "other party" issues - things such as the impact of the settlement on the co-defendants' claims for contribution and indemnity, including the quantum of or a cap on recovery and questions of releases, to take only some examples.

31 For instance, Philip is contractually bound under the terms of its Underwriting Agreement with the Underwriters to indemnify and hold the Underwriters harmless against all claims based on allegations of untrue statements or alleged untrue statements in a prospectus. More to the point, Philip is not entitled without the consent of the Underwriters, under the terms of the same Agreement, to settle any action in which such claims are made against it and unless the settlement includes an unconditional release in

favour of the Underwriters. Approval of the proposed Settlement at this state of the restructuring proceedings would deprive the Underwriters of the contractual right. What is significant at this point is not the attempt to compromise the claim, including the contractual right to the release, but rather the loss of the bargaining chip on the part of the Underwriters in the process as a result of the unilateral settlement as between Philip and the plaintiffs.

32 Philip, the Lenders, and counsel for the class action plaintiffs have mounted an adamant chorus that if the proposed Settlement is not approved the U.S. and Canadian class action plaintiffs will get nothing because Philip will be liquidated and, in addition, that there is simply no room for the class action plaintiffs to receive anything more than the 1.5% share distribution in the restructured Philip which is currently on the table. The Lenders point out that they are fully secured and that they need not leave available even that 1.5% interest (not to mention the 9% equity interest which they have agreed to leave available to other stakeholders generally). These pronouncements may well reflect the final reality of the situation. However, I am somewhat less inclined to accept them at face value than the parties are to make them, particularly at this stage of the proceedings. It would not be the first time in restructuring negotiations where an adamant chorus turned into a more harmonious melody before the end of the day. Only the final moments of the process will tell the tale. In the meantime, as many negotiating options as possible should be kept open as amongst claimants of equal status in the restructuring, in my view.

33 I do not say that this proposed Settlement, in its present or some other form, will not ultimately be approved. It is simply premature at this stage in the restructuring process to give it that imprimatur, in my opinion - if the imprimatur is to be given - for the reasons I have articulated. Accordingly, the question of approval of the proposed Settlement is adjourned to a date to be fixed which is more contemporaneous with the sanctioning hearing. In the meantime, Notice of certification and of the pending motion for approval is to be sent to all members of the class.

The Fairness Issues Regarding the Canadian Plan.

34 Much of the foregoing reasoning applies to the conclusions I have reached with respect to the issues raised by Deloitte & Touche and others respecting the Canadian Plan and its nexus with the proposed Settlement.

35 The claim of the plaintiffs in the CPA Proceedings as against Deloitte & Touche and the Underwriters includes a claim for the difference between the value received by the plaintiffs as a result of the settlement and their actual loss. If the Settlement and the Canadian and U.S. Plans are approved, however, these co-defendants will lose their rights to claim contribution and indemnity form Philip in the class action. This, in itself, is not a reason for impugning the fairness and reasonable of the Plans, because the ability to compromise claims against it is essential to the ability of a debtor corporation to restructure its affairs. Nonetheless, where the proposed structure of the reorganization affects the substantive rights of claimants in a fashion which treats them differently than they would otherwise be treated under Canadian law, and where the effect of that treatment is to place the claimants in a position where their ability to engage in full and complete negotiations with the debtor company are impaired, there is cause for concern on the part of the Court. That, in my view, is the case here.

36 The effect of the Canadian Plan, as presently structured, is to deprive Deloitte & Touche, the Underwriters and others such as the former directors and officers of Philip who may have claims of contribution and indemnity as against Philip arising out of the same "nucleus of operative facts" pertaining to the class action claims, for pursuing those contribution claim in the Canadian CCAA proceeding. The same is true, but for different reasons, of the claim of Royal Bank with respect to its equipment leases. This is accomplished by carving out the claims in question from the CCAA proceedings and providing that they are to be dealt with under the U.S. Plan in U.S. Bankruptcy Court in accordance with the provisions of the U.S. Bankruptcy Code. All claims against Philip are to be dealt

with in that fashion, notwithstanding that it was Philip which set in motion the CCAA proceeding in the first place and which sought and obtained the stay of proceedings preventing these very same claimants form pursuing their claims in Canada against it. At the same time, the Canadian Plan, but its very terms, is to be binding upon all holders of claims against Philip - including those which are subject to the Canadian Plan; see section 9.15 of the Canadian Plan. This is to be accomplished without even according the right to those claimants to vote on the Plan.

37 The binding nature of the Canadian Plan has the effect of requiring the responding claimants to provide releases in favour of Philip while they are at the same time not released by Philip from claims that might be subsequently asserted against them. Furthermore, as the Plan presently stands, Deloitte & Touche and the Underwriters will be against them. Furthermore, as the Plan presently stands, Deloitte & Touche and the Underwriters will be deemed to have released former directors and officers from claims for contribution and indemnity. The Class Action plaintiffs have chosen not to pursue the directors and officers, at the present time, and there is apparently upwards of $100 million in insurance that might be available to satisfy such claims. This is a matter of considerable concern for Deloitte & Touche and for the Underwriters. Philip has advised, during the course of these motions and before, that it does not intend the proposed Settlement or the Plan to preclude the ability of Deloitte & Touche and of the Underwriters to pursue the former officers and directors. For the present, however, the Plan is worded in such a way that they will be so precluded. The real point is that all of this is being visited upon the responding claimants without there being entitled to any say in the Canadian proceedings as to their willingness or lack of willingness to be so treated.

38 In my opinion it is the loss of the right to vote in the Canadian Plan which lies at the heart of the present dilemma. The mere fact that a Canadian creditor's rights are to be dealt with and affected by single or parallel insolvency proceedings in the U.S. Bankruptcy Court - or that the reverse may be the case (U.S. creditor/Canadian Court) - is not necessarily sufficient, in itself, to undermine the fairness and reasonable of a proposed Plan; see, for example Roberts v. Picture Butte Municipal Hospital (1998), 64 Alta. L.R. (3d) 218 (Alta. Q.B.); Re Starcom Services Corp., Bank. W.D. Wash., case no M-98-60005, Nov. 20, 1998. In Canadian insolvency proceedings under the CCAA, however, it is the right to vote on the compromise or arrangement which the debtor company proposes to make with them which is the central counterpart, on the part of the creditors, to the debtors right to attempt to make that compromise or arrangement. In my view, having chosen to initiate and take advantage of the CCAA proceedings, Philip cannot now evade the implications and statutory requirements of those proceedings by seeking to carve out certain pesky - and potentially large - contingent claimants, and to require them to be dealt with under a foreign regime (where they will be treated less favourably) while at the same time purporting to bind them to the provisions of the Canadian Plan. All of this without the right to vote on the proposal.

39 While the fact that their treatment under U.S. Bankruptcy law will apparently be considerably less favourable then their treatment under Canadian law is not determinative, it is certainly a factor for consideration when taken in conjunction with the loss of voting rights in the Canadian Plan. As counsel have presented it, contribution claimants such as Deloitte & Touche, the Underwriters and the directors and officers will have the status equivalent to equity holders under the U.S. Plan. Their claims will not be considered as unsecured debt claims in terms of priority ranking. Pursuant to the "cram down" provisions of the U.S. Bankruptcy Code, the Bankruptcy Court can approve a plan of reorganization even if a class of creditors votes not to accept the plan provided no junior-ranking class receives a distribution and the plan is otherwise fair and reasonable. Moreover, the U.S. Bankruptcy Court may on motion deem such a class of stakeholders to have voted to reject the plan in order to dispense with the necessity of having such a vote amongst its members. While Philip's deponents and its counsel have not said so expressly, it is the clear inference from the materials filed that that is precisely the route which Philip proposes to follow vis à vis the contribution claimant whose claims have been left to be dealt with

under the U.S. Bankruptcy Code.

40 For purposes of the CCAA the claim of an unsecured creditor includes a claim in respect of any indebtedness, obligation of liability which would be a claim provable in bankruptcy, and therefore includes a contingent claim for unliquidated damages. Thus, Deloitte & Touche, the Underwriters, the officers and directors, and Royal Bank are all entitled to assert claims in the CCAA proceedings. They are Canadian claimants, asserting claims against a Canadian company in a Canadian proceeding. In respect of the claims for contribution and indemnity those claims arise out of a "nucleus of operating facts" which the U.S. Courts - at the urging of Philip, amongst others - have already determined are more conveniently litigated in Canadian class action proceedings.

41 In respect of the Royal Bank, the claim relates to some 57 equipment leases entered into between the Bank and Philip under lease agreements governed by the laws of Ontario and with respect to equipment located (with one exception) in Ontario. However, under U.S. Bankruptcy laws, Philip would be entitled to "reject" leases, which it is not entitled to do under Ontario law, although it may of course "break" the leases if it is prepared to suffer the legal consequences. Again the attempt by Philip is to treat the claims under a regime which is more favourable to it and less so to the claimant. That attempt may not in itself be objectionable, but to the extent that it is accomplished by depriving the creditor of its right to vote and to participate in the Canadian proceedings which were initiated for the purposes of shielding Philip against the claim, it is troubling.

42 The rights of creditors under the CCAA cannot be compromised unless,

a) the creditor has been given a right to vote, in the appropriate class, on the proposed compromise;
b) the creditor's vote is in accordance with a value ascribed to the claim by a Court approved procedure;
c) the class in which the creditor has been appropriately placed has voted by a majority in number and two-thirds in value in favour of the compromise; and,
d) the Court has sanctioned the compromise on the basis that it is fair and reasonable (with considerable deference being given by the Court in this regard to the votes of the creditors).

43 See CCAA, section 4, 6 and 12; Re Olympia & York Developments Ltd. (1993), 12 O.R. (3d) 500, at p. 510 (Ont. Gen. Div.).

44 Here, for the reasons I have outlines, what Philip proposes is inconsistent with the foregoing.

45 Philip and the Lenders argue that the issues raised in this regard by the Respondents go entirely to the fairness and reasonableness of the U.S. and Canadian Plans, and that such considerations should be reserved for determination at the sanctioning hearings. I agree that generally speaking matters relating to fairness and reasonableness are better considered in the overall context of the final sanctioning hearing. Where, as here, however, the debtor company has acted earlier to obtain approval of a step in the restructuring process - in this case, the Class Action Settlement - which gives rise to issues that are inextricably linked to the overall fairness of the proposed Plan, and its compliance with statutory requirements, the consideration of those issues may be called for. This is one of those cases, Settlement - in conjunction with the manner in which the debtor intends to treat other claimants directly affected by the settlement, have the effect of requiring those claimants to participate in the subsequent restructuring negotiations without a full deck of cards.

46 Philip and the Lenders also argue that "comity" demands that this Court defer to the U.S. Bankruptcy Court in allowing the claims of Deloitte & Touche, the Underwriters, the former directors

and officers, and the Royal Bank to be dealt with in the U.S. Plan. They point out that in its Initial Order in the CCAA proceedings this Court approved an international Protocol which provides for co-operation between the U.S. and Canadian Court, to the extent possible. I do not think that either comity or the question of whether the claims will be dealt with ultimately under the U.S. Plan, are the issues here. In addition, the effect of the Protocol as I read it - given the circumstances outlined above - is to provide some protection to claimants on either side of the border from being swept into the rigours of the other countries regimes where to do so might prevent them from asserting their substantive rights under the applicable laws of their own jurisdiction.

47 In this regard, the following provisions of the Protocol are worthy of note:

> (C) Comity and Independence of the Courts
>
> (7) The approval and implementation of this Protocol shall not divest or diminish U.S. Court's and the Canadian Court's independent jurisdiction over the subject matter of the U.S. Cases and the Canadian Case, respectively. By approving and implementing the Protocol, neither the U.S. Court, the Canadian Court, the Debtors nor any creditors or interested parties shall be deemed to have approved or engaged in any infringement on the sovereignty of the United States or Canada.
>
> 8. The U.S. Court shall have sole and exclusive jurisdiction and power over the conduct and hearing of the U.S. Cases. The Canadian Court shall have sole and exclusive jurisdiction and power over the conduct and hearing of the Canadian Cases.
>
> 9. In accordance with the principles of comity and independence established in paragraphs 7 and 8 above, nothing contained herein shall be construed to:
>
> * increase, decrease or otherwise modify the independence, sovereignty or jurisdiction of the U.S. Court, the Canadian Court or any other court or tribunal in the United States or Canada ...;
> * preclude any creditor or other interested party from asserting such party's substantive rights under the applicable laws of the United States, Canada or any other jurisdiction including, without limitation, the rights of interested parties or affected persons to appeal from the decisions taken by one or both of the Courts.
>
> (emphasis added)
>
> (J) Preservation of Rights
>
> 27. Neither the terms of this Protocol nor any actions taken under the terms of this Protocol shall prejudice or affects the powers, rights, claims and defenses of the Debtors and their estates, the Committee, the Estate Representatives, the U.S. Trustee or any of the Debtors' creditors under applicable law, including the Bankruptcy Code and the CCAA.
>
> (emphasis added)

48 The extension of comity as between Courts in cross-border insolvency situations, and co-operation generally in such matters, are matters of great importance, to be sure, in order to facilitate the successful and orderly implementation of insolvency arrangements in such circumstances. Nothing I have said in

these Reasons is intended to counter that ethic. However, comity and international co-operation do not mean that one Court must code its authority and Jurisdiction over its own process or over the application of the substantive laws of its own jurisdiction, whenever any kind of differences between the two jurisdiction may arise. Both the Protocol and the provisions of subsection 18.6(2) of the CCAA - which gives this Court authority "to make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in c co-ordination of proceedings under [the CCAA] with any foreign proceeding" - confirm this, Subsection 18.6(5) of the CCAA provides that "nothing in this section requires the Court to make any order that is not in compliance with the laws of Canada or to enforce any order made by a foreign court" (emphasis added)

49 Here, there is yet no order of the U.S. Court, or treatment of the Claimants or Debtor to which comity may be extended, but there is - as I have outlined above - a failure to comply with the requirements of insolvency laws and procedure of Canada, as stipulated in the CCAA. I conclude, therefore, that the Canadian Plan as it presently stands is flawed because it seeks to exclude Canadian claimants from participation in its process by providing that their claims against Philip itself are to be governed by and treated in the U.S. proceedings while at the same time seeking to bind them to the provisions of the Canadian Plan, all without affording those claimants any right to vote.

50 There was much debate in argument over whether the issue of treatment of the claims in the Canadian or U.S. proceedings was a function of the "real and substantial connection" of Philip with the U.S. jurisdiction, or a function of the "real and substantial connection" of the responding claimants and their claims to the Canadian proceedings. There is no doubt that Philip has a substantial connection with the United States in terms of the residence of the majority of shareholders and the location of the majority of operating assets. This connection certainly justifies the U.S. Chapter 11 proceedings. However, Philip also has a substantial connection to Canada, with its headquarters in Ontario, its Canadian subsidiaries, and its 94 locations and 2,000 employees throughout the country. This connection, together with its array Canadian creditors, sustains the resort to the CCAA proceedings.

51 I do not think that the analysis fall to be made, in these particular circumstances, on purely foreign conveniens grounds. There is more to the situation than that.

Philip initiated the CCAA proceedings and sought and accepted the benefits flowing from that step. The responding claimants seek to assert claims in the Canadian proceeding against the Canadian company which instituted those proceedings, in relation to matters arising out of a Canadian class proceeding or (in the case of Royal Bank) out of Canadian contracts and equipment largely located in Canada. The substantive law of Canada under the CCAA, and the procedures therein laid down, entitle them to assert those claims in the Canadian proceedings and to have a vote on the "Plan" which is set forth by the debtor company to compromise them. They should not be deprived of those substantive and procedural rights without having any say in the matter. Putting it another way, I am satisfied that the unquestioned "juridical advantage" which Philip seeks to achieve through its proposed treatment of the responding claimants is outweighed by the unquestioned "juridical disadvantage" on the part of the latter, given that the juridical scales would otherwise be tipped towards Philip through the resort to a stratagem which in my view is not sanctioned under the CCAA.

52 Philip and the Lenders argue that there is great urgency to effect the restructuring process, and that requiring Philip to adhere to the procedures relating to classification, the valuation of claims, and voting - with the numerous issues that may have to be determined in that context - may well doom the process from the beginning. The Lenders are truculent, as their secured position lead them to be; they say that if the reorganization is not completed quickly they may simply abandon the process and exercise their rights to realize on their security, and the entire restructuring process will fail, with dire consequences for all concerned. Mr. McDougall, on behalf of Deloitte & Touche, characterized this as "the cry of

doom".

53 I am very aware of the need for timeliness in situations as these - particularly given the sensitive nature of Consolidated Philip's service oriented business. However, I do not think that the need for a timely resolution alone is justification for depriving claimants of their substantive rights under Canadian law, and for abrogating their right to vote which lies at the very heart of the Canadian restructuring process from the creditor's perspective. It is the tool which gives them ultimate leverage in the bargaining process, and without it their practical rights - as well as their substantive and procedural ones - are greatly diminished.

III - CONCLUSION

54 An order will therefor go in terms of the foregoing.

The Class Proceedings

55 As indicated, an Order is granted certifying the CPA Proceedings as a class proceeding, pursuant to subsection 5(1) of the Class Proceedings Act, as against Philip only and for settlement purposes only. The certification is without prejudice to any arguments the other defendants in the CPA Proceeding may wish to make in opposition to any element of the plaintiff's claim including, but not limited to, certification of a class as against them. In addition, notice of the certification and of the pending motion for approval of the proposed Settlement is to given to members of the class as certified, in accordance with the provisions of section 17 of the Act. The question of approval of the Settlement, in its present form or some other form as may be advised, is adjourned to a date to be fixed which is more contemporaneous with the sanctioning hearing.

The Fairness/Substantive Law Issues

56 Notwithstanding the observations in these Reasons about the Canadian Plan and the treatment of claims in the U.S. proceedings, I am reluctant to grant the sweeping declaratory relief sought by the Respondents. Whether the Plan is ultimately found to be fair and reasonable and in accordance with all necessary requirements remains still a matter for determination in the sanctioning hearing, after all the negotiations have been concluded and the votes counted. As much as is reasonably possible should be left to that process.

57 I am prepared to make an Order, however - and do - declaring that the Canadian Plan as it is presently constituted fails to comply with the procedural and statutory requirements of the CCAA regime in that it seeks to exclude the responding claimants from participation in its process by providing that their claims against Philip itself are to be governed by and treated in the U.S. proceedings while at the same time seeking to bind them to the provisions of the Canadian Plan, all without affording those claimants any right to vote. Anything further in this respect, it seems to me, should be left to the negotiation arena.

58 The position of the Royal Bank is slightly different. It is entitled, in addition, to an order,

a) declaring that the claim of Royal Bank against Philip under certain leases shall be determined with reference to Canadian law and in the Canadian proceedings;
b) amending the Canadian Plan so that the Bank's claim is not dealt with in the U.S. Plan; and,
c) amending sub-paragraph 14(d) of the Initial Order granted in the CCAA proceeding on June 25, 1999 - which presently permits Philip to terminate any

and all arrangements entered into by them - by providing that the sub-paragraph does not apply to the Royal Bank leases of personal property.

59 There will be not order as to costs.

60 Order accordingly.

BLAIR J.

qp/t/qlala/qlalm/qlcvs

1 These various actions were eventually consolidated and transferred to the United States District Court, Southern District of New York, by order dated June 2, 1998.

2 The common issue is very broadly and vaguely defined, and while such a definition has received approval in other cases, I do not mean to be taken as having approved such a definition for any purposes other than those of this particular case.

3 To use the phrase adopted by the parties.

TAB 4

Indexed as:

Laserworks Computer Services Inc. (Re)

Between
3004876 Nova Scotia Limited, appellant, and
Laserworks Computer Services Inc., respondent

[1998] N.S.J. No. 60

165 N.S.R. (2d) 296

37 B.L.R. (2d) 226

6 C.B.R. (4th) 69

78 A.C.W.S. (3d) 19

Docket: C.A. No. 141313

Nova Scotia Court of Appeal
Halifax, Nova Scotia

Freeman, Pugsley and Cromwell JJ.A.

Heard: December 9, 1997.
Judgment: February 13, 1998.

(41 pp.)

The Bankruptcy And Insolvency Act R.S.C. 1985, c. B-3; Proposals; Rejection of votes; Improper purpose; Class voting; Substantial injustice.

The Respondent made a proposal under the Bankruptcy and Insolvency Act (the BIA). The Appellant, a competitor but not previously a creditor, acquired sufficient claims to defeat the proposal and voted them over the respondent's objection at a meeting of creditors. At the hearing into the objection the Registrar disallowed the votes, finding they were exercised for an improper purpose, and restored the proposal. His decision was upheld on an appeal to the Supreme Court of Nova Scotia, where it was also found the appellant had breached requirements for class voting. The appellant appealed on the main grounds that the appellant's motive was not proven and in any event, not relevant.

Issue: The chief issue was whether the court's supervisory jurisdiction should be invoked to interfere in a proposal to creditors when it appeared the statutory process was being used for purposes not contemplated by Parliament.

Result: The appeal was dismissed with costs. The court's supervisory jurisdiction extended to proposals as well as petitions. Courts are empowered to remedy substantial injustice resulting not from motive alone but from use of the provisions of the Act for an improper purpose: tort-like behavior such as abuse of process or fraud in the bankruptcy context.

Counsel:

James A. Musgrave, for the appellant.
Roy F. Redgrave, for the respondent.
D. Bruce Clarke and Pamela J. Clarke-Priddle, for the respondent-trustee.

THE COURT: The appeal is dismissed, per reasons for judgment of Freeman J.A., Pugsley and Cromwell JJ.A., concurring.

1 **FREEMAN J.A.**:-- The respondent LaserWorks Computer Services Inc., a dealer in supplies for laser printers, made a proposal to its creditors under the provisions of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 (the BIA).

2 A competitor, Datarite, operating through the appellant 3004876 Nova Scotia Limited, acquired the claims of eighteen creditors and voted them over the objections of LaserWorks at the meeting of creditors, defeating the proposal. Only two of the remaining sixteen creditors opposed the proposal.

3 Acceptance required votes representing a majority in number and two-thirds in value of the class of unsecured creditors present in person or by proxy. The Registrar of Bankruptcy of the Supreme Court of Nova Scotia in Bankruptcy, Tim Hill, found:

> Upon the vote being taken, fourteen creditors with a total claim value of $206,531.65 voted in favour of the proposal. Twenty creditors with a total claim of $140, 370.00 voted against the proposal. Thus 41% of creditors representing 59% of the claims voted pro, and 59% of the creditors with 40.5% of the claims voted con. The proposal was defeated, subject to the resolution of the objections before the court today.

4 At the hearing into the objections the Registrar, after hearing evidence from the appellant's solicitor Victor Goldberg, who was not counsel on the appeal, disallowed the appellant's votes. He found the proposal had been accepted by the votes of the other creditors. His decision was upheld by Justice Stewart on an appeal to the Supreme Court of Nova Scotia in Bankruptcy.

Issues and Standard of Review

5 The overriding issue is whether the court's inherent supervisory jurisdiction should be invoked to interfere in a proposal to creditors under the BIA when it appears the statutory process is being used for purposes not contemplated by Parliament.

6 The appellant submits it was a true appeal before Justice Stewart, and not a hearing de novo, on the authority of Re McCulloch Estate (1992), 13 C.B.R. (3d) 201 (Tr. Div.) and Cockfield Brown Inc. (Trustee of) v. Reseau de Television TVA Inc. (1988), 70 C.B.R. (N.S.) 59 (Que. C.A.) On further appeal to this court the grounds are whether Justice Stewart erred in:

> 1. Failing to reverse the Registrar's finding that 18 creditors of LaserWorks assigned their rights to the appellant;
>
> 2. Sustaining the Registrar's finding that Datarite engaged in an improper purpose in acquiring and voting the claims of the 18 creditors;
>
> 3. Sustaining the Registrar's finding that the Appellant's purpose in acquiring and voting the claims was relevant; and
>
> 4. Concluding that there was an abuse on a minority of a class of unsecured creditors and that a duty in this respect was owed by the appellant.

7 An appeal lies to this court under s. 193 of the BIA which reads in part:

> 193. Unless otherwise expressly provided, an appeal lies to the Court of Appeal from any order or decision of a judge of the court in the following cases:
>
> (a) if the point at issue involves future rights;
>
> ....
>
> (e) in any other case by leave of a judge of the court of appeal.

8 The appellants assert future rights are involved and no leave is necessary. The respondents take no issue with this. Neither is issue taken with the jurisdiction of the Registrar and Justice Stewart to deal with the matters in question pursuant to the BIA. The issue is whether they erred.

9 The appellant's submission with respect to the standard of review is that:

> . . . the Registrar's discretion will not be disturbed on appeal unless he failed to consider or misconstrued a material fact or violated a principle of law. If the Registrar did not appreciate the nature of the evidence before him, it was open to the Supreme Court to substitute its discretion for that of the Registrar. There is also authority that the Registrar's decision should not be disturbed unless it was clearly wrong: Re Achilles (1993), 23 C.B.R. (3d) 20 B.S.S.C.).

10 It cites Industrial Acceptance Corp. v. Lalonde, [1952] 2 S.C.R. 109 p. 120; Re Gilmartin (a bankrupt), [1989] 2 All E.R. 835 (Ch. D.) p. 838; and Re Barrick (1980), 36 C.B.R. (N.S.) 286

(B.C.C.A.) p. 290. In Industrial Acceptance Estey J., writing for the Supreme Court of Canada, held at page 120 that:

> A judgment rendered in the exercise of a judicial discretion under s. 142 ought not to be disturbed by an appellate court, unless the learned judge, in arriving at his conclusion, has omitted the consideration of or misconstrued some fact, or violated some principle of law.

11 The respondent LaserWorks urges that this court should only substitute its own discretion when the Registrar is clearly wrong. Apparent failure by the Registrar to appreciate the nature of the evidence before him is too low a threshold:

> The court in Re Barrick ((1980), 36 C.B.R. (N.S.) 286 (B.C.C.A.)) substituted its discretion for that of the trial judge only after ruling that he misapplied a legal test. Justice Taggert, at page 290, gives three reasons the Court of Appeal should substitute its discretion for that of the trial judge:
>
> > In these circumstances, it would seem to me that the learned judge has not applied the correct test, has not given the effect that ought to be given to the trustee's report and has not appreciated the nature of the evidence which was before him. In these circumstances, I think we are justified for substituting our discretion for that of the trial judge.

12 On that basis the respondent submits the first three grounds of appeal fail.

13 The Trustee under the Proposal submits that "the Appellant has not satisfied the onus upon it in this appeal to overturn the decision of the Honourable Justice Stewart to decline to substitute her discretion for that of the Registrar."

14 The respondent also referred to the principles stated by McLachlin, J., in Toneguzzo-Norvel (Guardian Ad Litem of) v. Savein and Burnaby Hospital, [1994] 1 S.C.R. 114 at page 121, which this court has followed consistently:

> It is by now well established that a Court of Appeal must not interfere with a trial judge's conclusions on matters of fact unless there is palpable or overriding error. In principle, a Court of Appeal will only intervene if the judge has made a manifest error, has ignored conclusive or relevant evidence, has misunderstood the evidence, or has drawn erroneous conclusions from it: see P.(D.) v. S.(C.), [1993] 4 S.C.R. 141, at 188-89 (per L'Heureux-Dubé J.), and all cases cited therein, as well as Geffen v. Goodman Estate, [1991] 2 S.C.R. 353, at 388-89 (per Wilson J.), and Stein v. The Ship "Kathy K", [1976] 2 S.C.R. 802, at 806-8 (per Ritchie J.). A Court of Appeal is clearly not entitled to interfere merely because it takes a different view of the evidence. The finding of facts and the drawing of evidentiary conclusions from facts is the province of the trial judge, not the Court of Appeal.

15 These principles apply in bankruptcy matters, and provide guidance when, as here, the Registrar's findings have been upheld by a judge of the Supreme Court.

The Registrar's Decision

16 The Registrar based his decision on the following findings:

> Before turning to deal with these submissions, it is essential that I make some findings of fact. In large part the facts are uncontested. No affidavits were filed, but counsel agree that I may rely on the minutes of the meeting of creditors, the testimony by Mr. Goldberg upon the section 163(2) examination, and the list provided by Mr. Goldberg in compliance with his undertaking on the examination.
>
> I find that Datarite through its solicitor approached some but not all of the creditors of Laserworks with the intention of obtaining an assignment of those creditors' claims and consequently rights to vote on the proposal. The claims were obtained and the votes utilized to defeat the proposal. This would have the effect under section 57(a) of the BIA of placing LaserWorks into bankruptcy by virtue of a deemed assignment.
>
> I can only conclude that the purpose of Datarite was to effect the bankruptcy of LaserWorks. It is a reasonable supposition that the purpose was to remove a competitor from the marketplace. I find that it was the intention of Datarite to put LaserWorks in bankruptcy.
>
> I further find that the motive was to lessen competition.
>
> In my view, Datarite was engaged throughout in an improper purpose not contemplated by the BIA, the purpose of which is far removed from the use to which Datarite put it.

17 It is apparent that the Registrar, in speaking of "purpose", included both motive or intent and the steps taken to give effect to that motive or intent. While the record is somewhat sparse, as counsel have remarked, there was evidence in support of these findings. I am not satisfied that the Registrar failed to appreciate the nature of the evidence before him or that he was clearly wrong, or alternatively that he omitted the consideration of or misconstrued some fact, or violated some principle of law. The questions before this court relate to the effect of these findings.

18 The Registrar disallowed the votes of the eighteen creditors represented by the appellant because he considered they had been cast for an improper purpose. In the absence of authority specific to proposals to creditors, he applied jurisprudence related to bankruptcy petitions, stating:

> It has long been held that the court will not grant a petition in bankruptcy where the petition is filed for an improper purpose: Re E. De La Hooke (1934), 15 C.B.R. 485 (Ont. S.C.); Re Pappy's Good Eats Limited (1985), 56 C.B.R. (N.S.) 304 (Ont. S.C.); Dimples Diapers Inc. v. Paperboard Industries Corporation (1992), 15 C.B.R. (3d) 204 (Ont. G.D.); Re Shepard (1996), 40 C.B.R. (3d) 145 (Man. Q.B.).

In Hooke the petitioner obtained an assignment of a judgment against the debtor for the sole purpose of filing a petition in bankruptcy and of removing the debtor as a business competitor. In that case, as is the situation in this case, there was no evidence that the debtor had any business dealings with the party seeking to place the debtor in bankruptcy. The petition was dismissed.

In Hooke the court made extensive reference to the decision of the House of Lords in King v. Henderson, [1898] A.C. 720. The comments of James, L.J., at p. 732 are particularly germane here:

> After what Lord Justice Cotton has said, in which I entirely agree, people will probably think twice before they buy debts for the purpose of taking bankruptcy proceedings.

Lord Justice Cotton had commented that the proceedings in bankruptcy were not taken to obtain payment of the debt, but rather the debt was purchased for the purpose of taking the proceedings. I would simply add that in light of the decision I make here persons should certainly think twice before they purchase debts in order to defeat a proposal.

It is my opinion that the eighteen creditors are tainted with the improper motive of Datarite. In Pappy's Good Eats the petition was filed by a creditor with a genuine claim. The creditor entered into an agreement with three franchisees of the debtor. This agreement provided that the creditor would prosecute the bankruptcy proceedings while the franchisees financed the proceeding in exchange for a share of the dividends. The motive of the franchisees was to bring about a bankruptcy so as to terminate the franchise agreements between them and the debtor.

The court found that there had been an improper use of the bankruptcy legislation. The effect of the agreement was to embroil the creditor in the improper objectives of the franchisees who were intermeddling in the proceeding. This tainted the whole proceeding. Clearly where the object of the intermeddling party is to bring about the bankruptcy of the debtor an improper purpose is present. The court will act to prevent such an abuse of the legislation.

The other cases I have referred to, Dimples Diapers Inc. and Shepard also deal with bankruptcy petitions instigated for an improper collateral purpose. In Dimples that purpose was to recover a trademark and a business opportunity. In Shepard that purpose was to obtain control of certain shares.

While this case does not involve a bankruptcy petition, it does involve the placing of Laserworks into bankruptcy. In my view, it would be wrong to allow Datarite to do in the proposal process what it cannot do by petition. Datarite's intention was to place Laserworks in bankruptcy. The motive was to remove a com-

> petitor. That motive reveals an improper purpose. The court will not allow to be done by the back door what cannot be done by the front.
>
> By entering into this arrangement with the numbered company the eighteen creditors have tainted themselves and become embroiled in the improper purpose of Datarite. Their votes cannot stand. If Laserworks has the right to be free of this type of interference the Court must be able to fashion a remedy. This court does have the inherent jurisdiction to supervise the bankruptcy process and consequently the conduct of creditors where that conduct constitutes an abuse of the provisions of the BIA. While creditors can certainly vote in their own best interest, they may not collude with a third party to place a debtor in bankruptcy for an improper purpose. Such activity lacks commercial morality and offends the integrity of the bankruptcy process.

19 While Datarite was not permitted to vote the claims it had acquired, they remained debts of the insolvent debtor.

Justice Stewart

20 The first ground of appeal to this court, the issue of whether the claims of 18 creditors were actually assigned to Datarite, does not appear to have been a ground of appeal before Justice Stewart.

21 On the next two grounds of appeal, whether the Registrar failed to appreciate the evidence before him in concluding that Datarite's purpose in acquiring and voting the 18 claims was an improper one, and whether such purpose was a relevant consideration, Justice Stewart, in upholding the Registrar, took a different route to arrive at the same conclusion. She stated:

> Although stated in the context of voting by debenture holders when the majority had votes to modify the rights of the debenture holders in a clause, the statements of principle by Viscount Haldane of the Judicial Committee of the Privy Council in British America Nickel Corporation v. M. J. O'Brien, [1927] A.C. 369 at p. 371 are, no less, here applicable:
>
> > To give a power to modify the terms on which debentures in a company are secured is not uncommon in practice. The business interests of the company may render such a power expedient, even in the interests of the class of debenture holders as a whole. The provision is usually made in the form of a power, conferred by the instrument constituting the debenture security, upon the majority of the class of holders. It often enables them to modify, by resolution properly passed, the security itself. The provision of such a power to a majority bears some analogy to such a power as that conferred by s. 13 of the English Companies Act of 1908, which enables a majority of the shareholders by special resolution to alter the articles of association. There is, however, a restriction of such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes

> enabling them to bind minorities, namely, that the power given must be exercised for the purpose of benefitting the class as a whole, and not merely individual members only.

22 And later at p. 373, noting this to be a principle which does not depend on misappropriation or fraud, stated:

> . . . but their Lordships do not think that there is any real difficulty in combining the principle that while usually a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member.

The court, applying the principle stated by Viscount Haldane, should not sanction a scheme if it appears that the majority have not voted bona fide in the interests of the class as a whole.

Justice Quilliam in an unreported decision of the High Court of New Zealand, Re: Farmers' Co-Operative Organization Society of New Zealand Limited (M 12/97, 4 August 1987) in addressing the very issue of a company whose proposal had been defeated by the votes cast by some of its direct competitors, in circumstances where the majority had the right to bind the minority by statute relied on the principle enunciated in British American Nickel Corp. Inc. v. O'Brien, supra, during the objection to votes application before him. He concluded the votes should be discounted as their votes were cast out of self-interest and not in the interest of the class of creditors as a whole, or of the company. Unlike the present case, he did not determine there was specific activity of an improper purpose other than recognizing the votes were cast by creditors in direct commercial competition with the company.

The Registrar, on his finding of facts, was not faced with a pre-existing creditor voting as it wished for whatever reason. He was faced with a unique set of circumstances where he found the appellant shelf company and Datarite, a competitor of Laserworks, involved a selective, secret arrangement with creditors against Laserworks, an arrangement that would hurt some creditors and favour other creditors, although as competitors rather than as creditors, given its purpose of removing Laserworks from the market place and diverting from it, its asset, the market share, so it could be available to Datarite, all of which would result in the balance of the creditors receiving little, if anything, and Laserworks having been deemed a bankrupt.

23 Justice Stewart found that Datarite was not entitled to use its votes for motives unrelated to the best interest of the creditor group and only pursuant to its own self interest in removing a potential competitor from the market place without regard to the interests of the other members of its class, the other voting creditors. She concluded:

> The Appellant is not entitled to use its votes to achieve this improper purpose. The Registrar's decision prevents an abuse on a minority of the class of unsecured creditors and in so doing upholds a fundamental and viable in the circumstances principle of class voting. He did not err in concluding improper purpose is relevant.

24 On the fourth ground she found that while there had been no collusion by the eighteen creditors sufficient to deprive them of the right to vote, the Registrar was justified in determining that in the circumstances Datarite controlled the way the claims were voted. She upheld the Registrar's decision and declined to interfere with it.

Assignment--The First Ground

25 The appellant submits that the judge erred when she declined to address and reverse the Registrar's finding that 18 unsecured creditors of LaserWorks assigned their rights to the appellant. On a proper appreciation of the evidence, it submits, no assignment took place. It states in its factum:

> The appellant did not take issue with the Registrar's finding that four of the 18 creditors received payment for them prior to the vote. . . . Each of the four creditors provided executed assignments and proxies to Mr. Goldberg, and each assignment was completed by payment. The 14 remaining creditors did not receive payment for their claims prior to the vote, and the appellant submits that the learned Registrar failed to appreciate the evidence in this regard when he concluded that the claims of these 14 creditors had been assigned to the appellant before the vote was taken.

26 LaserWorks submits that the Registrar did not decide whether or not the claims voted by Datarite were assigned:

> The conclusion of the Registrar with respect to the assignment issue is:
>
> > Given my findings with respect to the intent and motive of Datarite, I find it unnecessary to consider whether Datarite should have exercised 1 vote or 18.
>
> The reference to 1 vote or 18 relates to the assignment of claims. If the 18 claims had been assigned to the Appellant, the authorities establish that only one vote could be cast on the proposal. The Registrar found it "unnecessary to consider" this issue. We submit that the Registrar would need to consider the issue before making a decision.

27 It seems reasonable that the Registrar did not intend to decide whether the claims were assigned because it would not determine the question before him. Even if the appellant were restricted to voting as one creditor, leaving a majority of creditors in favor of the proposal, the value of the claims voted by the appellant was sufficient to defeat the proposal and thus achieve the appellant's objective.

28 If the claims had been assigned to the appellant, the voting rights would have been merged and the appellant could only cast one vote for the value of the claims it had acquired. If the creditors retained their own claims, the appellant could have voted once for each creditor for whom it held a proxy. There is authority for this proposition and the parties seem in agreement with it. The rationale is clear. Each creditor has a vote, to be exercised in person or by proxy. If the claim is assigned, the assignor ceases to be a creditor. It loses its right to vote in person or to control the vote of the proxy. The assignor becomes a creditor and is able to vote its claim, no matter the amount of the claim. If it acquires the claims of other creditors the amount of its claim increases, but it does not pluralize itself. It remains one creditor, entitled to one vote.

29 The appellant referred to Toia v. Cie de Cautionnement Alta Inc. (1989), 77 C.B.R. (N.S.) 264 (Que. S.C.). The respondent insurance company paid out 19 claims against a bankrupt under a performance bond; each claimant signed a release and subrogated its claims to the respondent, which filed 19 proofs of claim. The Official Receiver permitted 19 votes but the Quebec Supreme Court reversed this, allowing only one vote. The appellant purports to distinguish Toia because "there the respondent completed the assignments by payment prior to the vote."

30 In my view it is of small importance whether the appellant bought for cash or on credit. The situation seems clear when creditors authorize votes on their behalf by proxy: each creditor is entitled to its vote and the proxy may cast votes for several creditors. It is equally clear when a creditor assigns its claim to another creditor: the assignee creditor has only one vote. This was the case with the four creditors whose assigned claims were accepted and paid for by the appellant. It is less clear with respect to the remaining fourteen creditors who had executed assignments to the appellant. The appellant says they had not yet been accepted, pending proof of the claims. However they had to be proven before they could be voted, and their values were proved for the purpose of calculating their percentage of the total of the unsecured claims. Any condition on the assignment would appear to have been met.

31 The intention of the parties must be determined: did the appellant vote those claims on its own behalf, or as an agent exercising the rights of the original creditors by proxy? If it had been necessary for the Registrar to decide this question, there was evidence before him that the original creditors had given control over their claims to the appellant by entering into enforceable contracts to assign them. That is, while the appellant voted the claim in the form of proxies, in fact it had acquired sufficient interest in the claims to vote them in its own right, as assignee, as though the assignments had been fully executed. It is clearly an improper practice for an assignee to purport to vote as the proxy of a creditor which has assigned its claim, thereby ceasing to be a creditor. If Datarite was otherwise entitled to vote at the creditor's meeting, it had one vote for the full value of the claims it had acquired. It was not justified in voting by proxy.

32 I would dismiss this ground of appeal.

Evidence of Datarite's purpose--the second ground

33 Mr. Goldberg testified as follows to Datarite's purpose in buying claims and voting against the proposal:

> Q. Can you tell me the benefit the numbered company will get in the bankruptcy of LaserWorks?

A. Well, the purpose of the numbered company hopefully in buying the claims is that it'll buy the claims at a reduced price and get full payment one day.

34 The appellant states that Mr. Goldberg's evidence was uncontradicted, and submits:

> It is respectfully submitted that the Registrar was clearly wrong in his appreciation of the evidence. The learned Judge concluded that the Registrar made a finding of credibility with respect to Victor Goldberg's evidence on this issue. However, the Registrar's decision does not indicate that Mr. Goldberg's evidence on this key issue was even considered. The Registrar simply failed to address Mr. Goldberg's evidence on this issue at all. It is therefore open to this Honourable Court to substitute its discretion for that of the Registrar. It is submitted that the Registrar could only find an improper purpose on the record by overlooking the only piece of direct evidence before him on Datarite's intentions.

35 Mr. Goldberg was obviously only stating his client's ostensible intentions, not its true ones. The Registrar in fact had commented on Mr. Goldberg's evidence after quoting a passage from the minutes indicating how he had responded to certain questions. He said:

> It is not unfair to say that Mr. Goldberg was obtuse to a very great degree. While this does not necessarily confirm suspicion as to the motives of his client, it does explain the concern expressed by the principals of LaserWorks.

36 The evidence before the Registrar included the proposal itself, which shows total liabilities of $585,459 of which $247,651 was unsecured, $334, 838 secured and $2,970 preferred. Assets totaled $306,158 including book debts of $170,000, leased vehicles $ 95,958, stock in trade $18,500, cash in the bank (which was the principal secured creditor) $8,000 plus fixtures, furnishings and equipment. Virtually all of the assets would be subject to security. The overall deficiency is shown as $279,301. It is difficult to see a basis for Mr. Goldberg's client's optimism that it might get full payment for the claims it bought at reduced value, or indeed, to see any significant source of dividends for unsecured creditors, on a bankruptcy.

37 Datarite had not been a creditor of LaserWorks before the proposal. There was evidence, however, that it had been a competitor. The Registrar was entitled to consider the evidence as a whole in making findings of fact and drawing inferences that led him to the conclusion that:

> ... Datarite's intention was to place Laserworks in bankruptcy. The motive was to remove a competitor. That motive reveals an improper purpose...

38 In my view the Registrar did not fail to appreciate the evidence nor otherwise err in arriving at this conclusion. Neither did Justice Stewart err in upholding him. I would dismiss this ground of appeal.

Is Purpose Relevant? The Third Ground.

(i) The Statute

39 The appellant submits that the trial judge erred in upholding the Registrar's decision that Datarite engaged in an improper purpose in acquiring and voting the claims of the 18 creditors, and that its purpose was relevant. In view of the conclusion on the second ground that the Registrar did

not err in finding improper purpose, the appellant is left with the relevancy argument. It argues that the authority relied on by the Registrar, De La Hooke, Pappy's Good Eats, Dimples Diapers and Shepard, arises under s. 43(7) of the BIA which deals only with bankruptcy petitions:

> 43(7) Where the court is not satisfied with the proof of the facts alleged in the petition or of the service of the petition, or is satisfied by the debtor that he is able to pay his debts, or that for other sufficient cause no order ought to be made, it shall dismiss the petition. (emphasis added.)

40 It cites the discussion of the discretion thus created in Houlden & Morawetz, Bankruptcy and Insolvency Law of Canada (3d) at p. 2-50:

> Section 43(7) permits the court to dismiss a petition if it concludes "that for any other sufficient cause no order ought to be made". Section 43(7) confers a discretion; the exercise of that discretion must be founded on sound judicial reasoning based on credible evidence and must be exercised judicially according to common sense and justice in a manner which does not occasion a miscarriage of justice.

41 Section 43(7) clearly does not create the supervisory jurisdiction of the court over the bankruptcy regime; it is simply a concrete application of a discretionary power inherent in the scheme of the BIA. Each step in the bankruptcy process, whether initiated by a creditor's petition for a receiving order or a debtor's assignment for the benefit of creditors, is supervised by court officials or the court itself. For example s. 108 in Part V, the Administration of Estates, relates to "any meeting of creditors". At the meeting which gave rise to this appeal the chairman applied s. 108(3):

> 108(3) Where the chairman is in doubt as to whether a proof of claim should be admitted or rejected, he shall mark the proof as objected to and allow the creditor to vote subject to the vote being declared invalid in the event of the objection being sustained.

42 Section 187(9) provides a broad directive:

> 187(9) No proceeding in bankruptcy shall be invalidated by any formal defect or by any irregularity, unless the court before which an objection is made to the proceeding is of opinion that substantial injustice has been caused by the defect or irregularity and that the injustice cannot be remedied by any order of that court.

43 The short answer to the question raised by this ground of appeal is that motive or purpose is relevant to a court authorized to remedy substantial injustice.

44 The appellant takes the narrow position that proposals are outside the discretionary supervisory jurisdiction of the court because they are not specifically included in s. 43(7) or some equivalent provision. This submission cannot be sustained.

45 There is a similarity between a creditor's petition for a receiving order under s. 43 and refusal of a proposal. In either case it is something done by a creditor or creditors that places the debtor in bankruptcy, likely against its will. But a proposal is also similar to an assignment: the

debtor has itself resorted to protection under the BIA and its proposal will be deemed to be an assignment unless it succeeds in persuading its creditors to accept it in their own best interests.

46 The appellant submits that s. 54 is the provision in the proposals Part of the BIA which corresponds with s. 43(7). S. 54 provides:

> 54(1) The creditors may, in accordance with this section, resolve to accept or may refuse the proposal as made or as altered at the meeting or any adjournment thereof.

47 While s. 43(7) provides an occasion for the exercise of the court's supervisory jurisdiction, an examination focused on the merits of the petition itself, s. 54(1) does not. Such an examination of a proposal is not necessary at that stage. The validity of the claims voted at the creditor's meeting at which the proposal is accepted or refused is subject to the court's scrutiny under s. 108(3). If the proposal is refused by a regular vote of creditors it vanishes and further examination is unnecessary; the debtor is deemed under s. 57(a) to have made an assignment in bankruptcy and the matter proceeds as on an actual assignment. If the creditors approve the proposal, it is then examined on its merits under s. 59, which provides:

> 59. (1) The court shall, before approving the proposal, hear a report of the trustee in the prescribed form respecting the terms thereof and the conduct of the debtor, and, in addition, shall hear the trustee, the debtor, any opposing, objecting or dissenting creditor and such further evidence as the court may require.
>
> (2) Where the court is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors, the court shall refuse to approve the proposal, and the court may refuse to approve the proposal whenever it is established that the debtor has committed any one of the offences mentioned in sections 198 to 200.

48 Proposals are therefore just as much a part of the bankruptcy regime, and just as subject to the supervision of the court exercising an equitable jurisdiction under the statute, as petitions and assignments. In Whiteman v. UDC Finance Ltd., [1992] 3 NZLR 684, Hardie Boys J., writing for the New Zealand Court of Appeal with respect to the New Zealand Insolvency Act, which varies in detail but not in principle from our own, said at p. 691 that proposals are merely

> . . . the other side of the coin to a petition for adjudication.

49 The only distinction between petitions and proposals in the exercise of the court's supervisory jurisdiction is that under the scheme of the BIA occasions for judicial scrutiny occur at different stages of the process. In the present appeal, court intervention was occasioned by objections to proofs of claims affecting the right to vote at the creditors' meeting considering the proposal. The correct procedure was followed, and the objections were considered by the Registrar who had jurisdiction under s. 187(9) to remedy substantial injustice.

50 Motive or purpose is not relevant to objections to proofs of claim based on statutory exceptions under the BIA. These are established in several sections, including s. 109(1), persons who had not duly proved and lodged a claim; s. 54(3), a relative of the debtor (who may vote against but not

for a proposal); 109(4), the debtor as proxy for a creditor; s.109(6), a creditor who did not deal with the debtor at arm's length (with exceptions); s. 110(1), a person with a claim acquired after the bankruptcy unless the entire claim is acquired; s. 111, a creditor with a claim on or secured by a current bill of exchange (subject to conditions); s. 112, a creditor holding security (subject to conditions); and s. 113(2), a trustee as proxy (subject to restrictions). See also s. 109, the trustee as creditor.

51 (It will be noted that many of these exceptions arise from circumstances that could give rise to conflict of interest. This will be considered further under the fourth ground of appeal.)

52 However the statutory exceptions are not a code exhausting the forms in which substantial injustice may manifest itself. Objections will be sustained under s. 108(3) if they result from a crime or a tort against the debtor or a crteditor. In the present appeal, and in the authorities cited by the Registrar, the substantial injustice assumes the guise of tortious behavior, to which motive is relevant. In the s. 108(3) context the commonest torts, or instances of substantial injustice arising from tortious behavior, relate to abuse of process and fraud. However conspiracy to harm was also found in Dimples Diapers.

53 Tortious or tort-like behavior falling short of a fully developed tort susceptible of formal proof or definition can nevertheless result in substantial injustice, particularly for persons at a point so vulnerable they must resort to insolvency protection. (See Shepard.) In my view that is why Parliament chose the language it did in s. 187(9): to create a discretionary jurisdiction in courts that is not fettered, for example, by the high standards required for establishing such torts as abuse of process in other contexts. What remains to be considered is the threshold level of the substantial injustice which will result in remedial action by the court.

(ii) The Authorities

54 The four cases cited by the Registrar establish that the threshold is crossed when the BIA is used for an improper purpose. An improper purpose is any purpose collateral to the purpose for which the bankruptcy and insolvency legislation was enacted by Parliament.

55 Farley J. held in Dimples Diapers that:

> . . . the Bankruptcy Act, R.S.C. 1985, c. B-3 has as its purpose the provision of "the orderly and fair distribution of the property of a bankrupt among its creditors on a pari passu basis". (L.W.Houlden and C.H.Morawetz, Bankruptcy Law of Canada, 3rd ed. (looseleaf) (Toronto: Carswell, 1989) at p. 1-3 [A&4]....

56 In the cases cited the improper purpose takes the form of abuse of process or tortious behavior closely analogous to abuse of process. In each case the court reacted to what could be seen as substantial injustice. The remedy of choice arising under s. 43(7) is refusal of the petition. The appropriate remedy in the present case is rejection of the tainted votes.

57 In a vigorous judgment in Dimples Diapers Farley J. dismissed the bankruptcy petition because it was brought for an improper purpose, to recover the diaper trademark and business opportunity, and awarded damages for abuse of process and conspiracy against three creditors. He held at p. 219:

> ...The tort of abuse of process consists in the misuse of a legal process for any purpose other than that which it was designed to serve. It is immaterial in establishing abuse of process that the process was properly commenced or founded by the defendants and it does not matter that the process be concluded in the instigator's favour. The improper purpose is the gravamen of liability. See Unterreiner v. Wilson (1982), 40 O.R. (2d) 197, 24 C.C.L.T. 54, 142 D.L.R. (3d) 588 (H.C.), at p. 203 [O.R.], appeal dismissed (1983), 41 O.R. (2d) 472, 146 D.L.R. (3d) 322 (C.A.), and J.G.Fleming, The Law of Torts, 7th ed. (Sydney: Law Book, 1987) at pp. 591-592.
>
> Potts J. In R. v. Cholkan & Co. v. Brinker (1990), 71 O.R. (2d) 381, 1 C.C.L.T. (2d) 291, 40 C.P.C. (2d) 6 (H.C). at p. 8 [C.P.C.] said:
>
> Most recently, Montgomery J. writing for the divisional Court in Bentham v. Rothbart (1989), 36 O.A.C. 13 (Div. Ct.), stated:
>
> The constituent elements of the tort of abuse of process are: (a) a collateral improper purpose such as extortion; and (b) a definitive act or threat in furtherance or a purpose not legitimate in the use of the process.

58 Montgomery J. was clearly using "extortion" as an example only. Any crime or tort would be an improper purpose.

59 In de la Hooke the petition was dismissed when petitioning creditors, who had had no business dealings with the debtor, obtained an assignment of a judgment debt he owed for the sole purpose of filing a petition in bankruptcy to remove him as a business competitor who was using a similar trade name. Registrar Cook cited a number of leading English cases relevant to the circumstances of the present appeal. These included King v. Henderson, [1898] A.C. 720 at p. 731 which considered abuse of process or fraud on the court; Ex Partre Griffin; in re Adams (1879), 12 Ch. Div. 480 in which a worthless debt was purchased to take proceedings in bankruptcy to force the debtor to give up a just debt, causing Brett L.J. to remark, "a viler fraud I have never heard of"; Ex parte Harper; In re Pooley (1882), 20 Ch. D. 585 at p. 692 in which buying a debt to force a bankruptcy in order to get rid of a trustee was found "a gross abuse of the bankruptcy laws;" and In re a Debtor [1928] 1 Ch. 199 at p. 211 in which the bankruptcy laws were used for the collateral purpose of extortion.

60 In Pappy's Good Eats a petition was denied when three franchisees of the debtor, who were not creditors, contracted with the petitioning landlord, who had a $65,000 unsatisfied judgment against the debtor, to pay the landlord's costs to petition the debtor into bankruptcy so they would be relieved of obligations under their franchise agreements. Henry J. held the effect of the agreement was to "embroil the petitioning creditor in the improper objective of the purchasers who as non-creditors have no status in these proceedings and are intermeddling in it. The whole proceeding is inescapably tainted; the petition must be dismissed." He found that "the abuse occurred when the parties agreed or arranged improperly to use the facility of the Act to advance the objectives of the franchisees to cause injury to the debtor."

61 In Shepard it was found that the purpose of the petitioner was to gain control over certain shares of the debtor, an important business advantage. "It is not appropriate or indeed, correct in

law, to have the courts facilitate such an objective when the objective is very clearly the main purpose of the application." This finding is consistent with a finding of substantial injustice resulting from abuse of process.

(iii) The Present Case

62 It is most significant that the appellant was not a creditor of LaserWorks prior to the proposal. Intermeddling by strangers to the pre-existing debtor creditor relationship for an improper purpose was a determinative factor in Pappy's Good Eats. The practice of buying dubious claims against an insolvent for purposes foreign to the bankruptcy process was denounced in the English cases cited in de la Hooke. The Registrar in the present case understandably looked askance at it. Few legitimate reasons come to mind for buying into a bankrupt estate. When somebody does so, it is a matter of common sense to assume, subject to correction, they intend to use the bankruptcy process for some purpose it was not meant for. In the present case it was readily apparent that mischief was afoot.

63 The "orderly and fair distribution of the property of a bankrupt among its creditors on a pari passu basis" was not the purpose behind the acts of the appellant. The appellant made separate approaches to each of the eighteen creditors whose claims it succeeded in acquiring. It negotiated a separate deal with each for varying considerations presumably seen to be more advantageous to the creditor than reliance on the proposal. From most of them it obtained an agreement, an executed assignment and a proxy. It purported to vote the proxies of former creditors whose claims had been assigned to it. Its purpose was not an orderly recovery of debts from the debtors assets but to limit competition by the debtor in its own marketplace by rejecting the debtor's proposal and forcing it into bankruptcy.

64 The appellant was acting on its own making sharp use of the provisions of the BIA for its own advantage. There was no evidence that the co-operating creditors were part of a conspiracy with the appellant to injure the debtor. Otherwise the tort of conspiracy to injure could be found where the predominant purpose of the appellant's conduct is to cause injury to the plaintiff, whether the means used by the defendants are lawful or unlawful: Canada Cement LaFarge Ltd. v. British Columbia Lightweight Aggregate Ltd., [1983] 1 S.C.R. 452.

65 It is undeniable that the appellant caused injury to the debtor not negligently but deliberately. The debtor made its proposal to avoid bankruptcy; bankruptcy therefore must have been seen by Laserworks as a more injurious alternative than acceptance of the proposal by the creditors. Laserworks had the heavy burden of persuading its creditors that their best interests lay in approving the proposal; it did not have the impossible burden of dissuading a financially stronger competitor bent on using the provisions of the BIA to destroy it as a competitor. The appellant derailed the proposal procedure to force the debtor into bankruptcy. Using bankruptcy to cause injury, thereby eliminating the debtor as an entity capable of competing in the marketplace, is abusive of the purpose of the BIA. It does not qualify as "the orderly and fair distribution of (its) property." Annihilation of an individual business or a company may be an unfortunate consequence of a bankruptcy, an unavoidable side-effect, but it is not the purpose of the BIA. Use of the Act to accomplish such an objective is in my view so abusive of the purpose of the legislation as to engage the supervisory jurisdiction of the courts under s. 187(9). It is a substantial injustice to be remedied.

66 No distinction in principle is possible between the present case and the four cited by the Registrar. He identified the problem and he applied the remedy. He was upheld on appeal in the Supreme Court. I would dismiss this ground of appeal.

Class voting--The Fourth Ground

67 In upholding the Registrar Justice Stewart added a string to his bow by introducing the class voting analysis of Viscount Haldane in British American Nickel. In light of the holdings respecting the second and third grounds of appeal, it is not necessary to the outcome to decide this ground.

68 The appellant submits that the trial judge was wrong in concluding there was an abuse on a minority of a class of unsecured creditors and that a duty in this respect was owed by the appellant:

> . . . There was no abuse on a minority of the unsecured creditors and no duty was imposed on the Appellant to cause votes to be cast in the best interest of the class. Without such a duty the learned Judge was without authority to consider Datarite's motives and the votes in question should have been allowed.

69 In British America Nickel Viscount Haldane stated that where a power is conferred on a special class, a majority in exercising a power to modify the rights of a minority must exercise that power in the interests of the class as a whole.

> . . . But their Lordships do not think that there is any real difficulty in combining the principle that while usually a holder of shares or debentures may vote as his interest directs, he is subject to the further principle that where his vote is conferred on him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member...

70 In the present case the minority creditors saw their alternative of furthering their best interests by voting in favour of the proposal disappear when the votes amassed by the appellant were exercised, not in the interest of making the most favourable recovery from a combination of a distribution of the assets of LaserWorks and its continuance in business as a customer or potential customer, but in the interests of removing a competitor of Datarite. Justice Stewart was concerned that the other creditors, as well as the debtor, suffered from the abusive use of the provisions of the BIA. Of the sixteen creditors who did not assign their claims to Datarite, fourteen voted in favour of the proposal.

71 The rationale for Viscount Haldane's conclusion in British America Nickel was carefully reviewed by Hardie Boys J. in Whiteman v. UDC Finance Ltd. The court found it should not intervene in the refusal of a proposal by creditors including several who were being sued by the debtor, and who therefore had a collateral interest in seeing him out of business.

72 Hardie Boys J. cited the same passage quoted above by Justice Stewart from Vicount Haldane's judgment. It concludes that there is a restriction on powers conferred on a majority of a special class in order to enable that majority to bind a minority:

> ...They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities;

> namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only.

73 Hardie Boys J. considered Re Farmers' Co-operative, which was also cited by Justice Stewart, in which votes of several creditors who were competitors of the debtor were disallowed.

> ...In a later development of the same matter, but not now involving the Court's sanction under s. 205, Gallen J. accepted that the Court has an overriding control, not limited to the approval stage under s. 205, and may restrict a right to vote where the equities of a particular situation require it: see [1992] 1 NZLR 348. It is unnecessary for present purposes to decide whether these cases were correctly decided, for even if they were, the principle is not of unlimited application, and does not apply to the exercise of voting rights generally. This is clear from what Viscount Haldane said in the British America Nickel case. Immediately after the passage already quoted, his Lordship said
>
> > Subject to this, the power may be unrestricted. It may be free from the general principle in question when the power arises not in connection with a class, but only under a general title which confers the vote as a right of property attaching to a share.
>
> Thus in Pender v. Lushington (1877) 6 Ch. D. 70, 75-76 Jessel MR said there is:
>
> > . . . no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interest.
>
> While the voting rights conferred by Part XV of the Insolvency Act are not akin to a "right of property attaching to a share", they are rights conferred without reservation. There is no requirement for class voting; there is instead a general right conferred equally on all creditors. The rationale of the principle does not apply. It is well settled that the motive (short of fraud) of a petitioning creditor, no matter how reprehensible, is irrelevant to his right to obtain an order of adjudication: King v. Henderson [1898] AC 720, Re King, ex parte Commercial Bank of Australia Ltd. (No. 2) [1920] VLR 490. The motive of a creditor voting on a proposal, really the other side of the coin to a petition for adjudication, can be no different. That is not to say that there may be no remedy in an extreme case, such as fraud or mistake. But certainly where, as here, there are perfectly legitimate reasons for opposing the proposal, a creditor is not to be denied that right because he may have some other motive as well...

74 If the exception made for fraud is broadened to "substantial injustice" I would take Hardie Boys J.'s conclusions to be a fair statement of the law in Canada as well, as applied by Canadian courts in the cases cited by the Registrar. The New Zealand court included mistake as well as fraud

as an exception. A creditor is not to be deprived of the right to vote for wrongful motives alone; motive must be coupled with a tortious act to support a finding of improper purpose.

75 A Canadian case supporting a broad interpretation of the right of creditors to vote on proposals is Re Bedard Louis Inc. (1991) 22 C.B.R. (3d) 218. The debtor sued three creditors who had sought to seize his goods before judgment for amounts far exceeding their claims against him. One creditor petitioned for a receiving order, and the Quebec Superior Court rejected the debtor's argument that the petitioner was not a creditor because of the large undecided actions. The debtor was declared bankrupt and later filed a proposal. The trustee refused to let the three creditors vote at a creditors' meeting considering the proposal because of a possible conflict of interest. The Superior Court allowed an appeal against the trustee's decision, and the Quebec Court of Appeal upheld the Superior Court, holding (headnote) that:

> No provision of the Act authorizes the trustee to exclude a creditor whom he considers to have a conflict of interest. The debtor's action for damages against the creditors, which constituted a debt not yet payable, did not strip the creditors of their status of ordinary creditors. By the proposal, the debtor presented the creditors with terms of payment which were different from those provided legally by contract.
>
> The Act was intended to allow the voting of all duly acknowledged creditors. Exceptions to that rule were properly specified in the Act and none of them pertained to a creditor against whom a debtor had filed legal proceedings.

76 The Proposals Part of the BIA recognizes only two classes of creditors, secured creditors who are presumably protected by the security they hold, and unsecured creditors, all the others. This does not appear to meet Viscount Haldane's criterion of a special class bound to exercise its voting rights for the benefit of the class as a whole. That concept seems surplus to and difficult to reconcile with the scheme of the BIA where, as the Quebec Court of Appeal found in Bedard, all duly acknowledged creditors are entitled to vote as they please, subject to exceptions set out in the Act (and the exception for tortious or criminal behavior.)

77 As remarked above, those exceptions reflect the manner in which Parliament dealt with conflicts of interest which might arise in the context of voting on proposals. Parliament has obviously legislated on the subject and cannot be assumed to have created by implication an exception for general, unspecified, conflicts of interest. The mere fact that a creditor is also a competitor of the debtor or otherwise in a conflict of interest with the debtor does not give rise to a statutory exception. The scheme for protecting minority creditors adopted under the BIA was not a class voting concept but rather a system of specific exceptions coupled with a discretionary power in the courts to remedy substantial injustice.

78 It is not necessary to make a final determination on this point. The rational of Justice Stewart's decision is found in her adoption of the Registrar's conclusions as to improper purpose in the following passage:

> The applicant is not entitled to use its votes to achieve this improper purpose. The Registrar's decision prevents an abuse on a minority of the class of unsecured creditors and in so doing upholds a fundamental and viable in the circum-

stances principle of class voting. He did not err in concluding improper purpose is relevant.

79 That is, while the Registrar's decision was consistent with considerations of class voting, he was upheld on his findings of improper purpose.

80 I would dismiss the fourth ground of appeal.

Conclusion

81 The appellant attempted to abuse the provisions of the BIA by using them to intermeddle for an improper purpose with the proposal of a debtor to its creditors, giving rise to a substantial injustice. This affected not only the debtor but the remaining creditors who supported the proposal. The Registrar made no error in discerning this from the evidence and in exercising the court's discretionary jurisdiction to remedy substantial injustice. He was upheld on appeal to the Supreme Court. The appellant's actions are not to be condoned. I would dismiss the appeal with costs which I would fix costs at $3,000 plus disbursements to the Respondent and $3,000 plus disbursements to the Trustee.

FREEMAN J. A.
Concurred in:
PUGSLEY J.A.
CROMWELL J.A.

qp/d/bfd

TAB 5

Indexed as:
Shepard (Re)

IN THE MATTER OF the Bankruptcy and Insolvency Act
AND IN THE MATTER OF the bankruptcy of Charles Duncan Shepard

[1996] M.J. No. 203

109 Man.R. (2d) 306

40 C.B.R. (3d) 145

62 A.C.W.S. (3d) 658

File No. 45451 BA

Manitoba Court of Queen's Bench
Brandon Centre

Registrar Harrison

March 21, 1996.

(3 pp.)

Bankruptcy -- Receiving order -- Application or petition -- Grounds for refusal.

This was an application by a company for a receiving order. The corporation had previously applied for the appointment of an interim receiver but that application had been denied. The company was involved in litigation with other companies of which one the bankrupt was a shareholder.

HELD: Application dismissed. The purpose of the litigation between the companies was not to accomplish the aims and purposes of the Bankruptcy and Insolvency Act but rather to obtain a very important business advantage. It was not appropriate or correct in law to have the courts facilitate such objective, which was the purpose of this application.

Counsel:

D.C. Ross, for the applicant, 3245071 Manitoba Inc.
Kris Janovcik, for Charles Duncan Shepard.

1 REGISTRAR HARRISON:-- This application for a receiving order follows the application by the applicant, 3245071 Manitoba Inc. for the appointment of an interim receiver. Reasons were issued September 28, 1995 denying the said interim application. In those reasons, this court applied the case of Re Churchill Forest Industries Ltd. (1971), 16 C.B.R. (N.S.) 158. The latter case allows the court wide discretion in the dismissal of a petition. This court applied the test to the application for an interim receiver. Obviously the test being used from Churchill Forest, supra, can be used, as derived, for a petition for a receiving order. The same considerations apply.

2 A review of the material filed since the above interim application reveals a further affidavit of Reid Scott, sworn January 15, 1996. Mr. Scott is the president and majority shareholder of the applicant. Mr. Scott emphasizes the fact that Mr. Shepard is not personally involved in any of the protracted litigation which is presently ongoing between a number of companies referred to in my reasons of September 28, 1995. This fact was also pointed out by Mr. Ross in his argument. Further, in paragraph 6 of his affidavit, Mr. Scott refers to the fact that the only asset which Mr. Shepard has, is his shareholding in the related company. An objective view of the affidavit reveals that Mr. Scott's focus is clearly the control of these shares. The balance of the affidavit contains a great deal of argument, and consequently, is of little assistance to the court.

3 Also in opposition to this application is filed the affidavit of Charles Duncan Shepard sworn the 17th day of January 1996. His position is set forth in the latter portion of paragraph 2 as follows:

> "... Therefore, contrary to the allegations of Mr. Scott in his initial and most recent Affidavit, I have made both continuous and reasonable efforts in dealing with my Judgment Creditors and have either settled or arranged for settlement of all Judgments except for the Petitioner's and that of International Brokerage Ltd., who cannot be found ..."

4 Regardless of the above, it would still appear that Charles Duncan Shepard remains for all intents and purposes, insolvent. While some efforts are being made to effectively deal with some of these judgments, Mr. Shepard makes no allegations that at the present time he is solvent. A review of court records indicates that Mr. Scott is also the subject of a large number of judgments from a variety of corporations and individuals.

5 I am satisfied that the reasons outlined by this court on September 28, 1995 should again be applied to the case at bar. The dominant purpose of this litigation is not to accomplish the aims and purposes of the Bankruptcy and Insolvency Act, but rather to obtain a very important business advantage. It is not appropriate or indeed, correct in law, to have the courts facilitate such an objective when the objective is very clearly the main purpose of the application.

6 The application for a receiving order is dismissed. Each party shall bear their own costs.

REGISTRAR HARRISON

qp/s/tld/mjb/DRS/DRS

---- End of Request ----
Download Request: Current Document: 1
Time Of Request: Monday, January 28, 2013 13:44:03

TAB 6

Indexed as:

Pappy's Good Eats Ltd. (Re)

IN THE MATTER OF the bankruptcy of Pappy's Good Eats Limited

[1985] O.J. No. 1748

56 C.B.R. (N.S.) 304

Ontario Supreme Court - High Court of Justice
In Bankruptcy

Henry J.

Oral judgment: September 5, 1985

Counsel:

N. Endicott, for the petitioning creditor.
W. Andrews, for the debtor.

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1 **HENRY J.** (orally):-- The petitioning creditor is the landlord of premises at 4016 Finch Avenue East in Scarborough, Ontario which it leased to the debtor Pappy's Good Eats Limited. The debtor carries on the business of a chain of fast food restaurants which are operated by franchisees under agreements with Pappy's Good Eats Limited as franchisor; the restaurant at 4016 Finch Avenue East, however, was originally operated by Pappy's Good Eats Limited itself in the premises leased from Northeast Land Inc., the petitioning creditor.

2 The lease was dated 21st April 1982. The debtor as tenant fell into arrears of rent and the landlord terminated the lease by formal notice dated 9th October 1984. The landlord obtained a consent judgment against the debtor for $63,451.48 plus $1,500 costs for a total in round figures of $65,000. On 22nd January 1985 the landlord instructed the sheriff to levy on a writ of execution dated 27th November 1984. On 24th January 1985 the sheriff made a return of nulla bona (as it used to be called) which was received by the landlord's solicitor, Mr. Endicott, on 4th February 1985.

3 On 4th February 1985 the landlord, as petitioning creditor, filed the petition herein alleging the judgment debt of $64,951.48. The petition alleges two acts of bankruptcy:

(a) that the debtor has ceased to meet its liabilities generally as they have become due; and

(b) that the debtor has permitted the execution levied against it on 24th January 1985 to be returned endorsed to the effect that the sheriff can find no property whereon to levy, seize or take in execution.

4 The debtor has filed the following notice disputing the petition:

1. The debt of Northeast Land Inc., arises out of rent arrears at 4016 Finch Avenue East, which was operated by one of our franchisees and represents approximately 4 months rent in arrears.
2. The franchise operation was financed by the Petitioner who held a Chattel Mortgage of $100,000.00 on the equipment. In November, the Petitioner levied distress and the store was closed. Subsequent [sic] Pappy's found a new franchisee 607305 Ontario Limited who signed a new Lease with the Petitioner, the terms of which are not known to us. In addition on November 30th, 1984, the said 607305 Ontario Limited executed a franchise agreement with Pappy's and is presently operating the location as a franchisee.
3. It was agreed with Mr. Ng, President of the Petitioner that in consideration of Pappy's finding a new tenant 607305 Ontario Limited and the execution and delivery of the new Lease and the payment by 607305 Ontario Limited of the $100,000.00 owed on the Chattel Mortgage that the debt of $64,951.48, for rent arrears would be satisfied and cancelled.
4. The Petitioner is making this application by agreement with and in concert with Wen Chung of Flowen Enterprise Corporation, the franchisee of Pappy's at 2450 Sheppard Avenue East, North York, for the purpose of assisting Flowen Enterprise Corporation who has commenced an action against Pappy's Good Eats Limited in the Supreme Court of Ontario for damages for alleged breach of contract by Action Number 570/85, and accordingly the Petitioner is not making this application bona fide."

5 I point out at once that the dispute notice does not raise any issue as to the failure of the debtor to meet its liabilities generally as they became due; the dispute (as it developed) is essentially twofold - that the debt alleged by the petitioning creditor has been satisfied and that the petitioning creditor is, in concert with certain franchisees who are not creditors, bringing the petition to assist the franchisees and not bona fide using the facility of the Bankruptcy Act.

6 Pursuant to this latter ground Mr. Andrews, counsel for the debtor company, made an application at the outset of trial for an order dismissing the petition on the following stated grounds:

1. The named petitioner is not the true petitioner.
2. The petition is brought at the insistence of Wen Chung, Ben Chun and Peter Chun who are not creditors.
3. The facts in the petition and the affidavit verifying the petition are false.
4. The purpose of the petition is not for the equal distribution of assets among creditors but for the colateral purpose of terminating franchise agreements between Pappy's Good Eats Limited and the said Wen Chung, Ben Chun and Peter

Chun and to terminate litigation between Wen Chung and Pappy's being Action 570/85.

5. The express purpose of the parties is to bring about the bankruptcy of Pappy's as set forth in a written agreement dated 4th February 1985 being the date of the petition."

7 I reserved this motion for disposition after hearing evidence. A number of other grounds were advanced by Mr. Andrews on behalf of the debtor in support of his position that the petition should be dismissed; I shall deal with them in due course.

8 Subject to the grounds urged upon me by Mr. Andrews in his preliminary motion which I set aside for the moment, the petitioning creditor satisfies me on all the evidence that the debtor has, within the six months preceding the filing of the petition, committed an act of bankruptcy within s. 25(1)(b) of the Act. First I find that an act of bankruptcy as defined in s. 24(1)(e) has been committed in that the sheriff made the return of nulla bona to which I have referred on 24th January 1985. Mr. Matioli, the president of the debtor company, met the two sheriff's officers who attended to levy execution. He testified on cross-examination by Mr. Endicott that he told Mr. Lowrie, one of the officers, that the debt to Northeast Land Inc. had been extinguished. Mr. Lowrie did not testify as he was not available for personal reasons which satisfied me. However, the evidence is that he did make up the notes on the report that was finally submitted by the sheriff to Mr. Endicott; in that report he did not note any such statement; the report which is set out according to the new format under the new rules discloses that there are no exigible assets to satisfy the execution and that the debtor's liabilities approximate $750,000. Mr. Matioli acknowledged on cross-examination that the report is "basically accurate" according to what he told the sheriff's officers. In my opinion, under the new rules (R. 60.07) this report, and the writ of seizure and sale being executed, are in substance for bankruptcy purposes the same as the old writ of fieri facias and return of nulla bona. I therefore accept this evidence as sufficient for purposes of s. 24(1)(e) of the Act as establishing that act of bankruptcy alleged.

9 Second, I find that the act of bankruptcy alleged under s. 24(1)(j) of the Act has been sufficiently proved. As I have said, the issue is not included in the dispute notice. A considerable number of unpaid creditors were referred to in the evidence but it is in some cases uncertain whether they are creditors of Pappy's Good Eats Limited or of one of its numbered company subsidiaries which are the operating companies. Mr. Matioli, the president, testified that trade creditors (such as suppliers of food products to the restaurants) are owed trade debts by a Pappy subsidiary. However, Mr. Matioli admitted in cross-examination that the following creditors have outstanding judgments against Pappy's Good Eats Limited (which I find are of sufficiently recent origin and which are unpaid): Vaunclair Meats Limited, $5,446.03; Canadian Flowers Limited, $15,996.98; Burgess Wholesale (1978) Limited, $4,271.39; Tory, Tory, DesLauriers and Binnington, $19,056.41.

10 Mr. Matioli said that the first three of these judgments were not based on the indebtedness of Pappy's Good Eats Limited but said that because Pappy's did not owe the money, he did not take any steps to have the judgment set aside. I cannot understand this explanation. I can only say that it is not open to the debtor at this stage of proceedings casually to brush aside outstanding judgments against it that have not been disputed (and indeed are in the hands of the sheriff for execution).

11 Mr. Matioli also admits an outstanding debt to Scarborough Foods for promotional material - $2,000.Mr. Bondi, another creditor, testified that the debtor owes him $11,649.25 for food and vegetables. Mr. Cnacellara, his solicitor, made a demand on the head office of the debtor in No-

vember 1983. As I understand his evidence the debtor agreed to pay the debt in periodic instalments; the instalments are not being paid but Mr. Bondi is apparently content to wait for it and in the meantime sells to Pappy's on a C.O.D. basis.

12 Mr. Bergman, the former solicitor for the debtor company, testified that he has an outstanding account for legal fees against it for approximately $900 rendered 5th November 1984. He has not received payment but a cheque (Ex. 9) was dishonoured.

13 The foregoing is sufficient to satisfy me that within the period of six months before the petition issued the debtor ceased to meet its liabilities generally as they became due within the meaning of s. 24(1)(j) of the Act.

14 The petitioning creditor must also prove a debt owed to it by the debtor of $1,000 or more. It relies on the outstanding judgment for $65,000 for arrears of rent. On the evidence, there is no doubt that the debt was owing and that the petitioning creditor obtained a consent judgment to reflect it.

15 It is the debtor's position that by an oral arrangement made between Mr. Ng as president of Northeast Land Inc. and the president of Pappy's Good Eats Limited, Mr. Matioli, the judgment for the rent arrears was satisfied or extinguished.

16 If I were of the opinion that the debtor raises a bona fide and arguable dispute that the judgment debt is no longer owing, I would stay the petition to await adjudication of that issue in the proper court. I am unable, however, on all the evidence to find such a bona fide dispute.

17 First the judgment is outstanding and no proper step has been taken to have it set aside although nine months have elapsed from the time when the debtor alleges that the debt was satisfied and seven months have elapsed since the issue of this petition.

18 Second, the debtor is unable to produce a satisfaction piece or other written document evidencing a compromise of the debt. If such a document had been executed as contemplated by the new R. 59.07 it would have sufficed as Mr. Endicott acknowledges.

19 There is no better or more conclusive evidence of a debt owing than a judgment of the court. It brings the proceedings to a state of finality subject always to the judgment being set aside by a court for fraud, misrepresentation or mistake. In bankruptcy proceedings the bankruptcy court is entitled to accept and rely on such a judgment whether it is a foundation of a petition or offered as proof of unpaid creditors' claims generally. It will only be in the most unusual circumstances that the bankruptcy court will accept a challenge to such a judgment.

20 In the present case the judgment for arrears of rent asserted by the petitioning creditor is not itself challenged. It was obtained, as the evidence shows, on consent to permit the creditor to recover the arrears which were never in dispute. What is now said is that judgment is satisfied.

21 Satisfaction of a judgment debt when asserted as a ground of a dispute to a petition in bankruptcy must, in my opinion, be evidenced by some written instrument; otherwise there is no prescribed way whereby the title to land against which it may be registered can be cleared or a proper objection can be taken to a sheriff's levy under writ of seizure and sale. The bankruptcy court is in no worse position - it can and must insist that satisfaction or extinguishment of a judgment be evidenced in written form.

22 Third, I have heard a good deal of evidence concerning the alleged compromise of the judgment debt for arrears of rent. On all the evidence the debtor does not satisfy the onus of showing that there is even a reasonably arguable case for the proposition it asserts.

23 When the petitioning creditor Northeast Land Inc. as landlord terminated the lease to Pappy's Good Eats Limited, negotiations began to sell the restaurant business and install a new franchisee, a Mr. Lau, in the premises at 4016 Finch Avenue East. Mr. Bergman was solicitor for Pappy's Good Eats and Mr. Endicott for the landlord Northeast Land Inc. The matter was settled on the foregoing basis which I paraphrase:

(a) that if the transaction with the new franchisee closed on 15th November 1984, the chattel mortgage assets would be purchased by the franchisee for $100,000 and that amount paid to Northeast Land Inc. to discharge the chattel mortgage.
(b) out of the proceeds of the transaction the arrears of rent would be paid to Northeast Land Inc.;
(c) if the transaction did not close, a consent to judgment furnished by Pappy's Good Eats Limited to Northeast Land Inc. would be available for the latter to obtain judgment for the arrears of rent.

24 The deal did not close and accordingly Northeast Land Inc. obtained the judgment which is now the basis of the petition. Immediately thereafter a new party, Mr. Heer, and his company negotiated with Pappy's Good Eats Limited for a franchise agreement and with Northeast Land Inc. for a lease. In the course of negotiations Mr. Ng dealt with Mr. Polera, the vice-president and Mr. Matioli the president of Pappy's Good Eats Limited. Both witnesses said that Mr. Ng told them that he would be satisfied to get $100,000 for the chattel mortgage and would not assert the judgment debt for the arrears of rent. Mr. Ng denies any such representation. Just before the documentation was executed, Mr. Matioli asked Mr. Heer to get a release of the judgment debt; he attempted to do so and Mr. Ng refused. The franchise and the lease agreements were then concluded.

25 I accept Mr. Ng's evidence that there was no agreement to release the judgment debt. I found him an entirely credible witness and his general honesty and reliability were heartily endorsed by Messrs. Matioli and Polera. I must say that these latter witnesses in cross-examination did not impress me with their reliability.

26 Not only was no release or other written document extinguishing the judgment debt created but I am satisfied that Mr. Ng at no time either in the first aborted deal or in the second promised or intended to release the debt for the arrears of rent. It would not, in the circumstances, have been business common sense to do so as the evidence shows.

27 I accordingly find that the debtor does not raise a bona fide or arguable dispute as to the debt upon which the petition is based. The petitioning creditor has proved the debt alleged in the petition so far as this stage of the proceedings is concerned.

28 Mr. Andrews raises a further point; there is an irregularity in the affidavit of verification in that by inadvertence, when the original petition was revised to show the return of nulla bona on 4th February the affidavit already sworn was not resworn. I would be prepared to exercise my discretion under s. 157 of the Act to correct it, if required to do so.

29 Based on the foregoing facts, I would in the ordinary case make a receiving order. I am, however, faced with the motion by Mr. Andrews to dismiss the petition which I have already men-

tioned and deferred. The evidence relating to that motion places an entirely different complexion on this case and I now proceed to dispose of it.

30 I find on all the evidence that Northeast Land Inc. had formed the intention prior to 4th January 1985 to issue the petition and had prepared the petition and had the affidavit of verification sworn by the president Mr. Ng on that date. The petition was not then filed because Mr. Endicott, the petitioning creditor's solicitor, advised a final step by way of a sheriff's levy on the writ of execution in his hands: the return of nulla bona to which I have referred reached Mr. Endicott on 4th February 1985. That triggered the filing of the petition on the same date with the addition of the second act of bankruptcy. I find that it was the intention of the petitioning creditor to do this irrespective of other intervening events to which I will refer. At that time the petitioning creditor was entitled to file the petition in its own behalf. On 21st January 1985 a meeting took place in Mr. Ng's office. There he was approached by three franchisees of Pappy's Good Eats Limited, Peter Chun, his brother Ben Chun and Wen Chung; also present were Mr. Ng, Mr. Heer and Mr. Endicott. The franchisees were dissatisfied with the performance of the franchisor, Pappy's, under the franchise agreements; Mr. Chung's company, Flowen Enterprise Corporation on 31st January 1985 commenced an action for breach of contract and other relief against Pappy's Good Eats Limited (Ex. 36); and to put the matter bluntly they wanted to see Pappy's in bankruptcy so as to terminate the franchise agreements and in some way to acquire the business. They proposed to assist Northeast Land Inc. as petitioning creditor by providing information relevant to the proceedings and also by assisting in financing those proceedings. Mr. Ng was unsure how to react to this but on legal advice he eventually instructed Mr. Endicott to negotiate a suitable arrangement and thereafter left the matter in his hands. After further negotiations, Mr. Endicott prepared a draft agreement which was signed on behalf of Northeast Land Inc. and by Wen Chung, Ben Chun and Peter Chun, the three franchisees. This agreement (Ex. 22) provides as follows:

1. Northeast Land Inc. will petition Pappy's into Bankruptcy using the services of Norman A. Endicott as solicitor and Yale & Partners Limited as Trustee, and Ben Chun, Peter Chun and Wen Chung will pay all the legal and trustee's expenses.
2. Chun and Chung will advance as a deposit on legal fees the sum of $2,000 and for guarantee for the trustee's fees the sum of $5,000 on the signing of this document (both subject to repayment from amounts actually received from the estate if any, based on a solicitor and client basis).
3. Chun and Chung will advance the sum of $15,000 (non-refundable) to Northeast on the signing of this agreement, and will pay to Norman A. Endicott in Trust $10,000 to be paid to Northeast Land Inc. upon the receiving order becoming final, and a further $5,000 to be paid by way of post dated cheque for three months after receiving order final.
4. Northeast Land Inc. grants an irrevocable power of attorney to Norman A. Endicott who shall act on the instructions only of Chun and Chung to negotiate any and all settlements with Pappy's Good Eats Limited, and to control the bankruptcy proceedings so far as Northeast Land Inc.'s interest is concerned. Northeast Land Inc. can accept nothing less than payment in full of its judgment dated the 27th November, 1984 against Pappy's, subject to the comment below. Northeast Land Inc. irrevocably appoints Norman A. Endicott, its solicitor in the action 21391/84 York, and in the bankruptcy proceedings for the said purposes.

5. From dividends or proceeds received in the bankruptcy or otherwise Northeast Land Inc. keeps the first $50,000 and the balance is paid to Chun and Chung except that from the first $15,000 received Chun and Chung shall recoup the last $15,000 paid to Northeast by Chun and Chung or an amount up to said $15,000, but all other dividends or funds received are payable to Chun and Chung.
6. In the event of any dispute between the parties, it is agreed that Norman A. Endicott shall be a final arbitrator notwithstanding that he is the solicitor for Northeast Land Inc.

31 The witnesses were unable to establish the date of signing with precision. The three franchisees signed it in Mr. Endicott's office. At that time Mr. Chung drew a cheque in favour of Mr. Endicott in trust for $22,000 which is dated 1st February 1985. The cheque was later certified by the bank on 4th February (Ex. 23). The agreement was then sent to Mr. Ng who signed it on behalf of Northeast land Inc.

32 Counsel seem to think it important to establish when the agreement was made - whether it was before or after the petition was filed on 4th February 1985. In my opinion that is not important. I find however on all the evidence, including the statement of common ground in Ex. A, that the agreement was complete on 1st February when the negotiations crystallized and Mr. Chung delivered the cheque to Mr. Endicott; clearly this was for advances called for by paras. 1, 2 and 3 of the agreement.

33 The purport of the agreement is that Northeast Land Inc. will prosecute the petition (whether already filed or not) to completion. The debt or part of it is not assigned to the franchisees - they are not creditors initially or by assignment. The agreement is to provide for a sharing of dividends if and when received by Northeast Land Inc. from the trustee according to the formula set out in the agreement. The franchisees are to pay the legal fees and the expenses of the trustee. The objective, so far as the franchisees are concerned, is to bring about the bankruptcy of the debtor. This is an improper use of the Bankruptcy Act.

34 Mr. Endicott submits that any impropriety is on the part of the other parties because Northeast Land Inc. always had, and continues to have, the right to prosecute the petition which it intended to do in any event; he says that the petitioning creditor simply had an opportunity to obtain a payment that would guarantee it some return on the judgment debt regardless of the failure of dividends and that this is an innocent purpose. I do not agree. The effect of the agreement is to embroil the petitioning creditor in the improper objective of the purchasers who as non-creditors have no status in these proceedings and are intermeddling in it. The whole proceeding thus is inescapably tainted; the petition must be dismissed.

35 There is also emerging a dispute as to the present standing of the agreement (Ex. 22). Mr. Endicott says that it has been repudiated by Mr. Chung: see Mr. Hartley's letter of 11th March 1985 (Ex. 24). On the other hand, Mr. Andrews asserts that the agreement is champertous - if so it is void as contrary to public policy. I do not decide either of these issues but leave the parties to the agreement to extricate themselves from it as best they can. Its enforceability is not material in this action. The abuse occurred when the parties agreed or arranged improperly to use the facility of the Act to advance the objectives of the franchisees to cause injury to the debtor.

36 Mr. Endicott urges me in case I should stay or dismiss the petition to admit as petitioning creditors one or both of St. Lawrence Foods or Burgess Wholesale. The short answer to this is that s. 25(13) of the Act does not permit the court to do so where the petition is dismissed.

37 The petition therefore will be dismissed with costs as asked.

HENRY J.

qp/s/plh

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Time Of Request: Monday, January 28, 2013 13:44:37

TAB 7

Indexed as:

Dimples Diapers Inc. v. Paperboard Industries Corp.

Between
Dimples Diapers Inc., et al., Plaintiffs, and
Paperboard Industries Corporation, et al., Defendants

[1992] O.J. No. 1961

15 C.B.R. (3d) 204

35 A.C.W.S. (3d) 511

Action Nos. 31-204-249-T and 91-CQ-12111

Ontario Court of Justice - General Division
Non-Jury Sittings - Toronto, Ontario

Farley J.

August 25, 1992

(36 pp.)

F.J.C. Newbould, Q.C., for Dimples Diapers.
S.G. Cloutier, for Paperboard Industries.

FARLEY J. (orally):-- This is a joint matter involving court file number 31-204-249-T Ontario Court (General Division) re in the matter of the bankruptcy of Dimples Diapers Inc. and court file number 91-CQ-12111 re improper purpose of lawsuit between Dimples Group Inc. and 2458195 Canada Limited, plaintiffs, and Paperboard industries Corporation, Professional Publishing Associates Limited, Scythes Inc., United Studios, Ron Uliani, Karen Russell, Rhonda Windsor-Maxwell, Anthony R. Boyden, Alan D. Steinberg, Helen Steinberg, defendants.

Counsel - M.D. O'Reilly, Q.C., S.G. Cloutier for the (*) petitioning creditors in bankruptcy and Paperboard Industries Corporation and it) Professional Publishing Associates Limited in the civil action; T. Dunne, C. Bolan for (*) Professional Publishing Limited; D. Berlach, Scythes Inc.;

Joel Kohm, Rhonda Windsor-Maxwell and Anthony R. Boyden; M.D Abramowitz for Alan D. Steinberg and Helen Steinberg; R. Uliani in person and for United Studios; F.J.C. Newbould, Q.C., J.W. Montgomery for the plaintiffs in the civil action and for the (**) debtor company Dimples Diapers Inc. (now 2458195 Canada Limited); P.P. DuVernet for the (**) debtor company.

Notes re parties and counsel. (*) On June 23, 1992, during the trial, the plaintiffs and Professional Publishing Associates Limited (Professional) reached a settlement in the improper purpose lawsuit, which also involved Professional seeking leave to withdraw its petition on the bankruptcy proceeding. At that stage Professional changed its counsel to T. Dunne and C. Boland in its capacity as petitioning creditor. I ruled on June 24, 1992, rather than the petition being withdrawn, another creditor(s) could be substituted for Professional as a petitioning creditor. Grand & Toy Limited (Grand & Toy) then was substituted for Professional. The petitioners were then Grand & Toy and Paperboard Industries Corporation.

(**) The debtor company being petitioned into the bankruptcy was known at the start of the bankruptcy hearing, June in, 1991, as Dimples Diapers Inc.; since that time it has changed its name to 2458195 Canada Limited. It was then represented by P.P. DuVernet. However, before the trial could be resumed in the second half of 1991, he withdrew as counsel and was replaced by F.J.C. Newbould, Q.C., which was instituted December 30, 1991. These proceedings were heard June 10 and 11, 1991 and June 18, 19, 23, 24, 25, and 30, 1992.

Paperboard industries Corporation and Professional petitioned Dimples Diapers Inc. (now called 2458195 Canada Limited) in the bankruptcy matter. Grand & Toy replaced Professional as a petitioning creditor during the last days of the hearing. 2458195 Canada Limited and its parent company, Dimples Group Inc., instituted a lawsuit alleging that the defendants had arranged for the bankruptcy petition to be initiated and proceeded with for an improper purpose.

One could, I believe, justly conclude that these proceedings were, in fact, a badly written soap opera involving unusual casting. However, when one pinches oneself, it is clear this was not a dream - but sadly it was reality. Some of the witnesses appeared to me to be genuine and sincere; others I regret to say were far less than candid. There was a great airing of dirty linen. Unfortunately when it came to the laundering in this case, the parties for the host parties appear to have forgotten to rinse out the soiled diapers. Rather they seem to have put these dirty diapers directly into she machine and turned it on, without the benefit of any cleansing agent, to churn out whatever may come.

The Cast of Characters

It may be of some assistance to provide a cast of characters with a brief description of some pertinent points:

Dimples Group Inc. (D Group I) - a public company whose shares are listed on the Vancouver Stock Exchange (previously called Samos Resources Ltd.), apparently a shell resource company before the Dimples reorganization.

2458195 Canada Limited (DDI) - the subsidiary of D Group I, previously named Dimples Diapers Inc. and prior thereto called BRT Global Manufacturing Inc., the debtor company in the bankruptcy proceedings.

Bottom Line Holdings Ins. (BLHI) - a private company owned by Rhonda Windsor-Maxwell (40 percent), Anthony R. Boyden, (30 percent) and Alan D. Steinberg (30 percent), but now subject to a dispute as to whether a Robert Read, a significant shareholder in D Group I, owns 50 percent with the equivalent dilution of the other shareholdings. By agreement dated April 28, 1989, BLHI licensed DDI concerning a particular type of reusable form fitting cloth diaper in return for a royalty on sales.

Rhonda Windsor-Maxwell (Windsor) - after she left another diaper company, Babykins, she contracted with Scythes to help design the "Dimples diaper". She is now the lover of Anthony R. Boyden.

Anthony R. Boyden (Boyden) - Boyden did not testify; it was claimed that he was unable to do so as he is presently in prison having confessed to a conspiracy to commit murder. I was advised that. the offence took place before any involvement with Dimples. He was said to be a market financier whom Windsor's broker, Brian Long, introduced her to concerning financing the Dimples operations. Boyden, Windsor and Long incorporated three companies (a) DDI to manufacture (or cause to be manufactured) the Dimples diaper; (b) BLHI to hold the rights and trademark to Dimples diaper; (c) Dimples Diapers Services Inc. (Services) which was said to be for the purpose of operating a diaper service so as to permit testing of the Dimples diapers, sometimes called "The Real Diaper Service".

Brian Long (Long) - Windsor's broker who introduced her to Boyden.

Alan D. Steinberg (Steinberg) - the dentist brother-in-law of Boyden who replaced Long as a shareholder.

Helen Steinberg (Helen) - Steinberg's wife.

Douglas Elliott (Elliott) - now the president of D Group I and DDI. He was a business acquaintance of Boyden. Boyden brought him into the Dimples organization as a consultant who had some knowledge and experience with public company.

Lynn Elliott (Lynn) - Elliott's wife who assisted Elliott at DDI.

Paperboard Industries Corporation (Paperboard) - a supplier of Packaging to DDI and a petitioning creditor ($98,859.56). DDI claims that Paperboard sold it defective goods.

Scythes Inc. (Scythes) - a cut and sew operation which manufactured diapers for DDI. DDI also claims that the goods supplied were defective. It had a claim of $82,939.02.

Professional Publishing Associates Limited (Professional) - an original petitioning creditor ($21,995) and a publisher which carried various advertisements of Dimples diapers in several of its magazines. Its witness was Mitchell Dent.

Ron Uliani (Uliani) - his firm name was United Studios through which he provided advertising and marketing services to DDI.

Karen Russell (Russell) - she had a loose association with Uliani in United Studios.

Grand & Toy Limited (Grand & Toy) - a supplier of office supplies to DDI with a claim of $2,494.16 according to its witness Doug Furlong. It was a replacement petitioner.

Proving Graphics (Proving) - a supplier of printing work to DDI with a claim for $14,787. Proving's witness Mike Leavy testified in 1991 that he was relatively satisfied with the explanations

he had been given and he figured "somewhere down the line there may be a possibility we will get paid." He was correct as D Group I settled the claim thereafter.

Yorkville Press (Yorkville) - Elliott advised that D Group I had settled this claim of $4,935 after the commencement of the bankruptcy hearing in June 1991. Ray Long, an employee, indicated DDI owed $6,124.

Vickers and Benson (V&B) - an advertising agency with a claim of $209,000 according to its witness Graham Lamb. This was also settled after the commencement of the hearing although it was not being pressed in June 1991. Terence O'Malley an officer of V&B was also a director of D Group I.

Dil Gujral (Gujral) - the then principal shareholder of Samos Resources Ltd (now D Group I) at the time it acquired DDI.

Lucy Zezza (Zezza) - an employee of Paperboard.

Don Mintz (Mintz) - a partner of Mintz and Partners, who were the auditors of D Group I and DDI. He indicated he was a friend of Elliott as well as being a trustee in bankruptcy.

Murray Hahn (Hahn) - a trustee in bankruptcy who was proposed by the petitioning creditors.

Wilfred Doyle (Doyle) - controller of Paperboard.

William Simpson (Simpson) - controller of a division of Paperboard.

Peter Simpson - principal of Peng Packaging.

Mitchell Dent (Dent) - general manager of Professional.

Douglas Campbell (Campbell) - treasurer and controller of Scythes.

Margaret Crown Thompson (Crown Thompson) - the owner of VIP Search Group, a supplier of permanent and temporary office employees to DDI with a claim for $16,060.

Richard Crown - Crown's husband.

Dorothy Keery (Keery) - an employee supplied to DDI by VIP Search Group with a claim of $235 for unpaid wages against DDI.

Jill Williams (Williams) - she worked for DDI from August 2990 to the end of the year as executive assistance to Windsor. Since then she has been controller for D. Group I.

Yorkton-Continental Securities (Yorkton) - a brokerage house which arranged a financing of $500,060 for D Group I in the fall of 1990. D Group I and DDI jointly issued a debenture to Yorkton in November 1990 to mature February 1991, secured against the assets of D Group I and DDI.

Dun and Bradstreet (D&B) - collection agency for Paperboard as to DDI account.

Alex Kyle (Kyle) - when D&B were not successful, Paperboard consulted Kyle, a lawyer, for advice regarding the commencement of an action. An action was commenced but "superceded" the next day by the bankruptcy petition.

Bankruptcy Petition

Windsor after some experience with another diaper company, Babykins, enlisted the aid of Scythes to do what was said to be her own line of diapers - the Dimples diaper. Long introduced her

to Boyden in early 1989 and the three companies, DDI, BLHI and Services were incorporated. By agreement dated April 28, 1989, BLHI gave DDI a licence to manufacture and sell. the Dimples diaper for a licence fee of six percent for a renewable term of five years. By further agreement dated May 5, 1989, BLHI sold all its shares of DDI to D Group I (then called Samos Resources Ltd.) in return for $20,000 antI a commitment for further funding. When Gujral failed to provide this financing, Boyden took control of the escrow position in D Group I and financed the marketing of the diaper with a line of credit. Elliott and Read were hired as consultants to assist in the managing of the public company on Boyden's recommendation.

It may be questioned whether Windsor ever had any respect for Elliott. He was characterized by her as someone whom Boyden endorsed from prior experience with Elliott. Windsor claimed that she never trusted Elliott and that subsequent events proved her right. I think it fair to say that Windsor loathed Elliott and continues to do so. It was also evident that he did not hold her in high regard.

The businesses (BLHI, D Group I, DDI and Services) moved into facilities which were leased by Services in Markham. Eventually these companies had 15 employees working on the Dimples diaper. Apparently there was some manufacturing problems encountered by Scythes with the diapers - pertaining to the snaps and the elastic. Elliott claims to have been surprised in finding out the extent of such problems and that such had been hidden from him at the time when financing was being organized for DDI. Scythes' position was that it was resolving the manufacturing difficulties.

Apparently there was a coup detat by Elliott - in November 1990, he took over de facto - if not de jure, control of DDI. Steinberg, who had had no manufacturing experience apparently, had enough of his position as vice president in charge of production of DDI and resigned in October of 1990. Boyden, vice president of finance, and Windsor, president, were given the gate by Elliott shortly after.

DDI was struggling to meet its payroll in December 1990. Bills were outstanding and apparently there were no receivables to cover same. Employees were laid off.

Then apparently there was a reorganization which came about. Dimples diaper business through some Unexplained process was transferred (for what consideration?) to D Group I. DDI had during the earlier period been dependent on D Group I providing it with funding - including a joint debenture through Yorkton.

Elliott testified that he had set up a review committee in DDI to determine what were proper payables to recognize, alleging that Windsor, Boyden and/or Steinberg had been using corporate funds to finance their own business operations. I discount very substantially the bona fides of this review process. Elliott's testimony in this regard defies gravity. If anything, the suppliers would appear to have been divided into a "friends" and "enemies" list. I find that there was ho overall determination of what the true debts of DDI were after Elliott effectively took over.

There was an attempt by Windsor, Boyden and the Steinbergs to regain control of the Dimples fort around the New Year period. In a changing of the guards in Ruritania, the old guard came in and changed the locks and put on a telephone answering machine with Helen's voice on it. The new guard retook the fort and proceeded to obtain an injunction. The old guard rallied with a wind-up application counter-attack. Only the lawyers looked "doomed" to make any money out of this Dimples mess.

If one were to believe Windsor, she merely was passing the time of day in the first quarter of 1991 in obeying the terms of the injunction concerning no had mouthing of DDI. She did admit to speaking to some of her old friends and acquaintances (eg. Zezza, Uliani, et cetera) she had met through her Dimples involvement, but she would have it that. she either merely said that they should consult their own lawyers re collecting their debts or she discussed truly personal matters with them. Her evidence was that neither she nor Boyden were involved in bringing about the bankruptcy petition.

One of her friends wad Uliani and she kept in close contact with him. He was very upset about his United Studios' account with DDI. He had been promised by DDI in a meeting with Russell, Windsor and Lynn that he would be paid, subject to a small discount, very shortly. When he wasn't, he went off on a crusade. While Uliani may have had many talents 86 a creative advertising person, in the legal matters affecting DDI he appeared to be more akin to the character of inspector Cleseau as witness his contacting Mintz to see if he could act as the trustee in bankruptcy. He would have it that be checked with Windsor first. He said that her side of the story seemed to be so convoluted. He then said he gave Elliott the opportunity to give his side. Uliani came down against Elliott. He considered his options - sue for the debt, start bankruptcy proceedings or attempt settlement. The depth of his legal knowledge and experience (Elliott would come up with a flurry of legal defences and settlement appeared hopeless) is belied by his ready grasping of a bankruptcy petition - despite the fact that he said it appeared complicated and expensive.

Having decided on bankruptcy, Uliani then proceeded to call virtually every trustee in the phone book, including Mints who also happened to he a friend of Elliott and his firm were the auditors of the Dimples group. Uliani was also inquiring of trustee's fees in late February. In his own version, he was not having any success - they were apparently all telling him the same thing concerning procedures and fees which he found too high. Undeterred, he said he asked Windsor if Boyden would have the name of a trustee and Boyden put Uliani onto Hahn in early February. This, of course, does not accord with the fact that Uliani was still seeking a trustee (including Mintz) for several weeks after. Uliani conversed with Boyden twice on March 18, 1991, concerning the petition, two days before it was issued. Uliani discussed with Windsor the attitude of the various creditors to the petition before the issue of the proposal. I find that Uliani involved Windsor and Boyden in more than a mere mechanical matter of giving him the name of a trustee; however it is to be recognized that the involvement may have been vice versa. I will note hereafter their deeper involvement.

Meanwhile Uliani was attempting to rally the creditors to the flag. Apparently he had success since Professional and Paperboard agreed to do so and contributed money. They, in fact, became the petitioners not Uliani. Professional did so, apparently as a flyer to collect its debt; it is noteworthy to mention Professional's insistence in having its financial exposure sapped at $500. Uliani suggested that if the petition were successful, there has a chance Windsor would get back the Dimples trademark with resultant good business opportunities for her and a chance for Professional to get its money back. Paperboard's decision is cloaked in mystery. It was at pains to suggest its involvement was last minute. However, what cannot be explained in this version was the fact that it had the day before through Kyle instituted a suit against DDI and yet now it completely reversed its field. Then again there was the tell tale evidence of the authorization for the trustee fees some three weeks before the petition. I found the evidence concerning the Paperboard situation rather suspect. Then there is the curious twist that Uliani got his money ($1,000) back from Hahn. And I also note that Windsor discussed the prospective petition with Hahn himself.

Then there was the testimony concerning the March 14, 1991, letter to DDI. The suggestion was that this letter was completely independent of the bankruptcy proceedings. Further it was proposed that the Steinbergs were only involved (since it was claimed that Steinberg was not up to dealing with Dimples matters for some months) because they had a computer/typewriter Helen's position was that she was only a mechanical typist. Steinberg's position was that he signed the letter only because Windsor had a pressing engagement elsewhere. However, it is clear that Steinberg was somewhat mixed up with respect to this letter. In cross-examination he was asked by Mr. Newbould concerning the press release of March 15, 1991, which discussed legal proceedings against Windsor, Boyden and Steinberg (and note the date involved):

> "QUESTION: Isn't it that press release that gave rise to this flurry of correspondence dated March 14 and March 19, 1991 and the press release of March 19?
>
> ANSWER: Yes."

Windsor apparently helped Steinberg in drafting the March 19, 1991, letter and press release. In passing I find it likely that the March 14th letter did not indicate the bankruptcy proceedings were then in the works so as to try to shield Windsor, Boyden and Steinberg from this element of involvement.

Scythes contributed $1,500 to the bankruptcy proceedings. It had a receivable from DDI and about $250,000 of inventory it could not dispose of. Scythes apparently hoped that a successful bankruptcy petition would allow it to more easily dispose of this inventory.

According to Rent, Boyden called him at Professional when he heard Dent was not signing. When Rent explained that it was because he had not got the expense capping letter; something clicked. Dent forthwith got the capping letter from Uliani.

As well the evidence shows that Boyden met with management of Scythes in February 1991 and advised them of the fight with current management. During this meeting, there was this discussion about bankruptcy as Scythes had previously received a call from Uliani. Scythes had declined to contribute the amount requested, $10,000, but Boyden advised that the amount they would have to contribute would be less than Uliani's suggestion. Boyden also advised them of the name of Hahn as the trustee. Scythes has acknowledged that if there were a successful petition in bankruptcy, that the product invoiced to DDI could conceivably be the property of the trustee in bankruptcy.

Further it appears that in March 1991, Windsor and Boyden approached Scythes about a "new" diaper product. They also indicated they would attempt to sell some of the Dimples inventory Scythes had in its possession. At Windsor's request, Scythes after snipping off the labels and eliminating any Dimples packaging, sent samples to the U.S.

Concerning the purpose of the bankruptcy proceedings the following should be noted: Uliani advised Dent at Professional that Windsor would get back the Dimples trademark and licence and that if so there was a better choice of collecting money from Windsor than from Dimples. Simpson of Paperboard told another executive Doyle that DDI had no assets or money to pay Paperboard,

with the result being that the petition against DDI might be considered or described as a punitive action. Paperboard was aware of the termination provisions of the licence before the petition. Paperboard as well hoped to recoup its debt from a resurrection of Windsor in business.

Scythes did not feel that it could recover any money from the petition but felt it would assist in getting its money for its inventory. If DDI were no longer in business, there would be less chance of anyone complaining about Scythes selling someone else's product. Scythes knew that in the event of bankruptcy, the licence could be terminated.

Uliani also held out hopes for the recoupment of his money if Windsor could get back into diapering. He then attempted to explain his traitorous offer whereby he was going to distance himself from Windsor, Boyden and Steinberg and come over to Elliott's side for 301000 shares of D Group I as a put up or hoax - something to confound the enemy. There was the suggestion, that he was just baiting DuVernet. However car whatever it was, it does show that Uliani appreciated the nature of the battle no matter whose side he was on at that time.

Windsor continued to try to make life miserable for D Group I and Elliott. She persisted in making complaints to the VSE. She alleged that Elliott and others were "scientologists", apparently feeling that this term or affiliation carries with it some mark of reprobation; Elliott denied being one in any event. Williams said that Windsor advised that she would be able to regain the diaper rights in a bankruptcy and thereafter take the benefit of a proposed financing and joint venture agreement.

Peter Simpson, the principal of Peng Packaging, testified that in early 1991 he received a call from Windsor that there was going to be a creditors' meeting and that. Boyden would be calling him. Boyden did call and advise that if a petition were successful, it would allow BLHI to get the diaper assets hack.

In early February 1991, Boyden and Windsor attended Crown Thompson and asked her to contribute to the bankruptcy petition. Crown Thompson had been friendly with Windsor and felt sorry for her. Vis-a-vis Windsor's involvement with Boyden, Crown Thompson was willing to believe Windsor if she advised Crown Thompson that Boyden was "green with purple stripes" or some other colour combination. Crown Thompson advised that it was for this reason that she had not mentioned Boyden and Windsor attending on her concerning the bankruptcy petition trying to engage her support in her June 992 testimony. However, she was troubled after this testimony and she recanted it at the resumption of the hearings this year. She was supported in her position by her husband.

Trying to reconstruct the truth from the testimony of this trial reminds one of the task given the King's men and horses in the tale of Humpty-Dumpty. However, the following is a useful guideline. Boyden did not testify it was suggested only through his other legal difficulties. Given the ample evidence given by others whose testimony appeared sound to me of his involvement in the bankruptcy question, it may not have been necessary for him to do so. Windsor has little regard for the legal process. During Steinberg's cross-examination, I caught her gesturing and mouthing answers to him at the same time, no mean feat. The solution (with apologies to Rube Goldberg) was to put her behind a pillar in the courtroom where she could hear but not be seen by the witness. However, in keeping an eye on her, I had to remind her on numerous occasions to stop edging out from behind the pillar. At times she appeared to testify as if "possessed" claiming a monopoly on good and indicating that the other side was only had, a side it is to be noted was invited in by her lover Boyden who had prior experience with Elliott. Windsor gave multiple conflicting statements as to

what she knew of the petition. Steinberg gave his evidence in an evasive manner; he would have us believe that there was a blank for six odd months and then a return to the fray in the third week of March 1991 (but not concerning the bankruptcy matter) when the tocsin was sounded. His signing the March 14th letter because Windsor had an engagement defies ordinary belief. By attempting to distance himself, he gets more caught up in the web. Helen's position was that she was an unthinking conduit for Steinberg's and Windsor's words from month to paper. Uliani did not testify with any great sense of reality. He found his friends to be Windsor and Boyden. He found his enemy to be Elliott who disappointed him by not paying what he says was agreed. He then started his crusade in league with Boyden and Windsor. Russell suffers from her association with Uliani. Lest it be thought that this was a walk over on the credibility question for Elliott, I would have to note that I was very skeptical of portions - such as the review committee and that it is only because of the others I have mentioned being so had that I would have to prefer his evidence to theirs where there was a difference. As to the remainder who testified, I found that those with no direct involvement gave generally straightforward testimony. With those who were more intricated, there was the usual wobble.

If this were an ordinary petition in bankruptcy I would have no hesitation in granting the petition. DDI is clearly insolvent. The actions of Elliott and D Group I have resulted apparently in whatever assets DDI might have had in being transferred to D Group I. Even if these were restored, it is questionable what value they might have given the disastrous operating results DDI suffered from. The act of bankruptcy is clear in that DDI failed to meet its obligations as they became due. The debts of ten creditors were proven. Some were settled by D Group I after the petition. However, it is clear that a number of undisputable accounts were not paid prior to the petition and that DDI had in effect closed its doors. The debts of the petitioners were in excess of $1,000 (each, even with the substitution of Grand & Toy for Professional). There is no doubt that Paperboard is owed some money given the authorizations that were given to it by the people who were then in charge of DDI. If there were errors concerning the packaging, they do not appear to be all one-sided. There is no necessity to show that DDI stopped paying its accounts in total since "generally" has been held to mean essentially in a material number of material cases: See Re Hugh M. Grant Ltd. (1982), 41 CBR (NS) 28 (Ont. SC).

It does not matter that D Group I has been able pay or otherwise compromise some of the debts since it is he condition of the debtor at the time of the filing of the petition that is in issue: See Re Relectra Limited (1979), 30 CBR (NS) 141 (Ont. SC). This case also stands for the proposition that the creditor should not have to rely upon the goodwill of a controlling shareholder to make good on the debts of the subsidiary. I also note that the mere existence of a dispute between the petitioning creditor and the debtor as to liability does not necessarily mean that the petition will be dismissed if the other facts alleged in the petition are established, namely, that the debtor has committed an act as of bankruptcy: See Re Vermillion Placers Inc. (1982), 41 CBR (NS) 173 (Ont SC).

Ordinarily, if it is to the benefit of the parties that an independent trustee investigate the affairs of a debtor, then a receiving order should issue: See Re 676915 Ontario Ltd (1989), 76 CBR (NS) 164 (Ont. SC). However, the Bankruptcy Act RSC 1985 c. C-3 has as its purpose the provision of "the orderly and fair distribution of the property of the bankrupt among its creditors on a pari passu basis." (Houlden and Morawetz, Bankruptcy law of Canada, 3rd ed. p. 1-3). Re De La Hooke (1934), 15 CBR 485 (Ont. SC) held that the petition must not be filed for some collateral purpose. In that case, the petition was dismissed since it as found to be filed for the purpose of removing a

business competitor who was using a similar trade name. Houlden and Morawetz went on to say at page 2-45:

> "When the effect of an agreement between the petitioning creditor and some non-creditors was to embroil the petitioning creditor in an improper objective of the purchasers of a business who as non-creditors had no status in the bankruptcy proceedings and were intermeddling in it, and the objective was to bring about the bankruptcy of the debtors, held - the whole proceeding was tainted and the Petition must be dismissed: Re Pappy's Good Eats Ltd. (1985), 56 CBR (NS) 334 (Ont. SC).
>
> Where a petition is inspired by spite and a spirit of revenge the court will not grant a receiving order: Re Vipond (1941), 21 CBR 129 affirmed 22 CBR 268 (Que. CA), see Re Westlake (1984), 53 CBR (NS) 207 (Ont. SC)."

While the punitive action proposition may not be viewed as a question of spite or revenge of the type envisaged, it is clear that the suggestion that the "menace be removed from the street" as related by Russell comes close to going over the line that one might tolerate in the business world. Is it as appropriate to club the cornered wounded rat to eliminate the chance that it will bite someone else before it crawls off to die from the rat poison it has ingested? However, Uliani's crusade in which Boyden and Windsor are inextricably involved reeks of the vengeance element referred to in Westlake.

> As Henry J. said at page 313 of Pappy's: "Mr. Endicott submits that any impropriety is on the part of the other parties because Northeast Land Inc. always had, and continues to have, the right to prosecute the petition which it intended to do in any event; he says that the petitioning creditor simply had an opportunity to obtain a payment that would guarantee it some return on the judgment debt regardless of the failure of dividends and that this was an innocent purpose. I do not agree. The effect of the agreement is to embroil the petitioning creditor in the improper objective of the purchasers who as non-creditors have no status in these proceedings and are intermeddling in it. The whole proceeding thus is inescapably tainted; the petition must be dismissed."

Clearly in the subject case it was the objective of Boyden, Windsor and Steinberg to get back the Dimples trademark and business opportunity. They attempted to do so in a number of ways including the bankruptcy proceedings which I find that Boyden, Windsor and Uliani were involved (and likely that Boyden and Windsor were masterminding through their henchman Uliani) and the March 14, 1991, letter allegations as I find Windsor and Steinberg to have been jointly and knowledgeably involved in.

Then there is the question of the Vendetta against DDI, D Group I and in particular those who controlled it now, Elliott and Read. Paperboard cannot claim that it was an unsuspecting party participant in the bankruptcy petition it was looking for a phoenix rising from the ashes from which to recover its debt. Professional suffered from the same condition. Scythes although a non-petitioner had the further aim of avoiding any problem with its potential disposal of the Dimples inventory.

I do not see that this petition is to be saved by the introduction of Grand & Toy which replaced Professional as petitioning creditor. It merely stepped into Professional's shoes pursuant to my ruling of June 23, 1992. It might have been a different result if this petitioner (Grand & Toy) had initiated its own independent petition since there was no allegation of linking it with the inappropriate actions of the others.

I, therefore, find that the bankruptcy petition against DDI is to be dismissed solely because it was brought for an improper purpose which cannot be excised from the bankruptcy Proceedings.

Improper Purpose Civil Lawsuit

Let me now turn to the abuse of process/conspiracy claim. The tort of abuse of process consists in the misuse of a legal process for any purpose other than that which it was designed to serve. It is immaterial in establishing abuse of process that the process was properly commenced or founded by the defendants and it does not matter that the process be concluded in the instigator's favour. The improper purpose is the gravamen of liability. See Unterreiner v. Wilson (1982), 40 O.R. (2d) 197 (HCJ) at p. 203, appeal dismissed (3983), 41 O.R. (2d) 472, (CA), and Fleming, the Law of Torts, seventh edition (1987) pp. 591-2.

Potts J. in R. Cholkan and Co. v. Brinker (1990), 40 CPC (2d) 6 at p. 8 said:

> "Most recently, Montgomery J. writing for the Divisional Court in Bentham v. Rothbart (1989), 36 O.A.C. 13 (Div. Ct.) stated:
>
> The constituent elements of the tort of abuse of process are:
>
> (a) a collateral and improper purpose such as extortion; and
> (b) a definitive act or threat in furtherance of a purpose not legitimate in the use of the process."

The Supreme Court of Canada in Canada Cement LaFarge Ltd et al. v. British Columbia Lightweight Aggregate Ltd et al. (1983), 145 D.L.R. (3d) 385 held that the tort of conspiracy to injure is available to a plaintiff in two situations: (1) where the predominant purpose of the defendants' conduct is to cause injury to the plaintiff, whether the means used by the defendants are lawful or unlawful; and (2) where the conduct of the defendants is lawful, the conduct is directed towards the plaintiff (alone or with others) and the defendants should know in the circumstances that injury to the plaintiff is likely to and does result.

Callaghan J. in Ontario Society for the Prevention of Cruelty to Animals v. Ontario Veterinary Association et al. (1985), 51 O.R. (2d) 183 (HCJ) indicated at p. 187 that:

> "The cause of action in conspiracy does not arise until special damage is sustained or the threat of such damage is imminent."

DDI submits that the actions of Windsor, Uliani and Steinberg in writing or contacting the VSE and of Helen in signing and releasing the press release of March 19, 1991, which was sent to Stock Watch, were definitive actions in furtherance of the improper purposes for bringing the bankruptcy Petition. It is obvious that the VSE was concerned about the petition; it wrote DuVernet on April 23, 1991, and expressed its concern and demanded a press release on the matter. The complaints would appear directed at getting the VSE to stop trading in the shares or to arouse the public

shareholders to take action and dump the stock, thereby effectively halting the then Elliott-Read promotion.

As Fleming supra said at p. 592:

> "In order to be improper the ulterior advantage must be one not reasonably related to the subject matter of the litigation and but for which the defendant would not have commenced the proceedings."

Scythes indicated in discovery that it wished to have DDI found bankrupt to ease the path of realizing an inventory which Scythes held for DDI. The plaintiffs have asked that their Statement of Claim be amended in this regard. I find no prejudice to Scythes in doing so and I grant this request under rule 26.

Care should be taken not to open up the flood gate of the tart of abuse of process. As Eberle J. said in Teledata Communications Inc. v. Westburn Industrial Enterprises Ltd (1990), 71 O.R. (2d) 466 (HCJ) at pp. 469-70:

> "...I agree with the authors of 25 Hals. 3rd ed, p. 367, under the heading of 'Malicious Abuse of Civil Proceedings' where they write as follows:
>
> > 'The law allows every person to employ its process for the purpose of asserting his rights without subjecting him to any liability other than the liability to pay the cost of the proceedings if unsuccessful.'
>
> This is the basis an which our system of litigation operates and has long operated."

While Scythes may he criticized for its support financially of the bankruptcy petition with a view to smooth its path of inventory disposal, I do not see that it has taken any definitive act or threat, as have Boyden,, Uliani and Windsor, in furtherance of that illegitimate purpose. It would seem that if it is to be found liable, it would have to be brought the basis of conspiracy tort.

Saunders J. in Re Aarvi Construction Company Ltd. (1978), 29 CBR (NS) 265 (Ont. SC) said at p. 267:

> "There is authority for the proposition that the bankruptcy court is not to be used as a collection agency, and any such use is an abuse of process. Such a proposition is analogous to the use of the criminal process to put pressure on a debtor to satisfy his obligations to a specific creditor. This does not mean that a petitioning creditor cannot have the collection of the debt owing to him as one of the purposes of instituting bankruptcy proceedings. In fact, in the realities of commercial world it has to he recognized that this is always an important, if not the principal, purpose of a creditor going to the expense of launching a petition in bankruptcy."

Grey J. in Re Arnco Business Services Limited (1983), 49 CBR (NS) 188 (Ont. SC) cited Aarvi with approval at p. 194.

The plaintiffs, however, referred to the Paperboard internal memorandum which states that Paperboard "had been given assurance by Rhonda (i.e. better than nothing) that if she regained control of the company, she would pay the debt" as being the consideration for Paperboard's assistance in the bankruptcy petition. I would think that even if Paperboard relied on this, although it would appear that it severely discounted the proposition, it would seem that Paperboard was only interested in collecting its debt.

I have found that the trio of Boyden, Windsor and Uliani were instrumental in arranging the Petition in bankruptcy for the ulterior motive of getting back the Dimples business aside from discrediting Elliott. While one might. be suspicious of the involvement of Steinberg (and possibly Helen) I found no linkage between them in the bankruptcy petition notwithstanding their involvement in the March 14 and 19th, 1991, correspondence and press releases.

Russell was involved in this matter through her relationship with Uliani; there was no evidence that would so involve her as a conscious effort in this matter. Uliani was the guiding mind of United Studios, which apparently is only a business style.

Professional and the plaintiffs settled and it was allowed to withdraw from the bankruptcy petition. While one might be extremely critical of Paperboard and Scythes as to their respective involvements in the bankruptcy Petition, I did not find the evidence sufficient to show that they were otherwise than stooges who were gulled into doing the dirty work of the mastermind trio while thinking they were in fact furthering their own best interests. See Maguire v. Calgary (1983), 43 A.R. 268 (C.A.) and Humble Investments Ltd v. Teachers' Investments (1982), 41 A.R. 176 (QB).

I, therefore, find only Windsor, Boyden and Uliani liable for abuse of process and conspiracy. The other defendants, however, should not have their costs against the plaintiffs given their degree of involvement. The plaintiffs might, with some justification, have felt that where there was smoke, there might well be fire.

What can he recovered front those defendants I have found liable? While it is true that the English rule involved in Quartz Hill Mining Co. v. Eyre (1883), 11 QBD 674 (CA) and Hathaway v. Barrow (1807) 1 Camp. 151 have been criticized by the English Court of Appeal in Berry v. British Transport Commission [1962] QBD 306, I think that as to the costs of defending the bankruptcy Petition, there should be recognition that an independent petition by Grand & Toy from the start might well have been successful. I would think that compensation for a successful defence in a bankruptcy petition should be restricted to those situations in which the debtor succeeds on the merits - that is, on the debtor's own merits and not because of any demerits by the petitioners or those who have orchestrated the petitioners.

However, it would appear to me that the special damages of the plaintiffs concerning the attendances upon the VSE have been proved with sufficient particularity at $22,216.82. There is to be judgment against Windsor, Boyden and Uliani for such amount.

MR. NEWBOULD: What was that amount, my lord?

THE COURT: $22.216.82.

MR. NEWBOULD: Thank you.

THE COURT: I will now entertain submissions with respect to costs.

-- NOTE: Submissions not recorded.

THE COURT: All right. It is, in my view, given the nature of the bankruptcy petition and the defence that was involved in it, that it is truly a case where the parties should bear their own expenses. With respect to the civil action, there will be costs awarded on a party and party basis against Rhonda Windsor-Maxwell, Anthony R. Boyden and Ron to Uliani, with respect to the civil action itself, and, therefore, there will be a requirement to segregate the amount from the bankruptcy petition defence.

Now, are those four parties able to determine that at the present time or what is the best way of proceeding with respect to that?

-- NOTE: Further discussion takes place.

THE COURT: I have endorsed the bankruptcy petition: August 25, 1992, oral reasons. Petition dismissed. Parties to bear own costs. And the abuse of process action: August 25, 1992, oral reasons. Judgment against Windsor-Maxwell, Boyden and Uliani for $22,216.82 including costs on party and party basis. If these interested parties are not able to work out the amounts, I may be spoken to.

MR. NEWBOULD: Should you endorse the record action dismissed against other defendants without costs?

THE COURT: All right. Thank you.

MR. NEW-BOULD: Thank you, Your Honour.

TAB 8

Case Name:

Blackburn Developments Ltd. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended
AND IN THE MATTER OF the Business Corporations Act, S.B.C. 2002, c. 57
AND IN THE MATTER OF Blackburn Developments Ltd., Petitioner

[2011] B.C.J. No. 2360

2011 BCSC 1671

27 B.C.L.R. (5th) 199

209 A.C.W.S. (3d) 315

2011 CarswellBC 3291

Docket: S111150

Registry: Vancouver

British Columbia Supreme Court
Vancouver, British Columbia

R.J. Sewell J.

Heard: November 24 and 25, 2011.
Judgment: December 7, 2011.

(54 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- Proposals -- Meetings of creditors -- Application by the Monitor of a company protected under the Act to disallow votes of a company that acquired assets of the protected company and to approve plan of arrangement entered into with another company -- Acquiring company obtained sufficient assets to defeat plan of arrangement -- Application dismissed -- Company's conduct was not an abuse of profit or was tortious and it did not result in substantial injustice -- It was bona fide party that sought to participate in restructuring of protected company -- Since plan was defeated there was no plan to be approved.

Application by the Monitor PricewaterhouseCoopers Inc. to disallow the votes of Streetwise Capital Partners Inc. Those votes were cast at a creditors' meeting held on November 21, 2011 to consider the plan of arrangement of Blackburn Developments Ltd. made by the Monitor with Pinnacle International Lands Inc. under the Companies' Creditors Arrangement Act. The Monitor also sought approval for the

Pinnacle Plan. Blackburn was a real estate development company that undertook a very large residential real estate development project. It granted a large number of mortgages over its land. By 2010 Blackburn was insolvent. While many creditors had mortgage security, the value of the properties charged was not sufficient to satisfy the amounts secured by the mortgages. Most of the mortgage creditors were unsecured or faced large deficiencies. In February 2011 Blackburn sought protection under the Act and on February 23, 2011 it obtained an order that granted a stay of proceedings to permit to the prepare its plan. The Monitor managed to enter into an agreement with Pinnacle in September. Under the plan Pinnacle agreed to provide sufficient funds to Blackburn to pay senior secured debt. Pinnacle would become Blackburn's sole shareholder and it would acquire its attributes, including its tax attributes. The plan would only go ahead if it was approved by Blackburn's creditors. Blackburn continued to pursue a restructuring plan. The only interested party was Streetwise. Streetwise specialized in realizing value from financially distressed enterprises. By August 30 Blackburn concluded that Streetwise's restructuring proposal offered the best recovery for creditors. It sent an email to most of its unsecured creditors to solicit support for the Streetwise proposal. The email included a letter of intent that bound any creditor signing it to assign its claim against Blackburn to Streetwise for two cents on the dollar. By September 30 Streetwise received sufficient signed letters of intent that ensured it could defeat any plan proposed under the Act. The Monitor did not accept Streetwise's proposed transaction because one of the largest creditors did not support it. The Court approved the agreement with Pinnacle on September 30. On October 5, 2011 the Court ordered the Monitor to execute the Pinnacle agreement because Blackburn no longer had directors who could do so. Blackburn was ordered to cease its restructuring activities. At the November 21 meeting Streetwise voted all of its claims against the Pinnacle Plan and it was defeated. The Monitor wanted to disallow Streetwise's votes. If such occurred the plan would be supported by sufficient creditors to be approved under the Act.

HELD: Application dismissed. The Court would not disallow Streetwise's votes, Streetwise's conduct was not an abuse of process, or was tortious, and its conduct did not result in a substantial injustice. Streetwise acted as a bona fide party who sought to participate in the restructuring of Blackburn up to September 30, 2011. Blackburn had the right to pursue a restructuring up to that date. Streetwise became involved in the proceeding when it was known that Blackburn's assets were being offered for sale. It did not act in bad faith when it acquired creditor claims even though it partly did so to acquire a blocking position. Since Streetwise's votes were not disallowed there was no plan to be approved.

Statutes, Regulations and Rules Cited:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 187(9)

Business Corporations Act, SBC 2002, CHAPTER 57,

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

Counsel:

Counsel for PricewaterhouseCoopers Inc.: K. Jackson, D. Toigo.

Counsel for Home Equity Development Inc. and Landus Development Group Inc.: J. Sandrelli.

Counsel for Pinnacle International Lands Inc.: W. Milman.

Counsel for Streetwise Capital Partners Inc.: D. Gruber, T. Louman-Gardiner.

Counsel for Christina Friesen and Martin Biggerstaff: B. Friesen.

Counsel for R. Wellsby and R. Wilson: D. Fitzpatrick.

Reasons for Judgment

1 **R.J. SEWELL J.**:-- The petitioner, Blackburn Developments Ltd. ("Blackburn"), is a real estate development company that undertook a very large residential real estate development project near Chilliwack, British Columbia. The development went on for many years. Blackburn sold some lots. In order to meet its financial obligations over the years it granted a large number of mortgages over its development lands and a golf course that was an important part of the development.

2 By 2010 and probably before, Blackburn was insolvent. It had incurred many millions of dollars of losses and owed its creditors, both secured and unsecured, in excess of $80,000,000. While many creditors had mortgage security over the Blackburn real estate portfolio, the value of the properties charged was not sufficient to satisfy the amounts secured by the mortgages and most mortgage creditors were in fact unsecured or faced large deficiencies. Despite Blackburn's difficulties, its management was still hopeful of restructuring its affairs. It was recognized that it had potentially valuable losses that could be monetized through a corporate reorganization. However, it was far behind in preparing its financial statements and filing its required income tax returns, and it was therefore impossible to value its tax attributes.

3 In February 2011 Blackburn sought protection pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 [*CCAA*]. On February 23, 2011 it obtained an order (the "Initial Order") granting a stay of proceedings against it to permit it to prepare a plan of arrangement (the "Plan") to present to its creditors.

4 From the outset of these proceedings it was apparent that Blackburn had two potential sources of funds to finance the Plan. The first was the development potential of its real estate holdings. The second was its tax attributes. It was also apparent that Blackburn faced formidable obstacles to completing a Plan. These included the chaotic state of its financial records, its lack of liquidity, the complicated state of the title to its real estate holdings, and the scepticism of some of its secured creditors about its ability to bring forward an acceptable plan.

5 These obstacles were addressed in part by the adoption of what has come to be known as a two track process in the *CCAA* proceedings by which Blackburn pursued a restructuring plan and the Monitor, PricewaterhouseCoopers, marketed its assets. This provided Blackburn with a chance to restructure and gave some comfort to its secured creditors that realization on their security would not be unduly delayed.

6 Initially the focus of the Monitor's marketing efforts was on the company's real estate and related assets. The potential of marketing the real estate and tax attributes through a reorganization was recognized but was not the primary focus of the early applications before me.

7 The applications addressed in these reasons arise partially out of the collision of the two processes. There are three applications, all by the Monitor. They are:

a. to disallow the votes of Streetwise Capital Partners Inc. ("Streetwise") cast at the creditors' meeting held to consider the Plan;
b. to sanction the Plan;

c. to extend the stay of proceedings to January 15, 2012.

8 The history of this proceeding is well known to the parties and need not be repeated in detail. By July 2011, the financial, tax and accounting records of Blackburn had been brought up to date, giving a clearer picture of the value of its tax attributes. The Monitor was in a position to begin the process of negotiating and finalizing an asset sale agreement. On July 22, 2011 I made an order (the "Claims Procedure Order") approving a claims procedure that authorized the Monitor to undertake a claims process. Paragraphs 22 and 23 of the Claims Procedure Order provided for assignment of claims and expressly stated that the assignee of a claim was entitled to vote that claim, provided it complied with the provisions of paragraph 23.

9 After July 22, management of Blackburn continued to pursue a restructuring as contemplated in the Initial Order.

10 With the benefit of hindsight it can now be seen that the two track process had a fundamental flaw. It was based on the erroneous assumption that an asset sale and a restructuring could be separately negotiated. In fact the Monitor was unable to negotiate any asset sale that was not effected through a restructuring.

11 It was able to enter into a Restructuring Term Sheet (the "Pinnacle RTS") with Pinnacle International Lands Inc. ("Pinnacle") in September 2011. As the name discloses, a restructuring was an essential part of the Pinnacle RTS. In the Pinnacle RTS, Pinnacle agreed to provide sufficient funds to Blackburn to pay senior secured debt and, through a corporate arrangement, ultimately become the sole shareholder of Blackburn. It would thereby acquire Blackburn's attributes. An essential step in the process therefore was approval by Blackburn's creditors of a plan of arrangement implementing the Pinnacle RTS.

12 In the period up to August 30, 2011 management of Blackburn pursued a restructuring, as contemplated in the Initial Order. The only entity that showed a serious interest in pursuing a restructuring with Blackburn was Streetwise, a company that specialized in realizing value from financially distressed enterprises. Streetwise is a self-described "vulture fund". By August 30, 2011, discussions between management of Blackburn and Streetwise had advanced to the point that the directors of Blackburn had concluded that Streetwise's restructuring proposal offered the best recovery for creditors.

13 On August 30, Mr. Rick Wellsby, one of the two directors of Blackburn, sent an email to most of the unsecured creditors of Blackburn soliciting their support for the Streetwise proposal. The email was criticized in the Monitor's submissions to me. I will return to those criticisms later in these reasons. The email attached a letter of intent that bound any creditor signing it to assign its claim against Blackburn to Streetwise for 2 cents on the dollar plus certain additional consideration.

14 Many creditors executed letters of intent. The letters of intent contained conditions precedent in favour of Streetwise that gave Streetwise until October 15, 2011 to satisfy itself that it had sufficient support for its proposed restructuring to proceed with it. For all practical purposes, the executed letters of intent were options in favour of Streetwise. By September 30, Streetwise had received sufficient signed letters of intent to ensure that, if it acted upon them, it could defeat any plan proposed pursuant to the *CCAA*.

15 On September 16, 2011, Streetwise proposed a transaction to the Monitor pursuant to which Streetwise would become the sole shareholder of Blackburn and acquire its tax attributes through a restructuring that required a plan of arrangement. Streetwise proposed a capital contribution, payment of a portion of the restructuring costs and payment of $1,250,000 as a fund to make a distribution to

unsecured creditors. The principal difference between the Pinnacle and Streetwise proposals was that the Pinnacle proposal called for Blackburn to retain its real estate holdings and provided sufficient capital to satisfy senior secured claims while the Streetwise proposal called for a disposition of those real estate assets, except for the golf course.

16 The Monitor did not pursue Streetwise's proposal for the reasons set out in paragraph 3.10 of the Monitor's 11th Report. Among those reasons was the fact that the Landus Group ("Landus") did not support the proposed transaction and in the Monitor's view no restructuring proposal could succeed without the support of Landus because Landus held sufficient unsecured claims to defeat any plan. On September 23, the Monitor informed Streetwise that it was moving forward with a preferred bidder.

17 On September 30, I approved The Pinnacle RTS on the recommendation of the Monitor. As part of that order I directed Blackburn to execute the Pinnacle RTS. I did so despite the fact that Streetwise sought to have the Monitor or the Court consider a revised offer from it. While I have already given my reasons for approving the Pinnacle RTS I repeat that I was concerned that the *CCAA* proceedings had already become prolonged, that restructuring costs were mounting alarmingly and that the Streetwise proposal did not have the support of Landus, without whose support no Plan could be approved.

18 However, Blackburn was unable to execute the Pinnacle RTS because both its directors, Messrs. Wellsby and Wilson, resigned. On October 5, I made a further order authorizing the Monitor to execute the Pinnacle RTS on behalf of Blackburn and to take the steps necessary to bring the a plan of arrangement implementing the Pinnacle RTS (the "Pinnacle Plan") to a meeting of creditors for approval. At the same time I ordered that Blackburn and its principals, including its former directors, cease restructuring activities.

19 In my brief oral reasons I tried to make it clear that I was in no way restricting any creditor from exercising its rights to oppose the Pinnacle Plan or to persuade other creditors to vote against it.

20 Streetwise did not appeal the September 30 order. However it did proceed to acquire the claims of those creditors who had signed letters of intent prior to September 30 and to purchase other claims. As a result Streetwise had by the end of October acquired claims in the amount of approximately $38,000,000, including approximately $7,500,000 in related party claims. The related party claims are subject to a challenge. However, even excluding those claims, Streetwise was the assignee of $30,500,000 in claims, more than sufficient to defeat the implementing of the Pinnacle Plan.

21 At the meeting of creditors held on November 21 Streetwise voted all its claims against approval of the Pinnacle Plan and it was defeated. However, the Monitor, supported by Landus and Pinnacle, seeks an order disallowing Streetwise's votes. If those votes are disallowed the result will be that the Pinnacle Plan will be approved by a sufficient number of creditors to be approved in accordance with s. 6 of the *CCAA*.

22 The Monitor submits that I have the discretionary jurisdiction to disallow Streetwise's votes, but not its right to receive a dividend, on its claims. It submits that I should exercise that jurisdiction to disallow the votes if I conclude that Streetwise has not acted in good faith and has voted its claims for a collateral and improper purpose. The Monitor concedes that there is no express provision in the *CCAA* permitting the court to disallow votes of a person who is a creditor. However, it submits that the broad discretion granted by s. 11 of the *CCAA* extents to controlling any conduct done in bad faith, particularly if that conduct has the effect of frustrating the due process of the administration of a *CCAA* plan. The Monitor says that that control extends to a power to disallow votes.

23 The Monitor relies on three authorities, two from the United States and one from Nova Scotia, to support the proposition that a court exercising supervisory jurisdiction over an insolvency matter has the

jurisdiction to disallow votes of creditors if those votes are cast for an improper purpose. Counsel for all parties agreed that this question has not previously been considered in Canada in *CCAA* proceedings.

24 The Monitor submits that Streetwise did not act in good faith when it voted against the Pinnacle Plan. The Monitor says that Streetwise acquired sufficient claims to block approval of the Plan as part of a scheme to defeat the Pinnacle Plan for the purpose of getting a second chance to acquire Blackburn's tax attributes for itself. The Monitor submits that it was improper for Streetwise to buy up claims and vote those claims in order to allow it to force the other interested parties to reconsider its offer for the tax attributes.

25 Streetwise submits that I have no jurisdiction to disallow votes by a creditor who has obtained its status in accordance with the Claims Procedure Order because in so doing I would be depriving that creditor of an express statutory right given by the *CCAA*. It also submits that the facts of this case do not call for making such an order even if I have jurisdiction to do so. Streetwise's position is that it has participated in good faith in the very process contemplated by the Initial Order and that it has acted throughout in the *bona fide* belief that there is more value to unsecured creditors than is provided by the Pinnacle RTS.

26 The three cases relied on by the Monitor are *In re Allegheny International Inc.*, 118 B.R. 282 (Bankr. W.D. Pa. 1990) [*Allegheny*], *In re DBSB North America Inc.*, 421 B.R. 133 (Bankr. S.D.N.Y., 2009) [*DBSB*], and *Re Laserworks Computer Services Inc.* (1997), 6 C.B.R. (4th) 69, [1998] N.S.J. No. 60 (CA) [*Laserworks*].

27 In this case Streetwise undoubtedly became involved in the Blackburn *CCAA* proceedings because it wished to acquire the tax attributes of Blackburn for itself. This is obvious from the terms of its September 16th offer to the Monitor. However the critical question is not why Streetwise first became interested in Blackburn but whether it voted against the Plan for an improper purpose. In deciding this matter I must proceed on the basis that Streetwise is a creditor pursuant to legally valid assignments. It is of course implicit in the position taken by the Monitor that Streetwise is entitled to share in the distribution to creditors that this is so.

28 I do not find it necessary to decide whether a judge supervising a *CCAA* proceeding has the jurisdiction to disallow the votes of a creditor while at the same time recognizing that the creditor has a valid claim for purposes of distribution. As is often the case in *CCAA* matters, the parties urgently require a decision. I will therefore proceed on the assumption that I have that jurisdiction. In so doing, I will attempt to adopt the analysis and apply the principles set out in *Laserworks*.

29 *Laserworks* was a case decided in the context of a proposal under the *Bankruptcy and Insolvency Act* [*BIA*]. In that case *Laserworks* made a proposal to its creditors. A competitor purchased sufficient claims to allow it to defeat the proposal. Under the *BIA* this had the effect of putting *Laserworks* into bankruptcy, thereby eliminating it as a competitor, the very purpose for which the competitor had purchased the claims. The remaining creditors favoured approval of the proposal. The Nova Scotia Court of Appeal found that the creditor had voted its claims for an improper purpose and that the Registrar had the discretion to disallow the votes of that creditor.

30 In *Laserworks,* the court set out the basis on which it thought it appropriate to intervene to disallow votes at paras. 50-56 as follows:

> 50 Motive or purpose is not relevant to objections to proofs of claim based on statutory exceptions under the BIA. These are established in several sections, including s. 109(1), persons who had not duly proved and lodged a claim; s. 54(3), a relative of the debtor (who may vote against but not for a proposal); 109(4), the

debtor as proxy for a creditor; s. 109(6), a creditor who did not deal with the debtor at arm's length (with exceptions); s. 110(1), a person with a claim acquired after the bankruptcy unless the entire claim is acquired; s. 111, a creditor with a claim on or secured by a current bill of exchange (subject to conditions); s. 112, a creditor holding security (subject to conditions); and s. 113(2), a trustee as proxy (subject to restrictions). See also s. 109, the trustee as creditor.

51 (It will be noted that many of these exceptions arise from circumstances that could give rise to conflict of interest. This will be considered further under the fourth ground of appeal.)

52 However the statutory exceptions are not a code exhausting the forms in which substantial injustice may manifest itself. Objections will be sustained under s. 108(3) if they result from a crime or a tort against the debtor or a creditor. In the present appeal, and in the authorities cited by the Registrar, the substantial injustice assumes the guise of tortious behavior, to which motive is relevant. In the s. 108(3) context the commonest torts, or instances of substantial injustice arising from tortious behavior, relate to abuse of process and fraud. However conspiracy to harm was also found in *Dimples Diapers*, [1992] O.J. No. 1961.

53 Tortious or tort-like behavior falling short of a fully developed tort susceptible of formal proof or definition can nevertheless result in substantial injustice, particularly for persons at a point so vulnerable they must resort to insolvency protection. (See *Shepard*, [1996] M.J. No. 203.) In my view that is why Parliament chose the language it did in s. 187(9): to create a discretionary jurisdiction in courts that is not fettered, for example, by the high standards required for establishing such torts as abuse of process in other contexts. What remains to be considered is the threshold level of the substantial injustice which will result in remedial action by the court.

(ii) The Authorities

54 The four cases cited by the Registrar establish that the threshold is crossed when the BIA is used for an improper purpose. An improper purpose is any purpose collateral to the purpose for which the bankruptcy and insolvency legislation was enacted by Parliament.

55 Farley J. held in *Dimples Diapers* that:

> . . . the *Bankruptcy Act*, R.S.C. 1985, c. B-3 has as its purpose the provision of "the orderly and fair distribution of the property of a bankrupt among its creditors on a pari passu basis". (L.W. Houlden and C.H. Morawetz, Bankruptcy Law of Canada, 3rd ed. (looseleaf) (Toronto: Carswell, 1989) at p. 1-3 [A&4]. ...

56 In the cases cited the improper purpose takes the form of abuse of process or tortious behavior closely analogous to abuse of process. In each case the court reacted to what could be seen as substantial injustice. The remedy of choice arising under s. 43(7) is refusal of the petition. The appropriate remedy in the present case is rejection of the tainted votes.

31 The court elaborated on the concept of substantial injustice at paras. 72-74, in a portion of the

judgment dealing with class voting, as follows:

> 72 Hardie Boys J. cited the same passage quoted above by Justice Stewart from Vicount Haldane's judgment. It concludes that there is a restriction on powers conferred on a majority of a special class in order to enable that majority to bind a minority:
>
> > ... They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only.
>
> 73 Hardie Boys J. considered *Re Farmers' Co-operative*, which was also cited by Justice Stewart, in which votes of several creditors who were competitors of the debtor were disallowed.
>
> > ...In a later development of the same matter, but not now involving the Court's sanction under s. 205, Gallen J. accepted that the Court has an overriding control, not limited to the approval stage under s. 205, and may restrict a right to vote where the equities of a particular situation require it: see [1992] 1 NZLR 348. It is unnecessary for present purposes to decide whether these cases were correctly decided, for even if they were, the principle is not of unlimited application, and does not apply to the exercise of voting rights generally. This is clear from what Viscount Haldane said in the *British America Nickel* case, [1927] A.C. 369. Immediately after the passage already quoted, his Lordship said
> >
> > > Subject to this, the power may be unrestricted. It may be free from the general principle in question when the power arises not in connection with a class, but only under a general title which confers the vote as a right of property attaching to a share.
>
> Thus in *Pender v. Lushington* (1877) 6 Ch. D.
>
> Jessel MR said there is:
>
> > . . . no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interest.
>
> While the voting rights conferred by Part XV of the *Insolvency Act* are not akin to a "right of property attaching to a share", they are rights conferred without reservation. There is no requirement for class voting; there is instead a general right conferred equally on all creditors. The rationale of the principle does not apply. It is well settled that the motive (short of fraud) of a petitioning creditor, no matter how reprehensible, is irrelevant to his right to obtain an order of adjudication: *King v. Henderson* [1898] AC 720, *Re King, ex parte Commercial Bank of Australia Ltd. (No. 2)*, [1920] VLR 490. The motive of a creditor voting on a proposal, really the other side of the coin to a petition for adjudication, can be no different. That is not to say that there may be no

> remedy in an extreme case, such as fraud or mistake. But certainly where, as here, there are perfectly legitimate reasons for opposing the proposal, a creditor is not to be denied that right because he may have some other motive as well ...
>
> 74 If the exception made for fraud is broadened to "substantial injustice" I would take Hardie Boys J.'s conclusions to be a fair statement of the law in Canada as well, as applied by Canadian courts in the cases cited by the Registrar. The New Zealand court included mistake as well as fraud as an exception. A creditor is not to be deprived of the right to vote for wrongful motives alone; motive must be coupled with a tortious act to support a finding of improper purpose.

32 The reference to "substantial injustice" in paragraph 74 of *Laserworks* finds its origin in s. 187(9) of the *BIA*. No such express provision is found in the *CCAA*. However, assuming without deciding that the same jurisdiction can be found in s. 11 of the *CCAA*, the test promulgated in *Laserworks* is difficult to meet. As I understand that test I must be satisfied that there has been conduct amounting to an abuse of process or other tortious or near tortious character and that that conduct has resulted in a substantial injustice before I can exercise my discretion to disallow a vote of a creditor.

33 In its submissions to me the Monitor placed particular emphasis on the fact that Streetwise was actively seeking to acquire the tax attributes of Blackburn. It points out that after I had approved the Pinnacle RTS, Streetwise continued to acquire claims. It submits that the inescapable inference to be drawn from these facts is that Streetwise acquired the claims and voted to block approval of the Pinnacle Plan not for the purpose of achieving the purposes of the *CCAA,* but for the improper purpose of forcing a situation in which it would acquire the tax attributes for itself.

34 All parties supporting the application to disallow Streetwise's votes emphasized that Streetwise was not a creditor of Blackburn at the outset of these proceedings, that it continued to purchase claims after it was aware that the Pinnacle RTS had been approved to be presented to creditors and that it was obvious that Streetwise wished to obtain the tax attributes of Blackburn. They submit that these circumstances are strong indicators that Streetwise was not acting in good faith.

35 The Monitor has asked that I infer that Streetwise exercised its votes for an improper purpose analogous to the improper purpose found in the authorities referred to above. Against that inference I have the evidence of Mr. Sethi, contained in two affidavits. The gist of that evidence is that Streetwise entered into restructuring discussions with management of Blackburn prior to August 30, 2011 and that by that date Streetwise believed that it had a viable restructuring plan. Mr. Sethi deposes that in accordance with its expectation it began to acquire the right to have debt assigned to it in order to facilitate approval of its proposed restructuring. Mr. Sethi says, and the documentary evidence supports, that he attempted to initiate discussions with the Monitor in mid-September 2011, but that the Monitor declined to negotiate with him.

36 Mr. Sethi deposes that when he became aware of the Pinnacle RTS, he attempted to put forward an alternative plan but was unsuccessful in persuading me to give more time to consider Streetwise's offer. Critically, he has deposed that he does not consider that the Pinnacle Plan fairly allocates the value of the tax attributes between the secured and unsecured creditors. In his affidavit #2 he states that he was of the view that there was more value in the unsecured claims than was being offered under the Pinnacle Plan and that accordingly Streetwise decided to acquire the unsecured claims that it effectively had under option. It also acquired additional claims in the same belief.

37 I think the substance of Mr. Sethi's evidence was that he was confident that Streetwise could recover more than the cost of acquiring the claims, either through an enhanced offer from Pinnacle or through some other plan that would be presented, if the Pinnacle Plan was defeated.

38 I accept Mr. Sethi's evidence as reliable. He was not cross-examined on his affidavit. The uncontradicted evidence before me is that Streetwise was acting as a *bona fide* party seeking to participate in a restructuring of Blackburn up to September 30, 2011. There is no dispute that management of Blackburn had the right to pursue a restructuring up to that date. Streetwise became involved in the proceeding at a time when it was known that Blackburn's assets were being offered for sale. I think I can infer that by the summer of 2011 it was obvious to everyone that any restructuring would result in a third party gaining control of Blackburn. I find that by September 30, 2011 Streetwise had committed considerable time and resources in pursuing what I will describe as the Blackburn opportunity.

39 I also accept as genuine Mr. Sethi's evidence that Streetwise proceeded to acquire creditor claims because it believed that it would ultimately recover more than it paid for those claims. I do not think that Streetwise can be said to be acting in bad faith by acquiring those claims even if it was motivated in part to do so to acquire a blocking position. It is obvious that a party with a blocking position is in a strong position in the negotiations over the terms of a plan of arrangement. That reality was demonstrated in this case by the Monitor's recognition that no plan of arrangement was possible without the support of Landus.

40 It seems to me that this case raises squarely the appropriateness of permitting "vulture funds" to participate in insolvency restructurings. In my view there is no compelling argument that the activities of vulture funds are undesirable. Even if there were, I think it is the role of Parliament and not the courts to address what limits, if any, should be placed on the activities of such funds. I also note that in this case the terms of the Pinnacle RTS were significantly improved after it became apparent that Streetwise had a substantial position in the claims. There is no doubt that the Pinnacle Plan put to the creditors on November 21 was significantly superior to that recommended by the Monitor on September 30. The inference that I draw from that is that the enhancements to the offer were motivated by a desire to enlist creditor support in the face of the Streetwise opposition to the Plan.

41 I think that the cases cited to me by the Monitor in which bad faith was found are distinguishable from this case. Firstly, the courts in those cases found that the creditor who acquired claims had no *bona fide* intention of profiting from realizing on those claims. In the American cases the courts relied on the fact that the claims were acquired at par or close to par as evidence that the acquiring party did not regard the investment in the claims as a legitimate profit making venture. In all three cases the acquiring creditor did not put forward any plausibly credible evidence that it acquired the claims to make a profit on them or that there was any reasonable prospect of a greater recovery for creditors if the plan or proposal was defeated. In addition, as far as I am able to discern, none of the cases involved an assignee that had become involved in the process with the support of management of the insolvent company. Finally I can see no indication that the plans or proposals under consideration in those cases were in effect liquidation proposals, as is the case in this proceeding.

42 In *DBSD* the Court found that the acquiring creditor had no *bona fide* interest in profiting from an investment in the debt as the debt was purchased at par. In *Allegheny* the Court also found as a fact that the acquiring creditor, Japonica, had no *bona fide* intention to profit from its investment in the debt. In addition it acquired *de facto* blocking positions in two separate classes whose interests were in direct conflict. These actions were in the Court's view inconsistent with Japonica's actions being carried out for economic reasons.

43 I also question whether the US decisions are consistent with the law in Canada. Firstly, the US decisions concern the exercise of an express statutory power to disallow votes. It appears from the cases cited that US courts have been prepared to exercise that power in situations in which they conclude that the votes have been exercised in aid of a plan to acquire control of the debtor company. I must frankly

say that I find the distinction made in those cases between pursuing economic interests as a creditor and as a potential owner difficult to grasp. In both cases the creditor is pursuing its economic interests. Both American decisions acknowledge that acquiring debt with a view to making a profit is not bad faith behaviour. Thus the activities of a vulture fund are permissible under US law.

44 As I have already stated, I think that the policy approach taken in *Laserworks* is preferable to that of the US authorities. As the above quoted passages make clear, the Court in *Laserworks* recognized that creditors are entitled to vote their claims in what they as creditors perceived to be their own economic interests as long as their actions are not unlawful or do not result in a substantial injustice.

45 I think this approach is preferable because it recognizes that the effect of such an order is to deprive the assignee of a statutory right and to subject it to having its contractual rights compromised against its will. In my view such a result would only be appropriate in the clearest of cases.

46 The Monitor and other parties were critical of the conduct of the directors of Blackburn and in particular with the contents of the August 30 email from Mr. Wellsby to Blackburn's creditors. The Monitor submits that this email contained misleading and inaccurate information that may well have misled creditors into signing the Letters of Intent that empowered Streetwise to obtain assignments of their claims. In the Monitor's submission I should take the allegedly misleading statements into account in deciding whether I should disallow Streetwise's votes.

47 It is quite clear that the email does contain inaccurate information, particularly with respect to the potential recovery creditors could expect if the proposed Streetwise restructuring plan was approved. I am also concerned that the email did not adequately explain that the Letters of Intent purported to give Streetwise the unilateral right to take an assignment of claims whether or not its proposed restructuring plan proceeded.

48 I have decided that I should not take the contents of the email into account in deciding these applications. The point made by the Monitor is that the assignments of claims acted upon by Streetwise may have been obtained as a result of misrepresentations contained in the email. However, even if that were so, in law the assignments would only be voidable at the instance of any affected creditor. While some assigning creditors have expressed regret to the Monitor about executing the Letters of Intent and assignments, none has applied to me to have the assignments set aside or for any other remedy against Streetwise. In addition, the Monitor has registered Streetwise as a creditor in accordance with the Claims Procedure Order. While that registration is not conclusive with respect to Streetwise's right to vote on the Pinnacle Plan, it does relieve me of the task of examining the circumstances of the assignments to determine their validity in the absence of an express challenge thereto.

49 I am also of the view that Mr. Wellsby did not intend to deceive the creditors when he sent the email. I accept his evidence that he genuinely believed that the Streetwise proposal offered the best recovery to creditors and that he continued to hold that belief after I approved the Pinnacle RTS.

50 After hearing the submissions of all parties and considering the extensive evidence before me I have concluded that in this case there was a genuine difference of opinion about the best course to follow to maximize recovery for the unsecured creditors of Blackburn. The Monitor was clearly of the view that it was futile to proceed with a restructuring without the support of Landus, which effectively had a blocking position given the extent of unsecured debt that it held. I accept that Streetwise and the directors of Blackburn held the genuine belief that the Pinnacle Plan unfairly favoured Landus and did not provide a fair dividend to unsecured creditors.

51 In this case I cannot find that the predominate purpose of Streetwise's negative vote was to acquire control of Blackburn and hence its tax attributes. Mr. Sethi has denied that that was the predominate

purpose and the surrounding circumstances do not lead to that conclusion. In addition, the liquidation analysis prepared by the Monitor does not lead to the conclusion that creditors will be worse off under liquidation.

52 Accordingly, the application to disallow Streetwise's votes is dismissed. With that dismissal there is no approved Plan to be sanctioned and it follows that that application is also dismissed.

53 At the hearing I extended the stay in this matter until December 15, 2011. As is probably apparent from these reasons it is my view that it is possible for the parties to reach an agreement that would permit a Plan to be approved. The difference of opinion over the appropriate allocation of the value of the tax attributes has unfortunately led to the defeat of the restructuring plan favoured by the Monitor. Despite this setback it is my view that the synergies between the values of the real estate assets and the tax attributes remain and I urge the parties to renew their efforts to reach an agreement on how to share those values.

54 To assist in that regard I am therefore prepared to hear an application to extend the stay beyond December 15 if the parties see any utility in so doing.

R.J. SEWELL J.

cp/e/qlrds/qlvxw/qlced/qlgpr

TAB 9

Court File No. 03-CL-4838

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF COTTON GINNY LIMITED/COTTON GINNY LIMITÉE

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

UNOFFICIAL TRANSCRIPTION OF THE ENDORSEMENT OF JUSTICE FARLEY
Heard: May 27 and 28, 2003

At the conclusion of the two day hearing (including viva voce testimony) yesterday, I advised that I was satisfied that the evidence on balance was that the four trade creditors had, by the end of the second conference call with the Monitor, Richter, agreed to a deal that was a binding agreement. It is not necessary to have that agreement reduced to writing before it is binding – unless, of course, part of the terms agreed to were that it had to be reduced to writing (with or without any additional "bells and whistles" or other **[word]** which may be added through further negotiations between counsel). However, I find that the evidence does not support that there was any such condition.

See *Fiegulli v. Acklund Ltd.* (1989), 59 D.L.R. (4th) 114 (BCCA) at pp 7-8 of printout. This principle was endorsed at paragraphs 14-15 of Bogue v. Bogue (1999), 46 O.R. (3d) 1 (CA). See also *Bawitko Investments Ltd. v. Kernels Popcorn Ltd.* (1991), 79 D.L.R. (4th) 97 (Ont. CA) at p. 6 of printout.

What I had in this matter was the Monitor's 10th report dated May 26, 2003 which at pp. 5-8 describe the agreement in question and the circumstances under which it was reached as ??? by the Monitor (and prepared by Mr. Tertigas). This was essentially consistent with the notes taken by Ms. Glazer of the Monitor and which by the agreement of counsel I was able to take without viva voce testimony from Ms. Glazer. In their testimony Messrs. Tertigas and Benchaya (another Richter person on the conference call patch in) advised that their recollection of the events in question were in accordance with the Monitor's report. As I observed the facts that the Monitor is required to be independent, neutral and objective as amongst all the parties does not mean that testimony from any Monitor personnel is to be given special consideration or weight; taken that position merely means that they are under special duties and responsibilities. However it appeared to me that they gave their evidence in a straightforward and unshaken way.

I should pause to note that as I did in Bank of America (Canada) v. **[word] [word]** Company (retailer of several years ago), I would reiterate here what I said there about the necessity to have a necessarily high tolerance for testimony in any court case for a variety of reasons including different sincere perceptions and rationalizations inherent in the human nature. In this case perhaps the only factor of this value not present is the effluxion of time affecting memories since in this situation we are dealing with events of merely a week ago. However, even this short a period of time, there can **[word]** be difficulties.

As I noted Mr. Singer's evidence looks to be tempered somewhat because, it appears, of his enthusiasm".

He had some difficulty with who in fact was on the call and he alone was of the view that not only was there a deal by the end of the second call that day, but there was also likely a deal by

the end of the first call. Therefore, I must not take his testimony as sufficient alone as to Mr. Batra having an authority proxy from Mr. Wong and that Mr. Wong afterwards advised him that he had changed his mind about the deal and was therefore going ahead with the motion.

Mr. Batra testified that there was in agreement on the four points. As a result of there being such an agreement congratulations were exchanged. No one on the second call declared that they disagreed that there was a deal or that there were conditions over and above. It was of course desirable to have the terms of the agreement reduced to writing so that the parties would be able to rely upon such memoralization in their future negotiations. Mr. Batra advised that he had been given the proxy as Mr. Wong had other commitments. Mr. Wong did **[word]** that he was meeting a relative from out of town at the airport. However, at the time of the arranged second call he advised that he was discussing the terms of the deal with his counsel and financial advisor. Mr. Batra advised after that Mr. Wong had got cold feet.

This of course is problematic since in his testimony Mr. Wong reiterated that he had an extreme dislike for those in control of the applicant company partly due to the fact that he had no faith in their business ability given that according to him they had driven the applicant into the ground and secondly that they had badly and rudely they treated him during the CCAA proceedings by ignoring his calls. He reiterated that he would not do a deal with them on any basis and that he was in effect prepared to do anything to scupper their efforts at reorganization. If that were so, then why would he wish to analyze the deal with his advisors. He did not advise his colleagues in the **[word]** trade creditor group of his animus to the applicant and its shareholders.

Mr. Wong reiterated that he was in negotiations with Mr. Pace of Continental Saxon (Saxon) to take over the applicant or its business enterprise. Strangely enough he did not reiterate that he

had any retailer experience – but instead he denied that the thought of supplying goods to such an enterprise controlled by Saxon and possibly others had not occurred to him until that proposition was put to him in questioning.

Mr. Wong's evidence I regret to say had some difficulty with the air of reality test. An additional aspect of that was the noticeable standing that he was advanced like he had instructed the motion to go on the next day (May 22nd) and not be adjourned, he could not explain why his counsel would nevertheless adjourn the motion.

However, Mr. Wong did acknowledge that Mr. Batra was an honourable man whom he would trust. This **[word]** supports Mr. Batra as having told the **[word]** about the authority proxy, but it also gives a realistic **[word]** as to Mr. Batra being a person who would be responsible with a proxy. He did acknowledge that it was possible that there was a deal on May 21st.

Where Mr. Wong advised that he knew that the deal had to be agreed to by all four trade creditors or there would be no deal, he testified that he made it clear that there was no deal for him. Messrs. Batra, Abboud and Singer did not testify as to any such advice from Mr. Wong and it would be strange for them to proceed to the 2nd call and indicate that they were happy with the deal if they knew that Mr Wong had in fact earlier vetoed it.

Mr. Wong said he made it clear to Mr. Frydenlund that there was no deal, yet that lawyer did not immediately advise the other side that those were his instructions. Indeed, in his first e-mail he raised the subject of having to verify with his clients whether or not there was a deal. He never responded at any time that he was advised by any of his clients that there was no deal.

It was pointed out that the draft agreement to memorialize the deal sent by Mr. Chapple to Mr. Frydenlund continued to be revised. However, this is consistent with Mr. Frydenlund in a typical and cautious lawyerly way i.e. **[word]** play to better his client's position. He was attempting and successful it appears in getting some "bells and whistles" and other protections – but that did not affect the four points of the deal. He acknowledged that these additional points were matters that he brought up, not that his clients advised were part of the deal.

Mr. Wong also had difficulty with his testimony as to whether he had never seen a draft of the memorialized agreement.

Reluctantly I find Mr. Wong's evidence to be unbelievable.

Mr. Abboud acknowledged that agreement "in principle". He did not object at the end of the second call to there being, as Mr. Tertigas described it, "a businessman's agreement". While he said he could not recollect it being said that Mr. Batra could speak for Mr. Wong, how could there be an agreement in principle if Mr. Wong **[word]**.

I would also note that some concern was raised that no lawyers were present at the conference call so as to advise anyone. It is not necessary to have lawyers present for businessmen to make a deal. Mr. Frydenlund never raised this as a concern.

I note that Mr. Tertigas advised that he was comfortable in recommending 35% to the shareholders of the applicant. When he made that recommendation in between the calls (at the same time as the creditors were discussing the points), he received confirmation that such was all right and that he could communicate that back to the creditor group. In essence Mr. Tertigas was

acting as a conduit agent – in other words an agent with authority to make the offer. The amended plan incorporates the applicable parts of the agreed deal.

Mr. Abboud reiterated that there were some qualifications but this must also be viewed in light of his having done a deal to assign his claim to Saxon. I note that he also had difficulty with his evidence – e.g. his advice that he never saw any "correspondence" until he testified, yet similar to Mr. Wong, he was on the service list of Mr. Frydenlund's e-mail of Mr. Chapple's material. In my view Mr. Abboud was attempting to tailor his evidence to fit what he now found was the most favourable **[word]** circumstances.

Similarly I had some difficulty with parts of Mr. Batra's testimony. For example he referred to there being a turnover of management clause in the applicant but this was not supported by any credible evidence.

I have therefore in the evidence before me concluded that it supports to more than the civil burden of proof that there was a deal as to the four points. In doing so I found the evidence of Messrs. Tertigas and Benchaya reliable. With respect to Mr. Frydenlund, I had no problem with his evidence but concluded that in essence as to the points in issue, his evidence (and lack of response as to there not being a deal) supportive of there being a deal. I had difficulty in accessing the evidence of Messrs. Batra, Abboud and Wong as to their not being a deal (Mr. Singer's evidence as I indicated should be tempered for his "enthusiasm"). It seems to me that

they may well have ??? that if there were no signed agreement, then they could still get out of the oral agreement. Texaco found out to its regret in the **[word]** – **[word]** **[word]** that was not an appropriate course of action.

J. M. Farley
May 30, 2003

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Superior Court of Justice

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Court file No 03-CL-4838.

In the matter of Cotton Honeymoon and CCAA.

At the conclusion of the two day hearing (including viva voce testimony) yesterday, I advised that I was satisfied that the evidence on balance was that the four trade creditors had, by the end of the second conference call with the Monitor Richter, agreed to a deal that was a binding agreement. It is not necessary to have that agreement reduced to writing before it is binding — unless, of course, part of the terms agreed to were that it had to be reduced to writing (with or without any additional "bells and whistles" or other provisions which may be added through further negotiations between counsel). However I find that the evidence does not support that there was any such condition.

See Fieguth v Advocate Hotel (1989), 59 DLR (4th) 114 (BCCA) at pp 7-8 of printout. This principle was endorsed at paras 14-15 of Bogue v Bogue (1999), 46 OR (3d) 1 (CA). See also Bakerview Investments Ltd v Kenels Popcorn Ltd (1991), 79 DLR (4th) 97 (Ont CA) at p 6 of printout.

What I had in this matter was the Monitor's 10th report dated May 26, 2003 which at pp 5-8 describe the agreement in question and the circumstances under which it was reached as summarized by the Monitor (and prepared by Mrs. Tolfrey). This was essentially consistent with the notes taken by Mr. Hayes of the Monitor and which by the agreement of counsel I was asked to take without viva voce testimony

from Mr. Glazer. In their testimony Messrs Fertyas and Bendayan (another Realtor person on the confirmation call potential) advised that their recollection of the events in question were in accord with the Auditor's report. As I observed the fact that the Auditor is required to be independent, neutral and objective as amongst all the parties does not mean that testimony from any witness is to be given special consideration or weight; rather that position merely means that they are under special duties and responsibilities. However it appeared to me that they gave their evidence in a straightforward and unbiased way.

I should pause to note that as I did in Bank of America Canada v United Van Company (attached of several years ago), I wanted reiterate here what I said there about the necessity to have a reasonably high tolerance for testimony in any court case for a variety of reasons including different sincere perceptions and rationalizations inherent in the human nature. In this case perhaps the only factor not present is the efflux of time affecting memories such in this situation we are dealing with events of merely a week ago. However even in that short a period of time, there can inadvertently be difficulties.

As I noted Mr. Singh's evidence has to be tempered somewhat because it appears, of his "enthusiasm".

He had some difficulty with who in fact was on the call and he alone was of the view that not only was there a deal ~~struck~~ by the end of the second call that day, but there was also likely a deal by the end of the first call. Therefore I must not take his testimony as sufficient alone as to Mr. Batra having an authority proxy from Mr. Wang and that Mr. Wang afterwards advised him that he had changed his mind about the deal and was therefore going ahead with the motion.

Mr. Batra testified that there was an agreement on the four points. As a result of there being such an agreement congratulations were exchanged. No one on the second call addressed the fact they disagreed that there was a deal or that there were conditions precedent above. It was of course desirable to have the terms of the agreement reduced to writing so that the parties would be able to rely upon such memorializations in their future relations. Mr. Batra advised that he had been given the proxy as Mr. Wang had other commitments. Mr. Wang did advise that he was receiving a release from one of Triton at the airport. However at the time of the concerned 2nd call he advised that he was discussing the terms of the deal with his counsel and succeeded agreeing. Mr. Batra advised that after Mr. Wang had got cold feet.

This of course is problematic since in his testimony Mr. Wang indicated that he had an extreme dislike for those in control of the

applicants company party due to the fact that he had no faith in the insurance ability given that according to him they had driven the applicant into the ground and secondly that they had badly and rudely treated him during the CCAA proceedings by ignoring his calls. He indicated that he would not do a deal with them or any of his and that he was in effect prepared to do anything to scupper their efforts at reorganization. If that were so, then why would he wish to analyze the deal with his advisers. He did not advise his colleagues in the trade group of his animus to the applicants and its shareholders.

Mr Wang indicated that he was in negotiations with Mr. Pace of Burkental Saxon (Saxon) to take over the applicant or its business enterprise. Strangely enough he did not indicate that he had any retailer experience — but indeed he denied that the thought of supplying goods to such an enterprise controlled by Saxon and possibly others had not occurred to him until that proposition was put to him in cross-examination.

Mr Wang's evidence I regret to say had some difficulty with the air of reality test. An additional aspect of that was that when leaving that he was advanced that he had instructed his solicitor to go on the next day (May 22nd) and not be adjourned, he could not explain why his counsel would necessitate adjournment.

However Mr. Way did acknowledge that Mr. Batra was an honourable man when he owned trust. This actually supports Mr. Batra's assertion that he trusted Mr. Way, but it also is [illegible] as to Mr. Batra being a person who would be responsible with a proxy. He did acknowledge that it was possible that there was a deal on May 21st.

When Mr. Way advised that he knew that the deal had to be agreed to by all four trade creditors or there would be no deal, he testified that he made it clear that there was no deal for him. Messrs Batra, Wood and Fuga did not testify as to any such advice from Mr. Way and it would be strange for them to proceed to the 2nd call and indicate that they were happy with the deal if they knew that Mr. Way had not yet earlier vetoed it.

Mr. Way said he made it clear to Mr. Engelund that there was no deal, yet that lawyer did not immediately advise the other side that those were his instructions. Indeed in his first email he raised the likelihood of having to verify with his clients whether or not there was a deal. He never responded at any time that he was advised by any of his clients that there was no deal.

It was pointed out that the draft agreement to memorialize the deal sent by Mr. Chapple to

Mr. Freyenlund continued to be vexed. However this is consistent with Mr. Freyenlund in a typical and cautious lawyerly way attempting to better his client's position. He was attempting and successful it appears in getting some "bells and whistles" and other protections — but that did not affect the four points of the deal. He acknowledged that these additional points were matters that he brought up, not that his clients advised were part of the deal.

Mr. Wong also had difficulty with his testimony as to whether he had seen a draft of the secondary agreement.

Reluctantly I find Mr. Wong's evidence to be unreliable.

Mr. Abood acknowledged the agreement "in principle". He did not object at the end of the second call to there being as Mr. Tertjas described it a businessmen's agreement. While he said he could not recollect it being said that Mr. Batros could speak for Mr. Wong, how could there be a agreement in principle if Mr. Wong not attending or discussing through a "proxy" especially since all along. I would also note that some of the concern was indicated that no lawyers were present at the conference call so as to advise anyone. It is not necessary to have lawyers present for businessmen to make a deal. Mr. Freyenlund never raised this as a concern.

I note that Mr. Tertjas advised that he was comfortable in recommending

35% to the shareholders of the applicant. When he made that recommendation in between the calls (— at the same time as the creditors were discussing the points), he received confirmation that such was all right and that he could communicate that back to the creditor group. In essence Mr. Bitzios was acting as a conduit agent — another words an agent with authority to make the offer. The amended plan incorporates the applicable parts of the agreed deal.

Mr. Abound indicated that there were some qualifications but this must also be viewed in light of his having done a deal to assign her claim to Saxon. In fact that he also had difficulty with his evidence — eg. his advice that he never saw any "correspondence" until [redacted] he testified, yet similar to Mr. Wong. He was on the service list of Mr. Freedland's email of the material including Mr. Chapple's material. In my view Mr. Abound was attempting to tailor his evidence to fit what he now found was the most favourable light in changed circumstance.

Similarly I had serious difficulty with parts of Mr. Bartel's testimony. For example he referred to there being a requirement of a memorandum change in the applicant but there was not supported by any credible evidence.

I have thought on the evidence before me concluded that it supports to more than the civil burden of proof that there was a deal as to the four points. In doing so I found the evidence of Messrs. Turtyes and Bencharey a reliable. With respect to Mr. Freundlich, I had no problem with his evidence but concluded that in essence as to the points in issue, his evidence (and lack of response as to there not being a deal) supportive of there being a deal. I had difficulty in accepting the evidence of Messrs Batra, Abboud and Wong as to there not being a deal (Mr. Singer's evidence as I indicated should be tempered for his "enthusiasm"). It seems to me that they may well have rationalized that if there was no signed agreement, then they could still get out of the oral agreement. Texaco found out to its regret in the Getty - Pennzoil situation that was not an appropriate course of action.

J. Farley

May 30, 2003.

TAB 10

Indexed as:

Canadian Airlines Corp. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended;
AND IN THE MATTER OF the Business Corporations Act (Alberta) S.A. 1981, c. B-15, as amended, Section 185
AND IN THE MATTER OF Canadian Airlines Corporation and Canadian Airlines International Ltd.

[2000] A.J. No. 771

2000 ABQB 442

[2000] 10 W.W.R. 269

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

265 A.R. 201

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

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

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

Action No. 0001-05071

Alberta Court of Queen's Bench
Judicial District of Calgary

Paperny J.

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

(185 paras.)

Counsel:

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

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

REASONS FOR DECISION

PAPERNY J.:--

I. INTRODUCTION

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

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

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

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

II. BACKGROUND

Canadian Airlines and its Subsidiaries

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

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

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

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

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

Events Leading up to the CCAA Proceedings

9 Canadian's financial difficulties significantly predate these proceedings.

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

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

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

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

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

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

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

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

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

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

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

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

Initial Discussions with Air Canada

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

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

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

Offer by Onex

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

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

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

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

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

Offer by 853350

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The Restructuring Plan

50 The Plan has three principal aims described by Canadian:

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

51 The proposed treatment of stakeholders is as follows:

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

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

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

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

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

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

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

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

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

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

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

The Affected Unsecured Creditors fall into the following categories:

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

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

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

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

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

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

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

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

III. ANALYSIS

59 Section 6 of the CCAA provides that:

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

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

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

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

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

(1) there must be compliance with all statutory requirements;
(2) all material filed and procedures carried out must be examined to determine if anything has been done or purported to be done which is not authorized by the CCAA; and
(3) the plan must be fair and reasonable.

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

1. Statutory Requirements

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

(a) the applicant comes within the definition of "debtor company" in section 2 of the CCAA;
(b) the applicant or affiliated debtor companies have total claims within the meaning of section 12 of the CCAA in excess of $5,000,000;
(c) the notice calling the meeting was sent in accordance with the order of the court;
(d) the creditors were properly classified;
(e) the meetings of creditors were properly constituted;
(f) the voting was properly carried out; and
(g) the plan was approved by the requisite double majority or majorities.

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

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

(b) CAC and CAIL have total claims that would be claims provable in bankruptcy within the meaning of section 12 of the CCAA in excess of $5,000,000.

(c) In accordance with the April 7, 2000 Order of this court, a Notice of Meeting and a disclosure statement (which included copies of the Plan and the March 24th and April 7th Orders of this court) were sent to the Affected Creditors, the directors and officers of the Petitioners, the Monitor and persons who had served a Notice of Appearance, on April 25, 2000.

(d) As confirmed by the May 12, 2000 ruling of this court (leave to appeal denied May 29, 2000), the creditors have been properly classified.

(e) Further, as detailed in the Monitor's Fifth Report to the Court and confirmed by the June 14, 2000 decision of this court in respect of a challenge by Resurgence Asset Management LLC ("Resurgence"), the meetings of creditors were properly constituted, the voting was properly carried out and the Plan was approved by the requisite double majorities in each class. The composition of the majority of the unsecured creditor class is addressed below under the heading "Fair and Reasonable".

2. Matters Unauthorized

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

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

a. Legality of proposed share capital reorganization

66 Subsection 185(2) of the ABCA provides:

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

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

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

b. All CAIL preferred shares held by 853350 will be converted into CAIL common shares.

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

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

Section 167 of the ABCA

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

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

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

71 The relevant portions of section 167 provide as follows:

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

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

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

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

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

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

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

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

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

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

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

Section 183 of the ABCA

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

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

Ontario Securities Commission Policy 9.1

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

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

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

b. Release

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

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

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

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

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

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

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

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

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

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

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

3. Fair and Reasonable

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

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

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

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

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

a. Composition of the unsecured vote

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

b. Receipts on liquidation or bankruptcy

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

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

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

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

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

Pension Plan Surplus

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

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

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

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

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

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

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

CRAL

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

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

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

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

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

International Routes

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

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

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

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

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

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

Tax Pools

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

Capital Loss Pools

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

Undepreciated capital cost ("UCC")

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

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

Operating Losses

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

Fuel tax rebates

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

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

c. Alternatives to the Plan

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

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

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

d. Oppression

Oppression and the CCAA

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

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

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

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

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

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

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

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

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

Oppression allegations by Resurgence

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

e. Unfairness to Shareholders

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

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

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

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

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

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

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

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

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

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

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

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

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

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

e. The Public Interest

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IV. CONCLUSION

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

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

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

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

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

PAPERNY J.

cp/i/qljpn/qlhcs

TAB 11

COMMERCIAL INSOLVENCY IN CANADA

SECOND EDITION

Kevin P. McElcheran, LL.B.

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> under the applicable provisions of the *BIA* or to place the debtor into receivership.[253]

This analysis led the Supreme Court of Canada to observe, "Because the *CCAA* is silent about what happens if reorganization fails, the *BIA* scheme of liquidation and distribution necessarily supplies the backdrop for what will happen if a *CCAA* reorganization is ultimately unsuccessful."[254]

The Supreme Court concluded that applying a common priority scheme (that is, adopting the BIA priority scheme for liquidation and distribution if a debtor company is unable to restructure under the CCAA) is desirable and promotes the legislative policy to encourage restructuring under the CCAA, by removing "skewed incentives against reorganizing under the *CCAA*"[255] that would arise if secured creditors' claims were better protected under the BIA than under the CCAA.

In keeping with this analysis, the Supreme Court has provided clear direction to courts supervising insolvency proceedings in Canada that "the comprehensive and exhaustive mechanism under the *BIA* must control the distribution of the debtor's assets once liquidation is inevitable."[256] The same rule must apply if the assets of the debtor company have been sold with the authority of the court under section 36 of the CCAA[257] and the proceeds of the sale must be distributed to creditors without a plan of compromise or arrangement.

9. DEVELOPMENT OF THE PLAN

(a) What is a Plan of Arrangement?

A plan of arrangement is essentially an agreement between the debtor company and its affected creditors to compromise their legal claims. The CCAA does not dictate the form of the plan, although it requires that a plan may only be sanctioned if it includes a provision for the payment of certain creditor claims, including certain government claims, wages and pension-related claims.[258] Additionally, the plan cannot compromise certain claims, including post-filing claims and claims arising

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253 *Ibid.*, at para. 14.
254 *Ibid.*, at para. 23.
255 *Ibid.*, at para. 47.
256 *Ibid.*, at para. 80.
257 Subject to the specific requirements of s. 36 relating to payment of certain claims.
258 CCAA, s. 6(3), (4), (5) and (6).

from fraud.[259] Aside from these specific restrictions, a plan of arrangement can include any provision that could be included in an agreement.[260]

Plans of arrangement, as well as proposals under the BIA that will be considered later in this chapter, usually take one of three forms. A "basket" plan or proposal offers the creditors a defined amount of consideration that can then be shared among the classes of affected creditors *pro rata* in each class on the basis of their proven claims. A second, less common format offers the creditors a predetermined proportionate recovery ("cents on the dollar") such that the amount of the consideration that must be delivered by the debtor varies depending on the value of the claims proven in each class. A third form of plan or proposal is often called a "liquidation" plan because the assets of the debtor are sold and the plan governs the distribution of the proceeds realized from such sale.[261]

(b) Developing a Plan of Arrangement

The key to developing and negotiating a plan of arrangement is the early establishment of a business plan that addresses the problems and business factors that caused the insolvency in the first place. The development of a credible business plan is central to gathering the support of key creditors. Because the granting of the Initial Order in CCAA cases is a matter of the court's discretion and because the court expects the debtor to articulate "at least the kernel" of a plan in its supporting material for the Initial Order,[262] the development of a credible business plan should begin before the filing.

The consideration offered in a plan or a proposal is flexible. It must be consistent with the business plan and be responsive to the financial requirements of the business plan. Accordingly, if the debtor's business plan does not require additional capital but requires improvement of the balance sheet and the deferral or elimination of debt maturities, the basic consideration in the plan could be equity securities. If the business plan requires additional capital investment, the restructuring may require the issuance of new equity or debt and the payment of cash to the creditors. In

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259 CCAA, s. 19.

260 *ATB Financial v. Metcalfe & Mansfield Alternative Investments II Corp.*, [2008] O.J. No. 2265, 47 B.L.R. (4th) 74, 43 C.B.R. (5th) 269 (Ont. S.C.J. [Commercial List]), affd [2008] O.J. No. 3164, 92 O.R. (3d) 513, 45 C.B.R.(5th) 163 (Ont. C.A.).

261 An example of a liquidation plan is the plan used by Canwest Publishing to distribute the proceeds of the sale of its business to certain financial creditors.

262 *Re Inducon Development Corp.*, [1992] O.J. No. 8, 8 C.B.R. (3d) 306 (Ont. Gen. Div.).

many cases, the plan or proposal will offer a mixture of cash and securities to creditors.

(c) Tax Implications of Debt Forgiveness

Whatever the format of the plan or proposal, the debtor must consider the tax implications of the restructuring. In most cases, the debtor company will have incurred substantial operational losses on its path to insolvency. Tax loss carry forwards often provide additional value that favours a restructuring of the existing debtor company (who can use the tax losses if the business continues) over a sale of the business as a going concern. However, a successful plan of arrangement will almost certainly result in the debt forgiveness that causes an income inclusion equal to the amount of the debt that is forgiven as a result of the compromises of debt made in the plan. The restructured debtor will lose the benefit of tax loss carry forwards to the extent of the debt forgiveness as it must use the carried forward losses to shelter the resulting income inclusion.

In many cases, the debtor company's tax position on implementation of the plan or proposal favours restructuring because there will be tax loss carry forwards left after the tax effect of debt forgiveness is taken into account. However, in the absence of an available tax shelter, the implementation of a plan of arrangement may trigger tax liabilities that may make restructuring less attractive than a sale of the business as a going concern.

(d) Business Confidentiality and Sealing Orders

Operating under CCAA protection is like living in a fishbowl for the debtor company. All aspects of its operations are subject to the scrutiny of the monitor and representatives of the debtor's creditors. This scrutiny is necessary because the debtor company faces critical business decisions throughout its restructuring process that affect all of its stakeholders and that require court approval or authorization on notice to such stakeholders. Ultimately, the CCAA requires that any sale of assets out of the ordinary course of the business must be authorized by the CCAA court on notice to the affected creditors. Further, a plan of arrangement must be sanctioned by the CCAA court on notice to creditors. However, these are the final steps in a process that requires effective court supervision at all stages leading up to the sale or restructuring of the debtor company's business.

Throughout the process and at the time of the completion of the restructuring through a sale or a plan, participating creditors, potential

TAB 12

In the Court of Appeal of Alberta

Citation: Alternative Fuel Systems Inc. v. Remington Development Corp., 2004 ABCA 31

Date: 20040129
Docket: #0301-0270-AC
Registry: Calgary

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

And in the Matter of Alternative Fuels Inc.

Between:

Remington Development Corporation

Respondent
(Applicant)

- and -

Alternative Fuel Systems Inc.

Appellant
(Respondent)

The Court:

The Honourable Madam Justice McFadyen
The Honourable Madam Justice Paperny
The Honourable Mr. Justice Clark

Reasons for Judgment Reserved

Appeal from the Order of
The Honourable Mr. Justice S. J. LoVecchio
Dated the 2nd day of September, 2003
Filed on the 17th day of September, 2003
(2003 ABQB 745, Docket: 0301-05678)

Reasons for Judgment of The Honourable Madam Justice Paperny
Concurred in by The Honourable Madam Justice McFadyen
Concurred in by The Honourable Mr. Justice Clark

Introduction

[1] This appeal raises a pure question of law: Does the *Landlord's Rights on Bankruptcy Act*, R.S.A. 2000, c. L-5 (LRBA) apply to the determination of a landlord's claim when the debtor tenant has received protection under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (CCAA).

Facts

[2] The respondent, Remington Development Corporation (Remington) is agent for the landlord of the appellant, Alternative Fuel Systems Inc. (AFS). Remington had two agreements with AFS to lease commercial space in Calgary from August 1, 2000 to January 31, 2016. Finding itself in financial difficulty, AFS petitioned and on April 9, 2003 received the order that it was a company to which the CCAA applies and could file a plan of compromise or arrangement under the CCAA. As part of its restructuring, AFS surrendered the leased premises to Remington in May 2003.

[3] Both Remington and AFS sought a valuation of the landlord's claim and a determination whether, as an unsecured creditor, the claim should form part of the unsecured creditor class in the CCAA. Before the chambers judge, AFS calculated Remington's claim under the LRBA was approximately $96,000 without considering offsets for prepaid rent and other items. On a full accounting, the sum could be further reduced to $15,000. A non-discounted mitigated claim for the unexpired term of the leases would be about $4.2 million, although, as a result of mitigation the largest portion of Remington's claim has now been reduced to $1.1 million while the smaller portion currently remains at $400,000.

[4] The chambers judge held that the LRBA does not automatically apply to limit or quantify the landlord's claim in CCAA proceedings.

Appellant's position

[5] The thrust of the appellant's submission, broadly stated, is that under the CCAA the amount of a landlord's claim in Alberta is the same amount as would be calculated in a bankruptcy. More specifically, the appellant submits that an unbreakable thread connects the CCAA to the LRBA. The thread begins with the plain meaning of s. 12(1) of the CCAA which refers to the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (BIA) to define claims under the CCAA. The thread continues to s. 12(2) of the CCAA which provides for a determination of the amount represented by a claim

in three different ways. In this appeal, the applicable sub-clause, s. 12(2)(a)(iii) provides that amount is that which might be proven under the BIA. A third link is s. 136 of the BIA which sets a priority for payment to a bankrupt's creditors and specifically, s. 136(f), which includes a landlord for priority payment, but limits the amount which may be claimed by a landlord. The next connection, says the appellant, is s. 146 of the BIA which further provides that in addition to ss. 136 and 73(4) of the BIA, rights of landlords are determined according to the law of the province in which leased premises are situated. In Alberta, that law includes the LRBA which further limits a landlord's rights in bankruptcy. Through this series of statutory provisions, it submits Parliament has provided that the landlord's rights under the CCAA are identical to those under the BIA and thus, under the LRBA.

Relevant legislation

[6] The relevant provision in the CCAA is s. 12 which provides:

> 12. (1) For the purposes of this Act, "claim" means any indebtedness, liability or obligation of any kind that, if unsecured, would be a debt provable in bankruptcy within the meaning of the *Bankruptcy and Insolvency Act*.
>
> Determination of amount of claim
> (2) For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor shall be determined as follows:
>
> (a) the amount of an unsecured claim shall be the amount
>
> (i) in the case of a company in the course of being wound up under the *Winding-up and Restructuring Act*, proof of which has been made in accordance with that Act,
>
> (ii) in the case of a company that has made an authorized assignment or against which a receiving order has been made under the *Bankruptcy and Insolvency Act*, proof of which has been made in accordance with that Act, or
>
> (iii) in the case of any other company, proof of which might be made under the *Bankruptcy and Insolvency Act*, but if the amount so provable is not admitted by the company, the amount shall be determined by the court on summary application by the company or by the creditor; and
>
> (b) the amount of a secured claim shall be the amount, proof of which might be made in respect thereof under the *Bankruptcy and Insolvency Act* if the claim were unsecured, but the amount if not admitted by the company shall,

> in the case of a company subject to pending proceedings under the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act*, be established by proof in the same manner as an unsecured claim under the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act*, as the case may be, and in the case of any other company the amount shall be determined by the court on summary application by the company or the creditor.
>
> Admission of claims
> (3) Notwithstanding subsection (2), the company may admit the amount of a claim for voting purposes under reserve of the right to contest liability on the claim for other purposes, and nothing in this Act, the *Winding-up and Restructuring Act* or the *Bankruptcy and Insolvency Act* prevents a secured creditor from voting at a meeting of secured creditors or any class of them in respect of the total amount of a claim as admitted.

[7] The following provisions in the BIA are also relevant:

Scheme of Distribution

Priority of claims

> 136. (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:
> ...
> (f) the landlord for arrears of rent for a period of three months immediately preceding the bankruptcy and accelerated rent for a period not exceeding three months following the bankruptcy if entitled thereto under the lease, but the total amount so payable shall not exceed the realization from the property on the premises under lease, and any payment made on account of accelerated rent shall be credited against the amount payable by the trustee for occupation rent;
> ...

Application of provincial law to landlords' rights

> 146. Subject to priority of ranking as provided by section 136 and subject to subsection 73(4), the rights of landlords shall be determined according to the laws of the province in which the leased premises are situated.

[8] The provisions in the LRBA which the appellant submits are relevant are:

> Assignment of property
> 1 A lessee against or by whom a receiving order or assignment is made under the *Bankruptcy and Insolvency Act* (Canada) is deemed to have made an assignment of

all the lessee's property for the general benefit of the lessee's creditors before the date of the receiving order or assignment.

Payment of rent after assignment

2 As soon as the receiving order or assignment is made

(a) the landlord of the lessee is not afterwards entitled to distrain or realize the rent by distress, and

(b) the trustee in whom the property of the lessee vests under the *Bankruptcy and Insolvency Act* (Canada) shall pay to the landlord in priority to all other debts

(i) an amount not exceeding in value the distrainable assets of the lessee and not exceeding 3 months' rent accrued due before the date of the receiving order or assignment, and

(ii) the costs of distress, if any.

Surplus rent

3 The lessee is a debtor to the landlord

(a) for all surplus rent in excess of the 3 months' rent accrued due at the date of the receiving order or assignment, and

(b) for any accelerated rent to which the landlord may be entitled under the lease but not exceeding an amount equal to 3 months' rent.

When landlord unable to claim from lessee

4 Subject to section 3, the landlord has no right to claim as a debt any money due to the landlord from the lessee for any portion of the unexpired term of the lessee's lease.

Analysis

[9] As a pure question of law, the standard of review is correctness. I agree with the Chambers Judge that the LRBA does not apply to limit or quantify the landlord's claim in CCAA proceedings.

[10] I arrive at this conclusion on the basis, first, that the condition precedent set out in the LRBA for its application (and mirrored in its correlative, Part II of the BIA, which deals with Receiving Orders and Assignments) is not satisfied when the debtor is not the subject of a receiving order or an assignment, nor does the LRBA fit within the scheme and intent of the CCAA. Second, the interpretation of s. 12 of the CCAA does not direct the importation of all the provisions of the BIA into the CCAA when determining the amount of the claim. Third and most significantly, the objects of the BIA and CCAA are distinct and each must be interpreted with their respective purposes in mind.

The condition precedent for application of the LRBA

[11] That provincial legislation can deal with a landlord's rights upon the bankruptcy of a tenant if it does not conflict with the BIA (***Principal Plaza Leasehold Ltd. v. Principal Group Ltd.*** (1996), 188 A.R. 187 (Q.B.)) is not in dispute. There is no question that the LRBA properly operates within a bankruptcy context, when the debtor is the subject of either a receiving order or an assignment.

[12] In such a case, s. 136(1)(f) of the BIA confers on the landlord a preferred claim for arrears of rent for a specified period and provincial legislation is called into operation pursuant to s. 146. Consequently the LRBA's provisions are invoked.

[13] The appellant seeks to invoke these provisions when a debtor is not the subject of a receiving order or an assignment, but rather, proposes a plan of arrangement under the CCAA. In my view, the LRBA's provisions are not invoked in such circumstances.

[14] The LRBA sets out the conditions under which the provisions of the Act operate. The triggering condition is that a receiving order or assignment under the BIA be made against or by the lessee. Section 1 describes the effect of a receiving order or assignment into bankruptcy. Section 2 operates "as soon as the receiving order or assignment is made", making it clear that the pre-condition is the receiving order or assignment.

[15] The entire LRBA should be read as relying upon the operation and effect of a receiving order or assignment under the BIA. Sections 3 and 4 of the LRBA, which limit the landlord's debt, must be interpreted as requiring the condition precedent of a receiving order or assignment. Nothing in the wording of the LRBA suggests it applies in the absence of a receiving order or assignment into bankruptcy, and no receiving order or assignment is made while a company attempts to restructure under the CCAA.

Section 12 of the CCAA

[16] The specific sub-clause at issue in this appeal is s. 12(2)(a)(iii), which appears under the heading "Determination of amount of claim". Omitting the irrelevant sub-clauses, it states:

> For the purposes of this Act, the amount represented by a claim of any secured or unsecured creditor shall be determined as follows: (a) the amount of an unsecured claim shall be the amount...(iii) in the case of any other company, proof of which might be made under the Bankruptcy and Insolvency Act, but if the amount so provable is not admitted by the company, the amount shall be determined by the court on summary application by the company or by the creditor.

[17] It is the appellant's position that this sub-clause must be interpreted as mandating the importation of the BIA and LRBA to expressly calculate the amount provable. I reject that interpretation for the three reasons set out below.

Use of the Word "Might" Conveying Discretion

[18] The first basis for my disagreement stems from Parliament's use of the words "might be made" (in sub-clause iii) which *per se* confers flexibility. This is underscored and reinforced when contrasted with the imperative "has been made" specified in the other two sub-clauses, (i) and (ii). In my view, "might" should be understood as meaning "could", i.e., the claim may be capable of being proven under the BIA.

[19] This interpretation is consistent with a long line of unassailable authorities. In ***Algoma Steel Corp. v. Royal Bank of Canada*** (1992), 11 C.B.R. (3d) 11 (Ont. Gen. Div.), Farley J. held that the word "shall" in s. 12(2) which then stated that "the amount represented by a claim...shall be defined as follows..." should be interpreted as "may" when one appreciates that the debtor companies and all affected stakeholders are entitled to a broad and liberal interpretation of the jurisdiction of the court under the CCAA.

[20] Ten years later, the following statement by Houlden and Morawetz in ***2003 Annotated Bankruptcy and Insolvency Act*** (Toronto: Carswell, 2002) at 1100 is analogous to the issue before us. Citing ***In re Parisian Cleaners and Laundry Ltd. v. Blondin*** (1938), 20 C.B.R. 452 (Que. C.A.), they stated: "The purpose of s. 12(2) [of the CCAA] is to provide a means of determining the amount of a claim, not to incorporate the provisions of the Bankruptcy and Insolvency Act as to what constitutes a preferred or unsecured claim.". (Emphasis added) The same proposition is also supported by ***Québec (Sous-ministre du revenu) v. Wynden Canada Inc.*** (1983), 47 C.B.R. (N.S.) 76 (Que. S.C.), and ***Quebec Steel Products (Industries) Ltd. v. James United Steel Ltd.*** (1969), 5 D.L.R. (3d) 374 (Ont. H.C.).

[21] In my view, the words "might be made under the BIA" should be understood to mean "could be made". In other words, the claim may be, but must not necessarily be, capable of being proven under the BIA.

Use of the Word "Determined" Conveying "Methodology"

[22] My second disagreement stems from my broader interpretation of the word "determined" as used in the opening sentence of s. 12(2). The interpretation urged upon us by the appellant is that "determined" should be interpreted as meaning "calculated". However, reference to the BIA indicates that use of the term has two meanings: it can mean either a "methodology" or a "calculation", i.e., a formula for calculating a specific amount.

[23] That "determination" is used to mean "methodology" is illustrated by the following example. Section s. 121(1) broadly defines "claims provable" and the subsequent sub-sections add more specificity. Section 121(2) states that the "determination" of whether contingent and unliquidated claims are provable claims and their valuation is in made accordance with s. 135. The term "determination" in s. 121(2) clearly refers to a methodology, since s. 135 does not provide a formula for calculation of the amount, but rather a methodology at s. 135(1.1):

Claims provable

121. (1) All debts and liabilities, present or future, to which the bankrupt is subject on the day on which the bankrupt becomes bankrupt or to which the bankrupt may become subject before the bankrupt's discharge by reason of any obligation incurred before the day on which the bankrupt becomes bankrupt shall be deemed to be claims provable in proceedings under this Act.

Contingent and unliquidated claims

(2) The determination whether a contingent or unliquidated claim is a provable claim and the valuation of such a claim shall be made in accordance with section 135.

Determination of provable claims

135(1.1) The trustee shall determine whether any contingent claim or unliquidated claim is a provable claim, and, if a provable claim, the trustee shall value it, and the claim is thereafter, subject to this section, deemed a proved claim to the amount of its valuation.

[24] When Parliament directed that the claims of unsecured creditors are those that might be proven under the BIA, it did not refer to the quantification or calculation of the amount provable in bankruptcy. In my view, it was intended to define who is included in the scheme of the CCAA, so as to override conflicting common law definitions.

The Dilemma of Which Section of the BIA To Invoke to Calculate Quantum

[25] This interpretation is supported by my third area of disagreement with the appellant. Were one to adopt the appellant's interpretation of sub-clause (iii), i.e., that the *amount* of the claim must be *calculated* in accordance with the methodology for calculating such claims under the BIA/LRBA, the issue then raised is: should one apply the method set out in s. 65.2 or that in s. 136, both of which apply to landlords? Each method yields substantially different results.

[26] As a preface, and at the risk of stating the obvious, the BIA governs two types of debtors. Part III, titled "Proposals", is similar to the scheme and object of the CCAA, and is intended to govern those debtors who, with the support their creditors, have a reasonable hope of returning to financial viability. In contrast, Part II, titled "Receiving Orders and Assignments" and its companion section, Part V ("Administration of Estates") govern situations where the debtor has no hope of returning to financial viability, but rather, its assets are vested in a trustee for distribution among the debtors' creditors. These two discrete objects of the BIA are essential to the analysis that follows.

[27] For landlords, the direction in s. 12(1)(a)(iii) of the CCAA cannot be read as requiring the valuation of the amount of the claim as set out in the BIA because the BIA itself provides two different methods and amounts that may be applicable to landlords' claims.

[28] The first is s. 65.2 (in Part III, Proposals), which makes provisions for disclaiming commercial leases. If the disclaimer of the lease is in accordance with the requirements of the section, s. 65.2(4) sets out the amount the landlord may claim as follows:

> Effects of disclaimer
> (4) Where a lease is disclaimed under subsection (1),
>
> (a) the landlord has no claim for accelerated rent;
>
> (b) the proposal must indicate whether the landlord may file a proof of claim for the actual losses resulting from the disclaimer, or for an amount equal to the lesser of
>
> (i) the aggregate of
>
> (A) the rent provided for in the lease for the first year of the lease following the date on which the disclaimer becomes effective, and
>
> (B) fifteen percent of the rent for the remainder of the term of the lease after that year, and
>
> (ii) three year's rent; and
>
> (c) the landlord may file a proof of claim as indicated in the proposal.

[29] Section 65.2 limits a landlord's claim under a proposal and provides for a larger amount than when the debtor is the subject of a receiving order or assignment. This accords with authorities which suggest that proposals must offer creditors some better advantage than a bankruptcy: ***Re Pateman*** (1991), 5 C.B.R. (3d) 115 (Man. Q.B.), ***Re Sumner Co.*** (1984) Limited (1987), 64 C.B.R. 219, ***In Re Allen Theatres Ltd.*** (1922), 3 C.B.R. 145 (Ont. S.C.).

[30] Section 136 (in Part V) provides a scheme for the distribution of the assets of a bankrupt who is the subject of a receiving order or an assignment under Part II. Landlords are specifically provided for at s. 136(1)(f) as follows:

> Priority of claims
>
> 136. (1) Subject to the rights of secured creditors, the proceeds realized from the property of a bankrupt shall be applied in priority of payment as follows:
> ...
> (f) the landlord for arrears of rent for a period of three months immediately preceding the bankruptcy and accelerated rent for a period not exceeding three months following the bankruptcy if entitled thereto under the lease, but the total amount so payable shall not exceed the realization from the property on the premises under lease, and any payment made on account of accelerated rent shall be credited against the amount payable by the trustee for occupation rent;

[31] This is the section that the appellant urges upon us as being part of the unbreakable thread. In my view, nothing in the wording of s. 136 assists it's position. On the contrary, the limitation on the amount a landlord may claim in s. 136(f) appears under the heading "priority of claim". As appellant's counsel explained, there is a trade off, the amount which the landlord receives is reduced from the full amount which could be claimed under a lease and in return, the landlord receives a priority position when the proceeds of the bankrupt's property is paid out. Section 136 requires payment of the enumerated claims in full in the order specified before any other unsecured creditor receives payment.

[32] However, there is no scheme for priority payment of claims set out in the CCAA. Thus, the effect on the landlord, were this interpretation accepted, is to compromise the claim not once, but twice, without the benefit of any priority, as noted by the Chambers Judge.

[33] If s. 65.2 were to be applied, it assumes that the proposal provisions, Part III of the BIA, applies to CCAA and not Parts II and V, the bankruptcy provisions. Section 146 of the BIA which allows for the application of provincial law is also included in Part V and its provisions are in reference to s. 136 which sets out distribution in bankruptcy proceedings, not proposals.

[34] If s. 12(2)(a)(iii) of the CCAA requires calculation of an amount in accordance with the BIA, as submitted by the appellant, it would have to stipulate which of ss. 65.2 or 136 is applicable. It

does not, providing further support that the BIA does not direct the calculation of the amount of a landlord's claim in a CCAA proceeding or that the CCAA requires s. 136 of the BIA be applied.

[35] During oral argument, the appellant sought to distinguish cases involving Ontario's provincial legislation which is not as restrictive as the Alberta LRBA. But the provincial legislation setting out the rights of landlords in bankruptcy proceedings is irrelevant if ss. 136 and 146 of the BIA do not apply to the CCAA.

[36] There are numerous cases dealing with landlords' claims that have treated the CCAA as an autonomous statute and did not look to s. 12 as directing the use of BIA provisions to determine the amount of the claim. ***Re Woodward's Limited*** (1993), 20 C.B.R. (3d) 74 (B.C.S.C.), is an example of the purposive approach taken by courts under the CCAA in dealing with creditors.

[37] Decisions in ***Re Agnew Group Inc.*** unreported February 4, 1994 (Ont. Gen. Div.), ***Sklar-Peppler Furniture Corporation v. Bank of Nova Scotia*** (1991), 86 D.L.R. (4th) 621 (Ont. Gen. Div.), ***Grafton-Fraser Inc. v. Canadian Imperial Bank of Commerce*** (1992), 90 D.L.R. (4th) 285 (Ont. Gen. Div.), and ***Ambro Enterprises Inc. (Re)*** (1993), 22 C.B.R. (3d) 80 (Ont. Gen. Div.), all treated landlord's claims very differently than the BIA and took a broad approach to the classification and quantification of landlords' claims to facilitate the object and purpose of the CCAA.

[38] The appellant was unable to cite any authority to compel us to a different conclusion. The appellant submits that the Court's decision in ***Luscar Ltd. v. Smoky River Coal Ltd.*** (1999), 175 D.L.R. (4th) 703, determined that s. 12(2) provides that an amount of a claim must be that amount as provided for under the BIA. I disagree. The issue in ***Smoky River*** (*supra*) was whether a CCAA judge had the discretion to establish a procedure for resolving a dispute between parties who had agreed by contract to arbitrate their disputes. This required that the dispute fall within the jurisdiction of the CCAA. In other words, the plaintiffs in the dispute had to be considered "creditors" for the purpose of the CCAA. The court's focus was on s. 12(1) of the CCAA, not s. 12(2). This Court looked to the similar wording between the BIA and CCAA referring to "debt provable in bankruptcy" and "claim provable in bankruptcy" to conclude that the plaintiffs, who had a contingent and unliquidated claim, were creditors. Valuation of the amount was not an issue since the claim was contingent and unliquidated. The issue was solely one of the court's discretion to establish a process to resolve the amount of the claim.

[39] The wording in s. 12(2)(a)(iii) is intended to be and must be general. That sub-clause captures all the unsecured claims of a company not subject to a receiving order or assignment or winding up. These unsecured claims include landlords as creditors, but also capture a host of unliquidated and contingent claims, the latter of which would not be defined as creditors at common law. Thus, the phrase "proof of which might be made under the Bankruptcy and Insolvency Act" directs that the various methods within the BIA to determine claims are to be employed to cover the wide range of potential claims. This clause is intended to define who is included in the scheme of the CCAA and override conflicting common law definitions.

[40] Moreover, amendments to both the BIA and CCAA in 1997 and 1998 were intended to harmonize the two pieces of legislation. Changes were made to the BIA to enhance the rights given to landlords, but no change in either legislation amended or introduced provisions to apply the BIA to landlords in CCAA proceedings.

[41] More recently, in November 2003, the Standing Senate Committee on Banking, Trade and Commerce released "Debtors and Creditors Sharing the Burden: A Review of the BIA and the CCAA", a report calling for substantial reform of the federal insolvency statutes (the "Report"). Twenty-two of the Committee's recommendations apply specifically to commercial insolvencies.

[42] A very broad range of stakeholders provided input on virtually all elements of the two *Acts*. The Committee concluded that [p. 173]: "We believe that the need for flexibility is paramount with the CCAA....". As a consequence, they recommend that the BIA and the CCAA continue to operate as separate statutes.

[43] The Report also considered the existence of contracts, including leases, and how these should be dealt with under the legislation. The Joint Task Force on Business Insolvency Law Reform was of the view that the ability set out in the BIA to disclaim executory contracts including real property leases should apply to all bankruptcy and insolvency proceedings. The Committee's final recommendation was that:

> The BIA and the CCAA be amended to permit disclaimer of executory contracts in existence in the date of commencement of proceedings under the Acts. This disclaimer should apply to all contracts, provided that a number of conditions are met. In particular: the debtor should be obliged to establish inability or serious hardship in restructuring the enterprise without the disclaimer; the co-contracting party should be permitted to file a claim in damages in the restructuring [and other conditions specific to collective agreements].
>
> [Emphasis added]

[44] The Report recognized that the CCAA treats landlords differently than the BIA and harmonization in respect of this difference was recommended. Significantly, no such recommendations were made with respect to implementing a consistent approach for the valuation of a landlord's claim.

Purposes of the BIA and CCAA

[45] Assuming the words are capable of bearing the interpretation urged upon us by the appellant, statutory interpretation requires that s. 12 be read in the context of the scheme, the object, and the intention of Parliament in passing the CCAA and where the CCAA refers to the BIA, regard must also be given to the scheme, object and intention of that Act.

[46] The proper approach to statutory interpretation requires that words be read contextually to give effect to the purpose and intent of the legislation. As the Supreme Court of Canada recently stated in ***Harvard College v. Canada (Commissioner of Patents)***, [2002] 4 S.C.R. 45 at para. 154, "This Court has on many occasions expressed the view that statutory interpretation cannot be based on the wording of the legislation alone (***Rizzo & Rizzo Shoes Ltd. (Re)***, [1998] 1 S.C.R. 27)". When interpreting specific provisions, a court must pay sufficient attention to the scheme of an act, its objects or the intention of the legislature.

[47] The BIA is a comprehensive legislative scheme largely designed to facilitate the orderly liquidation of the estate of a bankrupt. The purposes of the Act include conducting the liquidation in a manner that maximizes recovery for the general benefit of the creditors, treating similarly situated creditors fairly and in accordance with the Act. The Act sets out priorities and a detailed process, making the BIA a logical choice when the only possible outcome is dissolution. It provides a high degree of certainty for all creditors.

[48] The CCAA is a very brief piece of legislation with a purpose described in ***Elan Corp. v. Comiskey*** (1990), 1 O.R. (3d) 289 (C.A.) as follows:

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

[49] The very brevity of the Act and the fact that it is silent on details permits a wide and liberal construction to enable the Act to serve its remedial purpose: ***Chef Ready Foods Ltd. v. Hongkong Bank of Canada***, [1991] 2 W.W.R. 136 (B.C.C.A.).

[50] The role of the CCAA is unique. It affords the debtor company an opportunity to restructure its affairs in a manner that will permit it to continue as a going concern without intervention by creditors which might hamper or prevent the restructuring process. Its ultimate goal is to avoid bankruptcy, thereby maximizing creditor compensation, reducing the inevitable loss of employment precipitated by bankruptcy and, if successful, offering the prospect of shareholder equity. The debtor remains in possession and control of the company under the supervision of a court appointed monitor. See for example, ***Re Canadian Airlines Corp.***, [2000] 10 W.W.R. 269, 2000 ABQB 442, leave denied, [2000] 10 W.W.R. 314, 2000 ABCA 238, leave denied [2001] S.C.C.A. No. 60; ***Re***

Lehndorff General Partner Ltd. (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.); ***Northland Properties Ltd. v. Excelsior Life Insurance Co. of Canada***, [1989] 3 W.W.R. 363 (B.C.C.A.).

[51] The decision to seek protection under the CCAA is that of the debtor. There are numerous considerations in choosing the CCAA as opposed to utilizing the proposal provisions of the BIA, however, one significant factor is the high degree of flexibility the CCAA offers in terms of plan fundamentals and process. The BIA is highly rule driven with clearly defined standards and processes for developing a proposal. Thus, the debtor company under CCAA has far broader latitude within which to propose a plan capable of winning creditor support.

[52] A company which invokes the CCAA process retains a great deal of control over it. Under the CCAA claims process, the company, not the monitor, initially accepts or rejects claims. Section 12(2)(a)(iii) states, "if the amount so provable is not admitted by the company, the amount shall be determined by the court on summary application by the company or by the creditor".

[53] Section 12(2)(a)(iii) permits different treatment of different claims. The company can admit a claim, or refer it to a court to determine by summary application or trial. In recent cases, recognizing the need for expedited valuation of claims to facilitate the process, the courts have begun appointing a claims officer to make this determination.

[54] Rehabilitation of a company under the CCAA is furthered by a climate that allows for commercial realities and variables to be considered and negotiated among and by the affected parties. The debtor company, through the operation of the stay, is given the breathing room to explore alternatives and to structure a proposed plan that will find favour with creditors, sufficient to support the restructuring.

[55] To maximize flexibility, it is unwise and unnecessary to incorporate, by oblique reference, portions of the BIA or the LRBA that may not assist the process. What the CCAA requires is that the end result, the plan of arrangement, be fair and reasonable. Only when those conditions are met, will a plan of arrangement be approved by a court. What constitutes fairness is largely determined by the circumstances of each case. An important measure of fairness is the degree to which creditors approve it. Creditor support can create an inference that assenting creditors see the plan as viable and commercially reasonable given other available alternatives. The courts generally accept the view that the creditors are in a better position to determine whether the plan is in their own best interests.

The implications of incorporating all BIA provisions into the CCAA

[56] If the appellant's interpretation of s. 12 of the CCAA is accepted, such an interpretation would not be limited to claims by landlords but would include all other unsecured creditors who fall within the provisions of the BIA. At minimum, tax claimants, employees claims, and workers compensation indebtedness as provided in s. 136 of the BIA would apply to the CCAA, thereby increasing the rigidity and reducing the options for compromise.

[57] Under the BIA, the claims receiving priority after secured creditors are enumerated in s. 136 and have ten categories, each ranking behind the other. All must be paid in full before unsecured creditors recover anything. If the appellant is correct, arguably, those claims must be quantified under the BIA but without priority and subject to possible further compromise.

[58] Two other examples illustrate the uncertainty and difficulty that would arise if the appellant's submission was adopted. First, federal excise tax legislation gives Canada Customs and Revenue Agency (CCRA) a deemed trust for amounts due to it for GST and prohibits any legislation other than the BIA from overriding the deemed trust. There is no deemed trust in a bankruptcy, but cases including this proceeding have held a deemed trust exists in a CCAA restructuring. If the appellant is correct, then excise tax claims must be treated the same in CCAA and a deemed trust would be overridden.

[59] A second example that would import complex and unsettled issues in bankruptcy law is a severance claim. These claims raise thorny issues such as whether the bankruptcy itself triggers termination of employment without cause and thereby gives rise to a provable claim, whether legislation which continues a collective agreement gives rise to a severance claim, and whether a bankruptcy triggered by a creditor and not the bankrupt is to be distinguished. Under the CCAA, employees' claims for severance avoid those issues by treating employees as claimants and capable of being compromised under the CCAA. In ***Re Woodward's Ltd.***, a British Columbia case, the court recognized the claims of employees who were terminated and included them in the class of general creditors maintaining that once the amount of the claim had been agreed upon or determined by a court, the employees had the same rights as any other unsecured creditor.

The inconsistency of the BIA and LRBA with the objectives of the CCAA

[60] Automatically applying the LRBA when protection is sought under the CCAA results in the immediate compromise of a landlord's claim prior to the formulation of a plan. Its effect could be to isolate the landlord's claim, treating it differently and potentially unfairly by automatically compromising it without consideration of the plan as a whole. There is no compelling reason for such an *a priori* blanket regime for landlords in a CCAA proceeding that is intended to preserve the status quo pending the approval of a plan.

[61] There is no reported decision of a court applying s. 136 of the BIA, the LRBA or other provincial legislation equivalent to the LRBA. Instead, case law shows those provisions are not applied and courts have agreed with Farley J., who stated in ***Re Lehndorff General Partner Ltd.*** at para. 11, "Amounts owing to landlords in respect of arrears of rent or unpaid rent for the unexpired portion of lease terms are properly dealt with in a plan of compromise or arrangement: see ***Sklar-Peppler Furniture Corporation*** (1992), 8 C.B.R. (3d) 312 (Ont. Gen. Div.) especially at p. 318."

[62] Landlords' claims have been a source of difficulty under the CCAA and have spawned considerable academic comment on the problems and potential ways to resolve them. The chambers judge and the respondent have noted many including the following: Moffat, "Treatment of Landlords

in Commercial Re-organizations" (1997) 10 Comm. Insol. R. 14; Rotsztain and Kraft, "Landlords and Leases in Bankruptcy and Insolvency Act and Companies' Creditors Arrangement Act Reorganizations" [1994] ICR 2005; Marantz, "Retail Revival: The Eaton's Restructuring" (1998), 10 Comm. Insol. R. 37; Birkness, "*Re Woodward's Limited* – The Contextual Commonality of Interest Approach to Classification of Creditors" (1993) 20 C.B.R. (3d) 91; Kulidjian, Sheldon and Peck, "Potential Creditors Under the Companies' Creditors Arrangement Act" (1996) 13 National I. R. 4; Marantz, "Dealing with Proposals: Acting for the Creditor in CCAA and the New Bankruptcy Act Proposals" (Ontario: Canadian Bar Association C.L.E., 1993); Hayes, "Landlords' Rights on Bankruptcy and in Restructuring Proceedings" in *The Failing Smaller Business: Essential Debtor - Creditor Practice* (Law Society of Upper Canada, 1994); and Johnston and Campbell, "Using the CCAA to 'Cram Down' Landlords: *Sklar-Pepplar Furniture Corporation v. Bank of Nova Scotia* and its Aftermath" (1992) 1 Nat. Real Property L. Rev. (2d) 181.

[63] Much of the comment accords with those of Moffat, "Treatment of Landlords in Commercial Re-organizations", where the author states at 16:

> Unlike the proposal provisions of Part II of the BIA, the CCAA does not make any special provision for the valuation or classification of landlord claims under a plan. This does not give the debtor the power to compromise a landlord's claim in any way it chooses; the courts have placed limits on the method by which landlord claims may be valued and classified under a plan. A landlord which objects to its treatment under a plan may pursue a number of remedies, including seeking amendment of the plan prior to the meeting of creditors held to vote upon the plan, voting against the plan at the creditors' meeting, and opposing court approval of the plan at the sanction hearing.

[64] Courts have approved a variety of solutions to quantifying landlord's claims without reliance on the BIA or provincial legislation. In ***Sklar-Peppler Furniture Corporation v. Bank of Nova Scotia***, the court classified the landlords among the general class of unsecured creditors for both outstanding rent and any contingent claim for damages arising from repudiation of the lease. The court permitted the termination of certain leases upon the plan's approval and limited damages to three months arrears of rent, three months' rent after a protection order and share pro rata with other ordinary creditors for the balance of their claims. Borins J. stated at 318:

> [R]ecognition must be given to the legislative intent to facilitate corporate re-organization and that in the modern world of large and complex business enterprises the excessive fragmentation of classes could be counter-productive to the fulfilment of this intent....In my view, in placing a broad and purposive interpretation upon the provisions of the CCAA the court should take care to resist approaches which would potentially fragment creditors and thereby jeopardize potentially viable plans of arrangement, such as the plan advance in this application.

[65] In ***Grafton Fraser*** and in ***Re Agnew Group Inc.***, the landlords were granted claims based on the present value of the unexpired terms of the abandoned leases. In ***Agnew***, with the exception of one landlord with a particularly long term lease, landlords received a maximum of six months' rent.

[66] Rotsztain and Kraft in "Landlords and Leases in BIA and CCAA Reorganizations" commenting on ***Agnew*** and ***Grafton-Fraser*** note at 5-31 that, "A claim based on the present value of the unexpired term of the lease is something which landlords generally look upon more favourably than a straight payment of a few months' rent." The authors explain that this is because this approach recognizes the significant long term impact termination can have on landlords and allows the factoring in of tenant inducements which are generally built into rental payments over the entire lease.

[67] On this appeal, the appellant suggests incorporating the LRBA serves a useful purpose because without the LRBA limitations, the landlord's claim is so potentially large that it makes a restructuring impossible, and requires too much time to mitigate and thus to quantify the landlord's claim.

[68] Speaking generally, I disagree that the magnitude or quantification issues arising from a landlord's claim make restructuring impossible. Treatment of a landlord's claim under a plan may produce the same result as that under the LRBA and such plan might be approved by both the landlord and the court. Similarly, treatment under the plan could be less than or more than the amount provided for under the LRBA. But these are issues for negotiation and ultimately, court approval.

[69] In the absence of legislation, the unique and distinct purpose of the CCAA has been and must remain the focus for judicial interpretation and discretion. Where there is neither statutory direction nor demonstrated need, it is undesirable to import statutory provisions that may have a negative affect on the flexibility afforded by the CCAA and thus become an impediment to its creative use. Adopting the LRBA as determinative of a landlord's claim under the CCAA is an example of narrowing the benefit of a broad statute in favour of a certainty. As a general proposition and without considering the merits of that position in a particular plan, such an approach is to be discouraged.

Relief

[70] For these reasons, the appeal is dismissed.

Appeal heard on December 2, 2003

Reasons filed at Calgary, Alberta
this 29th day of January, 2004

Paperny J.A.

I concur: _____
McFadyen J.A.

I concur: _____
Clark J.

Appearances:

B. P. O'Leary, Q.C.
C. Murray
for the Appellant

L. B. Robinson
for the Respondent

R. J. Gilborn, Q.C.
for the Monitor

TAB 13

CITATION: Unique Broadband Systems, Inc. v. Gerald T. McGoey, 2012 ONSC 3911
COURT FILE NO.: CV-11-9283-00CL
DATE: 2012-08-13

SUPERIOR COURT OF JUSTICE – ONTARIO

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 UNIQUE BROADBAND SYSTEMS, INC.

BEFORE: Mr. Justice H.J. Wilton-Siegel

COUNSEL: *Joseph Groia* and *Gavin Smyth*, for Jolian Investments Limited and Gerald McGoey

E. Patrick Shea and *Alexander MacFarlane*, for the Applicant, Unique Broadband Systems, Inc.

Matthew Gottlieb, for the Monitor

Peter Roy and *Alexandra Carr*, for DOL Technologies Inc. and Alex Dolgonos

Aubrey Kauffman, for Peter Minaki

S. Michael Citak, for Douglas Reeson

Michael McGraw, for Louis Mitrovich

Paul LeVay, for Malcolm Buxton-Forman

HEARD: June 13, 2012

ENDORSEMENT

[1] In these proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36 (the "CCAA"), Jolian Investments Limited ("Jolian") and Gerald McGoey ("McGoey") bring two motions: (1) seeking an order requiring that Unique Broadband Services, Inc. (the "Applicant") pay Jolian and McGoey advances in respect of their legal services pertaining to the claims determination process in the Applicant's CCAA proceedings; and (2) seeking an order or direction of this court adding certain former directors of the Applicant to the claims determination process. Similar motions were also brought by DOL Technologies Inc. ("DOL") and Alex Dolgonos ("Dolgonos") but were settled prior to the release of this Endorsement.

[2] I propose to deal with the motion for advancement first and then to deal with the motion to add the third parties.

Motion for Advancement

[3] As mentioned, Jolian and McGoey move for an order requiring the Applicant to pay advances on an interim basis pursuant to the Applicant's indemnity obligations with respect to their reasonable legal, accounting and audit expenses incurred to date since July 5, 2011, being the date of the Initial Order in these CCAA proceedings.

[4] The entitlement of the moving parties to advancement was addressed in a motion before Marrocco J. before the commencement of the CCAA proceedings. By order dated June 24, 2011, Marrocco J. ordered the Applicant to advance fees in respect of their respective legal expenses as more particularly set out therein. The present motions proceed on the basis that the order of Marrocco J. is valid.

[5] The moving parties argue that, as their claims and the Applicant's counterclaims against them are now being dealt with under the CCAA claims process, they are not obligated to seek an order lifting the stay in the Initial Order to obtain the advancement of funds to pay their legal expenses relative to these claims and counterclaims.

[6] The moving parties argue that advancement is mandatory in the present circumstances to give effect to the purpose of indemnification, as set out in *Med-Chem Health Care Ltd.* v. *Misir*, 2010 ONCA 380 (C.A.) at para. 20 and *Manitoba (Securities Commission)* v. *Crocus Investment Fund*, 2007 MBCA 36 (C.A.) at para. 50, which they say should govern notwithstanding the CCAA proceedings. They submit that the CCAA proceedings were initiated in order to avoid honoring the order of Marrocco J. They also argue that it is inequitable not to advance funds to them when the current directors are receiving an advancement of funds in respect of the claims asserted by the moving parties against them.

[7] I have sympathy for the last of these arguments. Nevertheless, I think that any claim for advancement after CCAA proceedings have been initiated constitutes a proceeding that is subject to the stay in the Initial Order. In the present case, these claims for advancement are clearly subject to the provisions of paragraph 12 of the Initial Order, as a "proceeding or enforcement process" in respect of the Marrocco J. order, and to the provisions of paragraph 13, as a "right or remedy" against the Applicant or affecting its property.

[8] Accordingly, it is necessary to consider whether the court should exercise its discretion to lift the stay and order compliance with the order of Marrocco J. The principles to be applied for such purpose are set out in the decision of Pepall J. (as she then was) in *Re Canwest Global Communications Corp.*, [2009] O.J. No. 5379 (S. Ct.) at paras. 32 and 33. As Pepall J. noted, the onus on the moving parties is a heavy one.

[9] These motions must be assessed against the current status of the Applicant. The Applicant has limited cash resources, subject to receipt of further dividends from Look Communications Inc., which are in the discretion of its board of directors, or the sale of the Applicant's investment in that company. The Applicant has no current business activities and no

income. It is subject to the CCAA proceedings because the claims of the moving parties, together with the claims of DOL and Dolgonos as of the date of the hearing of this motion, exceed the estimated value of the Applicant's assets. The claims process will determine the value of these claims and, as a corollary, the entitlement of the moving parties to indemnification, which claims will rank ahead of the claims of the shareholders.

[10] I conclude it is not appropriate to lift the stay for the following reasons.

[11] First, a significant consideration respecting the lifting of the stay from the Applicant's perspective is the effect on the assets of the Applicant and on its ability to propose a plan of reorganization based on a completed claims process. An important consideration in that regard is the need to minimize cash outlays by the Applicant in order to maximize the likelihood that it will be able to pursue the claims process through to completion.

[12] If financial hardship had been demonstrated, the court may well have had to engage in a balancing of the respective positions of the Applicant and the moving parties. However, the moving parties have not provided any financial information. Therefore, they cannot demonstrate any prejudice to them from a refusal to lift the stay. In these circumstances, the balance of convenience clearly favours the Applicant.

[13] Second, in the absence of information regarding the magnitude of the total advancement likely required in respect of the claims process and of financial information regarding the moving parties, the court is also not in a position to assess the exposure of the Applicant to the risk of non-payment if the court were to determine later that either or both of the moving parties was not entitled to indemnification.

[14] Third, while I agree that advancement would normally be ordered even in the context of a CCAA proceeding, I do not agree that advancement is mandatory in these circumstances. Notwithstanding the strong policy statements of both Canadian and American courts in favour of indemnification, I have not been provided with any case law of either jurisdiction that suggests that the policy of indemnification trumps all other considerations in a CCAA context such that advancement is absolutely required. Moreover, I do not think that is a correct proposition of law, given the additional considerations described above that come into play in a CCAA context. Each circumstance must be assessed on its own facts.

[15] Fourth, I reject the argument that, because the only activity of the Applicant is as a "litigation vehicle", the legal fees and other fees for which advancement is sought are post-filing services to the Applicant payable under the terms of the agreement between the Applicant and Jolian. The legal services are rendered to the moving parties. Insofar as they seek advancement, their entitlement remains subject to a final determination regarding their right to indemnification, failing which any monies advanced would have to be repaid. This does not reflect the characteristics of services rendered to the Applicant.

[16] Fifth, I cannot assess the merits of the moving parties' claims in the claims process, or the Applicant's claims by way of set-off. I also am not in a position to say that any actions of the Applicant, including the initiation of CCAA proceedings to avoid payment of the amounts ordered by Marrocco J., among other considerations, are such that they disentitle the Applicant from the continued benefit of the stay. This is a matter that would require a trial at a later stage in this proceeding.

[17] Based on the foregoing, the motions for advancement are denied.

Motions to Add Parties to the CCAA Proceedings

[18] Jolian and McGoey also move for an order or direction adding each of Louis Mitrovich ("Mitrovich"), Peter Minaki ("Minaki") and Douglas Reeson ("Reeson") (collectively, the "Former Directors") to the claims process in order that the claims of Jolian and McGoey against them for contribution, indemnity and misrepresentation may be determined within the CCAA claims process. A similar motion of DOL and Dolgonos to add Malcolm Buxton-Forman was adjourned.

[19] While denying any wrongdoing as alleged by the Applicant in its set-off claims in the claims process, each of the moving parties intends assert these claims against the Former Directors based on the conduct of these parties in approving the agreements and certain payments at issue in the claims process.

[20] The moving parties make three submissions. They say the Former Directors are already parties to the CCAA proceedings by virtue of their claims for indemnification in the CCAA proceedings that were filed in response to the Applicant's Counterclaim in the action commenced by Jolian and McGoey against the Applicant prior to the CCAA proceedings. They say that, without a determination of the claims against the Former Directors, the CCAA process will be lengthened considerably pending a determination of the merits of these claims outside the CCAA. Lastly, they say the Applicant has interwoven the conduct of the Former Directors into its response to the claims of Jolian and McGoey in the claims process. More generally, the moving parties argue that it will be unfair if they are forced to participate in two sets of litigation in order to determine the totality of their claims.

[21] The claims fall broadly into two categories – claims for which the Applicant seeks recovery and claims for which the Applicant asserts a right of set-off. The nature of these claimS is of some relevance to the conclusions herein.

[22] The first category comprises claims for the recovery of certain expenses for which the moving parties were reimbursed, for the recovery of certain amounts paid to their legal counsel by way of advancement of legal fees, and for damages in respect of the sale of the Canadian engineering and manufacturing business in September 2003.

[23] The damage claim has not yet been formally asserted and may never be. Accordingly, I consider it premature to address the issue of adding third parties in respect of this claim at this

time. The moving parties are at liberty to have this matter addressed by the Court if the Applicant advises that it has decided to pursue this claim on the basis of the specific claim being asserted. As the moving parties have received the monies for which recovery is sought, they can have no right to contribution in respect of any payment they may be required to make in respect of such monies.

[24] The second category of claims pertain to actions of the directors in approving the management agreement between Jolian and the Applicant and certain payments and other compensation to Jolian or McGoey. It is my understanding that the moving parties assert a claim against the Former Directors to the extent of any right of set-off found by a court to exist in favour of the Applicant in respect of such matters.

[25] Subject to the disposition of the claim regarding the sale of the manufacturing and engineering business set out above, these motions are dismissed for the following reasons.

[26] First, in the consideration of these motions, I do not accept the submission of the moving parties that the issue of joinder is governed by r. 29.01 of the *Rules of Civil Procedure*. The issue must be addressed in terms of whether joinder of the Former Directors furthers or hinders a timely and expeditious reorganization process under the CCAA pursuant to the discretion of the court under that statute.

[27] Second, the claims asserted against the Former Directors by the moving parties do not involve the Applicant directly. There is reason to doubt the authority of the court to require that disputes between creditors and third parties be determined within a claims process under a CCAA proceeding: see *Pacific Coastal Airlines Ltd.* v. *Air Canada*, [2001] B.C.J. 2580. While the present case may not fall strictly into this category of case by virtue of the contingent indemnification claims of the Former Directors, the translation of the Applicant's Counterclaim into the Claims Process would appear to render these claims moot. More generally, the court should be cautious about including third party claims, particularly where inclusion of such claims is not necessary to enable a debtor to propose a plan of reorganization. Among other considerations, such a procedure may limit or otherwise affect the rights of the third parties otherwise available under the *Rules of Civil Procedure*.

[28] Third, if it were necessary to include the claims against these parties in order to put the Applicant in a position to propose a plan of reorganization, joinder might well be necessary. However, I am satisfied that the claims against the Former Directors can proceed outside the claims process without jeopardizing the reorganization process. To the extent that such claims have not been finally resolved before consideration of a plan of reorganization, it is possible to provide for a continuation of the contingent indemnification claims of the Former Directors post-reorganization in the plan of reorganization.

[29] Fourth, joinder of the Former Directors will unnecessarily complicate the claims process, inevitably lengthening the process and making it more expensive. The result would be an

enhanced risk that the Applicant will run out of cash resources prior to completion of the claims process and submission of a plan of reorganization.

[30] Fifth, I do not think that a valid consideration is the fact that these claims arise because the Applicant has asserted that the agreement between Jolian and the Applicant, and the amounts alleged to be payable to the moving parties, are unenforceable or are invalidated because of the actions of the Former Directors. McGoey also had full knowledge of and participated in, the actions giving rise to the set-off claims. The only circumstances in which the moving parties can assert viable claims against the Former Directors would be the circumstances in which the Applicant is successful in respect of its set-off claims against the moving parties. On the other hand, to the extent the Applicant is unsuccessful in asserting these set-off claims, the moving parties will have no need to pursue the Former Directors.

[31] Sixth, the moving parties argue that the participation of the Former Directors is necessary so that they will be available as witnesses in the claims process. There are, however, other means of ensuring the presence of these parties as witnesses in these proceedings.

[32] Lastly, the issue of potentially conflicting decisions and consequential prejudice to the moving parties was raised but not fully addressed in this motion. However, I have reached the following conclusions regarding this risk that collectively indicate that the potential for prejudice is not material and should be manageable.

[33] First, in respect of the claims for the recovery of monies described above, there is no such risk as the issue will be determined by the CCAA claims process. As noted, any right of contribution will arise in favour of the Former Directors, if they satisfy any judgment in favour of the moving parties, not in favour of the moving parties. The issue of the addition of the Former Directors in respect of the damage claim has been deferred pending a further hearing if required.

[34] Second, in respect of the claims for set-off, the Applicant seeks declarations of nullity on the grounds that the agreements and other amounts alleged to be payable were not in the best interests of the Applicant or were vitiated by a conflict of interest.

[35] Given the fact that the Former Directors have knowledge of the Applicant's set-off claims in the CCAA claims process, there is a good argument that *res judicata* will operate in respect of any finding that the agreements and other amounts at issue were not in the best interests of the Applicant.

[36] The claims for nullification based on the existence of a conflict of interest fall into two categories. To the extent that a determination is made that the moving parties were themselves in a conflict of interest, I think it is probable that contribution would not be available to them in any event on the basis that they do not come before the court with clean hands.

[37] Insofar as the Former Directors, but not the moving parties, were held to have been in a conflict of interest, I acknowledge that there is a possibility of conflicting decisions to the extent

that *res judicata* does not operate. However, that risk is considerably diminished, if not excluded altogether, by the intention of Jolian and McGoey to call each of the Former Directors as witnesses. In these circumstances, the same evidentiary record should be before the court in the CCAA claims process as would be before the court in any third party proceeding brought by the moving parties for damages based on misrepresentations by the Former Directors regarding the validity of such agreements and transactions.

[38] Accordingly, the motion of Jolian and McGoey to add the Former Directors as parties in the claims process is dismissed.

Additional Issue

[39] Each of the Former Directors has also brought a motion seeking an order for advancement of their respective legal fees in the event the court were to order that they be joined as parties in the Applicant's CCAA claims process. In the circumstances, it is unnecessary to address these motions and I decline to do so.

Costs

[40] In the event the parties are unable to reach an agreement regarding the costs of these motions, they shall have thirty days to submit written cost submissions not to exceed five pages in length.

C. Wilton-Siegel J.

Wilton-Siegel J.

Date: August 13, 2012

CITATION: Unique Broadband Systems (Re), 2012 ONSC 6366
COURT FILE NO.: CV-11-9283-00CL
DATE: 2012-11-09

SUPERIOR COURT OF JUSTICE - ONTARIO

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 UNIQUE BROADBAND SYSTEMS, INC.

BEFORE: Mr. Justice H.J. Wilton-Siegel

COUNSEL: *E. Patrick Shea*, for the Applicant, Unique Broadband Systems, Inc.

Joseph P. Groia, for Jolian Investments Limited and Gerald McGoey

Peter Roy, for DOL Technologies Inc. and Alex Dolgonos

Matthew P. Gottlieb, for the Monitor, Duff & Phelps Canada Restructuring Inc.

HEARD: November 8, 2012

ENDORSEMENT

[1] The applicant seeks an order approving a process for marketing the shares of LOOK Communications Inc. ("LOOK") owned by UBS Wireless Services Inc., a subsidiary of the applicant. The proposed sales process is set out in the Eleventh Report of the Monitor, Duff & Phelps Canada Restructuring Inc. (the "Monitor"). The application is opposed on several issues by Jolian Investments Limited and Gerald McGoey (the "McGoey respondents") and by DOL Technologies Inc. and Alex Dolgonos (the "Dolgonos respondents").

[2] The proposed sales process contemplates that two directors of the applicant, Kenneth Taylor ("Taylor") and Victor Wells ("Wells"), will constitute a committee that will have decision-making responsibility for the sales process. It is contemplated that this committee will engage the Monitor to act as its sales agent in marketing the LOOK shares to the public and in managing the negotiation process in respect of offers for the shares. The third director of the applicant, Robert Ulicki ("Ulicki"), has expressed an interest in making an offer for the LOOK shares, either personally or through a corporation related to him. Accordingly, he has not participated in the approval of the sales process and will not participate in any meetings of the board of the applicant pertaining to the sales process or in any meetings of the committee overseeing the sales process.

[3] The McGoey respondents and the Dolgonos respondents (collectively, the "respondents") raise three specific issues which will be addressed in turn.

[4] First, these respondents allege that Ulicki should be prevented by Court order from making an offer for the LOOK shares in the sales process. Ulicki was a director of LOOK from July 2010 to October 2010. In his capacity as a director of the applicant, Ulicki is also aware of expressions of interest made to the applicant prior to a decision being made by the board of the applicant to offer the LOOK shares for sale, as set out in an affidavit that he has filed in connection with this motion. Among other things, in addition to meetings with two prospective investment dealers in May 2012, Ulicki has also reviewed six letters from parties expressing an interest in acquiring the LOOK shares, either directly from the applicant or as part of a partial takeover bid of LOOK or other business combination transaction with LOOK. The timing of this involvement is not clear in respect of all of these third party approaches to the applicant. However, it is clear that, in some if not all instances, Ulicki is aware of the indicative range of values for the LOOK shares proposed by these interested parties.

[5] In considering this matter, the litmus test of the applicant and the Court must be the establishment of a sales process that is likely to maximize the value received by the applicant for its LOOK shares. The respondents allege that permitting Ulicki to participate in the sales process as a prospective purchaser will deter all other interested parties from making an offer. This case has not, however, been established on the record before the Court on this motion.

[6] LOOK is a public company. The progress of the litigation between LOOK and the respondents, among others, is public knowledge. The respondents have not demonstrated that Ulicki has received any information regarding LOOK, either during the short period in which he was a LOOK director or in his capacity as a director of the applicant, that has not been disclosed to the public or is not otherwise available from the litigation record.

[7] The respondents have also failed to demonstrate that the information Ulicki has received to date regarding the parties who have previously expressed an interest in the LOOK shares would deter those parties, or other parties, from making an offer for the LOOK shares. There is no direct evidence before the Court on this issue apart from the respondents' assertion, which amounts to speculation at this stage. Moreover, there is some inherent protection against such an occurrence in the present circumstances. In the event that Ulicki were the only offeror, the applicant would need to satisfy the Court that such circumstances did not reflect a flawed sales process and the decision-making of the directors in persisting with such a sales process would also be subject to review.

[8] I wish to note, however, that in concluding that it is not appropriate for the Court to order that Ulicki should refrain from participating in the sales process, the Court is not determining that Ulicki is entitled to participate in the sales process. That remains a decision of the committee of directors who will oversee the sales process and who have access to more information than was presented to the Court. While section 36 of the *Companies Creditors Arrangement Act*, R.S.C. 1985, c. C-36, (the "CCAA") does contemplate related parties purchasing assets of a debtor subject to CCAA proceedings, this provision does not establish an automatic right in favour of a related party to participate in a sales process. Ultimately, the committee of Taylor and Wells bears a continuing responsibility to be satisfied that the sales process is conducted in a

manner that will maximize the value to the stakeholders and to demonstrate the integrity of that process when Court approval of a proposed transaction is sought. As part of that responsibility, the committee must be satisfied that Ulicki's participation in the sales process will not, and did not, impair that objective. The decision of the Court is limited to facts before it. The fact that the respondents have failed to satisfy the onus on them to establish evidence that prospective purchasers will be deterred from making an offer for the LOOK shares does not relieve the applicant from its obligation to be satisfied that this will not occur based on the facts before it and any other facts that may subsequently come to the attention of the committee members.

[9] Second, the respondents seek the appointment of representatives to the committee of the applicant overseeing the sales process. This relief is denied for a general reason as well as reasons specific to each of McGoey and Dolgonos.

[10] The principal reason is that the respondents' request is inconsistent with the concept of a debtor-in-possession under the CCAA. Under CCAA proceedings, absent special circumstances, the debtor, rather than any third party, remains responsible for, and in control of, the debtor's business and any sale of its assets as part of an eventual reorganization. That control rests with the directors of the debtor. The respondents have failed to establish any special circumstances in this case that compel a different arrangement. As a related matter, it is unclear to whom such representatives would owe a duty. The only reasonable basis would be to impose the duties of directors upon any such representative. Such an arrangement would only make sense, however, if there were reason to doubt that the current committee members were unable to fulfil their functions without further assistance. In this case, the committee members, Taylor and Wells, are acknowledged to be independent directors. They are experienced business people. They are also advised by legal counsel. There is no suggestion that they will be influenced in some manner by Ulicki. There is no evidence that they are unable to perform the necessary oversight function without further assistance.

[11] In addition, McGoey is a contingent creditor but not a shareholder to any material extent in the applicant. There is no evidence that this interest is affected in any way by the sales process. The McGoey respondents believe any sale would be at a gross undervalue at the present time and seek a representative to, among other things, attempt to convince the applicant not to proceed with the sales process. However, special circumstances specific to a creditor, or a class of creditors, must be demonstrated before the Court would give consideration to the appointment of a representative. In this case, it would be premature to consider whether such circumstances exist until the claims of the McGoey respondents are quantified in the applicant's claims process. Even then, the mere fact of being the largest unsecured creditor is, by itself, insufficient to justify such relief. In addition, the McGoey respondents have a potential conflict in that, as defendants in the litigation commenced by LOOK, they may have an interest in the identity and intentions of any purchaser of the applicant's controlling interest in LOOK. If the proposed purchaser were unacceptable to McGoey, they might also have an additional reason for preventing such a sale. For these reasons specific to the McGoey respondents, it would be inappropriate to appoint a representative of the McGoey respondents to the committee overseeing the sales process.

[12] While Dolgonos is entitled to protection in respect of the conduct of the sales process as a shareholder, he approved the selection and appointment of Taylor and Wells pursuant to a settlement of his litigation against the applicant. As these parties form the present committee, he

has already had a significant say in the composition of the committee overseeing the sales process. He has failed to demonstrate circumstances entitling him to a personal representative on the committee. There is no reason to conclude that the independence of these two directors has been compromised since their appointment such that the shareholders generally require a representative on the committee to protect their interests. The fact that Dolgonos is a large, if not the largest, shareholder of the applicant does not give him any greater rights in respect of a proposed sale. Moreover, the Dolgonos respondents are also defendants in the action commenced by LOOK. As such, the same issue of a potential conflict of interest as was addressed in respect of the McGoey respondents arises in respect of the Dolgonos respondents.

[13] Third, the respondents challenge the intended engagement of the Monitor as the applicant's sales agent in lieu of the engagement of an investment dealer. There are two separate but related issues here – the identity of the applicant's sales agent and the manner of its remuneration.

[14] There is a reasonable basis for the appointment of the Monitor as the sales agent in the present circumstances. The evidence is that it is probable that the proposed transaction is too small to attract the interest of an investment banking firm unless a substantial success fee were paid. In these circumstances, the applicant considers it appropriate to engage the Monitor on a fee-for-service basis. The record states that the Monitor has experience in similar transactions and access to investment banking expertise from an affiliate. There is nothing in the record that contradicts this evidence. There is also nothing in principle that prevents a court-appointed monitor under the CCAA from also acting as a sales agent if there are good business reasons for doing so.

[15] With respect to remuneration, the applicant's decision to go with a fee-for-service arrangement is supportable in the present circumstances, given the magnitude of any success fee that would be required by an investment dealer. It is important to note that the applicant has the ability, and the responsibility, to control the extent of the Monitor's activities as sales agent, and its consequential fees, as the sales process unfolds. There is therefore a basis for ensuring that the sales agency fees stay within the parameters contemplated in the alternative scenarios of success or failure of the sales process. Further, the Monitor's fees remain subject to Court approval at a future date, at which time the creditors have the right to comment on the reasonableness of the services provided and the related fees.

[16] Accordingly, I conclude that the applicant's decision to engage the Monitor as its sales agent in respect of the proposed sales process is reasonable in the present circumstances.

[17] The applicant's proposed sales process, as described in the Monitor's Eleventh Report is therefore approved. For clarity, such approval does not, however, constitute the granting by the Court at this time of any approvals or exemption orders that may be required under corporate or securities legislation in respect of any proposed transaction that may result from such sales process.

[18] In addition, the stay of proceedings in the Initial Order of this Court dated July 5, 2011 is hereby extended to February 1, 2013 to permit completion of such sales process.

[19] If the parties are unable to agree on costs, they shall have thirty days from the date of this Endorsement to submit a costs outline and to make written submissions not exceeding five pages in length.

Wilton-Siegel J.

Date: November 9, 2012

TAB 14

Case Name:

Doman Industries Ltd. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act R.S.C. 1985, c. C-36 AND IN THE MATTER OF the Company Act R.S.B.C. 1996, c. 62 AND IN THE MATTER OF the Canada Business Corporations Act R.S.C. 1985, c. C-44 AND IN THE MATTER OF the Partnership Act R.S.B.C. 1996, c. 348 AND IN THE MATTER OF Doman Industries Limited, Alpine Projects Limited, Diamond Lumber Sales Limited, Doman Forest Products Limited, Doman's Freightways Ltd., Doman Holdings Limited, Doman Investments Limited, Doman Log Supply Ltd., Doman - Western Lumber Ltd., Eacom Timber Sales Ltd., Western Forest Products Limited, Western Pulp Inc., Western Pulp Limited Partnership, and Quatsino Navigation Company Limited, petitioners

[2003] B.C.J. No. 562

2003 BCSC 376

14 B.C.L.R. (4th) 153

41 C.B.R. (4th) 29

121 A.C.W.S. (3d) 276

2003 CarswellBC 538

Vancouver Registry No. L023489

British Columbia Supreme Court
Vancouver, British Columbia

Tysoe J.

(In Chambers)

Oral judgment: March 7, 2003.

(36 paras.)

Creditors and debtors -- Debtors' relief legislation -- Companies' creditors arrangement legislation -- Stay of proceedings against debtor -- Meetings, authorization by court -- Arrangement, judicial approval.

Application by Doman Industries for an order to authorize the calling of creditor meetings to consider its plan of arrangement under the Companies Creditors Arrangement Act. Application by the senior secured noteholders of Doman for an order to invalidate Doman's plan proposed and to file its own plan. Doman's creditors consisted of the senior secured noteholders, unsecured noteholders, a lender who provided it with an operating line of credit and unsecured trade creditors. The plan provided that the unsecured trade creditors would be paid in full. The unsecured noteholders would receive new notes plus shares in Doman. The new notes would be secured in second position against the senior notes. The plan did not seek to compromise the indebtedness owed to these noteholders. Doman sought a stay under the Act to prevent the senior noteholders from relying upon events of default, contained in their trust indenture, to allow them to accelerate repayment of indebtedness owed under their notes. Doman also sought a stay of the provision in the indenture that entitled the noteholders to require Doman to purchase their notes in the event of a change of control.

HELD: Both applications were allowed in part. Doman was granted one of its stays. The court had jurisdiction to grant a stay to prevent the senior noteholders from using the default events to accelerate repayment. The stay power in the Act could not be interpreted to allow Doman to be relieved of its purchase obligation. The Act was to be interpreted liberally. This request went beyond a liberal interpretation of the Act. The court would also not grant this request because the absence of a permanent injunction would not frustrate Doman's restructuring efforts. It was not certain that the senior noteholders would accept Doman's purchase offer. The court would not authorize the calling of the meeting. Doman's plan would not be sanctioned by the court. Doman was entitled to file a revised plan for approval. The senior noteholders were not allowed to file their own plan. Approval would constitute an improper unilateral variation of the indenture without Doman's approval. It would also give the noteholders a veto power over Doman's restructuring efforts.

Statutes, Regulations and Rules Cited:

Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36, s. 11, 11(4), 11.2.

Counsel:

M.A. Fitch, Q.C., S. Martin and R. Millar, for the petitioners.
G. Morawetz, R. Chadwick and J.J.L. Hunter, Q.C., for the ad hoc Committee of Senior Secured Noteholders.
J.F. Dixon, for Wells Fargo, National Association.
G.K. Macintosh, Q.C., and R.P. Sloman, for Herb Doman.
D.J. Hatter and R. Butler, for Her Majesty the Queen in Right of British Columbia.

R.D. Leong, for the Attorney General of Canada.
W.C. Kaplan, Q.C., and P.L. Rubin, for CIT Business Credit Canada Inc.
J.I. McLean, for the monitor, KMPG Inc.
D.I. Knowles, Q.C., M. Buttery and I. Nordholm, for Brascan Financial, Merrill Lynch and Oppenheimer Funds.
P. Macdonald and G. Gehlen, for Toronto Dominion Asset Management Inc., TD Securities Inc. and Tordom Company.
K. Zimmer, for Petro-Canada.
W. Skelly, for Pulp, Paper and Woodworkers of Canada, Locals 3 and 8.

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1 **TYSOE J.** (orally):-- There are two competing motions before the Court in these proceedings under the Companies Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the "CCAA"). The first is a motion of the Petitioners (the "Doman Group") for an order authorizing the calling of creditor meetings to consider a plan of compromise or arrangement prepared by the Doman Group (the "Reorganization Plan" or the "Plan"). The second motion is an application by a group of secured creditors called the Ad Hoc Committee of Senior Secured Noteholders (the "Senior Secured Noteholders Committee") for numerous orders, including orders relating to the invalidity of the Reorganization Plan, allowing the Senior Secured Noteholders to vote on the Plan and authorizing the Senior Secured Noteholders Committee to file its own secured creditor Plan.

2 One of the arguments which the Senior Secured Noteholders Committee wished to advance related to the constitutionality of the Court varying the terms of a contract in the absence of enabling provincial legislation. The Senior Secured Noteholders Committee applied to adjourn all of the applications so that the necessary notice for constitutional questions to the Attorneys General of British Columbia and Canada could expire. I refused the adjournment on the basis that the constitutional question can be argued upon the expiry of the notice periods if it is still necessary to do so. Accordingly, my rulings at this stage are subject to the constitutional challenge by the Senior Secured Noteholders Committee and nothing I say in these Reasons for Judgment should be construed as a determination of the constitutional validity of such rulings.

3 The Doman Group has the following four principal types of creditors:

(a) the Senior Secured Noteholders which are owed US$160 million and who hold security over most, but not all, of the fixed assets of the Doman Group;
(b) the Unsecured Noteholders which are owed US$513 million;
(c) the lender which provides the Doman Group with an operating line of credit and which holds security against its current assets; and
(d) unsecured trade creditors which are owed in the range of $20 to $25 million.

4 The Reorganization Plan seeks to compromise only the indebtedness of the Unsecured Noteholders and the unsecured trade creditors. It is proposed that the unsecured trade creditors will be paid in full up to an aggregate ceiling or cap amount of $23.5 million. The Reorganization Plan provides that the Unsecured Noteholders are to receive US$112,860,000 Junior Secured Notes plus

85% of the shares in the Doman Group (with the existing shareholders retaining the remaining 15% of the shares). The Junior Secured Notes are to be secured in second position against the assets subject to the security of the Senior Secured Noteholders.

5 The Senior Secured Notes were issued pursuant to a Trust Indenture dated as of June 18, 1999 (the "Trust Indenture"). The principal amount of the Senior Secured Notes is due on July 1, 2004. The Doman Group is in default of the payment of the interest due on the Senior Secured Notes but it is intended that the overdue interest be paid upon implementation of the Reorganization Plan. The Trust Indenture has the usual types of events of default, including the commencement of proceedings under the CCAA, non-payment of principal or interest on indebtedness owed by the Doman Group to the Senior Secured Noteholders or to other parties and the failure to remedy a breach of any of the provisions of the Trust Indenture within 30 days after notice of the breach has been given to the Doman Group. It also has the usual provision enabling the Trustee under the Trust Indenture or a specified percentage of the holders of the Senior Secured Notes to accelerate payment of the indebtedness upon the occurrence of an event of default and to thereby make all monies owing on the notes to be immediately due and payable.

6 Sections 4.13 and 4.16 of the Trust Indenture are also relevant to the present applications. Section 4.13 reads as follows:

> (a) The Company shall not, and shall not permit any of its Restricted Subsidiaries to, directly or indirectly, create, incur, assume or suffer to exist any Lien on any property or asset now owned or hereafter acquired, or any income or profits therefrom or assign or convey any right to receive income therefrom, except Permitted Liens (provided that Liens on Note Collateral or any portion thereof shall be governed by clause (b) of this Section 4.13) unless (i) in the case of Liens securing Indebtedness which is subordinated to the Notes and the Guarantees, the Notes and the Guarantees are secured by a Lien on such property, assets, income, profits or rights that is senior in priority to such Liens and (ii) in all other cases, the Notes and the Guarantees are equally and ratably secured.
>
> (b) The Company shall not, and shall not permit of its Restricted Subsidiaries to, directly or indirectly, create, incur, assume or suffer to exist any Lien on any property or asset now owned or hereafter acquired that constitutes Note Collateral, any income or profits from any Note Collateral or to assign or convey any right to receive income from any Note Collateral, except for Permitted Note Collateral Liens.

Section 4.16 reads, in part, as follows:

> Upon the occurrence of a Change of Control, each Holder of Notes shall have the right to require the Company to repurchase all or any part (equal to U.S. $1,000 or an integral multiple thereof) of such Holder's Notes pursuant to the offer described below (the "Change of Control offer") at an offer price in cash equal to 101% of the aggregate principal amount thereof plus accrued and unpaid interest, if any, and Liquidated Damages, if any, to the date of purchase (the "Change of Control Payment"). Within 10 days following any Change of Con-

trol, the Company shall mail a notice to each Holder stating: (1) that the Change of Control offer is being made pursuant to the covenant entitled "Change of Control" and that all Notes tendered will be accepted for payment; (2) the purchase price and the purchase date, which will be no earlier than 30 days nor later than 40 days from the date such notice is mailed and which shall be the same date as the Change of Control Payment Date with respect to the 1994 Notes and the 1997 Notes (the "Change of Control Payment Date"); ...

On the Change of Control Payment Date, the Company shall, to the extent lawful, (1) accept for payment Notes or portions thereof tendered pursuant to the Change of Control Offer, (2) deposit with the Paying Agent an amount equal to the Change of Control Payment in respect of all Notes or portions thereof so tendered and (3) deliver or cause to be delivered to the Trustee the Notes so accepted ...

7 The Reorganization Plan does not seek to compromise the indebtedness owed to the Senior Secured Noteholders. However, the Senior Secured Noteholders maintain that they are affected or prejudiced by the Reorganization Plan. They point to sections 4.12, 6.2 and 6.3 of the Reorganization Plan, the relevant portions of which read as follows:

4.12 Waiver of Defaults and Permanent Injunction

From and after the Effective Date:

(a) all Creditors and other Persons (including Unaffected Creditors) shall be deemed to have waived any and all defaults of the Doman Entities then existing or previously committed by the Doman Entities or caused by the Doman Entities, or non-compliance with any covenant, warranty, representation, term, provision, condition or obligation, express or implied, in any contract, credit document, agreement for sale, lease or other agreement, written or oral, and any and all amendments or supplements thereto, existing between such Person and the Doman Entities, including a default under a covenant relating to any other affiliated or subsidiary company of Doman other than the Doman Entities, and any and all notices of default and demands for payment under any instrument, including any guarantee, shall be deemed to have been rescinded;

(b) a permanent injunction shall be pronounced on the terms of the Final Order against Creditors and all other Persons (including Unaffected Creditors) having contractual relationships with any of the Doman Entities with respect to the exercise of any right or remedy contained in the instruments evidencing such contractual relationships or at law generally, which might otherwise be available to such Creditors or other Persons as a result of the filing of the CCAA Proceedings, the content of the Plan, implementation of the Plan, any action taken by the Doman Entities or any third party pursuant to the Plan or the Final Order either before or after the Plan Implementation Date, or any other matter whatsoever relating to the CCAA Proceedings, the Plan, or the transactions contemplated by the Plan; and

(c) the Doman Entities may in all respects carry on as if the defaults, non-compliance, rights and remedies referred to in this section 4.12 had not occurred.

6.2 Effect of Final Order:

In addition to sanctioning the Plan, the Final Order shall, among other things:

...

(f) confirm that all executory contracts, security agreements and other contractual relationships to which the Doman Entities are parties are in full force and effect notwithstanding the CCAA Proceeding or this Plan and its attendant compromises, and that no Person party to such an executory contract, security agreement or other contractual relationship shall be entitled to terminate or repudiate its obligation under such contract or agreement, or to the benefit of any right or remedy, by reason of the commencement of the CCAA Proceeding or the content of the Plan, the Change of control of Doman resulting from the Plan, the compromises extended under the Plan, the issuance of the Junior Secured Notes, or any other matter contemplated under the Plan or the Final Order; and

(g) confirm and give effect to the waivers, permanent injunctions and other provisions contemplated by section 4.12 of the Plan.

6.3 Conditions Precedent to Implementation of Plan:

The implementation of this Plan shall be conditional upon the fulfilment of the following conditions:

(a) Court Approval

Pronouncement of the Final Order by the Court on the terms contemplated by Section 6.2 and otherwise acceptable to the Doman Entities.

The term "Unaffected Creditors" used in Section 4.12 includes the Senior Secured Noteholders.

8 The application of the Doman Group is relatively limited in scope because it simply seeks authorization to hold creditor meetings to consider the Reorganization Plan. However, it is common ground that I should not authorize the holding of the creditor meetings if the Reorganization Plan cannot be sanctioned by the Court following the holding of the creditor meetings or if the implementation of the Reorganization Plan is contingent on the Court granting an order which it has no jurisdiction to make or would not otherwise make.

9 Counsel for the Doman Group submitted that the sole issue is whether the Court has the jurisdiction to grant a stay under s. 11(4) of the CCAA in the form of the permanent injunction specified under clause (b) of the Section 4.12 of the Reorganization Plan. I do not agree. In particular, clause (a) of Section 4.12 purports to bind Unaffected Creditors, which include the Senior Secured Noteholders, by deeming them to have waived all defaults under instruments between them and the

Doman Group. I agree with the counsel for the Senior Secured Noteholders Committee that creditors of debtor company under the CCAA cannot be bound by the provisions of a plan of compromise or arrangement if they have not been given the opportunity to vote on it: see Menegon v. Philip Services Corp., [1999] O.J. No. 4080 (Ct. Jus.) at para. 38. It would be inappropriate for me to authorize the calling of creditor meetings to consider the Reorganization Plan when I know that this Court would refuse to sanction it on the basis that it purports to bind parties who were not given the opportunity to vote on it.

10 However, my conclusion in this regard does not mean that I should accede to the request of the Senior Secured Noteholders Committee for the right to vote on the Reorganization Plan. In view of the submission made by the counsel for the Doman Group that the Plan was not intended to affect the rights of the Senior Secured Noteholders, I believe that the Doman Group should first be given the opportunity to propose a revised Reorganization Plan which does not include reference to Unaffected Creditors in clause (a) of Section 4.12 or any other provision which purports to bind parties who are not given the opportunity to vote on the Plan.

11 I next turn my attention to clause (b) of Section 4.12, which is the provision upon which I believe counsel for the Doman Group is relying to prevent Senior Secured Noteholders from acting on their security following the implementation of the Reorganization Plan. Although the permanent injunction contemplated in this clause is mentioned in the Reorganization Plan, it is not, strictly speaking, part of the Plan. Rather, the granting of the injunction is a condition precedent in the implementation of the Plan. The result of this distinction is that the Plan itself does not purport to bind the Senior Secured Noteholders in this regard and they are not entitled to vote on the Plan. Thus, the question becomes whether the Court has the jurisdiction to grant such an injunction because, if it does not have the jurisdiction, there would be no point in convening creditor meetings to consider a plan containing a condition precedent which cannot be fulfilled.

12 The Court is given the power to grant stays of proceedings by s. 11(4) of the CCAA, which reads as follows:

> (4) A court may, on an application in respect of a company other than an initial application, make an order on such term as it may impose,
>
> (a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
> (b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
> (c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

13 Since the re-emergence of the CCAA in the 1980s, the Courts have utilized the stay provisions of the CCAA in a variety of situations for a purpose other than staying creditors from enforcing their security or otherwise preventing creditors from attempting to gain an advantage over other creditors. One of the seminal decisions is Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd., (1988) 72 C.B.R. (N.S.) 1 (Alta. Q.B.), where the Court stayed the ability of a joint venture

partner of a debtor company from relying on the insolvency of the debtor company to replace it as the operator under a petroleum operating agreement.

14 Two other prominent examples are Re T. Eaton Co. (1997), 46 C.B.R. (3d) 293 (Ont. Gen. Div.) and Re Playdium Enterprises Corp. (2001), 31 C.B.R. (4th) 302, as supplemented at 31 C.B.R. (4th) 309 (Ont. Sup. Ct. Jus.). In the T. Eaton case, tenants in shopping centres in which Eaton's was also a tenant were prevented during the restructuring period from terminating their leases on the basis of co-tenancy clauses in their leases requiring anchor stores such as Eaton's to stay open. In the Playdium decision, the Court approved an assignment of an agreement in conjunction with a sale in a failed CCAA proceeding where the other party to the agreement, which had a contractual right to consent to an assignment, was objecting to the assignment. As the Court in the Playdium case relied on s. 11(4) of the CCAA, I assume that the Order prevented the other party to the agreement from terminating the assigned agreement as a result of the failure to obtain its consent to the assignment. I was also referred to my decision in Re Woodward's Ltd. (1993), 17 C.B.R. (3d) 236, where I relied on the inherent jurisdiction of the court to stay the calling on letters of credit issued by third parties at the instance of the debtor company.

15 The law is clear that the court has the jurisdiction under the CCAA to impose a stay during the restructuring period to prevent a creditor relying on an event of default to accelerate the payment of indebtedness owed by the debtor company or to prevent a non-creditor relying on a breach of a contract with the debtor company to terminate the contract. It is also my view that the court has similar jurisdiction to grant a permanent stay surviving the restructuring of the debtor company in respect of events of default or breaches occurring prior to the restructuring. In this regard, I agree with the following reasoning of Spence J. at para. 32 of the supplementary reasons in Playdium:

> In interpreting s. 11(4), including the "such terms" clause, the remedial nature of the CCAA must be taken into account. If no permanent order could be made under s. 11(4) it would not be possible to order, for example, that the insolvency defaults which occasioned the CCAA order could not be asserted by the Famous Players after the stay period. If such an order could not be made, the CCAA regime would prospectively be of little or no value because even though a compromise of creditor claims might be worked out in the stay period, Famous Players (or for that matter, any similar third party) could then assert the insolvency default and terminate, so that the stay would not provide any protection for the continuing prospects of the business. In view of the remedial nature of the CCAA, the Court should not take such a restrictive view of the s. 11(4) jurisdiction.

16 Spence J. made the above comments in the context of a third party which had a contract with the debtor company. In my opinion, the reasoning applies equally to a creditor of the debtor company in circumstances where the debtor company has chosen not to compromise the indebtedness owed to it. The decision in Luscar Ltd. v. Smoky River Coal Ltd., [1999] A.J. No. 676, is an example of a permanent stay being granted in respect of a creditor of the restructuring company.

17 Accordingly, it is my view that the court does have the jurisdiction to grant a permanent stay preventing the Senior Secured Noteholders and the Trustee under the Trust Indenture from relying on events of default existing prior to or during the restructuring period to accelerate the repayment of the indebtedness owing under the Notes. It may be that the court would decline to exercise its

jurisdiction in respect of monetary defaults but this point is academic in the present case because the Doman Group does intend to pay the overdue interest on the Notes upon implementation of the Reorganization Plan.

18 The second issue is whether the court has the jurisdiction to grant a permanent stay to prevent the Senior Secured Noteholders and the Trustee under the Trust Indenture from relying on a breach of Section 4.13 of the Trust Indenture to accelerate payment of the indebtedness owed on the Notes. The potential breach under Section 4.13 would be occasioned by the Doman Group granting second ranking security to the Unsecured Noteholders upon the implementation of the Reorganization Plan. I use the term "potential breach" because counsel for the Doman Group takes the position that the granting of this security would not contravene the provisions of Section 4.13.

19 I have decided that I should decline to make a determination of this issue because I did not receive the benefit of detailed submissions on the interpretation of Section 4.13 and the defined terms used in that Section. Counsel for the Doman Group simply argued that the wording was circular or ambiguous and noted that the definition of Permitted Indebtedness could include a refinancing of the Unsecured Notes. Counsel for the Senior Secured Noteholders Committee took the position, without elaboration, that Section 4.13 would be breached if the proposed security were to be granted. If the granting of the security would not contravene Section 4.13, then it would not be necessary for the court to grant a permanent stay preventing the acceleration of the indebtedness owing on the Notes as a result of the granting of the security and the issue would be academic. In my opinion, it is not appropriate for me to decide a potentially academic issue and I decline to do so.

20 The third issue is whether the court has the jurisdiction to effectively stay the operation of Section 4.16 of the Trust Indenture. Although I understand that there is an issue as to whether the giving of 85% of the equity in the Doman Group to the Unsecured Noteholders as part of the reorganization would constitute a change of control for the purposes of the current version of the provincial forestry legislation, counsel for the Doman Group conceded that it would constitute a Change of Control within the meaning of Section 4.16.

21 The language of s. 11(4) of the CCAA, on a literal interpretation, is very broad and the case authorities have held that it should receive a liberal interpretation in view of the remedial nature of the CCAA. However, in my opinion, a liberal interpretation of s. 11(4) does not permit the court to excuse the debtor company from fulfilling its contractual obligations arising after the implementation of a plan of compromise or arrangement.

22 In my view, there are numerous purposes of stays under s. 11 of the CCAA. One of the purposes is to maintain the status quo among creditors while a debtor company endeavours to reorganize or restructure its financial affairs. Another purpose is to prevent creditors and other parties from acting on the insolvency of the debtor company or other contractual breaches caused by the insolvency to terminate contracts or accelerate the repayment of the indebtedness owing by the debtor company when it would interfere with the ability of the debtor company to reorganize or restructure its financial affairs. An additional purpose is to relieve the debtor company of the burden of dealing with litigation against it so that it may focus on restructuring its financial affairs. As I have observed above, a further purpose is to prevent the frustration of a reorganization or restructuring plan after its implementation on the basis of events of default or breaches which existed prior to or during the restructuring period. All of these purposes are to facilitate a debtor company in restructuring its financial affairs. On the other hand, it is my opinion that Parliament did not intend s. 11(4) to author-

ize courts to stay proceedings in respect of defaults or breaches which occur after the implementation of the reorganization or restructuring plan, even if they arise as a result of the implementation of the plan.

23 In the present case, the obligation of the Doman Group to make an offer under Section 4.16 of the Trust Indenture does not arise until ten days after the Change of Control. The Change of Control will occur upon the implementation of the Reorganization Plan, with the result that the obligation of the Doman Group to make the offer does not arise until a point in time after the Reorganization Plan has been implemented. This is a critical difference in my view between this case and the authorities relied upon by the counsel for the Doman Group.

24 Section 11(4) utilizes the verbs "staying", "Restraining" and "prohibiting". These verbs evince an intention of protecting the debtor company from the actions of others, including creditors and non-creditors, while it is endeavouring to reorganize its financial affairs. This wording is not intended, in my view, to relieve the debtor company from the performance of affirmative obligations which arise subsequent to the implementation of the plan of compromise or arrangement. In the context of this case, the Doman Group is endeavouring to rely on s. 11(4) to relieve itself of the obligation to make an offer to repurchase the Senior Secured Notes upon a Change of Control. In my opinion, this goes beyond any liberal interpretation of s. 11(4).

25 Counsel for Doman Group submitted that the proposed injunction is no more than a restriction upon an acceleration clause. Even if that is the case, it is an acceleration clause which does not become operative until after the restructuring has been completed. It is not a provision which the Senior Secured Noteholders are entitled to enforce as a result of an event of a default or breach occurring or existing prior to or during the restructuring period.

26 There is no doubt that courts have power under s. 11(4) to interfere with the contractual relations during the restructuring period. It is my opinion, however, that s. 11(4) does not give the power to courts to grant permanent injunctions as a means to permit a debtor company to unilaterally and prospectively vary the terms of a contract to which it is a party.

27 Counsel for the Doman Group also submitted that the court has the inherent jurisdiction to restrain the Doman Group from making the offer under Section 4.16 of the Trust Indenture, much in the same way as I exercised the court's inherent jurisdiction in Woodward's, prior to the enactment of s. 11.2 of the CCAA, to restrain third parties from calling on letters of credit issued by a financial institution at the instance of the debtor company. The court has the inherent jurisdiction during the restructuring period to "fill in gaps" in the CCAA or to "flesh out the bare bones" of the CCAA in order to give effect to its objects: see Re Westar Mining Ltd. (1992), 14 C.B.R. (3d) 88 (B.C.S.C.) at p. 93 and Re Dylex Ltd. (1995), 31 C.B.R. (3d) 106 (Ont. Ct. Jus.) at p. 110. In my view, the Doman Group is not asking the court to fill in gaps in the CCAA during the restructuring period. Rather, it is asking the court to go beyond the type of stay contemplated by Parliament when it enacted s. 11(4) of the CCAA.

28 In the event that I am mistaken and the court does have the jurisdiction to grant a stay in respect of the operation of Section 4.16 of the Trust Indenture, I would exercise my discretion against the granting of such a stay on the basis of the current circumstances. The absence of a permanent injunction in relation to Section 4.16 will not necessarily frustrate the restructuring efforts of the Doman Group. Apart from any compromise which may be negotiated between the Doman Group and the Senior Secured Noteholders, it is far from a certainty that the Senior Secured Noteholders

will accept an offer made by the Doman Group under Section 4.16 to purchase the Notes at 101% of their face value. Indeed, counsel for the Doman Group suggested that in light of the 12% interest rate applicable to the Notes and prevailing interest rates, the Noteholders would not want to accept the offer of a 1% premium because they would not be able to reinvest the funds at an interest rate as high as 11%. Counsel went so far as to characterize the right of repurchase and associated premium as "illusory benefits". In addition, it may be possible for the Doman Group to restructure its financial affairs in a fashion which does not involve a Change of Control while the Senior Secured Notes are outstanding. Finally, the Doman Group has not made any effort to negotiate an accommodation with the Senior Secured Noteholders.

29 Although I have agreed with the reasoning of Spence J. at para. 32 of the Playdium decision, I should not be interpreted as agreeing with the correctness of the conclusion in Playdium. I have some reservations with respect to its conclusion but, as Playdium is clearly distinguishable from the present case, it is not necessary for me to decide whether or not it should be followed.

30 For these reasons, I conclude that the court does not have the jurisdiction to grant the permanent injunction contemplated by Section 4.12 (b) of the Reorganization Plan, at least as it relates to Section 4.16 of the Trust Indenture. Hence, it would be inappropriate for me to authorize the calling of creditor meetings to consider the Reorganization Plan in its present form because the condition precedent contained in section 6.3(a) of the Plan cannot be satisfied. I dismiss the application of the Doman Group, with liberty to re-apply in respect of a revised Reorganization Plan.

31 In addition to seeking an order allowing them to vote on the Reorganization Plan, the Senior Secured Noteholder Committee applied for an order authorizing it to file a secured creditor plan of arrangement or compromise and an order directing the Doman Group to pay all of its costs.

32 The form of the proposed secured creditor plan was attached to one of the affidavits. In essence, it includes the terms upon which the Senior Secured Noteholders represented by the Committee are prepared to waive breaches of the Trust Indenture occasioned by the restructuring of the Doman Group and to amend the Trust Indenture to allow the restructuring. One of these terms is the payment of a fee equal to 3% of the face value of the Senior Secured Notes (approximately US$5 million).

33 I am not prepared to allow the Senior Secured Noteholders Committee to file its own plan. If such a plan were filed and approved by the Senior Secured Noteholders, they would accomplish the same thing which they are complaining that the Doman Group was endeavouring to achieve through the permanent injunction; namely, a unilateral variation of the terms of the Trust Indenture without the agreement of the other party to the Trust Indenture. Such a plan may also have the effect of giving the Senior Secured Noteholders a veto power in respect of the Doman Group's restructuring.

34 The Senior Secured Noteholders Committee has not demonstrated a basis for the requested order that the Doman Group should pay all of its costs. The committee was presumably formed so that the Noteholders could act to protect or advance their own interests. It is not a committee requested by the Doman Group or constituted by the Court. The Noteholders may be entitled to some or all of such costs pursuant to the provisions of the Trust Indenture but that issue is not before me. As to the costs of these applications in the context of the Rules of Court, there has been divided success and I direct that each party bear own costs.

35 I dismiss the applications of the Committee for an order in relation to a secured creditor plan and an order in relation to its costs.

36 If the Senior Secured Noteholders Committee still wishes to pursue the constitutional question, arrangements for a hearing may be made through Trial Division. However, as I am not granting the application of the Doman Group for an order authorizing the calling of creditor meetings to consider the Reorganization Plan in its present form, it would seem to me that any such hearing should await the issuance of a revised form of the Plan.

TYSOE J.

cp/i/qw/qldrk/qlsng/qlbrl

---- End of Request ----
Download Request: Current Document: 1
Time Of Request: Monday, January 28, 2013 13:30:42

TAB 15

Case Name:

Crystallex International Corp. (Re)

IN THE MATTER OF a plan of compromise or arrangement of Crystallex International Corporation, (the "Applicant") AND IN THE MATTER OF the Companies' Creditors Arrangement Act, 1985, c. C-36 as Amended

[2011] O.J. No. 6035

2011 ONSC 7701

Court File No. CV-11-9532-00CL

Ontario Superior Court of Justice
Commercial List

F.J.C. Newbould J.

Heard: December 23, 2011.
Judgment: December 28, 2011.

(33 paras.)

Bankruptcy and insolvency law -- Proposals -- Court approval or rejection -- Reasonable terms -- Protection of creditors' interests -- Competing CCAA applications by debtor and Noteholders -- Debtor's application allowed -- Debtor's principal asset was right to develop gold project in Venezuela, but it had been stopped by state-owned corporation and was pursuing arbitration -- Success at arbitration would generate more than enough to pay creditors in full and there was no suggestion success was not likely -- Debtor's plan to remain in possession of assets, directors' and officers' indemnity and administration charge and ability to pursue interim financing reasonable and non-prejudicial -- Noteholders' plan to cancel all existing shares premature and did not balance all parties' interests.

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act (CCAA) matters -- Compromises and arrangements -- With unsecured creditors -- Applications -- Initial applications -- Sanction by court -- Competing CCAA applications by debtor and Noteholders -- Debtor's application allowed -- Debtor's principal asset was right to develop gold project in Venezuela, but it had been stopped by state-owned corporation and was pursuing arbitration -- Success at arbitration would generate more than enough to pay creditors in full and there was no suggestion success was

not likely -- Debtor's plan to remain in possession of assets, directors' and officers' indemnity and administration charge and ability to pursue interim financing reasonable and non-prejudicial -- Noteholders' plan to cancel all existing shares premature and did not balance all parties' interests.

Competing CCAA applications by the debtor and Noteholders. Both applications were filed the day before the notes held by the Noteholders became due. The debtor's principal asset was the right to develop a gold project in Venezuela, it had been stopped by a state-owned corporation and was currently pursuing arbitration. The debtor had a number of liabilities, the most significant of which was the unsecured notes. Success at arbitration would allow the debtor to pay creditors in full. The debtor was seeking authority to file a plan or arrangement and compromise, an order allowing it to remain in possession of its assets, directors' and officers' indemnity and administration charge and authority to pursue interim financing or rearrangement. The Noteholders were critical of the debtor's actions and sought an order requiring the debtor to issue new shares and cancel existing shares, raise equity to pay debts and give priority to Noteholders for new shares. The Noteholders' plan would immediately cancel the current equity holders' interest.

HELD: Debtor's application allowed; Noteholders' application dismissed. Cancelling existing shares was premature. The value of gold in the project was staggering and the debtor was seeking $3.8 billion at arbitration. There was no suggestion the debtor would not succeed and success would give it more than enough to repay all creditors. The Noteholders' plan did not fairly balance the interests of all parties. The debtor's plan was balanced and reasonable and did not prejudice creditors' interests.

Statutes, Regulations and Rules Cited:

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

Counsel:

Markus Koehnen, Andrew J.F. Kent and Jeffrey Levine, for the Applicant.

Richard Swan, S. Richard Orzy and Emrys Davis, for Computershare Trust Company of Canada.

Alex L. MacFarlane, for Tenor Capital Management.

David R. Byers, for Ernst & Young Inc. as proposed Monitor.

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1 **F.J.C. NEWBOULD J.**:-- This is a contest between two competing CCAA applications. One is proposed by the debtor Crystallex International Corporation ("Crystallex") and one is proposed by Crystallex's principal creditor, the noteholders under a 2004 Trust indenture (the "Noteholders") who are represented by the trustee Computershare Trust Company of Canada. Both Crystallex and the Noteholders agree that a CCAA application is appropriate. They disagree over which application should proceed.

2 This is not the first contest between Crystallex and the Noteholders. On two previous occasions the Noteholders applied for a declaration that there had been a "Project Change of Control" within the meaning of the trust indenture which, if it were the case, would have required Crystallex

to purchase the notes of the Noteholders before their maturity at 102% of par value plus accrued interest. Both applications were dismissed.

3 Both CCAA applications were filed on December 22, 2011, the day before the notes held by the Noteholders became due. I heard argument on December 23, 2011 and on that day made an Initial Order in the application brought by Crystallex and dismissed the application by the Noteholders, with reasons to follow. These are my reasons.

Business of Crystallex

4 The business of Crystallex and its difficulties in Venezuela are referred to in some detail in the two prior decisions dismissing the Noteholders' applications. It is not necessary to review here all of those details. A few will suffice.

5 The principal asset of Crystallex is its right to develop the Las Cristina gold project in Venezuela. Las Cristinas is one of the largest undeveloped gold deposits in the world containing indicated gold resources of approximately 20.76 million ounces.

6 Crystallex obtained the right to mine the Las Cristinas project in September 2002 through a Mining Operation Contract (the "MOC") with the Corporacion Venezolana de Guayana (the "CVG"), a state-owned Venezuelan corporation. Crystallex's position is that it complied with all of its obligations under the MOC and that neither the CVG nor the Government of Venezuela raised any material concerns about lack of compliance. The CVG confirmed on several occasions that the MOC was in good standing and that Crystallex was in compliance with it.

7 On February 3, 2011, CVG purported to "unilaterally rescind" the MOC. CVG rationalized its termination of the contract for reasons of "expediency and convenience" and because Crystallex had allegedly "ceased activities for over a year" on the project. Crystallex's position is that it did not cease activities. It was maintaining the mining site in a shovel-ready state and was awaiting receipt of an environmental permit which the Ministry of Environment advised would be issued, and for which the Ministry sent Crystallex a bill that Crystallex paid.

8 On February 16, 2011 Crystallex filed a Request for Arbitration with the International Centre for the Settlement of Investment Disputes ("ICSID") against Venezuela pursuant to a Bilateral Investment Treaty between Canada and Venezuela. ICSID is a mechanism through which private investors can seek legal redress against a foreign government for conduct that might be otherwise immune from suit.

9 In the arbitration, Crystallex claims restitution of the MOC, issuance of the environmental permit and compensation for interim losses. In the alternative, Crystallex seeks compensation of $3.8 billion for the value of its investment.

Crystallex's liquidity crisis

10 Crystallex has a number of liabilities, the most of significant of which is liability of approximately $100 million in senior unsecured notes that were issued pursuant to a Trust Indenture dated December 23, 2004. The notes fell due on December 23, 2011. In addition, Crystallex has other liabilities of approximately Cdn. $1.2 million and approximately US $8 million.

11 The principal asset of Crystallex is its arbitration claim of US$3.8 billion against Venezuela. In addition, Crystallex has mining equipment with a book value of approximately $10.1 million and cash of approximately $2 million.

12 Because of Venezuela's refusal to allow Crystallex to exploit Las Cristinas, Crystallex did not have the funds to pay out the 2004 notes on December 23, 2011. It is Crystallex's belief that a settlement of the arbitration claim or recovery on an arbitration award will result in Crystallex receiving cash far in excess of what is required to pay all of its creditors in full.

Crystallex application

13 The Crystallex application seeks the authority to file a plan of compromise and arrangement, an order that it remain in possession of its assets with the authority to continue to pursue the arbitration against Venezuela and continue to retain all of the various experts necessary for that purpose. It seeks a directors' and officers' indemnity and charge not exceeding $10 million to the extent that they do not have directors' and officers' insurance, which insurance may not be subrogated, and an administration charge of $3 million to cover the expenses of the Monitor, Crystallex and their solicitors.

14 Crystallex also seeks authority to pursue all avenues of interim financing or a refinancing of its business and to conduct an auction to raise interim or DIP financing pursuant to procedures approved by the Monitor. Crystallex has already received expressions of interest in DIP financing and an unsolicited offer of DIP financing from Tenor Capital Management. However the board of directors of Crystallex was not comfortable accepting the terms of the proposed DIP without a broader canvas of the market to determine if there were more favourable terms available.

Noteholders' application

15 The affidavit of Mr. Mattoni filed on behalf of the Noteholders is critical of the actions of Crystallex taken since at least the time that litigation between the two parties commenced in December 2008. It states that the Noteholders instructing Computershare hold approximately 77% of the outstanding notes and have made it clear that they will never support a restructuring that does not repay them in full immediately or which keeps the current management and board in a position of control going forward.

16 The Noteholders propose a Plan of Compromise and Reorganization to be authorized in the Initial Order, which contemplates:

(a) New common shares will be issued by Crystallex and all existing shares will be cancelled without any repayment of capital or other compensation.
(b) The Plan will involve a structured process by which there will be an attempt to raise sufficient new equity funds to repay all of the creditors in full.
(c) The existing shareholders will be entitled first to subscribe for the new common shares. Any new common shares not taken by the existing shareholders may be subscribed for by new investors.
(d) If the new common share offering is not fully subscribed for, then it will not proceed and the claims of creditors will be satisfied through a pro rata conversion of those claims to equity, such that all existing debt holders would become the equity holders and Crystallex would be debt-free.

17 The Plan contemplates a meeting of creditors to vote on the plan of arrangement and reorganization after a claims bar process has taken place.

18 The Initial Order proposed by the Noteholders provides that Crystallex shall carry on only such operations as are necessary to facilitate and implement the Plan and may continue to retain employees, consultants etc. to the extent necessary to facilitate and implement the Plan. It contains no ability of Crystallex to pursue the arbitration or to seek DIP or permanent refinancing.

19 In short, if the CCAA application of the Noteholders succeeds, it will mean that the interests of the current equity holders will be immediately cancelled.

Analysis

20 The CCAA is intended to provide a structured environment for negotiation of compromises between a debtor company and its creditors for the benefit of both. Where a debtor company realistically plans to continue operating or to otherwise deal with its assets but it requires the protection of the court in order to do so and it is otherwise too early for the court to determine whether the debtor company will succeed, relief should be granted under the CCAA. See *Re Lehndorff General Partner Ltd.*, (1993), 17 C.B.R. (3d) 24, per Farley J. The benefit to a debtor company could, depending upon the circumstances, mean a benefit to its shareholders.

21 It is clear that the CCAA serves the interests of a broad constituency of investors, creditors and employees. See *Hong Kong Bank of Canada v. Chef Ready Foods Ltd.* (1990), 4 C.B.R. (3d) 311 (B.C.C.A.). See also *Janis P. Sarra*, Rescue! The Companies' Creditors Arrangement Act (Thomson Carswell) at p.60. Thus it is appropriate at this stage to consider the interests of the shareholders of Crystallex.

22 In my view, to cancel the shares of the existing shareholders at this stage is premature. The value of the gold at Las Cristinas is staggering. Las Cristinas contains at least 20,000,000 ounces of gold. At today's gold prices, the gold has increased in value by approximately $20 billion since Crystallex acquired its rights under the MOU. Crystallex's damage claim is for $3.8 billion.

23 No one can be sanguine about the outcome of the arbitration. The noteholders, however, have not argued that the arbitration will not succeed, which is not surprising, because if their Plan is accepted, they may well end up owning Crystallex and pursuing the arbitration for their own gain. Mr. Swan stated in argument that the Noteholders do not intend to stand in the way of the arbitration claim. I dealt with the issue of CVG having grounds to rescind the CVG contract in my reasons of September 29, 2011 on the second attempt by the Noteholders to obtain a declaration that there had been a "Project Change of Control" and stated that while the issue of whether CVG breached its contractual provisions purporting to rescind the CVG contract is a matter for the arbitration, the noteholders had not established that CVG had grounds to rescind the CVG contract. There is no new evidence before me to suggest otherwise.

24 Crystallex has spent over $500 million on the project. In the event that Crystallex only recovered that amount, without interest and without any compensation for the loss of the ability to develop the project, Crystallex would still have more than enough to pay all of its debts and have substantial value left over for its shareholders.

25 There is evidence that Venezuela has a history of settling arbitrations and examples of substantial sums being paid are included in the record, including offering Exxon a settlement of $1 billion in December 2011 arising from the nationalization of certain assets.[1] At a procedural meeting on December 1, 2011, the arbitration tribunal in the claim by Crystallex against Venezuela established Washington D.C. as the seat of the arbitration proceeding and established a timetable for the

arbitration which requires Crystallex to submit its witness statements, supporting documents and written argument in February 2012. The hearing of the arbitration is scheduled for November 2013.

26 In my view, what the Noteholders propose at this stage, including the cancellation of the common shares held by the shareholders of Crystallex, is not a fair balancing of the interests of all stakeholders. To say that they will never vote in favour of any plan unless they are paid out immediately or the current management and board of Crystallex is removed is not reflective of the purposes of the CCAA at this stage.

27 The application of Crystallex and the terms of its Initial Order are not prejudicial to the legitimate interests of the Noteholders. The Noteholders are entitled to submit any proposal they wish to the board of Crystallex who will be obliged to consider it along with any other proposals obtained. The board of directors of Crystallex has a continuing duty to balance stakeholder interests. If the Crystallex board does not choose their proposal, the Noteholders would have their remedies, if appropriate, in the CCAA process. What the Noteholders have sought in their CCAA application is to effectively prevent Crystallex from taking steps under the CCAA to attempt to obtain a resolution for all stakeholders without the benefit of seeing what Crystallex may be able to achieve. It cannot be said at this stage that the efforts of Crystallex are doomed to fail.

28 The Noteholders contend that their Plan is reasonable as it permits investors to invest in new shares of Crystallex and gives Crystallex the ability to determine if the market thinks that the arbitration claim is worth at least $100 million, the amount required by the Noteholders' Plan to permit the issuance of the new shares. There is no evidence, however, that the attempt to raise funds in a tight timetable as set out in the Noteholders' Plan by means of issuance of new common shares is the best or the only possible means of raising money, or a true test of the market's view of the value of the arbitration claim, and for a court at this stage to require that to be done would in my view be impermissibly usurping the power of the board of directors of Crystallex in its restructuring efforts. See *Re Stelco* [2005] O.J. No. 4733 (C.A.) at para. 26.

29 In the circumstances, I am not prepared to act on the Noteholders' Plan or to issue an Initial Order as proposed by them. In my view, the Crystallex proposal in its proposed Initial Order is in keeping with the objectives of the CCAA and will permit a fair and balanced process at this initial stage.

30 Mr. Swan said that with respect to the Crystallex application, the most significant concern of the Noteholders is that the DIP financing may be used as a long-term financing vehicle for months and years without presenting a real refinancing plan, and that to provide security would change the status quo. It seems to me that this concern is somewhat premature, as it is not known what financing, DIP or otherwise, will be achieved and proposed for approval by the Court.

31 Crystallex proposes a Directors' and Officers' charge of $10 million to secure the indemnity provided to them in the Initial Order. In its proposed Initial Order, the Noteholders proposed an indemnification secured by a charge of $100,000. In argument, Mr. Swan contended that $500,000 to $1 million was more typical and that $10 million was wholly excessive. It must be remembered that the charge only applies to liabilities in excess of the D&O insurance coverage that the directors and officers have, which is $20 million and in place until September 2012. It is not known whether the policy can be renewed in September 2012 at a reasonable cost. It may be that the charge may never be needed, in which case the Noteholders should have no concern about the size of it. If it is needed, however, I would not at this stage limit it to the amount suggested by the Noteholders. There has

already been extensive litigation involving Crystallex and the directors and officers understandably need assurances of the kind normally provided in CCAA proceedings. To lose the senior officers and directors of Crystallex at this stage would undoubtedly have a negative impact on the preparation and prosecution of the arbitration claim. Mr. Byers on behalf of Ernst & Young Inc., the proposed Monitor, stated that the Monitor would be prepared to look at the quantum of the charge. In the circumstances, I accept the $10 million figure for the charge with the proviso that the Monitor review it and if thought appropriate report back to the Court.

32 Crystallex proposes an Administration Charge of $3 million. The Noteholders propose an Administration Charge limited to $1 million. In light of the contentious nature of the relationship between the Noteholders and Crystallex, I think the Administration Charge of $3 million is reasonable.

Conclusion

33 It was necessary that the Initial Order be signed on December 23, 2011. Its provisions reflect my comments in this endorsement. The return date for any application for the extension of the stay provisions in the Initial Order is scheduled for January 20, 2012 at 9 a.m.

F.J.C. NEWBOULD J.

cp/e/qlafr/qlvxw/qljxh/qlhcs

1 In the first attempt of the Noteholders to obtain a declaration of a Change of Control as a result of the threats of Venezuela to confiscate Crystallex's interests, there was evidence that Crystallex had advice that it was better to try to negotiate rather than arbitrate, which had led the board of directors to attempt to negotiate. Whether there has been a change of policy in Venezuela is no doubt a question mark.

TAB 16

Indexed as:

Royal Oak Mines Inc. (Re)

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

[1999] O.J. No. 4848

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

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

Court File No. 99-CL-3278

Ontario Superior Court of Justice
Commercial List

Farley J.

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

(6 paras.)

Counsel:

No counsel mentioned.

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

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

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

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

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

6 Order to issue.

FARLEY J.

cp/s/qlrme

TAB 17

C. A.
1903
Nov. 23.

In re TEA CORPORATION, LIMITED. SORSBIE *v.* SAME COMPANY.

[00153 of 1903.]
[1902 S. 1894.]

Company—Winding-up—Scheme of Arrangement with Creditors and Contributories—Sanction of Court—Dissent of Class of Contributories having no Interest in Assets—Joint Stock Companies Arrangement Act, 1870 (33 & 34 *Vict. c.* 104), *s.* 2—*Companies Act*, 1900 (63 & 64 *Vict. c.* 48), *s.* 24.

Under s. 2 of the Joint Stock Companies Arrangement Act, 1870, combined with s. 24 of the Companies Act, 1900, the Court has jurisdiction to sanction a scheme of arrangement with the creditors and contributories of a company in liquidation, notwithstanding the dissent of one class of contributories, if the Court is satisfied that having regard to the value of the company's assets that class has no interest in them.

Under such circumstances the scheme must be treated as made between the company and their creditors, and between the company and the other classes of contributories, and a provision made by it for the benefit of the dissentient class must be regarded as in the nature of a gift or concession to them.

Decision of Buckley J. affirmed.

APPEAL from an order of Buckley J. sanctioning a scheme of arrangement made by the above company with creditors and contributories.

The corporation was incorporated on July 24, 1897, with a nominal capital of 200,000*l.*, divided into 20,000 preference shares of 5*l.* each and 20,000 ordinary shares of 5*l.* each. The preference shares had a preference as regarded capital as well as dividends. There had been issued 13,000 of the preference shares and 10,300 of the ordinary shares. All the shares had been paid up in full except 426, on which calls amounting to 2130*l.* were in arrear. The principal object of the company was to acquire estates in Ceylon and to carry on there the business of tea planters.

Shortly after its incorporation the company acquired some tea estates in Ceylon, the area of which was more than 7000 acres, chiefly of freehold tenure.

In the year 1897 the company created first mortgage deben-

ture stock to the amount of 65,000*l.*, bearing interest at 5 per cent. per annum.

On December 20, 1897, a trust deed to secure this stock was executed between the company of the one part, and the Debenture Corporation and T. J. Lawrence, as trustees for the debenture stockholders, of the other part. The whole of this debenture stock had been issued and remained outstanding.

In the year 1902, owing to depression in the tea trade, the company became unable to keep down the interest on the debenture stock, and on December 2, 1902, the trustees of the trust deed, under the powers contained in it, appointed a receiver, who took possession of the company's estates in Ceylon, and proceeded to carry on the company's business thereon.

The above action was brought on behalf of the debenture stockholders, and in it an order was made by Byrne J. on January 26, 1903, that the trusts of the trust deed should be carried into execution, and it was declared that the holders of the debenture stock were entitled to a charge upon the property comprised in the deed for securing the repayment of the principal and interest owing in respect of the debenture stock, and the usual accounts and inquiries were directed to be taken and made.

On March 12, 1903, an extraordinary general meeting of the shareholders was held at which an extraordinary resolution, in accordance with sub-s. 3 of s. 129 of the Companies Act, 1862, was passed to the effect that it had been proved to the satisfaction of the company that the company could not by reason of its liabilities continue its business, and that it was desirable to wind up the company, and a liquidator was appointed.

At meetings of the shareholders under s. 161 of the Companies Act, 1862, held on April 24 and May 20, 1903, resolutions approving of a scheme for the reconstruction of the company were duly passed, but that scheme was afterwards abandoned.

The trustees of the trust deed then issued a summons in the above action for liberty to sell the property and assets comprised in the deed. The summons was returnable on June 30, 1903.

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A scheme of arrangement under the Joint Stock Companies Arrangement Act, 1870, was then prepared, and on July 24, 1903, a petition was presented by the company and the liquidator to obtain the sanction of the Court to the scheme.

The petition was entitled in the action; in the matter of the company; and also in the matter of the Companies Acts, 1862 to 1900, and in the matter of the above Act of 1870.

The scheme was sanctioned by the Court with some slight modifications, and as modified it provided as follows:—

"1. A new company shall be formed under the Companies Acts, 1862 to 1900, as a company limited by shares, with the same name as the present company, or with such other name as may be determined by the liquidator with the approval of the Court.

"2. The capital of the new company shall be 70,000*l.*, divided into 70,000 shares of 1*l.* each. The objects of the new company shall include the acquisition and undertaking of all or any of the assets and liabilities of the present company. The memorandum and articles of association of the new company shall be framed in accordance with the draft which has already been prepared with the privity of the liquidator. The first directors of the company shall be Alfred Bull, Thomas James Lawrence, and Vivian Hugh Smith, or, in case of the refusal or inability of any of the said persons to act as director, some other person nominated in his place by the liquidator with the approval of the Court.

"3. The liquidator shall enter into an agreement with the new company for the adoption of this scheme by the new company and for the transfer to the new company, upon the footing and subject to the provisions of this scheme, of the assets of the present company.

"4. The new company shall create first mortgage debenture stock, charged by way of fixed charge on its immovable property in Ceylon, and by way of floating charge on the rest of its undertaking, property, and assets, and bearing interest at 4*l.* 10*s.* per cent. per annum as from the 1st July, 1903. The company shall be bound to redeem the stock at par on the 31st December, 1940. The amount of the stock shall be 52,000*l.* The

trust deed securing the stock shall be framed in accordance with the draft already prepared with the privity of the liquidator. The trustees of the stock shall be the Debenture Corporation, Limited. The debenture stock is to be reduced to 40,000*l.* by purchase or drawings as provided by the said draft deed, the new company for that purpose applying its profits up to at least 1000*l.* per annum.

"5. The new company shall pay to each debenture stockholder of the present company a sum in cash equal to 20 per cent. of the nominal amount of his holding, and all arrears of interest thereon to the 1st July, 1903, and shall allot to him first mortgage debenture stock of the new company to the amount of 80 per cent. of his holding, and in exchange for such payment and for the certificate for such stock of the new company he shall surrender his debenture stock of the old company and deliver up his certificate for the same, and shall be deemed to accept such payment as aforesaid and the delivery of the certificate for the stock of the new company as complete satisfaction for all his claims in respect of the debenture stock of the old company.

"6. The new company will take over and discharge all the liabilities of the old company (other than its liabilities in respect of the principal and interest on its debenture stock), and will pay and discharge all the costs, charges, and expenses of the trustees of the deed securing the present company's debenture stock and of the receiver appointed by them, and all the costs as between solicitor and client of all parties of the action: *Sorsbie* v. *The Tea Corporation, Ld.* [1902 S. 1894], and also all the costs of and incidental to the winding-up and dissolution of the present company, including the costs of and incidental to this scheme and to carrying the same into effect.

"7. Each holder of preference shares in the present company shall, in respect of each such preference share of 5*l.* held by him, be entitled to claim an allotment of four shares of 1*l.* each in the new company, with a sum of 10*s.* per share credited as paid up thereon.

"Each holder of ordinary shares in the present company, in respect of each such ordinary share, shall be entitled to claim

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an allotment of one share of 1*l.* in the new company, with a sum of 10*s.* per share credited as paid up thereon.

"8. The new company shall not be bound to allot any shares hereunder to any person, whose registered address in the books of the old company is in the United Kingdom, Ireland, the Channel Islands, France, or the Empire of Germany, unless, within twenty-eight days from the date of the posting of the notice to him by the liquidator of his right to claim the shares to which he is entitled, he shall by writing addressed to the new company claim the allotment, and shall in respect of each partly paid share for which he shall apply pay 1*s.* on application. As regards any person whose registered address in the books of the old company is in Ceylon, the company shall not be bound to allot any shares hereunder to any such person, unless within eight weeks from the date of the posting of the said notice he shall by writing addressed to the new company claim the allotment, and shall in respect of each such share for which he shall apply pay 1*s.* on application. The balance on each partly paid share shall be paid as to 4*s.* on allotment, and as to 5*s.* within three months from allotment. The liquidator shall, within seven days after this scheme shall be sanctioned as aforesaid, give to each member notice thereof at his registered address.

"9. The liquidator of the present company shall sell for what they will fetch such of the above-mentioned shares of the new company as the members of the present company shall be entitled to claim, but shall not claim within the respective periods aforesaid, and the new company shall allot the said shares to the purchasers, and the net purchase-money received by the liquidator for the said shares (after deducting expenses of sale) shall be distributed rateably amongst those shareholders who were respectively entitled to claim, but did not within the respective periods aforesaid claim such shares.

"10. As soon as conveniently may be after this scheme becomes binding, the present company and the liquidator and all other necessary parties shall do and execute all such deeds and documents as may be necessary for the conveyance and transfer to the new company of the property of the present

company in the terms of this scheme, and for otherwise carrying this scheme into effect. Until the transfer to the new company of the business of the present company in pursuance of such deeds or documents, the receiver and the liquidator shall be deemed to be carrying on the same on account of the new company as a going concern, but until the assignment and transfer the receiver and the liquidator shall be at liberty to discharge out of the same any debts and liabilities to be undertaken by the new company.

"11. All further proceedings in the action of *Sorsbie* v. *The Tea Corporation, Ld.* [1902 S. 1894], shall be forthwith stayed.

"12. All further proceedings in the liquidation of the present company shall be stayed, except such as may be necessary for carrying into effect this scheme or the order confirming the same.

"13. Unless (*a*) this scheme is adopted by the new company within three weeks after the sanction of this scheme by the Court, and (*b*) all the said shares to be allotted hereunder are duly allotted within ten weeks after such sanction, the liquidator may, with the sanction of the Court, declare that the scheme has fallen through, and thereupon the winding-up of the present company shall proceed in due course, and all the other provisions of this scheme shall be at an end.

"14. The liquidator may assent to any modification in this scheme, or to any condition which the Court may think fit to approve or impose.

"15. Nothing in this scheme contained shall affect any charge, lien or security, except as herein otherwise expressly provided."

By the direction of the Court separate meetings were held of the debenture stockholders, the unsecured creditors of the company, the preference shareholders, and the ordinary shareholders, for the purpose of considering the scheme.

At the meeting of the debenture stockholders thirty-five holders, whose holdings amounted to more than 47,000*l*., were present, and a resolution approving of the scheme was passed unanimously.

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At the meeting of the unsecured creditors five creditors, whose debts amounted to 11,187*l.*, were present, and they unanimously approved of the scheme. The unsecured debts of the company amounted to about 12,000*l.*

At the meeting of the preference shareholders thirty-five shareholders, whose holdings amounted to 6445 shares, were present. Of these twenty, holding 5173 shares, voted in favour of a resolution approving of the scheme, and nine, holding 652 shares, voted against the resolution. The resolution was therefore carried by the proper statutory majority.

At the meeting of the ordinary shareholders twenty-four shareholders, whose holdings amounted to 1958 shares, were present. Of these eight, holding together 1269 shares, voted in favour of a resolution approving of the scheme, and sixteen, holding together 689 shares, voted against the resolution. The resolution was therefore not carried by the proper statutory majority, and was lost.

The petition alleged that the proceeds of the company's assets if realized would be insufficient to leave any surplus for distribution among the contributories, and that they had therefore no interest in the matter.

Buckley J. came to the conclusion that the company's assets might realize 20,000*l.* more than the amount of the debts, so that, after paying the creditors, there would not be enough to pay the preference shareholders in full, and that consequently the ordinary shareholders had no interest in the matter. His Lordship accordingly, on August 7, 1903, made an order sanctioning the scheme, and declaring it to be binding on the mortgage debenture stockholders and the creditors and contributories of the company, and also on the liquidator thereof.

One of the ordinary shareholders appealed.

Buckmaster, K.C., and *Austen-Cartmell*, for the appellant. It is contended that such a scheme as this could not be sanctioned by the Court under the Act of 1870. Under s. 161 of the Companies Act, 1862, rights are given to dissentient shareholders, and this scheme deprives them of those rights.

Sect. 2 of the Act of 1870 (1) applies to creditors, and it has no application to contributories. But, before sanctioning a scheme of arrangement with creditors under the Act of 1870, the Court has required meetings of the contributories to be held : *In re English, Scottish and Australian Chartered Bank* (2) ; *In re London Chartered Bank of Australia.* (3) Dissentient shareholders cannot be deprived of the rights given to them by s. 161. It is submitted that s. 24 of the Companies Act, 1900, does not take away their rights under s. 161 of the Act of 1862. This scheme compels the ordinary shareholders either to give up their rights altogether, or to accept instead of them shares in the new company with a liability to calls. . Sect. 24 of the Act of 1900 does not enable the company to bind the shareholders by a scheme which imposes a new liability on them. That can be done only under s. 161 of the Companies Act, 1862, and with the safeguards there provided.

But, if s. 24 does enable the Court to bind contributories by such a scheme, it can only do so if resolutions approving the scheme have been passed by every class of contributories in the same way as, in order to bind the creditors, resolutions in favour of the scheme must be passed by every class of

(1) By the Joint Stock Companies Arrangement Act, 1870, s. 2, "Where any compromise or arrangement shall be proposed between a company which is, at the time of the passing of this Act or afterwards, in the course of being wound up, either voluntarily or by or under the supervision of the Court, under the Companies Acts, 1862 and 1867, or either of them, and the creditors of such company, or any class of such creditors, it shall be lawful for the Court, in addition to any other of its powers, on the application in a summary way of any creditor or the liquidator, to order that a meeting of such creditors or class of creditors shall be summoned in such manner as the Court shall direct, and if a majority in number representing three-fourths in value of such creditors or class of creditors present either in person or by proxy at such meeting shall agree to any arrangement or compromise, such arrangement or compromise shall, if sanctioned by an order of the Court, be binding on all such creditors or class of creditors, as the case may be, and also on the liquidator and contributories of the said company."

By the Companies Act, 1900, s. 24, "The provisions of s. 2 of the Joint Stock Companies Arrangement Act, 1870, shall apply not only as between the company and the creditors, or any class thereof, but as between the company and the members, or any class thereof."

(2) [1893] 3 Ch. 385.

(3) [1893] 3 Ch. 540.

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creditors. In the present case the ordinary shareholders have rejected a resolution approving the scheme. So that if s. 24 renders s. 2 of the Act of 1870 applicable to contributories the conditions of the section have not been complied with. In *In re Canning Jarrah Timber Co.* (1) the Court of Appeal, in sanctioning a scheme under the Act of 1870, which imposed a new liability on the shareholders, required the liquidator to undertake that the dissentient shareholders should be entitled to the rights given to them by s. 161 of the Act of 1862. In that case there had been a preliminary special resolution under s. 161 authorizing a transfer of the company's assets to a new company. There has been no such resolution in the present case. It is submitted that the contributories can be bound only under s. 161; at any rate, a new liability cannot be imposed on them. In *In re Brownfields Guild Pottery Society* (2) the Court, in sanctioning a scheme under the Act of 1870, did not require any meeting of the shareholders to be called, but the scheme did not impose any new liability on them.

[*Clauson*, for the liquidator. The scheme in that case is set forth in Palmer's Company Precedents, 8th ed. Part II. p. 819.]

Here the evidence shews that the company's property is likely to become much more valuable.

Manby, for ordinary shareholders, supported the appeal.

Mark Romer, for other ordinary shareholders. The new company are to give something to the ordinary shareholders, and the inference is that their shares have some value. It is submitted that the Court has no jurisdiction to sanction the scheme unless it is approved by the proper majority of each class of shareholders.

A. àBeckett Terrell, for the plaintiff in the action, supported the scheme.

Eve, *K.C.*, and *Clauson*, for the company and the liquidator. It was admitted in the Court below that the assets if realized would not produce more than 20,000*l.* beyond the amount of the debts. The preference shareholders have a preference as

(1) [1900] 1 Ch. 708. (2) W. N. (1898) 80.

regards capital, and the nominal amount of the preference shares is 65,000*l.* Consequently, there is nothing left for the ordinary shareholders. No doubt before the Act of 1900 schemes have been sanctioned by the Court when there was no evidence that the value of the company's assets did not exceed the amount of the debts. The case is somewhat analogous to the Australian bank cases; probably if there was a forced sale the creditors would take the whole. It is contended that by virtue of s. 2 of the Act of 1870 and s. 24 of the Companies Act, 1900, the Court can sanction the scheme as an arrangement between the company and their creditors and the preference shareholders. The ordinary shareholders have under the circumstances no interest in the assets. This jurisdiction is conferred independently of s. 161 of the Companies Act, 1862. The decision in *In re Canning Jarrah Timber Co.* (1) did not turn upon s. 161; the Court only required as a condition of its sanction that the dissentient shareholders should be placed in the same position as they would have been under that section. Such a condition might, if necessary, be imposed here. But, it is submitted, it is not necessary, because the ordinary shareholders have really no interest. The scheme is a fair and proper one as between the company and their creditors, and as between the company and the preference shareholders, and the ordinary shareholders have no interest in the matter.

Rowden, K.C., and *Gordon Brown*, for the trustees of the trust deed and a large holder of debenture stock. The Act of 1870 was passed for the benefit of creditors; s. 24 of the Act of 1900 was intended to extend that benefit to contributories.

Buckmaster, K.C., in reply.

VAUGHAN WILLIAMS L.J. Two questions of law are raised in this case. Buckley J. has found as a fact that the value of the company's assets is such as to negative the notion that the ordinary shareholders have any financial interest whatever in them, and it is not denied that on the evidence before him the learned judge was right in coming to that conclusion. Some further affidavits have been since made for the purpose of

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shewing that the learned judge was misinformed as to the value of the assets, but I do not think we ought to allow those affidavits to be read. That being so, we must take it that the conclusion of Buckley J. upon the facts was right.

Then the first question of law is this. It is said that the present scheme is one which might have been carried into effect under s. 161 of the Companies Act, 1862; and, it being a scheme of that character, it is said that you cannot have a scheme which embraces that which might have been done under s. 161, unless in some way the dissentient shareholders are placed in the position in which they would have been placed in a scheme carried out under s. 161. In my opinion that proposition is much too wide. Reference has been made to the cases of the Australian banks—*In re English, Scottish and Australian Chartered Bank* (1) and *In re London Chartered Bank of Australia* (2)—in which the Court directed meetings of the contributories to be held to consider proposed schemes of arrangement with creditors under the Act of 1870, and thus recognised a right of the contributories to be consulted. But it is said that those cases have no application to the present case, because if the whole of this company's property was converted into money for the purpose of paying its debts there would be no surplus to go to the ordinary shareholders. And it was said that in giving the ordinary shareholders of the old company an option to take up shares in the new company, on which a certain amount was to be credited as paid up, you were not giving them any interest in consideration of their surrendering their old shares; but this offer was a gratuitous act on the part of the debenture stockholders and preference shareholders, for if they insisted on their strict rights there would be nothing left for any one else. That may be true. But then it is said that here it is common ground that, if the company's assets were realized, something would be left for the preference shareholders, and it is contended that this scheme could not be carried out under the Act of 1870 without having recourse to s. 161 of the Companies Act, 1862. I am not sure how that may be. Under the Act of 1870 alone it may be the Court

(1) [1893] 3 Ch. 385. (2) [1893] 3 Ch. 540.

would have refused to sanction such a scheme, unless it had been satisfied that the ordinary shareholders had been consulted about it. But, be that as it may, we have now s. 24 of the Companies Act, 1900, which, as it seems to me, removes any difficulty of that sort. [His Lordship read s. 24, and continued:—]

It is, I think, quite plain that by this section the Legislature intended that the contributories should have a right to vote in a manner similar to that in which the creditors were to vote under the Act of 1870, and that they should be bound in the same way. Under the Act of 1870 the creditors were to be divided into classes, and each class was to vote separately, and under s. 24 the contributories are to be dealt with in the same way. In the present case the contributories were divided into two classes, preference shareholders and ordinary shareholders, and they voted in those classes, and the majority of the preference shareholders voted in favour of the scheme. It is said, however, that the scheme is rendered defective because the ordinary shareholders did not vote in favour of it. I think the right answer to this was given by Buckley J. You are to divide the shareholders into classes, and when you have done that you find that the preference shareholders have an interest in the assets. But when you come to the ordinary shareholders you find that they have no interest whatever in the assets, and Buckley J. was of opinion that, having regard to this fact, their dissent from the scheme was immaterial. I think that the learned judge was right in so holding. It seems to me that by the very terms of s. 24 you are to divide the contributories into classes and to call meetings of each class, and if you have the assent to the scheme of all those classes who have an interest in the matter, you ought not to consider the votes of those classes who have really no interest at all. It would be very unfortunate if a different view had to be taken, for if there were ordinary shareholders who had really no interest in the company's assets, and a scheme had been approved by the creditors, and all those were really interested in the assets, the ordinary shareholders would be able to say that it should not be carried into effect unless some terms were

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made with them. In my opinion the decision of the learned judge was right, and the appeal should be dismissed.

ROMER L.J. I agree. If you were to look only at the scheme as prepared and did not know the facts, you would conclude that it did involve an arrangement or compromise between the company and the ordinary shareholders. But, in my opinion, the respondents are not estopped from setting forth the real facts, and contending, as they have done, (1.) that the ordinary shareholders have in fact no interest in the matter, and (2.) that this scheme is really put forward as an arrangement between the company and their creditors, and between the company and the preference shareholders, leaving out the ordinary shareholders as having really no interest in the matter. The learned judge, as I understand, came to the conclusion upon the evidence before him as to the value of the company's assets that the ordinary shareholders had no interest in the assets, and I cannot gather from the appellant's counsel that the judge was in substance wrong in coming to that conclusion. Having regard to the evidence and the admissions made in the Court below, I think he was right in drawing the inference that the ordinary shareholders had no interest, and I base my judgment solely on that ground.

That being so, I can see no difficulty in holding that this scheme is only an arrangement as between the company and their creditors and as between the company and the preference shareholders, and as such it is authorized by s. 2 of the Act of 1870 combined with s. 24 of the Companies Act, 1900. It is true that by the scheme some shares in the new company are offered to the ordinary shareholders in the old company; but I think that must be regarded as rather in the nature of a gift by the creditors and the preference shareholders to the ordinary shareholders, and not as shewing that they had an interest in the assets which they were surrendering. Certainly the ordinary shareholders cannot be heard to complain of a gift being made to them when they had no right to it but for the scheme, and there is no appeal on behalf of the creditors or the preference shareholders from this provision of the scheme.

In my opinion, therefore, the scheme was rightly sanctioned by the learned judge.

STIRLING L.J. I am of the same opinion. There are three classes of persons who claim to be interested in the assets of the company, namely, (1.) the creditors of the company, secured and unsecured; (2.) the preference shareholders; (3.) the ordinary shareholders. Having regard to what took place in the Court below, it must, I think, be taken that the assets are not sufficient to meet the claims of the creditors and the preference shareholders, and that the ordinary shareholders have no interest. In this state of things it seems to me that it was within the power of the Court to sanction the scheme, as regards the creditors under s. 2 of the Act of 1870, and as regards the preference shareholders under that section combined with s. 24 of the Companies Act, 1900. But it is objected that the scheme gives to the ordinary shareholders an option to take shares in the new company, and that the inference is that they had an interest in the assets. It is answered that the scheme deals only with the creditors and the preference shareholders, and that the offer of shares to the ordinary shareholders is really a concession to them on the part of the preference shareholders which those shareholders were entitled to make. It seems to me that this is the right view. Whether this option could have been given against the wish of the preference shareholders is another question. But the ordinary shareholders are not entitled to complain of it. In my opinion the decision of the learned judge was right.

Solicitors: *R. R. G. Norman; S. J. R. Stammers; W. S. Morris; Linklater & Co.*

W. L. C.

TAB 18

CITATION: Robertson v. ProQuest Information and Learning Company, 2011 ONSC 1647
COURT FILE NO.: 03-CV-252945CP / CV-10-8533-00CL
DATE: 20110315

ONTARIO

SUPERIOR COURT OF JUSTICE
(Commercial List)

RE: IN THE MATTER OF THE CO*MPANIES' 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.

- AND -

HEATHER ROBERTSON, Plaintiff

AND:

PROQUEST INFORMATION AND LEARNING COMPANY, CEDROM-SNI INC., TORONTO STAR NEWSPAPERS LTD., ROGERS PUBLISHING LIMITED and CANWEST PUBLISHING INC., Defendants

BEFORE: Pepall J.

COUNSEL: *Kirk Baert*, for the Plaintiff

Peter J. Osborne and *Kate McGrann*, for Canwest Publishing Inc.

Alex Cobb, for the CCAA Applicants

Ashley Taylor and *Maria Konyukhova*, for the Monitor

REASONS FOR DECISION

Overview

[1] On January 8, 2010, I granted an initial order pursuant to the provisions of the *Companies' Creditors Arrangement Act* ("*CCAA*") in favour of Canwest Publishing Inc. ("CPI") and related entities (the "LP Entities"). As a result of this order and subsequent orders, actions against the LP Entities were stayed. This included a class proceeding against CPI brought by

Heather Robertson in her personal capacity and as a representative plaintiff (the "Representative Plaintiff"). Subsequently, CPI brought a motion for an order approving a proposed notice of settlement of the action which was granted. CPI and the Representative Plaintiff then jointly brought a motion for approval of the settlement of both the class proceeding as against CPI and the *CCAA* claim. The Monitor supported the request and no one was opposed. I granted the judgment requested and approved the settlement with endorsement to follow. Given the significance of the interplay of class proceedings with *CCAA* proceedings, I have written more detailed reasons for decision rather than simply an endorsement.

Facts

[2] The Representative Plaintiff commenced this class proceeding by statement of claim dated July 25, 2003 and the action was case managed by Justice Cullity. He certified the action as a class proceeding on October 21, 2008 which order was subsequently amended on September 15, 2009.

[3] The Representative Plaintiff claimed compensatory damages of $500 million plus punitive and exemplary damages of $250 million against the named defendants, ProQuest Information and Learning LLC, Cedrom-SNI Inc., Toronto Star Newspapers Ltd., Rogers Publishing Limited and CPI for the alleged infringement of copyright and moral rights in certain works owned by class members. She alleged that class members had granted the defendants the limited right to reproduce the class members' works in the print editions of certain newspapers and magazines but that the defendant publishers had proceeded to reproduce, distribute and communicate the works to the public in electronic media operated by them or by third parties.

[4] As set out in the certification order, the class consists of:

> A. All persons who were the authors or creators of original literary works ("Works") which were published in Canada in any newspaper, magazine, periodical, newsletter, or journal (collectively "Print Media") which Print Media have been reproduced, distributed or communicated to the public by telecommunication by, or pursuant to the purported authorization or permission of, one or more of the defendants, through any

electronic database, excluding electronic databases in which only a precise electronic reproduction of the Work or substantial portion thereof is made available (such as PDF and analogous copies) (collectively "Electronic Media"), excluding:

(a) persons who by written document assigned or exclusively licensed all of the copyright in their Works to a defendant, a licensor to a defendant, or any third party; or

(b) persons who by written document granted to a defendant or a licensor to a defendant a license to publish or use their Works in Electronic Media; or

(c) persons who provided Works to a not for profit or non-commercial publisher of Print Media which was licensor to a defendant (including a third party defendant), and where such persons either did not expect or request, or did not receive, financial gain for providing such Works; or

(d) persons who were employees of a defendant or a licensor to a defendant, with respect to any Works created in the course of their employment.

Where the Print Media publication was a Canadian edition of a foreign publication, only Works comprising of the content exclusive to the Canada edition shall qualify for inclusion under this definition.

(Persons included in clause A are thereinafter referred to as "Creators". A "licensor to a defendant" is any party that has purportedly authorized or provided permission to one or more defendants to make Works available in Electronic Media. References to defendants or licensors to defendants include their predecessors and successors in interest)

B. All persons (except a defendant or a licensor to a defendant) to whom a Creator, or an Assignee, assigned, exclusively licensed, granted or transmitted a right to publish or use their Works in Electronic Media.

(Persons included in clause B are hereinafter referred to as "Assignees")

> C. Where a Creator or Assignee is deceased, the personal representatives of the estate of such person unless the date of death of the Creator was on or before December 31, 1950.

[5] As part of the *CCAA* proceedings, I granted a claims procedure order detailing the procedure to be adopted for claims to be made against the LP Entities in the *CCAA* proceedings. On April 12, 2010, the Representative Plaintiff filed a claim for $500 million in respect of the claims advanced against CPI in the action pursuant to the provisions of the claims procedure order. The Monitor was of the view that the claim in the *CCAA* proceedings should be valued at $0 on a preliminary basis.

[6] The Representative Plaintiff's claim was scheduled to be heard by a claims officer appointed pursuant to the terms of the claims procedure order. The claims officer would determine liability and would value the claim for voting purposes in the *CCAA* proceedings.

[7] Prior to the hearing before the claims officer, the Representative Plaintiff and CPI negotiated for approximately two weeks and ultimately agreed to settle the *CCAA* claim pursuant to the terms of a settlement agreement.

[8] When dealing with the consensual resolution of a *CCAA* claim filed in a claims process that arises out of ongoing litigation, typically no court approval is required. In contrast, class proceeding settlements must be approved by the court. The notice and process for dissemination of the settlement agreement must also be approved by the court.

[9] Pursuant to section 34 of the *Class Proceedings Act*, the same judge shall hear all motions before the trial of the common issues although another judge may be assigned by the Regional Senior Judge (the "RSJ") in certain circumstances. The action had been stayed as a result of the CCAA proceedings. While I was the supervising CCAA judge, I was also assigned by the RSJ to hear the class proceeding notice and settlement motions.

[10] Class counsel said in his affidavit that given the time constraints in the *CCAA* proceedings, he was of the view that the parties had made reasonable attempts to provide adequate notice of the settlement to the class. It would have been preferable to have provided

more notice, however, given the exigencies of insolvency proceedings and the proposed meeting to vote on the *CCAA* Plan, I was prepared to accept the notice period requested by class counsel and CPI.

[11] In this case, given the hybrid nature of the proceedings, the motion for an order approving notice of the settlement in both the class action proceeding and the *CCAA* proceeding was brought before me as the supervising *CCAA* judge. The notice procedure order required:

1) the Monitor and class counsel to post a copy of the settlement agreement and the notice order on their websites;

2) the Monitor to publish an English version of the approved form of notice letter in the National Post and the Globe and Mail on three consecutive days and a French translation of the approved form of notice letter in La Presse for three consecutive days;

3) distribution of a press release in an approved form by Canadian Newswire Group for dissemination to various media outlets; and

4) the Monitor and class counsel were to maintain toll-free phone numbers and to respond to enquiries and information requests from class members.

[12] The notice order allowed class members to file a notice of appearance on or before a date set forth in the order and if a notice of appearance was delivered, the party could appear in person at the settlement approval motion and any other proceeding in respect of the class proceeding settlement. Any notices of appearance were to be provided to the service list prior to the approval hearing. In fact, no notices of appearance were served.

[13] In brief, the terms of the settlement were that:

a) the *CCAA* claim in the amount of $7.5 million would be allowed for voting and distribution purposes;

b) the Representative Plaintiff undertook to vote the claim in favour of the proposed *CCAA* Plan;

c) the action would be dismissed as against CPI;

d) CPI did not admit liability; and

e) the Representative Plaintiff, in her personal capacity and on behalf of the class and/or class members, would provide a licence and release in respect of the freelance subject works as that term was defined in the settlement agreement.

[14] The claims in the action in respect of CPI would be fully settled but the claims which also involved ProQuest would be preserved. The licence was a non-exclusive licence to reproduce one or more copies of the freelance subject works in electronic media and to authorize others to do the same. The licence excluded the right to licence freelance subject works to ProQuest until such time as the action was resolved against ProQuest, thereby protecting the class members' ability to pursue ProQuest in the action. The settlement did not terminate the lawsuit against the other remaining defendants. Under the *CCAA* Plan, all unsecured creditors, including the class, would be entitled to share on a pro rata basis in a distribution of shares in a new company. The Representative Plaintiff would share pro rata to the extent of the settlement amount with other affected creditors of the LP Entities in the distributions to be made by the LP Entities, if any.

[15] After the notice motion, CPI and the Representative Plaintiff brought a motion to approve the settlement. Evidence was filed showing, among other things, compliance with the claims procedure order. Arguments were made on the process and on the fairness and reasonableness of the settlement.

[16] In her affidavit, Ms. Robertson described why the settlement was fair, reasonable and in the best interests of the class members:

> In light of Canwest's insolvency, I am advised by counsel, and verily believe, that, absent an agreement or successful award in the Canwest Claims Process, the prospect of recovery for the Class

> against Canwest is minimal, at best. However, under the Settlement Agreement, which preserves the claims of the Class as against the remaining defendants in the class proceeding in respect of each of their independent alleged breaches of the class members' rights, as well as its claims as against ProQuest for alleged violations attributable to Canwest content, there is a prospect that members of the Class will receive some form of compensation in respect of their direct claims against Canwest.
>
> Because the Settlement Agreement provides a possible avenue of recovery for the Class, and because it largely preserves the remaining claims of the Class as against the remaining defendants in the class proceeding, I am of the view that the Settlement Agreement represents a reasonable compromise of the Class claim as against Canwest, and is both fair and reasonable in the circumstances of Canwest's insolvency.

[17] In the affidavit filed by class counsel, Anthony Guindon of the law firm Koskie Minsky LLP noted that he was not in a position to ascertain the approximate dollar value of the potential benefit flowing to the class from the potential share in a pro rata distribution of shares in the new corporation. This reflected the unfortunate reality of the *CCAA* process. While a share price of $11.45 was used, he noted that no assurance could be given as to the actual market price that would prevail. In addition, recovery was contingent on the total quantum of proven claims in the claims process. He also described the litigation risks associated with attempting to obtain a lifting of the *CCAA* stay of proceedings. The likelihood of success was stated to be minimal. He also observed the problems associated with collection of any judgment in favour of the Representative Plaintiff. He went on to state:

> ... The Representative Plaintiff, on behalf of the Class, could have elected to challenge Canwest's initial valuation of the Class claim of $0 before a Claims Officer, rather than entering into a negotiated settlement. However, a number of factors militated against the advisability of such a course of action. Most importantly, the claims of the Class in the class proceeding have not been proven, and the Class does not enjoy the benefit of a final judgment as against Canwest. Thus, a hearing before the Claims Officer would necessarily necessitate a finding of liability as against Canwest, in addition to a quantification of the claims of the Class against Canwest.

> ... a negative outcome in a hearing before a Claims Officer could have the effect of jeopardizing the Class claims as against the remaining defendants in the class proceeding. Such a finding would not be binding on a judge seized of a common issues trial in the class proceeding; however, it could have persuasive effect.
>
> Given the likely limited recovery available from Canwest in the Claims Process, it is the view of Class Counsel that a negotiated resolution of the quantification of Class claim as against Canwest is preferable to risking a negative finding of liability in the context of a contested Claims hearing before a Claims Officer.

[18] The Monitor was also involved in the negotiation of the settlement and was also of the view that the settlement agreement was a fair and reasonable resolution for CPI and the LP Entities' stakeholders. The Monitor indicated in its report that the settlement agreement eliminated a large degree of uncertainty from the *CCAA* proceeding and facilitated the approval of the Plan by the requisite majorities of stakeholders. This of course was vital to the successful restructuring of the LP Entities. The Monitor recommended approval of the settlement agreement.

[19] The settlement of the class proceeding action was made prior to the creditors' meeting to vote on the Plan for the LP Entities. The issues of the fees and disbursements of class counsel and the ultimate distribution to class members were left to be dealt with by the class proceedings judge if and when there was a resolution of the action with the remaining defendants.

Discussion

[20] Both motions in respect of the settlement were heard by me but were styled in both the *CCAA* proceedings and the class proceeding.

[21] As noted by Jay A. Swartz and Natasha J. MacParland in their article "*Canwest Publishing – A Tale of Two Plans*"[1]:

> "There have been a number of *CCAA* proceedings in which settlements in respect of class proceedings have been implemented including *McCarthy v. Canadian Red Cross Society*, *(Re:) Grace Canada Inc., Muscletech Research and Development Inc.,* and *(Re:) Hollinger Inc.* ... The structure and process for notice and approval of the settlement used in the LP Entities restructuring appears to be the most efficient and effective and likely a model for future approvals. Both motions in respect of the Settlement, discussed below, were heard by the *CCAA* judge but were styled in both proceedings." [citations omitted]

(a) Approval

(i) *CCAA* Settlements in General

[22] Certainly the court has jurisdiction to approve a *CCAA* settlement agreement. As stated by Farley J. in *Re Lehndorff General Partner Ltd.,*[2] the *CCAA* is intended to provide a structured environment for the negotiation of compromises between a debtor company and its creditors for the benefit of both. Very broad powers are provided to the *CCAA* judge and these powers are exercised to achieve the objectives of the statute. It is well settled that courts may approve settlements by debtor companies during the *CCAA* stay period: *Re Calpine Canada Energy Ltd.*[3]; *Re Air Canada*[4]; and *Re Playdium Entertainment Corp.*[5] To obtain approval of a settlement under the *CCAA*, the moving party must establish that: the transaction is fair and reasonable; the transaction will be beneficial to the debtor and its stakeholders generally; and the

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[1] Annual Review of Insolvency Law, 2010, J.P. Sarra Ed, Carswell, Toronto at page 79.

[2] (1993), 17 C.B.R. (3rd) 24 (Ont. Gen. Div.) at 31.

[3] [2007] A.B.Q.B. 504 at para. 71; leave to appeal dismissed [2007] A.B.C.A. 266 (Alta. C.A.).

[4] (2004), 47 C.B.R. (4th) 169 (Ont. S.C.J.).

[5] (2001), 31 C.B.R. (4th) 302 (Ont. S.C.J.) at para. 23.

settlement is consistent with the purpose and spirit of the *CCAA*. See in this regard *Re Air Canada*[6] and *Re Calpine.*[7]

(ii) Class Proceedings Settlement

[23] The power to approve the settlement of a class proceeding is found in section 29 of the *Class Proceedings Act*, 1992[8]. That section states:

> 29(1) A proceeding commenced under this *Act* and a proceeding certified as a class proceeding under this *Act* may be discontinued or abandoned only with the approval of the court, on such terms as the court considers appropriate.
>
> (2) A settlement of a class proceeding is not binding unless approved by the court.
>
> (3) A settlement of a class proceeding that is approved by the court binds all class members.
>
> (4) In dismissing a proceeding for delay or in approving a discontinuance, abandonment or settlement, the court shall consider whether notice should be given under section 19 and whether any notice should include,
>
> (a) an account of the conduct of the proceedings;
>
> (b) a statement of the result of the proceeding; and
>
> (c) a description of any plan for distributing settlement funds.

[24] The test for approval of the settlement of a class proceeding was described in *Dabbs v. Sun Life Assurance Co. of Canada*[9]. The court must find that in all of the circumstances the

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[6] *Supra.* at para. 9.

[7] *Supra.* at para. 59.

[8] S.O. 1992, C.6.

settlement is fair, reasonable and in the best interests of those affected by it. In making this determination, the court should consider, amongst other things:

a) the likelihood of recovery or success at trial;

b) the recommendation and experience of class counsel; and

c) the terms of the settlement.

As such, it is clear that although the *CCAA* and class proceeding tests for approval are not identical, a certain symmetry exists between the two.

[25] A perfect settlement is not required. As stated by Sharpe J. (as he then was) in *Dabbs v. Sun Life Assurance Co. of Canada*[10]:

> Fairness is not a standard of perfection. Reasonableness allows for a range of possible resolutions. A less than perfect settlement may be in the best interests of those affected by it when compared to the alternative of the risks and costs of litigation.

[26] Where there is more than one defendant in a class proceeding, the action may be settled against one of the defendants provided that the settlement is fair, reasonable and in the best interests of the class members: *Ontario New Home Warranty Program et al. v. Chevron Chemical et al.*[11]

(iii) The Robertson Settlement

[27] I concluded that the settlement agreement met the tests for approval under the *CCAA* and the *Class Proceedings Act*.

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[9] [1998] O.J. No. 1598 (Ont. Gen. Div.) at para. 9.

[10] (1998) 40 O.R. (3rd) 429 at para 30.

[11] [1999] O.J. No. 2245 (Ont. S.C.J.) at para. 97.

[28] As a general proposition, settlement of litigation is to be promoted. Settlement saves time and expense for the parties and the court and enables individuals to extract themselves from a justice system that, while of a high caliber, is often alien and personally demanding. Even though settlements are to be encouraged, fairness and reasonableness are not to be sacrificed in the process.

[29] The presence or absence of opposition to a settlement may sometimes serve as a proxy for reasonableness. This is not invariably so, particularly in a class proceeding settlement. In a class proceeding, the court approval process is designed to provide some protection to absent class members.

[30] In this case, the proposed settlement is supported by the LP Entities, the Representative Plaintiff, and the Monitor. No one, including the non-settling defendants all of whom received notice, opposed the settlement. No class member appeared to oppose the settlement either.

[31] The Representative Plaintiff is a very experienced and sophisticated litigant and has been so recognized by the court. She is a freelance writer having published more than 15 books and having been a regular contributor to Canadian magazines for over 40 years. She has already successfully resolved a similar class proceeding against Thomson Canada Limited, Thomson Affiliates, Information Access Company and Bell Global Media Publishing Inc. which was settled for $11 million after 13 years of litigation. That proceeding involved allegations quite similar to those advanced in the action before me. In approving the settlement in that case, Justice Cullity described the involvement of the Representative Plaintiff in the class proceeding:

> The Representative Plaintiff, Ms. Robertson, has been actively involved throughout the extended period of the litigation. She has an honours degree in English from the University of Manitoba, and an M.A. from Columbia University in New York. She is the author of works of fiction and non-fiction, she has been a regular contributor to Canadian magazines and newspapers for over 40 years, and she was a founder member of each of the Professional Writers' Association of Canada and the Writers' Union of Canada. Ms. Robertson has been in communication with class members about the litigation since its inception and has obtained funds from

> them to defray disbursements. She has clearly been a driving force behind the litigation: *Robertson v. Thomson Canada*[12].

[32] The settlement agreement was recommended by experienced counsel and entered into after serious and considered negotiations between sophisticated parties. The quantum of the class members' claim for voting and distribution purposes, though not identical, was comparable to the settlement in *Robertson v. Thomson Canada*. In approving that settlement, Justice Cullity stated:

> Ms. Robertson's best estimate is that there may be 5,000 to 10,000 members in the class and, on that basis, the gross settlement amount of $11 million does not appear to be unreasonable. It compares very favourably to an amount negotiated among the parties for a much wider class in the U.S. litigation and, given the risks and likely expense attached to a continuation of the proceeding, does not appear to be out of line. On this question I would, in any event, be very reluctant to second guess the recommendations of experienced class counsel, and their well informed client, who have been involved in all stages of the lengthy litigation.[13]

[33] In my view, Ms. Robertson's and Mr. Guindon's description of the litigation risks in this class proceeding were realistic and reasonable. As noted by class counsel in oral argument, issues relating to the existence of any implied license arising from conduct, assessment of damages, and recovery risks all had to be considered. Fundamentally, CPI was in an insolvency proceeding with all its attendant risks and uncertainties. The settlement provided a possible avenue for recovery for class members but at the same time preserved the claims of the class against the other defendants as well as the claims against ProQuest for alleged violations attributable to CPI content. The settlement brought finality to the claims in the action against CPI and removed any uncertainty and the possibility of an adverse determination. Furthermore,

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[12] [2009], O.J. No. 2650 at para. 15.

[13] *Robertson v. Thomson Canada*, [2009] O.J. No. 2650 para. 20.

it was integral to the success of the consolidated plan of compromise that was being proposed in the *CCAA* proceedings and which afforded some possibility of recovery for the class. Given the nature of the CCAA Plan, it was not possible to assess the final value of any distribution to the class. As stated in the joint factum filed by counsel for CPI and the Representative Plaintiff, when measured against the litigation risks, the settlement agreement represented a reasonable, pragmatic and realistic compromise of the class claims.

[34] The Representative Plaintiff, Class Counsel and the Monitor were all of the view that the settlement resulted in a fair and reasonable outcome. I agreed with that assessment. The settlement was in the best interests of the class and was also beneficial to the LP Entities and their stakeholders. I therefore granted my approval.

Pepall J.

Released: March 15, 2011

CITATION: Robertson v. ProQuest Information and Learning Company, 2011 ONSC 1647
COURT FILE NO.: 03-CV-252945CP / CV-10-8533-00CL
DATE: 20110315

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

IN THE MATTER OF THE CO*MPANIES' CREDITORS 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.

- AND -

HEATHER ROBERTSON,

Plaintiff

AND:

PROQUEST INFORMATION AND LEARNING COMPANY, CEDROM-SNI INC., TORONTO STAR NEWSPAPERS LTD., ROGERS PUBLISHING LIMITED and CANWEST PUBLISHING INC.,

Defendants

REASONS FOR DECISION

Pepall J.

Released: March 15, 2011

TAB 19

CITATION: Cytrynbaum et al. v. Look et al., 2012 ONSC 4578
DATE: 20120928
DOCKETS: CV-11-9386-00CL
CV-12-9693-00CL
CV-12-9688-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN	
MICHAEL CYTRYNBAUM, FIRST FISCAL MANAGEMENT LTD., STUART SMITH, SCOTT COLBRAN, JASON REDMAN Applicants	*Matthew P. Sammon* and *Rory Gillis*, for the Applicants, Michael Cytrynbaum and First Fiscal Management Ltd. *Edward Babin* and *Cynthia Spray*, for the Applicant, Stuart Smith
– and –	*Andrew Lewis,* for the Applicant, Jason Redman
LOOK COMMUNICATIONS INC. Respondent	*David Conklin* and *Peter Kolla*, for the Respondent, Look Communications Inc.
AND BETWEEN:	*Joseph Groia* and *Gavin Smyth,* for the Applicants, Jolian Investments and Gerald McGoey
JOLIAN INVESTMENTS LIMITED and GERALD MCGOEY Applicants	*Peter L. Roy* and *Alexandra Carr*, for Alex Dolgonos and Dol Technologies Inc.
- and -	
LOOK COMMUNICATIONS INC. Respondent	
AND BETWEEN:	**HEARD:** August 2 and 3, 2012
ALEX DOLGONOS AND DOL TECHNOLOGIES INC. Applicants	
- and -	
LOOK COMMUNICATIONS INC. Respondent	

L. A. PATTILLO J.:

REASONS FOR JUDGMENT

Introduction

[1] These proceedings concern the entitlement of former directors, officers, employees and consultants of the Respondent Look Communications Inc. ("Look") to interim advancement of their legal fees and expenses from Look in order to defend themselves against legal proceedings commenced by Look.

[2] The Applicants/Moving Parties have commenced three separate but parallel Applications as well as three motions within one of the Applications seeking, among other things, declarations that Look is obliged, pursuant to both Look's by laws and indemnification agreements entered into with each of the Applicants, to advance all costs and expenses incurred or to be incurred by them in defending legal proceedings brought against them by Look arising out of various actions taken by them in 2009 in their capacity as directors, officers, employees and consultants of Look surrounding the sale by Look of its key assets.

[3] At issue in this case is whether the Court's supervisory power set out in s. 124(4) of the *Canada Business Corporations Act,* R.S.C. 1985, c. C44, as amended ("*CBCA*") applies to these proceedings and if so, the way in which the Applicants' entitlement to advancement should be determined.

Background

[4] The following facts provide an overview of the events in issue and do not appear to be in dispute between the parties.

(a) The Applicants

[5] The individual Applicants, Michael Cytrynbaum ("Cytrynbaum"), Stuart Smith ("Smith"), Scott Colbran ("Colbran"), Jason Redmond ("Redmond") and Gerald McGoey ("McGoey") are all former directors and/or officers of Look. Alex Dolgonos ("Dolgonos") was an employee of Look and also provided consulting services to it. The three corporate Applicants, First Fiscal Management Ltd. ("First Fiscal"), Jolian Investments Limited ("Jolian") and DOL Technologies Inc. ("DOL") are corporations controlled by Cytrynbaum, McGoey and Dolgonos respectively.

[6] At all material times, Cytrynbaum was a director and the Executive Chairman of Look's board of directors (the "Board"). He was a member of the Board's Compensation and Human Resources Committee and its Audit and Governance Committee. Cytrynbaum also provided management consulting services to Look on behalf of First Fiscal, which had a Management Services Agreement with Look. Cytrynbaum received $60,000 a year from Look as Executive Chairman and $180,000 through First Fiscal for management services.

[7] McGoey was the CEO of Look, a director and Vice-Chairman of the Board and was also a member of its Compensation and Human Resources Committee. McGoey's services as both CEO and Vice Chairman were provided to Look pursuant to a Management Services Agreement (the "MSA") between Look and Unique Broadband Systems Inc. ("UBS"). UBS was Look's principle shareholder at the time and McGoey was the CEO of UBS and a member of its board of directors. Look paid UBS $2,400,000 annually for McGoey's services pursuant to the UBS MSA. Jolian is McGoey's management services company. Jolian had a management services agreement with UBS for McGoey's services to UBS but had no such agreement with Look.

[8] Smith was a non-executive director of Look and served as the chair of the Board's Compensation Committee. Smith was paid directors' fees of $22,000 annually by Look.

[9] Colbran was also a non-executive director of Look. He was a member of the Audit and Corporate Governance Committee and was also paid directors' fees of $22,000 annually. Colbran filed no affidavit in the proceedings and took no part in the argument.

[10] Look's remaining director during the relevant period was Louis Mitrovich ("Mitrovich") who was also a non-executive director. Mitrovich settled with Look prior to the Action and CBCA Motion being commenced and has filed an affidavit in these proceedings on behalf of Look.

[11] Redman was Look's Chief Financial Officer. In 2009, he received a salary of $175,000. He was not a director of Look.

[12] Dolgonos, who was an employee/consultant of UBS, provided technology related services to Look as a consultant pursuant to the UBS MSA. In March 2005, Dolgonos became an employee of Look in order to become a member of its employee benefit plan and was paid a salary of $60,000 a year by Look. DOS had a management services agreement with UBS in respect of Dolgonos' services to UBS but had no such agreement with Look.

(b) The Respondent

[13] Look is a CBCA company and was listed on the TSX Venture Exchange from 2004 until November 2011. Prior to the winding down of its business in late 2009, Look carried on the business of distributing wireless, internet and cable services to subscribers in Ontario and Quebec through licensed spectrum which it owned.

(c) Look's Option and Share Appreciation Rights Plans

[14] In order to attract and incent its directors, officers and consultants, Look put in place a share option plan ("Option Plan") in 2002 and a share appreciation rights plan (the "SAR Plan") in 2005. Both Plans were tied to the market value of Look's shares.

[15] The Option Plan provided that the exercise price was to be set by the Board at the time of grant and could not be less than the market price of Look's shares on the day preceding the grant. Section 8.2.1 specifically provided that, in the event of certain actions by Look including liquidation, dissolution or winding up, Look had the right, on notice, to permit the exercise of all options within a 20-day period.

[16] The SAR Plan provided that share appreciation rights ("SARs") could be awarded by the Board to directors, employees and consultants based on the market value of Look's shares at the time. When exercised, Look would pay the difference between their value on the date they were awarded and the date when exercised. The SAR Plan provided that SARs benefits would arise, among other things, if Look sold all or substantially all of its assets. In such an event and subject to the Board's authority and determination that Look had adequate liquidity, SARs benefits would be paid based on the difference between the market price of its shares on that date and the grant price. Further, if the SAR Plan was terminated by the Board, the Board had the discretion to allow payment of benefits, again based on the market value.

[17] As directors and officers of Look, each of the individual Applicants was granted both options and SARs. By 2009, of the 6,984,149 options Look had granted, 4,441,997 (approximately 64%) were held by its directors and senior management. By the same time, Look had granted 36,945,347 SARs, of which Cytrynbaum, McGoey, Dolgonos and Redman had received 30,437,843 or 82%. In the case of Cytrynbaum, McGoey and Dolgonos, they had each assigned their SARs rights to their respective Applicant companies.

(d) The Events Surrounding the Sale of Look's Key Assets in 2009

[18] Prior to 2009, Look's business had been in serious decline. Its gross revenue and subscriber numbers had declined each year from 2005 to 2008. Extensive efforts by the Board to either sell the company or obtain the necessary capital to allow it to compete were unsuccessful. By late 2008, Look's future was in serious doubt. In December 2008, the Board concluded the best course was to sell some or all

of Look's assets under supervision of a court-appointed monitor pursuant to a CBCA plan of arrangement ("POA").

[19] Look's shareholders approved the POA sales process at a meeting on January 14, 2009. On January 21, 2009, Look obtained a Court Order authorizing the POA sale process and appointing Grant Thornton as the monitor. When the bidding for the sale closed on February 16, 2009, the only bid received for Look's key assets was a bid for $80 million from Inukshuk Wireless Partnership ("Inukshuk"), a partnership of Rogers and Bell.

[20] On May 4, 2009, following lengthy negotiations with Inukshuk, the Board approved the sale of Look's spectrum and broadcast license to Inukshuk for $80 million, conditional on, among other things, Bell being paid $16 million to settle outstanding litigation. At the same meeting, the Board authorized Look to vest all unvested options to permit option holders to exercise their options in the market and also to compensate all SARs holders using the market price on the date prior to the date Look obtained Court approval for the sale.

[21] On May 14, 2009, Look obtained Court approval for the sale to Inukshuk.

[22] On June 16, 2009, the Board decided, on the recommendations of McGoey and Redman, to unconditionally set aside $11 million for a severance, retention and bonuses pool effective May 31, 2009. The Board also accepted management's proposal to conditionally authorize management to cancel all options and SARs and to use a value of $0.40 per share to value the options and shares.

[23] On August 25, 2009, the Board's Compensation Committee (which was composed of the entire Board) approved McGoey's recommendations to pay bonuses to members of management including himself, Cytrynbaum and Redman as well as Dolgonos.

[24] The Inukshuk sale closed on September 11, 2009. Following the closing, Look paid out $20,008,709 or 32% of the net sale proceeds to its officers, directors, employees and consultants by way of bonuses and equity cancellation payments. The equity cancellation payments, which included both the options and the SAR's were based on the value of $0.40 a share. The payments to Cytrynbaum, McGoey and Dolgonos on account of both the bonuses and the equity cancellation payments were made to First Fiscal, Jolian and DOL pursuant to invoices for fees received from each of those companies. The Applicants received $15,553,273 of these payments which amounts to 24.9% of the net sale process.

[25] The following table sets out the amount of bonuses and/or equity cancellation payments the Applicants received from Look shown also as a percentage of Look's net sale proceeds:

Name	Bonus	Equity Cancellation Payment	Total	% of Net Sales Proceeds*
First Fiscal/Cytrynbaum	$2,400,000	$1,746,104	$4,146,104	6.6%
Jolian/McGoey	$2,400,000	$3,165,698	$5,565,698	9.0%
DOL/Dolgonos	$2,400,000	$1,550,737	$3,950,737	6.3%
Redman	$1,107,000	$393,000	$1,500,000	2.4%
Smith	—	$195,367	$195,367	0.3%
Colbran	—	$195,367	$195,367	0.3%
TOTALS FOR APPLICANTS	**$8,307,000**	**$7,246,273**	**$15,553,273**	**24.9%**
Mitrovich	—	$195,367	$195,367	0.3%
Others	$2,776,397	$1,483,672	$4,260,069	6.9%
Total Payments	**$11,083,397**	**$8,925,312**	**$20,008,709**	**32.1%**[1]

[26] Prior to receiving the equity cancellation payments, the Applicants each entered into, among other things, a release directed to Look releasing it from all actions and demands for damages and indemnity

"in any way relating to my entitlements under the Company's Share Appreciation Rights Plan and the 2002 Stock Option Plan" (the "Release").

[27] On January 19, 2010, Look issued its 2009 Management Information Circular ("MIC"). The MIC contained the first disclosures to the market of the specific payments that were made to the Applicants following the sale to Inukshuk. The payments were referred to in the MIC as contingent restructuring awards ("CRAs").

[28] Strong shareholder criticism arose concerning the payments which Look made to the directors and senior management out of the Inukshuk sale proceeds. Following a meeting of the Board on June 16, 2010, where the issue of indemnity was discussed, Look paid $1,550,000 for retainers to three law firms acting for the Applicants. On July 21, 2012, immediately after these monies were paid, the individual Applicants resigned as directors and officers of Look.

(e) Indemnification of Directors and Officers of a CBCA Company

[29] Section 124 of the CBCA provides a "comprehensive code of general application" regulating the indemnification of present and former directors and officers of corporations. See: *R. v. Bata Industries Ltd.* (1995), 25 O.R. (3d) 321 (C.A.) at para. 25, referencing s. 136 of the *Ontario Business Corporations Act*, R.S.O. 1990, c. B-16 ("*OBCA*") which is similar in wording to s. 124 of the *OBCA*.

[30] Section 124(1) permits a corporation to indemnify a director or officer, a former director or officer or another individual who acts or acted at the corporation's request "against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by the individual" in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of his or her association with the corporation.

[31] Section 124(2) provides that the corporation may advance moneys to a director, officer or other individual for costs and expenses of a proceeding mentioned in subsection (1) subject to repayment if the individual does not fulfill the conditions of subsection (3).

[32] Section 124(3) provides that a corporation may not indemnify an individual under subsection (1) in respect of any action or claim unless the individual acted "honestly and in good faith with a view to the best interests of the corporation" and, in respect of a criminal or administrative action or a proceeding that is enforced by a monetary penalty, the individual had reasonable grounds for believing that his or her conduct was lawful.

[33] Section 124(4) provides as follows:

> (4) A corporation may with the approval of a court, indemnify an individual referred to in subsection (1), or advance moneys under subsection (2), in respect of an action by or on behalf of the corporation or other entity to procure a judgment in its favour, to which the individual is made a party because of the individual's association with the corporation or other entity as described in subsection (1) against all costs, charges and expenses reasonably incurred by the individual in connection with such action, if the individual fulfils the conditions set out in subsection (3).

(f) Indemnification of Look's Directors and Officers

[34] Section 3.12 of Look's by-laws (the "By-Law") makes mandatory what s. 124 of the CBCA permits. It provides:

> 3.12 **Indemnity of Directors and Officers.** Subject to the provisions of the Act, the Corporation shall indemnify a director or officer of the Corporation, a former director or officer of the Corporation or another individual who acts or acted at the Corporation's request as a director or officer, or an individual acting in a similar capacity, of another entity, against all costs, charges and expenses, including an amount paid to settle an action or satisfy a judgment, reasonably incurred by the individual in respect of any civil, criminal, administrative, investigative or other proceeding in which the individual is involved because of that association with the Corporation or other entity; and the Corporation shall with the approval of a court, indemnify such individual or advance moneys under this section 3.12 in respect of an action by or on

> behalf of the Corporation or other entity to procure a judgment in its favour, to which such individual is made a party because of such individual's association with the Corporation or other entity as described above against all costs, charges and expenses reasonably incurred by such individual in connection with such action, if in each case such individual:
>
> (a) acted honestly and in good faith with a view to the best interests of the Corporation, or, as the case may be, to the best interests of the other entity for which the individual acted as director or officer or in a similar capacity at the Corporation's request; and
> (b) in the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, the individual had reasonable grounds for believing that his or her conduct was lawful.
>
> The Corporation shall advance moneys to an individual referred to hereinabove for the costs, charges and expenses of a proceeding referred to hereinabove. Such individual shall repay the moneys if the individual does not fulfil the conditions set out in paragraphs (a) and (b) above.

[35] In addition, in January of 2007, both the corporate and individual Applicants entered into a written indemnification agreement with Look (the "Indemnification Agreement"). The indemnity provided by the Indemnification Agreement is broader than the By-Law.

[36] Paragraph 1(a) of the Indemnification Agreement applies to third party proceedings threatened or brought against the indemnitee by reason of the fact that the indemnitee is or was a "director, officer, employee, consultant or agent of the Corporation or any subsidiary". It provides for indemnification for expenses (including legal fees), judgments, fines and amounts paid in settlement actually and reasonably incurred "if the Indemnitee acted honestly and in good faith and with a view to the best interests of the Corporation".

[37] Paragraph 1(b) provides a similar indemnity in respect of "any threatened, pending or completed action or proceeding by or in right of the Corporation ..." Paragraph 1(b) provides an indemnity to an Indemnitee who was or is a party or threatened to be a party to any action or proceeding, whether threatened, pending or completed, brought by or in the right of the Corporation. It indemnifies against expenses (including legal fees) and, to the fullest extent permitted by law, amounts paid in settlement.

[38] Paragraph 1(c) provides that if the Indemnitee is required by law to pay any tax because receipt of any amount under the Agreement, Look shall increase the amount payable to cover the tax liability.

[39] Paragraph 2(a) of the Indemnification Agreement deals with advancement of expenses. It provides:

> 2(a) *Advancement of Expenses.* The Corporation shall advance all expenses incurred by the Indemnitee in connection with the investigation, defence, settlement or appeal of any civil or criminal action or proceeding referenced in Section 1(a) or (b) hereof. Indemnitee hereby undertakes to repay such amounts advanced only if, and to the extent that, it shall ultimately be determined by a court of competent jurisdiction from which no further right of appeal exists that Indemnitee is not entitled to be indemnified by the Corporation as authorized hereby. The advances to be made hereunder shall be paid by the Corporation to Indemnitee (or, if requested by the Indemnitee, shall pay the expenses directly) within 10 days following delivery of a written request therefor (accompanied by written evidence of the expense claimed) by Indemnitee to the Corporation.

(g) Proceedings before the Court

[40] In July 2011, following an investigation by Look's new management and board of directors into the conduct of the Applicants when they were directors or officers of Look, particularly concerning payment of the bonuses and equity cancellation payments, Look commenced action No. CV-11-9291-00-CL against the Applicants (the "Action").

[41] The Action alleges that the individual Applicants breached their fiduciary duties to Look and claims, among other things, repayment of the bonuses and equity cancellation payments received by the Applicants. It also seeks to have the indemnity agreements entered into between Look and the Applicants declared *ultra vires* and invalid. In addition, in August 2011, Look commenced a motion against the Applicants under s. 192 of the *CBCA*, seeking an order requiring the Applicants to repay the bonuses and equity cancellation payments (the "*CBCA* Motion").

[42] After Look commenced the Action, the Applicants demanded Look comply with its obligations under the By-Law and the Indemnity Agreement to advance legal expenses in respect of both the Action and the CBCA Motion. When Look refused, the Applicants commenced the present Applications.

[43] Cytrynbaum, First Fiscal, Smith, Colbran and Redmond commenced Application CV-11-9386-00CL on August 5, 2011, amended November 25, 2011, for, among other things, a declaration that Look is obliged, pursuant to the Indemnification Agreement as well as the By-Law, to advance all expenses incurred by the Applicants in defending the Action and the CBCA Motion (the "Cytrynbaum Application").

[44] Subsequently, Cytrynbaum and First Fiscal, as well as Smith and Redman each commenced motions in the Cytrynbaum Application seeking, among other things, an order directing Look to advance all expenses incurred or to be incurred in respect of the Action and the CBCA Motion on an interim basis and adjourning the remainder of the Cytrynbaum Application to the judge hearing the Action.

[45] On April 16, 2012, Dolgonos and DOL commenced Application CV-12-9688-00CL seeking, among other things, a declaration that Look has an obligation to advance all expenses incurred in defence of the Action pursuant to the Indemnification Agreement (the "Dolgonos Application"). Dolgonos and DOL further requested an order that any order or finding made on the Dolgonos Application be without prejudice to any finding or order the trial judge in the Action may make in respect of the Applicants' entitlement to indemnity from Look. In the alternative, Dolgonos and DOL sought an order directing a trial of an issue in relation to the matters raised in the Dolgonos Application and leave of the Court to permit Dolgonos and DOL to bring an interim motion for advances for expenses.

[46] On April 17, 2012, McGoey and Jolian commenced Application CV-12-9693-00CL. They seek, among other things, a determination as a question of law whether they are entitled to advancement of their legal expenses pursuant to the By-Law and the Indemnification Agreement (without prejudice to

Look's right to seek to prove at trial that the Applicants have no entitlement to indemnification) and an order requiring Look to make such advances. They seek, in the alternative, if the Court determines that it has an approval function in respect of advancement, an order requiring the issues raised proceed to trial (the "McGoey Application").

[47] In response to the Cytrynbaum Application, in August 2011, Look delivered an eight volume record of approximately 4,000 pages containing affidavits from seven different affiants (some providing more than one affidavit) including an expert in executive compensation. Following the delivery of reply materials by Cytrynbaum and First Fiscal in early June 2012, Look delivered two further supplementary affidavits. In addition, Look has cross-examined five witnesses.

[48] The Cytrynbaum Application and Motions, the Dolgonos Application and the McGoey Application are collectively referred to hereafter as the "Proceedings".

Position of the Parties

[49] The Applicants submit that pursuant to the By-Law and/or the Indemnification Agreement they each entered into with Look, Look is required to provide them with interim advancement of their legal fees and expenses to enable them to defend themselves against the Action and the CBCA Motion without any consideration of their entitlement to indemnity at this stage of the Proceedings.

[50] Given, as set out by the Supreme Court in *Blair v. Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5 (S.C.C.), that all persons are presumed to act in good faith unless proven otherwise, the Applicants submit the ultimate issue of whether they are entitled to an indemnity in respect to the Action and the CBCA Motion cannot be determined in a summary way in these proceedings and must be dealt with at a trial. In the event it is finally determined that they are not entitled to an indemnity, the Applicants will be required to pay Look back for any monies advanced and they have all undertaken to do so.

[51] Look acknowledges that the issue of whether the Applicants are entitled to indemnity in respect of expenses arising from the Action and the CBCA Motion cannot be determined in a summary manner in these Proceedings. It submits, however, that pursuant to s. 124(4) of the CBCA, the court has a supervisory role in determining whether a corporation should advance monies to former officers and directors in circumstances where the corporation has commenced an action against them for breach of fiduciary duty. In that regard, Look submits that the individual Applicants have acted *mala fides* and not in its best interests. In support of this position, Look relies upon not only the allegations in the Action and CBCA Motion but also on the significant amount of evidence it has tendered regarding the actions of the Applicants in their capacity of directors and/or officers of Look both before and after the sale to Inukshuk, culminating with their resignations in July 2010.

[52] Look submits that s. 124(4) of the *CBCA* applies to the Proceedings and Look may only advance indemnification amounts where the court approves the advance upon being satisfied that the individual Applicants have met the good faith conditions prescribed by s. 124(3).

[53] Look further submits that the Release entered into by each of the Applicants in advance of the payment to them of the bonuses and equity cancellation payments operates as a complete release of their claims for indemnity against Look.

[54] The Applicants submit in response that s. 124(4) applies only to derivative actions and is accordingly not applicable. Dolgonos and the three Applicant companies further submit that s. 124 is not applicable to them. The individual Applicants deny that they acted *mala fides* and contrary to the best interests of Look in respect of the authorization and payment of bonuses and equity cancellation payments and repeat, in any event, that issue can only be determined at a trial. They further deny that the Release applies to the indemnities or their claim for advancement.

The Issues

[55] The following are the issues raised by the parties in these Proceedings:

1. Does s. 124(4) of the CBCA apply to these Proceedings?

2. If so, what effect does s. 124 have upon the right to advancement set out in the By-Law and Indemnification Agreement?

3. If s. 124(4) applies, can the question of entitlement to interim advancement be determined in these Proceedings?

4. In the event that the Applicants are entitled to interim advancement pursuant to the By-Law, the Indemnification Agreement or both, does the Release operate to prevent such advancements?

Law and Analysis

I. Section 124(4) of the CBCA

[56] The determination of whether s. 124(4) applies to these Proceedings involves a question of statutory interpretation. It is now commonly accepted that the preferred approach to statutory interpretation is encapsulated by Driedger's modern principle: "Today there is only one principle or approach, namely, the words of an Act are to be read in their entire context and in their grammatical and ordinary sense harmoniously with the scheme of the Act, the object of the Act, and the intention of Parliament." See *Bell ExpressVu Limited Partnership v. Rex*, 2002 SCC 42, [2002] 2 SCR 5 at para. 26. Subsidiary principles of statutory interpretation are only applicable when the contextual approach reveals an ambiguity as to the meaning of the provision: *Bell ExpressVu* at para. 28. In my view, there is no ambiguity here.

[57] In *Blair*, at para. 74, Iacobucci J., on behalf of the Court, noted that the objective underlying the indemnity provisions for directors and officers is to maintain a balance between, on the one hand, encouraging responsible behaviour by directors and officers and, on the other hand, permitting enough leeway to attract strong candidates to foster entrepreneurism. See too *Bennett v. Bennett Environmental Inc.* (2009), 94 O.R. (3d) 481 (C.A.) at pars. 23 to 25.

[58] With that objective in mind, I turn to the wording of s. 124(4). In my view it is clear and unambiguous concerning its application. It applies to actions "by or on behalf of the corporation." That includes in my view both actions by the corporation itself and actions brought on behalf of the corporation. While the latter encompasses derivative actions, the former has no such limitation. In that regard, the wording in s. 124(4) is broader than the wording in s. 239(1) of the *CBCA* which specifically concerns derivative actions and describes them as being "in the name and on behalf of a corporation".

[59] In addition, the interpretation of s. 124(4) to include actions by the corporation as well as derivative actions is consistent with the scheme of s. 124 generally. Section 124(1) deals with third party claims against made against directors and officers. On the other hand, s. 124(4) refers to actions by or on behalf of the corporation. The latter are subject to the supervisory function of the court because the very nature of these actions leaves both parties vulnerable to abuse from the other side.

[60] Nor do I think there is a principled basis for limiting the supervisory function of the court in s. 124(4) to derivative actions only. The court has an important role to play in circumstances where the corporation is suing its former directors and officers for breach of fiduciary duty and indemnity and advancement is in issue. Such issues are difficult for both sides. The review by the court in such circumstances operates to protect both sides. Actions which have no merit should not delay advancement. On the other hand, directors or officers who have engaged in misconduct towards the corporation ought not to be allowed to use corporate funds to defend themselves.

[61] Further, s. 124(4) must be read in conjunction with s. 118(2)(d) of the CBCA which imposes personal liability on directors that vote for or authorize the payment of an indemnity contrary to s. 124(4). Given such liability, it makes sense for the court to have a supervisory function in circumstances where the corporation is suing its former directors or officers for breach of fiduciary duty.

[62] I am also of the view that interpreting s. 124(4) to encompass both actions by corporations directly and derivative actions against former directors and officers is consistent with and effectively balances the above noted objectives of s. 124 generally.

[63] In my view, requiring the court to scrutinize indemnification and advances in circumstances where a corporation has sued its former directors and officers ensures corporations cannot arbitrarily avoid indemnity or advancement obligations to former directors and officers who have acted in good faith and in the best interests of the corporation, while at the same time ensuring that directors and officers who have not so acted cannot further harm the corporation. Directors and/or officers that have acted *mala fides* to harm the corporation ought not to be able to further draw upon the corporation to defend themselves. Such oversight, in my view, will not impede the recruitment of qualified directors and officers or impact upon their entrepreneurial spirit.

[64] The Applicants rely on the heading of s. 124(4) which provides "Indemnification in derivative actions" to restrict the application of the subsection to derivative actions only. While headings are to be considered part of the legislation and can be taken into account in the interpretation, they are not determinative: *Skapinker v. Law Society of Upper Canada*, [1984] 1 S.C.R. 357 (S.C.C.) at pars. 26-27. In my view, given the clear and unambiguous wording of the statutory text, the heading cannot operate to restrict the application of s. 124(4) to derivative actions only.

[65] The Applicants further rely on the legislative history of s.124 to support their argument that s. 124(4) is intended to apply only to derivative actions. They refer to the report commissioned by the Government of Canada to consider revisions to the CBCA that was released in 1971, called *Proposals for a New Business Corporations Law for Canada, Volume 1: Commentary and Volume 2: Draft Canada Business Corporations Act* (commonly referred to as the "Dickerson Report"). The Dickerson Report recognizes that a director or officer who is sued in a derivative action "had probably not been acting in the interests of the corporation and therefore his conduct should be more closely scrutinized." In my view, the same rationale for scrutiny applies where the corporation is suing its former director or officer directly for breach of fiduciary duty.

[66] In my view, interpreting s.124(4) in a manner that does not limit its applicability to derivative actions is supported by the decisions in *Med-Chem Health Care Ltd. v. Misir* (2010), 103 O.R. (3d) 769 (C.A.) and *Catalyst Fund General Partner I Inc. v. Hollinger Inc.* (2006), 20 B.L.R. (4th) 249 (Ont. S.C.).

[67] *Med-Chem* involved, among other things, motions by the defendants, former directors of Med-Chem, for advancement of legal expenses incurred and to be incurred in an action against them by Med-Chem. The defendants relied upon a by-law of Med-Chem's that provided for indemnification. The motion judge (at para. 41 of her reasons reported 2009 CarswellOnt 9101 framed the issue before her as whether the court should approve the advance of moneys to the former directors under s. 136(4.1) of the *OBCA*, or under Med-Chem's by law, pending disposition of the action on the merits. The motion judge reviewed the evidence before her and concluded there was no evidence of *mala fides* on the part of the defendants. The motion judge ordered Med-Chem to pay advances to its former directors.

[68] In dismissing the appeal from the motion judge's decision, Goudge J.A., on behalf of the panel hearing the appeal, stated as follows in respect of the exercise of discretion by the motion judge under s. 136(4.1) of the *OBCA* at paras. 25 and 26:

> [25] Section 136(3) provides that an individual who does not act honestly in good faith is disqualified from being indemnified. Blair says that the policy objective behind indemnification requires that individuals be assumed to act in good faith unless proven otherwise. The motion judge found that, on the evidence before her, the *mala fides* of the former directors had not been established. She went further and concluded that, given their conduct as described in the appellant's own material, and the court's previous approval of indemnification for them in the action brought by Dr. Alvi personally, the former directors have sufficiently established the *bona fides* of their conduct. There was ample evidence before the motion judge to sustain both these conclusions and there is no basis for this court to interfere with them.
>
> [26] In deciding to exercise her discretion under s. 136(4.1) to approve these advances, the motion judge considered a number of factors, all of which are relevant and reasonable in my view.

[69] *Hollinger* involved an application to set aside a consent order which provided for certain resignations of directors in return for severance payments and releases. In turn, the directors involved sought indemnity for their legal expenses in accordance with indemnification agreements entered into with Hollinger. In dismissing the directors' motion, Campbell J. interpreted the indemnification agreements in a manner consistent with s. 124(4) and held the agreements did not authorize advances in a case where the company brought its own claim against the former directors alleging bad faith. The learned judge stated at para. 55:

> It would be contrary to common sense to require the Corporation to indemnify directors against whom the allegation is made by the Corporation of 'lack of good faith without a view to the best interests of the Corporation'. At this stage, there is simply an allegation. If the directors are successful, they will be entitled to be reimbursed for the legal fees they have incurred.

[70] The Applicants rely on *Jolian Investments Ltd. v. Unique Broadband Systems Inc.*, 2011 ONSC 3241, 90 B.L.R. (4th) 188 in support of their submission that they are entitled to advancement pursuant to the By-Law and the Indemnity Agreement and s. 124(4) does not apply. *Jolian* involved motions for summary judgment by Jolian, McGoey, Delgonos and DOL seeking declarations that they were entitled to indemnity including the obligation of advancement in respect of a counterclaim commenced by UBS in

response to actions brought by them against it. Among other things, the moving parties relied on indemnity agreements entered into with UBS that were substantially similar in wording to the Indemnity Agreements in issue in these Applications. UBS is an Ontario corporation.

[71] In ordering UBS to provide advances of indemnity to the moving parties, Marrocco J. considered the application of s.136 of the OBCA. In particular, Marrocco J. held that s. 136(4.1) of the OBCA, which is identical in wording to s. 124(4) of the *CBCA,* applied only to derivative actions and therefore was not applicable in respect of UBS' counterclaim. In reaching this conclusion, the learned judge relied on the heading of the subsection: "Derivative actions", the minimal impact the section would have on the proceedings given that two of the parties are corporations and not subject to s. 136(4.1) and the supervisory function of the court over derivative actions.

[72] As I have already noted, in the absence of ambiguity, the heading of the subsection is not determinative in interpreting the wording in the subsection. Nor in my view does the impact the subsection's application on other parties have any bearing on the interpretation of the subsection. Finally, and as I've already noted, the supervisory function of the court need not be limited to just derivative actions.

[73] I note as well that although the learned judge relied on *Med-Chem* for the proposition that it would impair the objectives of indemnification if funds were only made available to individual directors after the conclusion of litigation, he did not consider this general comment from *Med-Chem*'s in light of the balancing objectives behind s. 124(4) of the *CBCA* already discussed. Furthermore, he did not consider the *Hollinger* decision in reaching the conclusion he did.

[74] With respect therefore, I am unable to agree with Marrocco J.'s interpretation of s. 136(4.1) of the *OBCA*. In my view, for the reasons stated, s. 124(4) of the *CBCA* is not limited to just derivative actions. It applies to both actions by the corporation and actions on behalf of the corporation.

[75] The Applicants refer to the decisions of the Delaware Chancery and Supreme Courts in the State of Delaware in support of their position that determination of advancement does not involve litigation of the merits of entitlement to indemnification. Delaware law concerning officer and director entitlement to advancement pursuant to a by-law or an indemnification agreement is based on article 145 of the *Delaware Code*. That article contains no statutorily imposed conduct requirement as is contained in s. 124(4) of the CBCA.

[76] While Delaware law is not binding on this court, it is never the less well regarded in the area of corporate law. Given, however, the above noted distinction, in my view Delaware law is of no assistance in considering the applicability of s. 124(4).

II. Section 124(4) and the By-Law and Indemnification Agreement

[77] As noted, the By-Law provides an indemnity to directors and officers and former directors and officers. It begins with the words: "Subject to the provisions of the Act..." It then incorporates the wording of s. 124(4) in the first full paragraph and provides that, with the approval of a court, Look shall indemnify or advance moneys pursuant to the indemnity "in respect of an action by or on behalf of the Corporation." While it further states in the last paragraph that the corporation "shall" advance moneys to a director or officer or former director or officer for the costs, charges and expenses of a proceeding referred to, in my view, given opening words of the provision, the latter wording does not operate to override or eliminate the provisions of s. 124(4).

[78] The Indemnification Agreement contains no reference to the provisions of s. 124(4) and the requirement for court approval in respect of advances of indemnification amounts. As noted, s. 2(a) provides for mandatory advancement for both third party actions and actions by or in the right of the corporation with no provision for court approval in respect of the latter.

[79] In my view, parties to an indemnification agreement cannot exclude advancement from being subject to court approval as set out under s. 124(4). As noted by Osborne J.A. in *Bata* at paragraph 24, s. 136 of the OBCA, which is identical to s. 124 of the CBCA, establishes the circumstances under which a corporation may, with or without court approval, indemnify an officer or director and, by implication, when a corporation cannot indemnify an officer or director. Just as a corporation cannot indemnify an officer or director in the absence of the requirement that they act "honestly and in good faith with a view to the best interests of the corporation", neither in my view can they contract to exclude the court's discretion to approve advancement under s. 124(4). Section 124 provides a complete statutory code that details when and how a company can and cannot indemnify and provide indemnification advances to present and former directors and officers.

[80] For the above reasons, therefore, it is my view that s. 124(4) applies to these Proceedings and the court is accordingly required to approve the advance of monies sought by the Applicants.

III. Can the Issue of Entitlement to Interim Advancement be Determined in these Proceedings?

[81] Advancement, by its very nature, is separate and distinct from indemnification. It occurs well before the final determination of indemnification. Even though the Applicants have proceeded by way of Applications, given the motions seeking interim advancement and the request for interim advancement in the Applications, the Proceedings are in essence interlocutory as opposed to final.

[82] A final determination of whether a director or officer is entitled to indemnification may or may not require a trial depending on the nature of the evidence put forward by the parties. In this case, entitlement to indemnification is an issue in the Action and accordingly will be dealt with at the trial.

[83] What then is the proper procedure that the court should follow under s. 124(4) to approve whether a corporation should advance monies on an interim basis prior to a final determination of entitlement to indemnification?

[84] The Applicants submit that the determination of their right to advancement is analogous to the determination of an insurer's duty to defend and whether ultimately the insurer is required to pay out on the insurance policy.

[85] In my view, duty to defend cases are not applicable to the determination by the Court of advancement pursuant to s. 124(4) of the CBCA. Duty to defend is determined on a preliminary basis utilizing the pleadings filed against the insured. If the pleadings allege facts which, if true, may require the insurer to indemnify the claim under the policy, the insurer is obliged to provide a defence: *Moneco Ltd. v. Commonwealth Insurance Co.*, [2001] 2 S.C.R. 699 (S.C.C.) at para. 28.

[86] Section 124(4) provides for "approval" by the Court and imposes a conduct requirement. By implication, the process requires the consideration of evidence. Further, the use of the "pleadings rule" to determine advancement would not be in the interests of the directors and officers who are seeking advancement generally or the Applicants particularly. In almost all cases, the corporation will allege breach of fiduciary duty and mala fides in its pleading as Look has done in the Action. Accepting those allegations as true, the Applicants would not be entitled to advancement pursuant to either the By-Law or the Indemnification Agreement.

[87] Look submits that the court can deny advancement if it is satisfied, based on the evidence before it, that it cannot conclude the Applicants have acted in good faith with a view to Look's best interests. Look's test, in my view, ignores the presumption of good faith that applies to the Applicant directors and officers. Having regard to both the interim nature of the proceedings and the presumption in favour of the

Applicant directors and officers set out in *Blair*, it is my view that, in order for the court to deny advancement in the face of the By-Law and the Indemnity Agreement permitting the same, Look must establish a strong *prima facie* case that the Applicants acted *mala fides* towards the corporation. That is, it must establish on the evidence that it is likely to succeed at trial.

[88] I would note here that there is nothing unusual about an interlocutory judge engaging in some limited weighing of the evidence at hand. Indeed, this is often necessary for a number of different types of interlocutory proceedings. Furthermore, in my view, there is nothing in *Med-Chem* or any other authority that suggests the presumption from *Blair* cannot be rebutted at a preliminary stage. Indeed, as discussed above, this is exactly the approach the motions judge adopted in *Med-Chem* when she framed the issue before her as whether the court should approve the advance of moneys to the former directors under s. 136(4.1) of the *OBCA*

[89] On any application to determine the question of indemnity or advancement, former officers and directors have the presumption of good faith in their favour as set out in *Blair*. The onus is therefore clearly on the corporation to establish that the directors and/or officers acted *mala fides*, contrary to the best interests of the corporation.

[90] *Mala fides* or bad faith includes fraud or misappropriation against a corporation. It may also include conduct coloured by opportunistic or self-seeking behavior which exhibits a type of dishonesty that should not be countenanced by an award of indemnity: *Bennett v. Bennett Environmental Inc.* (2009), 94 O.R. (3d) 481 (C.A.) at para. 29. It can also encompass recklessness, described as conduct that is so inexplicable it leads to the inference of an absence of good faith: *Enterprises Sibeca Inc. v. Frelighsburg (Municipality)*, 2004 SCC 61, [2004] 3 S.C.R. 304. (S.C.C.) at para. 25.

[91] Given the presumption of good faith, therefore, it is my view that it is not sufficient for the corporation to simply raise an allegation of bad faith in the pleadings or make bald unsubstantiated allegations to that effect in an affidavit. A higher evidentiary standard is required. In my view, the corporation must establish on the evidence that it has a strong *prima facie* case that the director or officer seeking interim advancement acted *mala fides* to permit the court, at an interim stage, not to approve interim advancement pursuant to s. 124(4) of the CBCA where such advancement is permitted by the corporation's by-laws or an indemnification agreement or both.

Look's Case Against the Applicants

[92] Look submits that the individual Applicants, in their position as Board members, officers or employees, acted *mala fides* and not in Look's best interests in a number of ways. In particular, it submits:

> 1. The individual Applicants focused their own interests in obtaining the Indemnity Agreements, not only for themselves but, in the case of Cytrynbaum, McGoey and Dolgonos, for their company's who in the later two cases had no relationship with Look;
>
> 2. They abandoned the terms of the Option Plan and the SAR's Plan and, contrary to the assurances given to shareholders, implemented an approach that greatly benefited their interests contrary to the interests of Look and its shareholders;
>
> 3. They improperly allocated bonuses, particularly to Cytrynbaum, McGoey, Dolgonos and Redman;
>
> 4. They failed to disclose either the approvals or the payments to the Court Monitor, the Court and the shareholders;
>
> 5. On the eve of their resignations, they caused Look to advance $1.55 million to their personal counsel on account of retainers in respect of anticipated legal proceedings against them by Look and the shareholders.

[93] Although Look relies on a number of incidents in support of its position that the individual Applicants acted *mala fides* and not in the best interests of Look, for reasons that will become apparent, I

need only focus on two: the approval and payment of the equity cancellation payments to the Applicants in June and September 2009 and the payment by Look of $1.55 million in retainers in July 2010.

The Equity Cancellation Payments

[94] On May 4, 2009, when the Board approved the sale to Inukshuk and agreed to vest all options and extend them for a year and assess the benefits to be paid to SARs holders and the company's liability for such benefits as of the date on the day before the Final Approval Order for the sale, Look's share price was $0.16.

[95] On May 5, 2009, Look issued a news release announcing the proposed sale. On May 11, 2009, Look's shares opened at $0.19.

[96] On May 13, 2012, the day before the date when Look received the Final Approval Order for the sale, Look's shares closed at $0.20. On May 14, the closing price for Look's shares that day was $0.23.

[97] In my view, Look's evidence indicates a strong *prima facie* case that the decision of the Board on June 16, 2009, to authorize management to cancel all options and SARs using a value of $0.40 a share was not in the best interests of Look for a number of reasons.

[98] First, the Board's decision was contrary to the terms of both the Option and the SAR Plans. It was also contrary to the Board's own resolution on May 4, 2009 respecting the use of market value (which was consistent with both Plans).

[99] Further, the value of $0.40 a share had no relationship to the market value of Look's shares over the period. Except for a short period in January and February of 2009, Look's shares very seldom ever closed above $0.30 during 2009. Often the price was less than $0.20. For the period from May 4, 2009 to June 16, 2009, the daily closing price on the TSX Venture Exchange for Look's shares fluctuated between

$0.13.5 at the low and $0.27 at the high. From June 16th to the end of September 2009, by which time the payments had been made, the share price never went above $0.30.

[100] The evidence indicates that the Board determined the value of $0.40 a share based on the recommendation of McGoey and Redman without any assistance from compensation or valuation experts. The value of $0.40 was based on a proposed sale of the shares of Look at that price. At the time, however, while McGoey and Redman had met with a representative of an interested party to discuss a possible sale, no offer for the shares, either oral or written, had been received. When the interested party subsequently decided not to proceed, no effort was made by the Board to revisit the question of the $0.40 share value.

[101] Further, by selecting a value of $0.40 a share, each of the directors and Redman benefited personally at Look's expense. The grant price for Cytrynbaum and McGoey's SARs was $0.19 a share. If the cancellation price was the market value of Look's shares on May 13, 2009, as the Board had initially determined on May 4, 2009 ($0.20), Look would have had to pay Cytrynbaum $73,384 and McGoey $147,768. Instead with a value of $0.40 a share, Look was required to pay them more than 10 times that amount. Similarly, as a result of the $0.40 share value, each of the directors also received a significant increase in the monies paid to them by Look on account of cancellation of their SARs.

[102] The same analysis applies in respect of the options. While the Board cannot be faulted for wanting to prevent a run of the market arising from the exercise of options, by setting a value far in excess of the market, the Board created a significant liability for Look while at the same time receiving a significant personal benefit.

[103] In total, Look was required to pay equity cancellation payments for both options and SARs of approximately $9 million, which was far in excess of the amount it would have had to pay if the value had

been based on Look's market price at the time. Further, it was the Applicants who received the vast majority of that money.

[104] In approving the value of $0.40 in the circumstances in which they did, coupled with the resulting significant benefit to themselves, the evidence strongly indicates the directors pursued their own interests ahead of Look's. Each of the directors received equity cancellation payments either directly or through their companies in an amount far greater than they would have been entitled to.

[105] Cytrynbaum submits that in reaching the decisions it did in June 2009 concerning the equity cancellation payments, the Board relied on legal advice received from Look's corporate counsel at the time. Based on *Blair*, it is further submitted that such reliance affords a complete defence to Look's allegations of *mala fides*.

[106] There is no question that legal advice can provide a defence to an allegation of *mala fides*. There has been much evidence presented concerning the legal advice provided at the time and the information it was based on. In my view, while the defence of legal advice is an arguable defence, it does not overcome Look's strong evidence of *mala fides*. Based on my review of the legal advice provided to the Board, both in advance of and at the June 16, 2009 meeting, it addressed the general authority of Look's directors to make special compensation awards in recognition of their role in significant transactions or events. There is no evidence, however, that the decision to value Look's shares at $0.40 a share for the equity cancellation payments was based on legal advice.

[107] In my view, Look's evidence is more than sufficient to establish a strong *prima facie* case that by recommending and approving the equity cancellation payments at a value of $0.40 a share, McGoey and Redman in their capacity as officers and Cytrynbaum, McGoey, Smith and Colbran in their capacity as directors, acted *mala fides*, in their own self interests and not in the best interests of Look.

The Retainer Payments

[108] By the spring of 2010, shareholder opposition was mounting to the bonus and equity cancellation payments made by Look to the Applicants. Look had received letters from shareholders complaining about the payments. A dissident group of UBS shareholders had requisitioned a shareholder meeting for July 5, 2010, with the purpose of replacing its board of directors. Because UBS was Look's largest shareholder, the individual Applicants expected that the Board and senior management would be replaced with the ultimate goal of recovering the payments made to the Board and management, including the Applicants.

[109] In late May, early June 2010, Look's management sought legal advice as to whether Look could establish an indemnity trust to fund the Applicants' indemnity claims for, among other things, legal fees and expenses arising out of any legal proceedings that they anticipated would be commenced against them in connection with the monies they had received from Look.

[110] When Look's regular corporate counsel, David McCarthy at Stikemans, declined to act on the issue given the potential conflict if legal proceedings arose, Look's management retained Jeffrey Kramer, a senior litigation lawyer who had acted for Look in the past. Mr. Kramer initially met with McGoey and Redman on May 26, 2010, to obtain the background. Over the next few weeks he met or spoke mainly with Redman. He also met with and spoke with Hillary Clarke, a lawyer with McMillians who had been retained by the Applicants to act for them personally. He was advised by Redman that the Board was going to meet on June 16, 2010 and he was asked to attend.

[111] As Mr. Kramer became more involved in the issue and the facts, he became concerned with the scope of his retainer given the time frames involved. Mr. Kramer also had concerns that an indemnity trust would not be in the best interests of Look. On June 15, 2010, Mr. Kramer advised Redman and Ms. Clarke that he had no choice but to advise the Board at its meeting the next day that in his opinion an indemnity trust did not appear to be in the best interests of Look; that proceeding with it was questionable from a legal point of view and that it appeared to be a bad strategic move. He also raised concerns about a serious conflict of interest arising from the fact that the directors and officers who were instructing Ms. Clarke were also instructing him on behalf of Look.

[112] Mr. Kramer did not attend the Board meeting on June 16, 2010. He was told by Redmond early that morning that the meeting had been cancelled. Ms. Clarke, on the other hand, was present at the meeting. So too was Mr. McCarthy.

[113] At the outset of the Board meeting, Mr. McCarthy advised the Board that his role would be limited to a review of the applicable indemnity provisions and he would provide no litigation advice. Mr. McCarthy then provided a detailed review of the indemnity provisions of the By-Law, the Indemnity Agreement and the relevant provisions of the CBCA, following which he left the meeting. Ms. Clarke remained. Mr. Kramer's advice to Look's management concerning the issues surrounding an indemnity trust and the conflict of interest was not provided to the Board, notwithstanding that McGoey, Redman and Ms. Clarke were present.

[114] The minutes of the meeting reflect Mr. McCarthy's presentation and the fact that Look had received a letter signed by all the directors, Redman and on behalf of First Fiscal and Jolian requesting indemnity pursuant to the Indemnity Agreement in respect of anticipated litigation against them. There is no indication in the minutes that the Board made any decision concerning the payment of indemnity.

[115] As noted, in July 2010, on the eve of the individual Applicants' resignations from Look's Board and employment, Look paid $1,550,000 on account of retainers to three law firms acting for the Applicants.

[116] Mr. Kramer filed an affidavit in the proceedings outlining his involvement from May 26 to June 16, 2010. He was not cross-examined and no evidence was presented contradicting his evidence.

[117] In my view, Look's evidence establishes a strong *prima facie* case that the individual Applicants, in authorizing Look to pay the retainers, acted *mala fides*, in their own self interest and not in Look's best interests.

[118] In failing to advise the Board of the legal opinion Look had received from Mr. Kramer prior to the June 16, 2010 Board meeting, McGoey and Redman, as officers of Look, acted in their own self interest and not in the best interests of Look. While McGoey was not involved in every meeting with Mr. Kramer and particularly the June 15th meeting where he gave the advice which resulted in his exclusion from the June 16th meeting, I have no doubt given his involvement in the issue that McGoey was well aware of Mr. Kramer's advice. Significant retainers were subsequently paid by Look to lawyers retained by both McGoey and Redmond personally.

[119] The evidence also establishes that Look has a strong *prima facie* case that in authorizing and paying the retainer amounts, the individual Applicants, except Dolgonos (as will be discussed below), acted *mala fides*, in their own personal self interest and not in Look's best interests. Although the Board received advice on the indemnity provisions applicable from Mr. McCarthy, it received no advice directed to the appropriateness of the proposed payments in question given the circumstances. Mitrovich testified that no explanation was provided to the Board as to how such payments were in Look's best interests. Mr. McCarthy left the meeting after his presentation and the only lawyer who remained was Ms. Clarke who was acting for

the directors and management personally. This was a significant conflict of interest. Of the monies paid as a retainer, Ms. Clarke's firm received $1,200,000.

[120] I am further of the view, given the strong opposition which had arisen from Look's shareholders to the payments which had been made to the Board and senior management from the proceeds of the Inukshuk sale, that payment of further significant amounts on account of retainers for the Applicants, was not in Look's best interests.

Cytrynbaum, McGoey, Smith, Colbran and Redman

[121] For the above reasons, therefore, I am of the view that, based on the evidence presented, Look has established a strong *prima facie* case that the individual Applicants, excluding Dolgonos, acted *mala fides*, in their own self interests and not with a view to the interests of Look in respect of the Board's approval of the equity cancellation payments based on a value of $0.40 a share and in relation to the payment of retainers by Look to lawyers acting for the Applicants personally. Accordingly, Look has met its onus. I am not prepared to approve interim advancement to the individual Applicants (except Dolgonos) of their legal fees and expenses in respect of the Action or the CBCA Motion pursuant to s. 124(4) of the CBCA.

Dolgonos

[122] There is a dispute between Look and Dolgonos as to his employment status with Look. Dolgonos submits that he was simply an employee of Look during the relevant period and never an officer. He submits that he performed technology consulting services for Look at the request of UBS pursuant to the UBS MSA and an agreement between UBS and DOL. As an employee, he received $60,000 a year from Look. As a result, Dolgonos submits his entitlement to advances is not subject to court approval under s. 124(4) of the *CBCA* and arises from the Indemnity Agreement.

[123] Look submits that Dolgonos was an officer of the corporation during the relevant period. It points to a new hire form created in March, 2005 which describes Dolgonos as being Look's Chief Technology Officer. Look submits that given his duties at the company, he should be considered a member of Look's management and accordingly subject to the provisions of s. 124(4) of the *CBCA*.

[124] The evidence of what Dolgonos's role was at Look and the duties he performed is far from clear. Section 2(1) of the CBCA defines an "officer" as an individual appointed as an officer under s. 121, the chairperson of the board of directors, the president, a vice-president, the secretary, the treasurer, the comptroller, the general counsel, the general manager, a managing director of a corporation or "any other individual who performs functions for a corporation similar to those normally performed by an individual occupying any of those offices."

[125] While it may be that Dolgonos did carry out a management role, at this junction, based on the record before me, I am not prepared to conclude Dolgonos was an officer within the meaning of the CBCA at the relevant times.

[126] In addition, and even if the evidence establishes that Dolgonos was an officer of Look at the material times, there is no evidence in these proceedings that he was involved in any of the impugned decisions that Look relies on to establish *mala fides*. In particular, there is no evidence he had any involvement in establishing the $0.40 share price or payment of the retainers. Look points to the large sums of money he received on account of bonus and equity cancellation payments having regard to his role with the company. In my view, those payments are more an issue for management and the Board who recommended and approved them rather than Dolgonos who received them.

[127] Accordingly, the issue of advancement in respect of Dolgonos falls to be determined on the wording of the Indemnity Agreement. In that regard, the wording of the Indemnity Agreement is clear.

Dolgonos as a consultant and/or employee of Look is entitled to receive interim payment of expenses pursuant to s. 2(a) of the Indemnification Agreement unless and until it is finally determined "by a court of competent jurisdiction" that he is not entitled to be indemnified pursuant to the Agreement. In that case, he will be required to pay back the monies advanced on his behalf.

[128] Look submits that the issue of whether the Indemnity Agreement is valid or applies is an issue to be determined in the Action. At this stage, the failure of Look to advance expenses pursuant to the Indemnity Agreement is an alleged breach of contract. The relief Dolgonos is seeking in his Application is in effect a mandatory injunction ordering Look to pay advances prior to a determination of the issue of entitlement in the Action. In that regard, Look submits that Dolgonos has failed to meet the test required to obtain a mandatory injunction: he has not established a strong *prima facie* case; he has failed to establish any irreparable harm if the relief is not granted or that the balance of convenience favours the granting of such an injunction. See *Barton-Reid Canada Ltd, v. Alfresh Beverages Canada Corp*., [2002] O.T.C. 799 (S.C.) at para. 9.

[129] In my view, Look's submission has no merit in respect of Dolgonos. The record is clear that he was an employee of Look. As such, he is entitled to advancement in accordance with the provisions of the Indemnification Agreement. If it turns out at the conclusion of the Action he is not entitled to indemnity he will have to repay the amounts advanced by Look. To hold otherwise would effectively render the indemnity meaningless. It would permit a corporation, in the face of an indemnity agreement, to simply refuse to honour the agreement requiring the employee to pay all his or her legal costs pending final determination of the corporation's action. Given the policy goals behind indemnity (and advancement), it is not appropriate to apply the test for a mandatory injunction in respect of employees who have been given an indemnity agreement.

IV. The Release

[130] In light of my decision to not approve advancement in respect of any of the Applicants except Dolgonos, the issue of the whether the Release operates to prevent advancement is only applicable in respect of Dolgonos.

[131] In my view, at this stage, I am not prepared to find that Look has established that the Release operates to prevent Dolgonos from receiving advances pursuant to the Indemnification Agreement. The Release was provided in exchange for Dolgonos giving up all rights surrounding the cancellation of the SAR Plan and the Option Plan. It is not a general release. The wording of the Release specifically limits it to any and all actions etc. "in any way relating to my entitlements under the Company's Share Appreciation Rights Plan and the 2002 Stock Option Plan." In my view, therefore, the wording of the Release does not extend to any claim by Dolgonos under the Indemnification Agreement.

First Fiscal, Jolian and DOL

[132] Section 124 of the CBCA has no application to First Fiscal, Jolian and DOL, the management services companies of Cytrynbaum, McGoey and Dolgonos respectively. Nor are they entitled to the presumption of good faith discussed in *Blair*. That presumption applies to persons not corporations.

[133] First Fiscal provided consulting services to Look through Cytrynbaum. Neither Jolian nor DOL had any employment, consulting or agency relationship with Look. Their claim for indemnity and for interim advancement is based solely on the Indemnification Agreement.

[134] The Indemnity Agreement clearly provides in Sections 1(a) and (b) and elsewhere that it applies where the "Indemnitee" was a "director, officer, employee, consultant or agent" of Look. Further, section 8 of the Indemnity Agreement provides;

> 8. Effectiveness of Agreement. This Agreement shall be effective as of the date set forth on the first page and shall apply to acts or omissions of Indemnitee which occurred prior to such date if Indemnitee was an officer, director,

> consultant, employee or other agent of the Corporation, or was serving at the request of the Corporation as a director, officer, employee, consultant or agent of another corporation, partnership, joint venture, trust or other enterprise, at the time such act or omission occurred.

[135] The Indemnification Agreement is a contract between arms length parties. None of the policy concerns behind director, officer or employee indemnities or advances prior to a final determination of entitlement apply. I am therefore in agreement with Look that in respect of the three companies, in order for them to receive advancement of expenses pursuant to the Indemnity Agreement, the onus is on each of them to establish the previously referred to test for a mandatory injunction: strong *prima facie* case; irreparable harm and balance of convenience.

[136] In my view, on the evidence, none of the three companies have established the requirements. On the clear wording of the Indemnity Agreement, it does not apply to Jolian or DOL. Neither of those companies were ever an officer, director, consultant, employee or other agent of the Corporation. The same, however, cannot be said about First Fiscal which had an agreement with Look in respect of Cytrynbaum's consulting services. Further, there is no evidence from any of the companies of irreparable harm. Finally, in my view, given the circumstances behind the payments to the companies, the balance of convenience clearly favours Look.

[137] I am also not prepared to permit interim advancement of legal expenses for First Fiscal and Jolian even if the Indemnity Agreement applies. Simply put, because I have found that Look has established a strong *prima facie* case that Cytrynbaum and McGoey are not entitled to interim advances for expenses because of their conduct as directors and officers of Look, it follows in my view that their management services corporations which they control ought not to be held in any different position.

Conclusions

[138] The motions in the Cytrynbaum Application by Cytrynbaum and First Fiscal, Smith and Redman for interim advancement of expenses relating to the Action and the CBCA Motion are therefore dismissed.

[139] The Application by McGoey and Jolian for interim advancement in the McGoey Application is also dismissed.

[140] The Dolgonos Application for interim advancement is allowed in respect of Dolgonos but dismissed in respect of DOL. Dolgonos is entitled to interim advancement of his legal fees and expenses in respect of the Action and CBCA Motion in accordance with the provisions of the Indemnity Agreement.

[141] The issue raised in each of the Applications concerning each of the Applicants' entitlement to indemnity pursuant to Look's By-Law and the Indemnification Agreement is directed to be determined by way of trial of an issue, to be tried together with or immediately after the trial in the Action, as the trial judge may determine. In that regard, the affidavits and cross-examinations thereon, as well as any witness examinations and the documents filed in these Proceedings shall constitute discovery and production concerning the indemnity issue.

[142] Finally, I wish to make it clear that the findings I have made in these Proceedings concerning entitlement to interim advances on account of indemnification have been made in the context of interlocutory proceedings and are therefore in no way binding on the trial judge in his or her determination of the ultimate issue of whether the Applicants are entitled to indemnification from Look. Nor should the fact that I have not dealt with all of Look's allegations be taken as an indication that they are without merit. It was simply not necessary given my view of the evidence concerning the two incidents I relied on.

[143] In light of the issues raised by the parties and argued by counsel, none of the counsel provided cost outlines at the conclusion of the argument nor were any requested by me. In the normal course, at this stage I would ask counsel for their cost outlines and submissions.

[144] In light of my conclusions in respect of interim advancement and because the issue of indemnification remains to be decided, I am inclined to the view that the costs of the motions before me should be awarded in the cause based on the determination of the indemnity issue. That order would also apply to Dolgonos although in the interim he is entitled to receive his costs of the Dolgonos Application by way of advancement under the Indemnity Agreement.

[145] Because, however, no submissions as to costs have been made, if the parties wish to make cost submissions to the contrary, they should be provided in writing within 20 days and any reply submissions, if necessary, should be provided within 10 days following. In the absence of receipt of such submissions, costs of the Applications and motions shall be in the cause concerning entitlement to indemnity.

L. A. Pattillo J.

Released: September 28th, 2012

CITATION: Cytrynbaum et al. v. look et al., 2012 ONSC 4578
DATE: 20120928
DOCKETS: CV-11-9386-00CL
CV-12-9693-00CL
CV-12-9688-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

BETWEEN:

MICHAEL CYTRYNBAUM, FIRST FISCAL MANAGEMENT LTD., STUART SMITH, SCOTT COLBRAN, JASON REDMAN

Applicants

- and -

LOOK COMMUNICATIONS INC.

Respondent

AND BETWEEN:

JOLIAN INVESTMENTS LIMITED and GERALD MCGOEY

Applicants

- and -

LOOK COMMUNICATIONS INC.

Respondent

AND BETWEEN:

ALEX DOLGONOS AND DOL TECHNOLOGIES INC.

Applicants

- and –

LOOK COMMUNICATIONS INC.

Respondent

REASONS FOR JUDGMENT

L. A. PATTILLO J.

Released: September 28, 2012

TAB 20

POLICY 5.1

LOANS, BONUSES, FINDER'S FEES AND COMMISSIONS

Scope of Policy

This Policy outlines the Exchange's policies on loans to an Issuer, and bonuses, finder's fees, and commissions paid by an Issuer. A statutory exemption must be available for the issuance of securities as payment for finders' fees, commissions or bonuses, failing which, a discretionary exemption from the appropriate Securities Commission must be obtained.

The main headings in this Policy are:

1. Loans to Issuers
2. Bonuses
3. Finder's Fees and Commissions
4. Application to Members
5. Filing Requirements

1. Loans to Issuers

1.1 Disclosure

In accordance with the Exchange's timely disclosure policies, an Issuer must disclose by news release any loan or advance of funds to the Issuer which involves any charge on or security interest in its assets or which otherwise constitutes Material Information.

1.2 Notice to Exchange

(a) The Issuer must provide the Exchange with prompt written notice of the proposed loan if the lender is not a chartered bank, trust company or treasury branch, and:

(i) any arrangement exists to issue securities in connection with the loan, either at the time of the loan agreement or at some future date (such as bonus shares or convertible debt); or

(ii) the Issuer mortgages or charges all or substantially all of its assets as collateral for the loan.

(b) The notice, in the form of a formal letter, must provide the following information and accompanying documents:

(i) the loan agreement and any other loan documents evidencing indebtedness such as a promissory note;

(ii) the relationship between the lender or guarantor (including any beneficial ownership of securities of the Issuer, which must be disclosed) and the Issuer;

(iii) a description of how the Issuer proposes to service and repay the loan;

(iv) a description of how the Issuer proposes to use the proceeds;

(v) details of any bonus to be paid pursuant to the loan or guarantee;

(vi) confirmation that the loan or guarantee is necessary and would not be granted without the bonus;

(vii) where bonus shares are issued for a guarantee, documentation on which the Issuer has relied in order to assess the guarantor's ability to guarantee the debt. Such documentation may include:

(A) a statement of net worth attested to by the person or company making the guarantee;

(B) a bank letter of credit;

(C) the most recent annual audited financial statements of the guarantor; or

(D) any other evidence acceptable to the Exchange; and

(viii) the fee prescribed by Policy 1.3 - *Schedule of Fees*.

2. Bonuses

An Issuer may issue bonuses consisting of Listed Shares or non-transferable Warrants to a lender or guarantor in consideration of the risks taken by the lender or guarantor. The amount of the permitted bonus is based on the size of the loan and graduated in proportion to the apparent level of risk. Bonuses may not be granted in relation to the issuance of convertible securities.

2.1 Notice Requirements

(a) The Issuer must give prompt notice of a bonus transaction to the Exchange as described in section 5.1. Tier 2 Issuers must receive Exchange acceptance of the proposed transaction before issuing any bonus shares or Warrants.

(b) The Issuer must issue a news release about the transaction if it represents Material Information.

2.2 Bonus Limitations

(a) If the ability of the Issuer to repay a loan is not evident and/or if a guarantee represents the primary collateral for a loan, the Issuer may grant a bonus of shares or non-transferable Warrants to the lender or guarantor, as the case may be. The maximum number of shares that may be issued as a bonus is 20% of the total dollar amount of the loan/guarantee divided by the Discounted Market Price of the shares. The deemed value of a Warrant is one half the value of a share, so the maximum number of Warrants that may be issued as a bonus is 40% of the total dollar amount of the loan/guarantee divided by the Discounted Market Price of the shares. The maximum exercise period of the Warrants is the earlier of five years, or the term of the loan. The issue price of shares must not be less than the Discounted Market Price and the exercise price of the Warrant must not be less than the Market Price.

(b) Any interest on the loans must be at a reasonable rate, which reflects the risk to the lender. Only one bonus may be granted on a loan regardless of the term of the loan.

(c) Warrants must provide that the number of Warrants will be reduced or cancelled on a pro rata basis if the loan is reduced or paid out in the first year before the Warrant expires. Generally, the Exchange will not require the reduction of the term of the Warrants to less than one year. The reduction or cancellation must take place within 30 days after the reduction or paying out of the loan.

3. Finder's Fees and Commissions

An Issuer which receives a measurable benefit through the efforts of a person who is neither an employee nor an Insider of the Issuer can reward those efforts by paying a finder's fee or commission in the form of cash, shares, Warrants or an interest in assets. Appropriate registration and Prospectus exemptions must be available for any issuance of securities.

3.1 Notice Requirements

(a) The Issuer must give prompt notice of the finder's fee or commission to the Exchange as described in section 5.1. Tier 2 Issuers must receive Exchange acceptance of the proposed transaction before paying any finder's fee or commission.

(b) All Issuers must issue a news release about the transaction if it represents Material Information. The Exchange deems a transaction involving finder's fees or commissions to constitute Material Information under Policy 3.3 - *Timely Disclosure.*

3.2 Criteria

Arm's Length Finder or Agent

(a) The finder or agent must not be a Non-Arm's Length Party to the Issuer, except to the extent that an agent may have been specifically commissioned to locate, arrange or acquire a benefit for the Issuer which it would not have otherwise obtained. The Exchange can waive this requirement at its discretion if the Issuer provides satisfactory reasons for the finder's fee or commission.

When Payable

(b) The benefit to the Issuer can be the identification or introduction of subscribers to a private financing, or the sellers or buyers of an asset, or any other measurable benefit that has in fact been received by the Issuer. The amount of the benefit received is easily determined in the case of a specific financing. If the benefit is staged over time (for example an asset purchase or joint venture agreement), the Exchange focuses on the benefit received in the first year.

(c) If an Issuer proposes to pay fees for benefits to be received in the future, particularly more than one year, the fee or commission must be paid in stages as the benefits are received by the Issuer. However, if the outcome of a transaction is outside the control of the Person receiving the fee, and the benefit cannot reasonably be determined, the Exchange will generally only permit the Issuer to pay a finder's fee or commission based on the finder's actual costs plus a reasonable profit to compensate for time and effort.

Payment in Shares

(d) If the compensation is payable in Listed Shares, the number of shares issued as finder's fees or commission is calculated by dividing the dollar value of the fee or commission by the Market Price for the Issuer's Listed Shares. The restrictions as to the time of payment set out above apply to payments in shares as well.

Payment in Warrants

(e) If the compensation is payable in Warrants, subject to sections 3.4 and 4.1, the Issuer may grant the finder or agent Warrants to acquire up to double the number of Listed Shares that are permitted under the guidelines in section 3.2(d). The Warrants must be non-transferable and exercisable at no less than the greater of the placement or transaction price and the Market Price for those shares. Any Warrants granted will be subject to a maximum five year term from the date of the grant.

3.3 Finder's Fee Limitations

The finder's fee limitations apply if the benefit to the Issuer is an asset purchase or sale, joint venture agreement, or if the benefit to the Issuer is not a specific financing. The consideration should be stated both in dollars and as a percentage of the value of the benefit received. Unless there are unusual circumstances, the finder's fee should not exceed the following percentages:

Benefit	Finder's Fee
On the first $300,000	Up to 10%
From $300,000 to $1,000,000	Up to 7.5%
From $1,000,000 and over	Up to 5%

As the dollar value of the benefit increases, the fee or commission, as a percentage of that dollar value should generally decrease.

3.4 Commission Limitations

When a commission is paid as compensation, for a specific financing, the Issuer may negotiate the amount of compensation payable, as long as the Issuer does not issue Warrants which, assuming full exercise will represent more than 25% of the number of shares issuable pursuant to the financing.

4. Application to Members

4.1 Bonuses, finder's fees and commissions payable to Members are governed by this Policy, except for the finder's fee and commission limitations set out in sections 3.3 and 3.4.

4.2 Under the TSX Venture Exchange Rule Book and Policies, directors, officers, partners, registered representatives, traders, assistant traders and employees in or of Members cannot directly or indirectly sell properties or other assets to, or acquire properties or other assets from, Issuers without the prior specific approval of the Exchange. For more certainty, except for Members, who are governed by the requirements set out in this Policy, these Persons also cannot receive any direct or indirect compensation for acting as a finder for, or agent of, an Issuer without the prior specific approval of the Exchange.

4.3 Except in very unusual circumstances, the Exchange will not give its approval for any direct or indirect compensation contemplated in section 4.2 of this Policy 5.1. If an Issuer proposes to pay a bonus, finder's fee or commission which is not permitted by the TSX Venture Exchange Rule Book and Policies, the Issuer must disclose the proposed payment and the fact that the finder or agent falls within the defined category when submitting materials to the Exchange for the relevant transaction.

4.4 The restrictions in sections 4.2 and 4.3 of this Policy 5.1 also apply to Persons who perform substantially the same functions as those Persons listed above, whether or not they are under the direct Membership jurisdiction of the Exchange.

4.5 A Person who breaches these restrictions will be in a conflict of interest, which may affect the fitness of that Person to continue to be registered under the applicable Securities Laws.

5. Filing Requirements

5.1 Notice

The Issuer must provide the Exchange with written notice of the proposed bonus, finder's fee or commission. Subject to section 5.2, the notice, in the form of a formal letter, must provide the following information and accompanying documents:

(a) notice from the Issuer or its counsel of any registration and Prospectus exemptions being relied upon by the Issuer and the registration exemption being relied upon by the finder;

(b) a copy of the agreement relating to the bonus, finder's fee or commission;

(c) a copy of the related Private Placement, acquisition or loan agreement if not already filed (the Exchange prefers that these agreements be filed simultaneously);

(d) in the case of a finder's fee or commission confirmation that the finder or agent is neither an employee nor an Insider of the Issuer; and

(e) the fee prescribed by Policy 1.3 - *Schedule of Fees*.

5.2 Where there is a loan or advance of funds made to the Issuer that is provided in conjunction with, or in relation to, a proposed bonus, finder's fee or commission, then the notice referred to in section 5.1, must also include the relevant information and accompanying documents set forth at section 1.2(b) of this Policy.

5.3 Further News Releases and Notice

The Issuer must issue a news release announcing the closing of the Private Placement, acquisition, loan agreement or any other transaction related to the issuance of the bonuses, finders' fees or commissions. The news release must disclose the expiry dates of the hold period(s) for the securities issued as bonuses, finders' fees or commissions, and for any securities issued as part of the related transaction.

TSX Venture Exchange

POLICY 5.2

CHANGES OF BUSINESS AND REVERSE TAKEOVERS

Scope of Policy

This Policy applies to any transaction or series of transactions entered into by an Issuer or a NEX Company that will result in a Change of Business ("COB") or Reverse Takeover ("RTO"). Certain Reactivations may also be subject to some or all of the provisions of this Policy. Issuers are reminded that this Policy must be read in conjunction with National Instrument 51-102 - *Continuous Disclosure Obligations*, in respect of reverse takeovers as defined in that Instrument. It must also be read in conjunction with Policy 5.9.

This Policy describes the filing and related procedures to be followed in connection with a COB or RTO. Transactions filed in furtherance of a COB or RTO must also be in compliance with any other relevant policies in the Manual (including Private Placements and Acquisitions and Dispositions of Non Cash Assets).

The main headings in this Policy are:

1. Interpretation
2. Public Disclosure
3. Sponsorship and Trading Halt
4. Shareholder Approval
5. Procedural Steps
6. Application of Initial Listing Requirements
7. Vendor Consideration and Escrow
8. Treasury Orders and Resale Restrictions
9. Financial Statements
10. Other Requirements

1. Interpretation

1.1 In this Policy:

"Change of Business" or **"COB"** means a transaction or series of transactions which will redirect an Issuer's resources and which changes the nature of its business, for example, through the acquisition of an interest in another business which represents a material amount of the issuer's market value, assets or operations, or which becomes the principal enterprise of the issuer. See Section 1.2 of this Policy for guidance on the general application of this definition to vertical or horizontal business integrations and resource Issuers.

"COB Agreement" or "RTO Agreement" means any agreement or other similar commitment respecting the COB or RTO which identifies the fundamental terms upon which the parties agree or intend to agree, including:

(a) the Target Assets;

(b) the parties to the COB or RTO;

(c) the value of the Target Assets and the consideration to be paid or otherwise identifies the means by which the consideration will be determined; and

(d) the conditions to any further formal agreements or completion of the COB or RTO.

"Completion Date" means the date of the Final Exchange Bulletin.

"Disclosure Document" means the document describing the transaction, required to be distributed to shareholders and filed with the Exchange pursuant to this policy. The Disclosure Document will be either the Information Circular (Form 3D1) to be filed when shareholder approval for the transaction is sought at a meeting or Filing Statement (Form 3D2) to be filed when shareholder approval is sought by consent.

"Final Exchange Bulletin" means the bulletin issued by the Exchange following closing of the COB or RTO and the submission of all Post-Approval Documents which evidences the final Exchange acceptance of the COB or RTO.

"Non-Arm's Length Parties to the COB or RTO" means the Vendors, any Non-Arm's Length Parties of the Vendors, the Target Company, and any Non-Arm's Length Parties of the Target Company.

"Resulting Issuer" means the Issuer existing on the Completion Date.

"Reverse Takeover" or **"RTO"** means a transaction or series of transactions, involving an acquisition by the Issuer or of the Issuer, and a securities issuance by an Issuer that results in:

(a) new Shareholders holding more than 50% of the outstanding voting securities of the Issuer; and

(b) a Change of Control of the Issuer. The Exchange may deem a transaction to have resulted in a Change of Control by aggregating the shares of a vendor group and/or incoming management group,

but does not include any transaction or series of transactions whereby the newly issued securities are to be issued to shareholders of an issuer listed on TSX or another senior exchange under a formal takeover bid made pursuant to Securities Laws.

A transaction or series of transactions may include an acquisition of a business or assets, an amalgamation, arrangement or other reorganization.

Any securities issued pursuant to a Private Placement effected concurrently, contingent upon, or otherwise linked to a transaction or series of transactions, may be used in order to determine whether a transaction or series of transactions satisfies (a) and/or (b), above.

"Target Assets" means the assets, business, property or interest therein being purchased, optioned or otherwise acquired in connection with the COB or RTO.

"Target Company" means a Company to be acquired in connection with the COB or RTO, or the Vendors of the Target Assets.

"Vendor" or "Vendors" means the beneficial owner(s) of the Target Assets.

1.2 Application of the Change of Business and Reverse Takeover Definitions

(a) Generally the definition of a COB is not intended to apply to situations involving an Issuer acquiring or moving into a business that represents a vertical or horizontal business integration or where a resource Issuer is continuing in a different resource-based business. Issuers are encouraged to contact the Exchange for a pre-filing consultation to ascertain whether such a transaction will be deemed a COB.

(b) In certain circumstances, a transaction or series of transactions involving significant acquisitions, financings and/or management changes may alter the character of an Issuer to the extent that the Exchange will apply the standards applicable to a COB or RTO, notwithstanding that such transactions do not technically meet the criteria of a COB or RTO. Issuers undertaking a combination of such transactions should consult with the Exchange in advance to determine if the requirements applicable to a COB or RTO will be imposed on the Issuer in connection with such transactions.

1.3 Transactions Forming Part of a COB/RTO

Where an Issuer has undertaken a series of transactions that taken together meet the definition of COB or RTO, the Exchange may require that escrow or restrictions on resale or voting be placed on securities issued pursuant to those transactions. These restrictions may be required in situations where the transactions have been previously filed and accepted without such restrictions. In addition, when a series of transactions is deemed to constitute a COB or RTO, the Exchange may require that:

(a) shareholder approval be sought for any prospective transaction forming a part of the COB or RTO; and

(b) voting be restricted in respect of such shareholder approval.

1.4 Where an Issuer undertakes a transaction that forms part of a COB or RTO (including a Private Placement, a shares for debt transaction, an acquisition or a name change), it must disclose this information in its Exchange filing application and in the news release disclosing the transaction.

2. Public Disclosure

2.1 Initial News Release

When a COB Agreement or an RTO Agreement is reached, the Issuer must immediately submit a comprehensive news release to the Listed Issuer Services Department of the Exchange for review. The news release must include:

(a) the date of the COB Agreement or RTO Agreement;

(b) a description of the Target Assets, including:

(i) the industry sector in which the Resulting Issuer will be involved upon the Completion Date;

(ii) the history and nature of business previously conducted by the Issuer, and

(iii) a summary of any available significant financial information (with an indication as to whether such information is audited or unaudited and the date it was prepared);

(c) a description of the terms of the COB or RTO including the amount of proposed consideration, how the consideration will be paid and specifying the amounts to be paid by way of cash, securities, indebtedness or other means;

(d) the location of the Target Assets and, in the case of the acquisition of a Target Company, the jurisdiction of incorporation or creation of the Target Company;

(e) the full names and jurisdictions of residence of each of the Vendors and, if any of the Vendors is a Company, the full name and jurisdiction of incorporation or creation of that Company and the name and jurisdiction of residence of each of the individuals who directly or indirectly beneficially holds a controlling interest in, or who otherwise controls or directs that Company;

(f) identification of:

(i) any direct or indirect beneficial interest of any of the Non-Arm's Length Parties of the Issuer in the Target Assets;

(ii) any Non-Arm's Length Parties of the Issuer that are Insiders of any Target Company; and

(iii) any relationship between or among the Non-Arm's Length Parties of the Issuer and the Non-Arm's Length Parties of the Target Company and the names and backgrounds of all Persons who will constitute Principals of the Resulting Issuer;

(g) a description of any financing arrangement for or in conjunction with the COB or RTO including the amount, security, terms and use of proceeds;

(h) a description of any deposit or loan to be made;

(i) an indication of any significant conditions required to complete the COB or RTO;

(j) if a Sponsor has been retained, identification of the Sponsor of the COB or RTO and the terms of sponsorship;

(k) the following statement:

"Completion of the transaction is subject to a number of conditions, including Exchange acceptance and disinterested Shareholder approval. The transaction cannot close until the required Shareholder approval is obtained. There can be no assurance that the transaction will be completed as proposed or at all.

Investors are cautioned that, except as disclosed in the [Management Information Circular and/or Filing Statement] to be prepared in connection with the transaction, any information released or received with respect to the [COB or RTO] may not be accurate or complete and should not be relied upon. Trading in the securities of [insert name of Issuer] should be considered highly speculative.

The TSX Venture Exchange has in no way passed upon the merits of the proposed transaction and has neither approved nor disapproved the contents of this press release.";

(l) if a Sponsor has been retained, the following statement:

"[Insert name of Sponsor], subject to completion of satisfactory due diligence, has agreed to act as sponsor to [Insert name of Issuer] in connection with the transaction. An agreement to sponsor should not be construed as any assurance with respect to the merits of the transaction or the likelihood of completion";

(m) if applicable, any additional disclosure required by Policy 5.9, and

(n) all other requirements of Policy 3.3 – *Timely Disclosure.*

The Exchange will co-ordinate the timing of the news release with the Issuer in order to ensure proper dissemination.

2.2 Subsequent News Releases

The Issuer must issue a news release:

(a) every time there is Material Change relating to the COB or RTO and in accordance with applicable Securities Laws;

(b) identifying the Sponsor;

(c) every 30 days following the initial news release referred to in section 2.1, to update the status of the COB and RTO;

(d) when an Issuer intends to continue a trading halt. The news release must disclose the Issuer's intention to remain halted; and

(e) when the COB or RTO has closed.

3. Sponsorship and Trading Halt

3.1 When a Sponsor is Required

A Sponsor Report may be required by the Exchange in connection with a COB or RTO. See Policy 2.2 - *Sponsorship and Sponsorship Requirements.*

3.2 Initial Trading Halt

As soon as an Issuer notifies the Exchange of a proposed COB or RTO, the securities of the Issuer will be immediately subject to a trading halt.

3.3 Pre-Filing Consultation

In order to minimize the halt in trading, the Exchange recommends that the Issuer conduct a pre-filing consultation with the Exchange, particularly where the proposed COB or RTO may involve unique or unusual circumstances.

3.4 Requirements for Reinstatement of Trading

The securities of the Issuer will remain halted until each of the following has occurred:

(a) where the transaction is subject to sponsorship, the Exchange has received a Sponsorship Acknowledgement Form (Form 2G) as required by Policy 2.2 - *Sponsorship and Sponsorship Requirements*, which confirms that:

(i) the Sponsor has reviewed and has no concerns respecting the requisite Personal Information Forms (Form 2A) and, if applicable, any Declarations;

(ii) the securities of the Issuer held by officers, directors, other Insiders and Promoters of the Issuer and the Target Company are subject to the terms of a pooling agreement and such securities will not be released until the Exchange has granted final Exchange acceptance of the COB or RTO (a "Pooling Arrangement"); and

(iii) a comprehensive news release prepared and accepted by the Exchange in accordance with section 2.1, has been issued; or

(b) where the transaction is not subject to sponsorship:

(i) the Exchange is provided with written confirmation from the Issuer's legal counsel, confirming that a Pooling Arrangement is in place; and

(ii) a comprehensive news release prepared and accepted by the Exchange in accordance with section 2.1, has been issued;

(c) the Exchange has received a Personal Information Form (Form 2A) or, if applicable, a Declaration (Form 2C1) for each person who will be a director, senior officer, Promoter (including a Promoter as described in Policy 3.4 – *Investor Relations, Promotional and Market – Making Activities*) or other Insider of the Resulting Issuer;

(d) the Exchange has completed all preliminary background searches it considers necessary or advisable; and

(e) the Exchange has completed a preliminary assessment of the ability of the Issuer to satisfy Exchange Requirements following the COB or RTO and reviewed any potentially significant issues involving the COB or RTO.

3.5 Continuation of Halt/Subsequent Trading Halt

Where the conditions in Section 3.4 of this Policy are satisfied, the Exchange may nonetheless continue or reinstate a halt in trading of the securities of an Issuer for reasons that may include:

(a) documentation is not submitted within the time periods prescribed by this Policy;

(b) the Sponsor terminates the sponsorship agreement;

(c) the nature of the business of the Resulting Issuer is or will be unacceptable to the Exchange;

(d) the number of conditions precedent that are required to be satisfied by the Issuer, in order to complete the COB or RTO, or the nature or number of any deficiency or deficiencies required to be resolved is or are, so significant or numerous, as to make it appear to the Exchange that the halt should be reinstated or continued; or

(e) the Exchange determines that it is appropriate or in the public interest.

4. Shareholder Approval

4.1 An Issuer must obtain Shareholder approval of a COB or an RTO before the Completion Date.

4.2 Subject to Policy 5.9 and applicable corporate and Securities Laws relating to proxy solicitation, the Exchange may accept the written consent of shareholders in lieu of a vote held at a meeting. If shareholder approval is obtained by consent, the Issuer must provide shareholders with a Filing Statement (Form 3D2) prior to obtaining their consent. The Filing Statement must be prepared and delivered in accordance with sections 5.3 and 5.7 of this Policy, and filed via SEDAR.

4.3 Shareholder approval must be obtained at a meeting or by consent:

(a) by a majority of votes cast by Shareholders where the transaction is an Arm's Length Transaction;

(b) where the transaction involves Non-Arm's Length Parties or other circumstances exist which may compromise the independence of the Issuer with respect to the transaction, by a majority of the votes cast by Shareholders, excluding those votes attaching to securities beneficially owned by

(i) Non-Arm's Length Parties to the Issuer, and

(ii) Non-Arm's Length Parties to the COB or RTO, and

(c) by means of minority approval pursuant to Policy 5.9 if the transaction is subject to the provisions of Policy 5.9.

4.4 Where the proposed COB or RTO is a transaction that is subject to Policy 5.9, the Exchange may accept the written consent of shareholders subject to the conditions in section 4.3 and the grant of any applicable exemption pursuant to Policy 5.9 and applicable Securities Laws.

5. Procedural Steps

5.1 Filing of Initial Documents

The Initial Documents must be filed with the Exchange within 75 days after the news release announcing the COB Agreement or RTO Agreement. Failure to submit documents may result in a halt in trading.

5.2 Initial Documents

The following Initial Documents must be filed:

(a) a submission letter from the Issuer (or, with the consent of the Issuer, from the Target Company) giving notice of the proposed COB or RTO and providing the following information:

(i) the name of the Issuer;

(ii) a summary of the transaction and identification of all material and any unusual terms;

(iii) the particular registration and Prospectus exemptions, if any, being relied upon if securities are to be issued as part of the transaction;

(iv) confirmation of whether the proposed COB or RTO is subject to Policy 5.9; and

(vi) a list of the enclosed documents;

(b) a draft copy of the Disclosure Document (Form 3D1) where shareholder approval is sought at a meeting or the draft Filing Statement (Form 3D2) where shareholder approval is sought by consent, including the financial statements required pursuant to section 9 of this Policy;

(c) Form 2J – *Securityholder Information*;

(d) if applicable, a preliminary Sponsor Report accompanied by confirmation that the Sponsor has reviewed the Disclosure Document on a preliminary due diligence basis. See Policy 2.2 – *Sponsorship and Sponsorship Requirements*;

(e) a list of the material contracts that the Issuer or the Target Company has entered into in the last 12 months which list has not been previously filed with the Exchange;

(f) a copy of any material contract that the Issuer or Target Company has entered into relating to:

(i) the issuance of securities,

(ii) a loan or advance of funds to the Target Company,

(iii) a Non-Arm's Length Party Transaction, or

(iv) the assets upon which the listing of the Resulting Issuer will be based;

(g) a copy of each independent Geological Report or other technical report required to be filed with the Exchange, and a certificate of qualifications and independence from the author of each report;

(h) in the case of a non-resource Resulting Issuer, a copy of a business plan for the next 12 month period;

(i) a valuation or appraisal prepared in support of the value ascribed to the Target Assets which includes a certificate of independence and qualification from the author;

(j) details of any other evidence of value as contemplated by Policy 5.4 – *Escrow, Vendor Consideration and Resale Restrictions*; and

(k) the applicable minimum fee as prescribed by Policy 1.3 - *Schedule of Fees*.

5.3 Disclosure Document and Certificates

(a) The Issuer must prepare a Disclosure Document for an RTO or COB which must contain full true and plain disclosure relating to the Issuer and any Target Company, assuming completion of the transaction. Any Disclosure Document in relation to an RTO or COB must be prepared in accordance with the requirements of applicable Securities Laws and in accordance with the Exchange Information Circular/Filing Statement Form (Forms 3D1/3D2). Issuers are reminded of the additional disclosure requirements of Policy 5.9, where applicable.

(b) The Disclosure Document must include a manually executed certificate page signed by a duly authorized officer of the Sponsor if the Issuer has not obtained a waiver of sponsorship, and:

(i) the Resulting Issuer will be a mining issuer or an oil and gas issuer, the Principal Properties of which are outside of Canada where either (A) the majority of the Resulting Issuer's board of directors will not be Canadian or U.S. residents or individuals who have a demonstrated positive association as directors or officers with public companies that are subject to a regulatory regime comparable to the companies listed on a Canadian exchange (in which case the Issuer must provide the Exchange with evidence that such regulatory regime is comparable (in terms of registration, regulatory oversight, and filing requirements)); or (B) any control person of the Resulting Issuer is not a Canadian or U.S. resident;

or

(ii) the Resulting Issuer will be an industrial, technology, real estate, investment or research and development issuer where: (A) a principal component of its business operations will be located outside of Canada or the U.S.; (B) the majority of the board of directors will not be Canadian or U.S. residents; or (C) any control person of the Resulting Issuer is not a Canadian or U.S. resident.

(c) If certification by the Sponsor is required, the certificate page of the Disclosure Document must state as follows:

"To the best of our information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to [insert name of Issuer] assuming completion of the [describe transaction]."

5.4 Exchange Review

The Exchange will review the Initial Documents and provided there are no material deficiencies, will advise the Issuer that it may set a meeting date to approve the COB or RTO. Where the transaction has not been sponsored, the Exchange will require additional time to review the Initial Documents and to confirm that appropriate due diligence measures have been undertaken by the Issuer and its advisors.

5.5 Conditional Approval of the Exchange

Following the resolution of all material deficiencies to the satisfaction of Exchange staff, the application is submitted to the Listings Committee for consideration. If the COB or RTO is accepted, the Exchange will issue a conditional acceptance letter advising that the application has been accepted subject to certain conditions including Shareholder approval and the submission and satisfactory review of all Pre-Approval Documents and all Post-Approval Documents.

5.6 Pre-Approval Documents

Following the Exchange's conditional acceptance of the Issuer's application, the Issuer must file its Pre-Approval Documents with the Exchange. The Pre-Approval Documents include:

(a) a copy of the Disclosure Document to be provided to Shareholders where applicable;

(b) the financial statements as required by section 9 of this Policy, included in the Disclosure Document, including balance sheets originally signed by two directors and originally signed auditor's reports;

(c) a copy of any material contract or agreement previously filed with the Exchange in draft form; and

(d) a consent letter from any auditor, engineer, appraiser or other expert (an "Expert") named in the Disclosure Document as having prepared or rendered a report, opinion or valuation (a "Report") on any part of the Disclosure Document or named as having prepared a Report filed in connection with the Disclosure Document. The letter must consent to the inclusion of or reference to the Expert's Report, and state that the Expert has read the Disclosure Document and has no reason to believe that there are any misrepresentations contained in it which are derived from the Expert's Report or of which the Expert is otherwise aware. In the case of the consent of an auditor, the letter must also state:

(i) the date of the financial statements on which the Report is based, and

(ii) that the auditor has no reason to believe that there are any misrepresentations in the information contained in the Disclosure Document:

(A) derived from the financial statements on which the auditor has reported, or

(B) within the knowledge of the auditor as a result of the audit of the financial statements.

5.7 Process for Shareholder Approval

Once the Exchange advises that the Pre-Approval Documents have been accepted for filing, the final version of the Disclosure Document and if applicable, notice of meeting and proxy must be sent to the Shareholders of the Issuer and filed with the Exchange and Securities Commission(s) via SEDAR. If the Exchange accepts Filing Statement rather than an Information Circular, it must be filed on SEDAR using the category "Other" under the continuous disclosure category for Exchange filings.

Subject to section 4 of this Policy, the Issuer must hold its Shareholders' meeting, or may seek Shareholders consent to approve the proposed COB or RTO. If the requisite Shareholder approval is obtained, the Issuer may close the COB or RTO (subject to final Exchange acceptance) and may complete or close any concurrent transactions.

5.8 News Release

Upon closing of the COB or RTO, the Resulting Issuer must issue a news release disclosing all Material Changes and any outstanding conditions for final Exchange acceptance before filing the Post-Approval Documents. The Resulting Issuer should contact the Exchange before issuing the news release to co-ordinate the timing of the release.

5.9 Name Change or Stock Consolidation/Split

Management of the Resulting Issuer must co-ordinate the timing of any name change or stock consolidation/split with the Exchange such that any change to a corporate name, any consolidation, stock split or reclassification of securities is effected as soon as possible for trading purposes after becoming legally effective. The Issuer must advise all Persons who are issued security certificates that give effect to any such change that their certificates may not be accepted for delivery or transfer until the change becomes effective for trading purposes. See Policy 5.8 - *Name Change, Share Consolidations and Splits*.

5.10 Post-Approval Documents and Procedures

Following the Shareholder approval, the Issuer must file the Post-Approval Documents with the Exchange. The Post-Approval Documents include:

(a) a certified copy of the scrutineer's report which details the results of the vote on the resolution to approve the COB or RTO. The report must confirm that applicable minority approval pursuant to Policy 5.9 was obtained (where the transaction is subject to Policy 5.9) or where the transaction involved Non- Arm's Length Parties to the Issuer, the votes of the Non-Arm's Length Parties to: the Issuer, COB or RTO were not included when compiling the results of the Shareholder vote. If applicable, the report must confirm that Shareholder approval was obtained on any other matters in respect of which it was required. Where shareholder approval is obtained by consent, the Issuer must provide the consent letters to the Exchange;

(b) an original or notarially certified copy of any escrow agreement(s) required to be entered into pursuant to Section 7 of this Policy;

(c) a legal opinion or officer's certificate confirming that all closing conditions other than Exchange acceptance have been satisfied;

(d) if applicable, the final executed Sponsor Report; and

(e) the balance of the applicable fees prescribed by Policy 1.3 - *Schedule of Fees*.

5.11 Final Exchange Bulletin

If the Post-Approval Documents are satisfactory, the Exchange will issue the Final Exchange Bulletin confirming the final Exchange acceptance of the COB or RTO and indicating any new name or stock symbol.

5.12 Trading

At the opening of trading two days after the issuance of the Final Exchange Bulletin, the securities of the Resulting Issuer will commence trading.

6. Application of Initial Listing Requirements

6.1 When an Issuer undergoes a COB or an RTO, before the Completion Date, the Resulting Issuer must satisfy the Exchange's Initial Listing Requirements for a particular industry sector in either Tier 1 or Tier 2 as prescribed by Policy 2.1 - *Initial Listing Requirements*.

6.2 References in Policy 2.1 - *Initial Listing Requirements* to Approved Expenditures of the applicant Issuer will mean Approved Expenditures of the Target Company or Vendor(s) of the Target Assets. References in Policy 2.1 to Working Capital, Financial Resources or Net Tangible Assets of the Issuer will mean the consolidated working capital, financial resources and Net Tangible Assets of the Resulting Issuer.

6.3 Subject to Section 3.3 of Policy 2.1, if the new business or asset will comprise the Issuer's primary business, the Issuer must acquire a Significant Interest in the business or asset.

6.4 The directors and management of the Resulting Issuer must meet the requirements set out in Policy 3.1 - *Directors, Officers, Other Insiders & Personnel and Corporate Governance*.

7. Vendor Consideration and Escrow

The Issuer and the Target Company must comply with the provisions of Policy 5.4 – *Escrow, Vendor Consideration and Resale Restrictions*.

8. Treasury Orders and Resale Restrictions

8.1 Securities issued pursuant to a COB or RTO may be subject to Resale Restrictions, including hold periods under applicable Securities Law. The Issuer must ensure that it complies with any requirement of applicable Securities Law to legend the securities for any Resale Restriction or hold period or any other requirement to advise the recipient of securities of Resale Restrictions or hold periods.

9. Financial Statements

9.1 Except as specifically modified below, the financial statements of the Issuer and the Target Company to be included in the Disclosure Document must comply with the applicable provisions of Forms 3D1 or 3D2, as applicable.

9.2 Notwithstanding section 9.1, the Exchange cannot waive financial statement requirements in respect of any information circular filed in connection with a reverse takeover, as that term is defined in National Instrument 51-102. Issuers must therefore obtain such waivers from applicable Securities Commission(s).

9.3 Waivers

(a) Where the Exchange waives a requirement for audited financial statements because such audited financial statements are not otherwise required under applicable Securities Laws, it is the responsibility of the Issuer to ensure that the financial records of the Target Company are adequate and that sufficient audit procedures are performed to:

(i) enable an auditor to provide an unqualified opinion in connection with the Issuers' future financial statements; and

(ii) enable the Issuer to prepare audited financial statements in connection with any future Prospectus offering filings.

10. Other Requirements

10.1 Share Price

(a) The price for securities issued by an Issuer under or in conjunction with a COB or RTO must not be less than the Discounted Market Price.

(b) The exercise price of convertible securities under or in conjunction with a COB or RTO must not be less than the Market Price.

(c) The determination of price per security in this section is likely different than the determination of price for the purposes of the *pro forma* financial statements, as set forth at Section 9.1 of this Policy.

10.2 Stock Options

The Exchange will generally not accept for filing stock options granted in connection with a COB or RTO:

(a) until at least 30 days have passed since the Completion Date and at least ten trading days have passed since the day on which trading in the Issuer's securities resumes; or

(b) unless the exercise price is equivalent to or greater than the price of a concurrent financing (of which a significant percentage of the subscribers are at arm's length to the Issuer or Resulting Issuer) done in conjunction with the COB or RTO, and the issuance was disclosed in the Disclosure Document and any offering document.

10.3 Loans and Advances to Target Companies

Any proposed loans or advances of funds in excess of $25,000 in the aggregate, from the Issuer to the Target Company must receive Exchange acceptance prior to such funds being loaned or advanced to the Target Company.

10.4 Fees

Any finder's fees paid must comply with Policy 5.1 – *Loans, Bonuses, Finder's Fees and Commissions*.

10.5 Consulting Fees

The Exchange may seek the opinion of an independent engineer, appraiser or other expert in determining the reasonableness of a technical report, Geological Report, business valuation or other Expert Report filed with the Exchange. In such circumstances, the Exchange may require the Issuer or any Resulting Issuer to pay for the Exchange's costs.

10.6 Assessment of a Significant Connection to Ontario

Where, pursuant to an RTO, a Resulting Issuer will have a Significant Connection to Ontario, it must immediately notify the Exchange and make an application to be deemed a reporting issuer pursuant to section 19.2 of Policy 3.1 – *Directors, Officers, Other Insiders & Personnel and Corporate Governance*.

10.7 Delay and Inactivity

(a) If the Disclosure Document has not been sent to Shareholders within 75 days after the Initial Submission Date and, in the opinion of the Exchange, the delay is due to inactivity of the Issuer or the person filing the Initial Documents, the Exchange may:

(i) close its file as "not proceeded with" and require the Issuer to issue a news release with respect to the status of the proposed transaction; or

(ii) require that an updated Disclosure Document containing updated material facts and updated financial statements, Geological Reports, valuations or other reports be filed.

(b) If Post-Approval Documents required pursuant to subsection 5.10 have not been submitted to the Exchange within the time prescribed by the Exchange following the Shareholder approval, the Exchange may:

(i) require the Issuer or the Resulting Issuer to issue a news release explaining the delay; and/or

(ii) halt or suspend trading in the Shares of the Issuer or Resulting Issuer, pending filing of the Post-Approval Documents.

(c) Inactivity may be evidenced by the failure to make reasonable and timely efforts to provide acceptable responses to the comments of the Exchange.

10.8 Securities Laws

If applicable, Issuers and the Resulting Issuer must comply with NI 51-102 - *Continuous Disclosure Obligations* including the relevant provisions relating to changes in year end, changes of auditors, forward-looking information and future oriented financial information and financial outlooks. Acceptance for filing by the Exchange of a Disclosure Document should not be construed as assurance of compliance with these policies.

Review and acceptance for filing by the Exchange of any Disclosure Document prepared in connection with a COB or RTO or the issuance of an Exchange Bulletin confirming final acceptance should not be construed as assurance that the parties to the transaction are in compliance with applicable Securities Laws, including any registration or Prospectus exemption or disclosure requirements for a securities exchange take-over bid circular, offering memorandum or other disclosure document.

Parties to a COB or RTO are reminded of the restrictions under Securities Laws and Exchange Requirements when dealing with confidential information and trading in securities while in possession of such information. See Policy 3.1 - *Directors, Officers, Other Insiders & Personnel and Corporate Governance.*

TAB 21

Case Name:

Mecachrome Canada inc. (Re)

IN THE MATTER OF THE PLAN OF COMPROMISE OR ARRANGEMENT OF: MECACHROME CANADA INC., MECACHROME MONTRÉAL-NORD INC., MECACHROME TECHNOLOGIES INC. and MIRABEL-MECACHROME INC., Petitioners
and
ERNST & YOUNG INC. and SAMSON BÉLAIR DELOITTE & TOUCHE INC., Co-Monitors

[2009] Q.J. No. 16095

EYB 2009-164655

No.: 500-11-035041-082

Quebec Superior Court
District of Montreal

The Honourable Clément Gascon, J.S.C.

Heard: July 14 and 16, 2009.
Oral Judgment: July 16, 2009.
Reasons transcribed and revised: July 28, 2009.

(78 paras.)

Bankruptcy and insolvency law -- Companies' Creditors Arrangement Act matters -- Compromises and arrangements -- Proposals -- Many factors militated against granting the Motion as sought and approving the plan funding arrangement -- The evidence did not establish that a proper maximizing value process had been undertaken so as to justify approving the PFA as it stood -- At present, the terms of the PFA discouraged rather than invited the coming forward of other potential bidders -- The Court's assessment of the situation was that there is likely still margin to do better -- Motion dismissed.

Motion by Mecachrome Canada inc. (Mecachrome) to approve a plan funding agreement (PFA) entered into between Mecachrome, the DIP Lenders and Mecadev SAS, a newly formed entity to remain under the control of the DIP Lenders -- The goal was to enable the restructuring of Mecachrome's affairs by preparing, negotiating and implementing a plan of arrangement with their

creditors -- - The PFA set out the terms and conditions on which the DIP Lenders proposed to fund a plan of compromise or arrangement to be implemented pursuant to the Companies' Creditors Arrangement Act in respect of Mecachrome -- Under the PFA and the Proposed Plan, the DIP Lenders would acquire all the shares of Mecachrome International Inc. (MII) -- In consideration, they undertook to pay to MII approximately Euros 55,000,000, of which some Euros 30,000,000 would serve for distribution purposes to the unsecured creditors of Mecachrome -- MII issued Euros 200,000,000 of senior subordinated notes in 2006 -- The holders of these notes represented by far the largest group of unsecured creditors in the CCAA proceedings -- The Ad Hoc Committee of note holders contested the motion -- It argued that the DIP Lenders had chosen to unilaterally put forward a PFA which did not have their support as key stakeholder and which are premised upon an untested offer -- HELD: Motion dismissed -- Many factors militated against granting the Motion as sought and approving the PFA -- The cumulative effect of the absence of any legitimate and open process in order to obtain funding proposals beyond those of the DIP Lenders or the Ad Hoc Committee after May 15, 2009, the narrow definition of what constituted a Superior Proposal under the PFA and the lack of flexibility given to the Board of Directors of MII in qualifying a proposal as a Superior Proposal or in considering or recommending such, and the chilling effect of the rather high break fee contemplated in the PFA, forced the conclusion that the arguments of the Ad Hoc Committee's Contestation had to prevail -- The evidence did not establish that a proper maximizing value process had been undertaken so as to justify approving the PFA as it stood -- At present, the terms of the PFA discouraged rather than invited the coming forward of other potential bidders -- The Court's assessment of the situation was that there is likely still margin to do better.

Statutes, Regulations and Rules Cited:

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

Counsel:

Me Sylvain Rigaud, Ogilvy, Renault, Attorneys for Petitioners.

Me Jean Fontaine, Stikeman Elliott, Attorneys for Go-Monitors.

Me Sylvain Vauclair, McCarthy, Tétrault, Attorneys for "Fonds de Solidarité des travailleurs du Québec (F.T.Q.), FCRP Aerofund et FCRP Aerofund Il, représentés par Société de gestion ACE Management), prêteurs temporaires".

Me Fred Myers and Me Brendan O'Neill, Goodmans LLP and Me Jonathan Warin, Lavery, De Billy, Attorneys for "Comité ad hoc des détenteurs de billets".

Me Gordon Levine, Kugler, Kandestin, Attorneys for Bank of New York Mellon (formerly "Bank of New York") and BNY Trust Company of Canada.

Me Francis Meagher and Me Guillaume Hébert, Marchand Melançon Forget, Attorneys for General Electric Canada Equipment Finance G.P.

Me Kurt A. Johnson, Irving Mitcheli Kalichman LLP, Attorneys for Makino, Inc. et SST-Canada, ULC.

REASONS FOR JUDGMENT
ON MOTION TO APPROVE A PLAN FUNDING AGREEMENT (#59)
THE MOTION AT ISSUE

1 The Court renders judgment on a Motion to Approve a Plan Funding Agreement. The reasons are delivered in the English language as the Motion, the Exhibits, the Monitor's Report and the Contestation involved are all drafted in that language.

2 While the Court was ready to render judgment on July 5, at the request of the parties' Counsel, the delivery of these reasons was postponed for 24 hours in view of their ongoing discussions.

3 By their Motion dated July 7, 2009, Mecachrome International Inc. (MII), Mecachrome Canada Inc., Mecachrome Montréal-Nord Inc., Mecachrome Technologies Inc. and Mirabel Mecachrome Inc. (collectively, the Canadian Debtors), ask the Court to issue an order approving a Plan Funding Agreement (the PFA) entered into between MII and FCPR Aerofund, FCPR Aerofund II, the Fonds de solidarité des travailleurs du Québec FTQ (together, the DIP Lenders) and Mecadev SAS, a newly formed entity to remain under the control of the DIP Lenders.

4 The original PFA at issue, dated July 4, 2009[1], was amended during the second phase of oral arguments, namely on July 14, 2009, and replaced by another one, this time dated July 13, 2009[2].

5 The Motion is filed pursuant to a restructuring process initiated on December 12, 2008, whereby the Canadian Debtors applied to the Court for the issuance of an initial order under Sections 4, 5 and 11 of the CCAA[3].

6 The goal was to enable the restructuring of their affairs by preparing, negotiating and implementing a plan of arrangement with their creditors. The Canadian Debtors were then - and are still - operating at a deficit and facing serious liquidity problems.

7 On that same day, the subsidiaries of MII incorporated in France, that is, Mecachrome France SAS and Mecachrome SAS (the French Debtors), also applied for the commencement of a parallel safeguard procedure in France.

THE PFA

8 The PFA referred to in the Motion sets out the terms and conditions on which the DIP Lenders propose to fund a plan of compromise or arrangement (the Proposed Plan), to be implemented pursuant to the CCAA in respect of the Canadian Debtors and their creditors.

9 In short, the PFA as amended provides for:

a) the execution and implementation of the restructuring transactions agreed upon in the Proposed Plan attached as Schedule A to the PFA;
b) the DIP Lenders to act as sponsors for the funding;
c) MII agreeing to undertake, upon request by the DIP Lenders, a corporate reorganization of the business, operations and assets of the company and its subsidiaries, but only after the vote of the creditors on the Proposed Plan and the sanction order of the Court;
d) the possibility for MII to consider, negotiate and ultimately accept a proposal which is a Superior Proposal, from a financial point of view, to the one provided in the PFA. In such a case, the DIP Lenders have the right to offer to amend the terms of the PFA to match the Superior Proposal within

a five-day period. If they elect not to match such Superior Proposal, MII has the right to terminate the PFA, but will be required to pay a break fee;

e) other events giving rise to the right to receive a break fee, including breach of specified covenants and failure of the Board of Directors of MII to recommend approval of the Proposed Plan;

f) MII's obligation to pay to the DIP Lenders all fees and expenses incurred in connection with the DIP loan agreement and the transaction contemplated by the PFA and all transactions related thereto if the Proposed Plan is not approved by the creditors;

g) a number of conditions precedent to closing, including obtaining the required creditors' support and Canadian Court approval, all required appropriate regulatory approvals, consents from certain third parties under the company's contracts, renegotiation of certain agreements, and absence of material adverse change.

10 Under the PFA and the Proposed Plan, the DIP Lenders will acquire all the shares of MII. In consideration, they undertake to pay to MII, through Mecadev, approximately Euros 55,000,000, of which some Euros 30,000,000 will serve for distribution purposes to the unsecured creditors of the Canadian Debtors. The other Euros 25,000,000 will essentially be used to repay the DIP loan advances, the Bank Syndicate's secured loan, the claims of a specific creditor and the fees and disbursements of the transaction.

11 For the DIP Lenders, the PFA is equivalent to an acquisition proposal of the business of MII, as the Monitor points out at paragraph 30 of his Fifth Report.

12 For the unsecured creditors of the Canadian Debtors, the Proposed Plan arising there from would entail a recovery of about 12% of their claims.

THE CONTESTATION

13 The record shows that MII issued Euros 200,000,000 of senior subordinated notes (the Notes) in May 2006, guaranteed by the Canadian Debtors and the French Debtors.

14 An Ad Hoc Committee of Holders of the Notes is actively involved in the restructuring process. It represents by far the largest group of unsecured creditors in the CCAA proceedings. The members of the Ad Hoc Committee hold approximately 70% of the Notes. The Noteholders are the unsecured creditors who will most significantly have to bear the losses arising from this CCAA restructuring.

15 The Ad Hoc Committee contests the Motion at issue. In a nutshell, they consider that the DIP Lenders:

a) have unilaterally put forward a pre-emptive PFA under which they propose to take ownership 0f 100% of MII;

b) have sought to do so in the absence of a Court-approved marketing process being conducted to confirm the fairness of the consideration they are offering;

c) rather than inviting negotiations and a fair process, seek to prevent MII from truly negotiating further any other reasonable arrangement;

d) seek a break fee and expense reimbursement despite the absence of a fair process and knowing that their Proposed Plan, as currently drafted, does not have the support of key stakeholder, that is, the Noteholders they represent.

16 While, so they say, open to achieve a consensual restructuring solution for the Canadian Debtors, the Ad Hoc Committee argues that the DIP Lenders have chosen to unilaterally put forward a PFA and Proposed Plan which do not have their support as key stakeholder and which are premised upon an untested offer.

17 Their clear and unambiguous intention, reiterated during oral argument, is to veto the Proposed Plan arising from the PFA.

18 The Canadian Debtors reply that under the special circumstances of this case:

a) time 5 of the essence and they need to proceed forthwith to a vote by the unsecured creditors on the Proposed Plan;
b) to that end, the PFA remains the best and, indeed, the only available funding arrangement received so far for the presentation of any kind of plan of arrangement to the unsecured creditors;
c) the matter should be put to a vote of the unsecured creditors, in the interest of ail stakeholder involved;
d) the Monitor supports the PFA, even more so in its amended format.

19 Of course, the Monitor and the DIP Lenders support the argument of the Canadian Debtors.

ANALYSIS AND DISCUSSION

20 For a restructuring process that has started barely six months ago, it is quite unfortunate to see that key stakeholder, such as the DIP Lenders and the Ad Hoc Committee of Noteholders, have chosen to crystallize their respective position and not to pursue more constructive dialogue together.

21 They both appear to have lost sight of the fact that neither one will be able to achieve any reasonable and acceptable solution to this restructuring without the cooperation of the other.

22 In his wisdom, the Monitor had warned both of these parties along these lines at paragraph 41 of his Fourth Report of June 26, 2009, apparently to no avail, or at the very least, with not much success. Neither the DIP Lenders nor the Ad Hoc Committee appear to have paid attention to his remarks.

23 On the one hand, the DIP Lenders' approach of presenting the initial PFA and the Proposed Plan as a "take it or leave it" proposal, not open to discussion or negotiation, certainly appears questionable. Even more so when one now realizes that, faced with the articulated contestation of the Ad Hoc Committee and their line of questions to the Monitor, the DIP Lenders have finally decided to amend their PFA during the second phase of oral arguments, so as to tone down what was said to be irrevocable.

24 No doubt such change of heart would have been far more beneficial to the whole process if done earlier rather than at the very last minute. Very precious days, if not weeks, have been lost as a result. This does not enhance the credibility of the process adopted towards the conclusion of the PFA.

25 On the other hand, the Ad Hoc Committee's Contestation seems to forget the high risks involved with their position. They consider that the PFA, even as amended, remains unacceptable. Yet, their Contestation may end up in an absence of any reasonable arrangement and thus, in a liquidation of the Canadian Debtors and an even smaller recovery for the Noteholders compared to the one contemplated in the PFA and the Proposed Plan.

26 The Ad Hoc Committee does raise legitimate objections, but they do not appear to bring much to the table in terms of concrete or reasonable solution at this stage.

27 Be that as it may, the parties and their learned Counsel and financial advisors have elected to rely on this Court's judgment to sort out what, in all due respect, they should have solved together through reasonable concessions and compromises.

28 In so doing, through their respective Motion and Contestation, they ask the Court to decide which of the two (2) conflicting positions should prevail. There is no inbetween. Either the Motion is well founded or the Contestation is. The Court cannot change the terms of the PFA at the centre of this debate. This negotiation belongs to the parties, not to the Court.

29 To rule upon this issue, the Court must exercise the powers given in this respect by the relevant provisions of the CCAA. This includes notably the exorcise of its judicial discretion and inherent jurisdiction, the whole in furtherance of the objectives of the Act.

30 As this Court already stated before, the fundamental goal of the CCAA is found in its very title, that is an Act to facilitate compromises and arrangements between companies and their creditors. It is aimed at enabling a debtor company, with the support of its creditors, to weather its financial difficulties and continue to operate in the interest of all interveners and society in general.

31 The manner in which the CCAA favours this objective is through the conclusion of a plan of arrangement approved by minimum levels of majority of creditors, in number and in value. Of course, this objective must be reached at the best cost and on the best possible conditions for the creditors who inevitably suffer the consequences.

32 In the Court's assessment of the situation as it stands today, the probabilities of achieving this fundamental goal of the CCAA appears to be better served by refusing to approve the PFA presented rather than by tying the hands of the Canadian Debtors in the manner entailed by such PFA.

33 In a situation like this one, where the Court is asked to approve and give its blessing to a PFA leading to a Proposed Plan pursuant to which the DIP Lenders will end up acquiring MII, a CCAA restructuring requires the Canadian Debtors and the Monitor to satisfy the Court that they have proceeded in a manner where the transparency, integrity, credibility and fairness of the process is beyond reproach.

34 Notwithstanding the clear efforts of the Canadian Debtors and the Monitor, the Court considers that this not the case here. Too many factors militate against granting the Motion as sought and approving the PFA as it stands, even in its amended format.

35 In the Court's opinion, the cumulative effect of a) the absence of any legitimate and open process in order to obtain funding proposals beyond those of the DIP Lenders or the Ad Hoc Committee after May 15, 2009, b) the narrow definition of what constitutes a Superior Proposal under the PFA and the lack of flexibility, if any, given to the Board of Directors of MII in qualifying a proposal as a Superior Proposal or in considering or recommending such, and, c) the chilling effect

of the rather high break fee contemplated in the PFA, forces the conclusion that the arguments of the Ad Hoc Committee's Contestation must prevail.

36 To rule otherwise would pay scant respect to the need for a sufficient, transparent and open process before a Court sanctions the potential acquisition of the whole business in the context of a CCAA restructuring.

37 As well, to allow the process contemplated by the PFA to move forward with no additional amendments will somehow usurp the key exercise of the right to vote belonging to the creditors under the CCAA. The Court is of the view that, as it stands now, the PFA unnecessarily ties up the hands of the Canadian Debtors with respect to the consideration of potentially available alternate solutions that, in the end, could benefit the affected creditors.

38 This is wrong and should not be condoned lightly. Some explanations are called for.

39 First, the Court agrees that the evidence does not establish that a proper maximizing value process has been undertaken so as to justify approving the PFA as it stands now.

40 In fact, short of the DIP Lenders and the Ad Hoc Committee, neither the Canadian Debtors, nor the Monitor or anyone else have apparently interested any other entity in funding an arrangement.

41 The lack of any steps taken towards that end appears to be linked to the short time frame allegedly available and the exclusivity clause of the DIP financing agreement that was extended to May 15, 2009. In the context of what is equivalent to an acquisition proposal of the business, this is hardly acceptable.

42 The evidence indicates that as recently as last December 2008, prior to agreeing to a DIP financing arrangement under very difficult circumstances, the Canadian Debtors still canvassed no less 23 potential parties before making a final choice.

43 While the interest shown then remained very sketchy, as only two (2) proposals were received, the following key changes however took place since that time:

a) a well-organized data room pertaining to the business and its financial information has been set up, after what appears to have been a lot of work by many;
b) there 15 a new CEC and a new CFD now in charge of the business;
c) significant downsizing of the business has taken place since the beginning of the CCAA process;
d) a new business plan has been prepared by MII in May 2009.

44 In view of this, it is hard to understand why no steps were taken in order to interest any other parties in funding a potential arrangement. The impression given by the evidence offered is that the focus was limited solely to the DIP Lenders and the Ad Hoc Committee, and nothing else. The Monitor's Fifth Report seems to confirm that, apparently, it would have been unworkable to proceed otherwise.

45 As stated, albeit in a different but still similar context, by the Ontario Court of Appeal in Soundair[4], by the Ontario Superior Court of Justice in Tiger Brand Knitting[5], by the Alberta Court of Queen's Bench in Calpine[6], and by this Court in Boutiques Euphoria[7], in a process such as this one, there has to be some demonstration by the Canadian Debtors that reasonable attempts have been

made to properly canvass the market before approving a PFA that is, in essence, presented to the affected creditors as the best available deal under the circumstances.

46 To that end, the PFA, which is aimed at acquiring all the shares of MII with a right to match any competing offer and a break fee should a Superior Proposal be accepted, closely resembles a stalking horse bid process with no real canvassing of the market at any point in time, be it prior to its finalization or after its approval.

47 The inclusion of an exclusivity clause of limited duration in the DIP financing agreement may have given a head start to the DIP Lenders in any acquisition proposal scenario. However, in the Court's opinion, it did not, and could not, have the impact of relieving the Canadian Debtors and the Monitor of their duty and obligations towards all the other stakeholder.

48 A CCAA process does insulate a debtor company from the attacks of its creditors. However, at the same time, the Act places the process under the Court's supervision. This has meaning and consequences. The benefits that the Act gives to a debtor company do not exist without corresponding obligations, particularly in terms of fairness, transparency and openness towards all stakeholder.

49 The mere fact that, here, these obligations must be met and the results achieved, and rightly so, within a very tight time frame does not entail that these duties could or should be ignored.

50 From that standpoint, even though the DIP Lenders have finally decided, at the last hour, to withdraw their exclusivity clause requirements, it remains that the narrow definition of what constitutes a Superior Proposal seriously limits the possibility of even seeing other bidders involved once the PFA is approved. In other words, because of the content of the PFA as it stands now, once it is approved as sought, it appears unlikely that any kind of transparent and open process will follow.

51 The situation would no doubt have been worse with the exclusivity clause initially included in the PFA. The clause has now been removed. Yet, under the PFA, the conditions precedent to a Superior Proposal being qualified as such and the lack of flexibility of the Board of Directors of MII towards any proposal other than the PFA render quite unlikely the remote possibility of the Canadian Debtors seeing any other proposal once the PFA at issue is approved.

52 From that perspective, if the PFA is truly the best available funding arrangement under the circumstances, it is difficult to understand why the definition of Superior Proposal had to be 50 narrowly construed and why the MII Board of Directors' powers of recommendation so precisely limited, mostly when one sees that the DIP Lenders have the opportunity to match any Superior Proposal within five days.

53 At present, the terms of the PFA discourage rather than invite the coming forward of other potential bidders.

54 Contrary to what the Canadian Debtors argued, the issue is not whether the MII Board of Directors will likely consider or not a Superior Proposal received, even though their flexibility is very limited in that regard. The issue is rather whether or not the PFA as drafted does indeed favour any Superior Proposal coming forward because of its narrow and convoluted definition.

55 Second, while no doubt serious, the alleged urgency and need to proceed quickly to a vote of the unsecured creditors on the Proposed Plan on the basis of the PFA appears to be somewhat qualified. While no less than a few days ago, the PFA was being presented to the Court as a "take it or

leave it" proposal, no terms of which could be modified, time has rather shown that even that initial PFA was not yet a fully matured and final proposal.

56 Faced with strong opposition by the Ad Hoc Committee 0f the Noteholders, the DIP Lenders first renounced to the rather unrealistic tight time frame they were insisting upon in their initial PFA. Then, they finally withdrew the gist of the exclusivity requirements that the Monitor himself had considered inappropriate for some time, to the knowledge of the DIP Lenders.

57 Furthermore, faced with the criticism regarding its level, they slightly reduced the amount of their break fee. Finally, they clarified the ambiguities concerning the pre-acquisition proposal clauses and the application of the break fee and fee and expenses clauses.

58 Considering the position voiced initially by the DIP Lenders, it appears obvious that none of this would have taken place without the benefit of the Contestation of the Ad Hoc Committee. That Contestation was triggered by the Canadian Debtors' Motion and the corresponding need to satisfy the Court as to the reasonability of the PFA conditions, including the integrity and transparency of the process leading to it.

59 In this respect, the additional delays caused so far by the Contestation have enhanced rather than hurt the process by allowing at the very least some problematic clauses of the PFA to be withdrawn or qualified.

60 Third, turning to the break fee, the Court agrees with the Ad Hoc Committee's submission that the amount proposed appears disproportionate to the amount that the DIP Lenders are putting on the table for the Canadian Debtors' plan of arrangement.

61 Under the PFA, the DIP Lenders undertake to pay through Mecadev Euros 55,000,000 to MII. The proposed break fee, as reduced, is Euros 2,500,000, which s about 4.5% of the Euros 55,000,000 offered.

62 Based on the evidence presented to the Court, this appears excessive. In the chart of break fees attached to the Motion[8], the average break fee, in a merger and acquisition scenario, is about 2.9%. Also, no precedent involving similar break fees in the context of a restructuring process has been offered to the Court.

63 Finally, according to the evidence, the amount of the break fee is at least twice the amount of real expenses incurred so far by the DIP Lenders under the PFA process. Accordingly, it does include some sort of a risk premium or effort premium of some magnitude.

64 The burden of showing that the break fee is reasonable rests upon the Canadian Debtors. The evidence in support thereof is sketchy at best. This is not an issue that one should consider lightly in the context of a CCAA restructuring supervised by a Court, whereby the unsecured creditors, who are already suffering the consequences of the restructuring as here, end up in reality paying the cost of such break fee.

65 Fourth, the Court considers that the other arguments that the Canadian Debtors insisted upon are not convincing under the circumstances.

66 On the one hand, while the approval and support of the Monitor remains an important factor, it is not decisive in and of itself.

67 Here, the Monitor is faced with nothing else and reasonably fears that the process may be going to a dead end without the PFA. Admittedly, this is not an easy situation. Yet, in the Court's

view, it is no reason to close one's eyes towards a process that appears to be submitted as a "fait accompli" under the PFA.

68 On the other hand, the argument voiced often by the Canadian Debtors and the Monitor, to the effect of letting the matter go to a vote on the Proposed Plan by the unsecured creditors, does not answer the problem truly at issue here.

69 The Court is asked to approve and give its blessing to the PFA. Once the PFA is approved, there is no going back. The creditors will not be in a position to change its terms, if alone, with respect notably to the narrow definition of a Superior Proposal, the lack of flexibility given to the Board of Directors of MII in terms of recommendations, and the applicability of the break fee. Letting the matter go to a vote on the Proposed Plan will not deal with these issues at any point in time.

70 In this regard, the Stelco decision[9] relied upon by the Canadian Debtors and the DIP Lenders is of no assistance. In that case, the decision to send the matter to a vote notwithstanding the opposition voiced was reached in a different context.

71 The process involved had been going on for twenty some months. Prior plans had been presented and had failed. No one had any formal or decisive veto like here. The Court was of the view that the plan was not doomed to fail and that the break fee was reasonable. The process was neither at issue.

72 In this case, this is not so.

73 The position voiced by the Ad Hoc Committee suffers no ambiguity. It should not be discarded lightly. No one has suggested that they have any other ulterior motive than to try to obtain the best possible value for their claims within the best available process and through the best efforts.

74 It is not with happiness that the Court concludes that it cannot approve the PFA as it stands today. No one knows if time or a more open process will lead to a better result. However, this uncertainty is insufficient to approve the process leading to the PFA and the PFA as it stands.

75 To paraphrase the Ad Hoc Committee's submission, approval of the PFA on the terms proposed would limit the flexibility and optionality of the process at a time when, given that the DIP Lenders' PFA has not been tested and is not supported by key stakeholder, the process does require flexibility, optionality and credibility.

76 All in all, the Court's assessment of the situation is that there is likely still margin to do better. The behaviour of the DIP Lenders and the amended PFA are silent testimony in support of that assertion.

FOR THESE REASONS GIVEN VERBALLY AND REGISTERED, THE COURT:

77 DISMISSES the Motion;

78 COSTS TO FOLLOW.

CLEMENT GASCON, J.S.C.

cp/s/qlcys/qlvls/qlcla

1 Exhibit R-1.

2 Exhibit R-1A.

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

4 Royal Bank v. Soundair Corp., (1991), 7 C.B.R. (3d) 1 (Ont. C.A.), at para 16.

5 Tiger Brand Knitting Co., Re, (2005) 9 C.B.R. (5th), 315 (Ont. S.C.J. [Commercial List]), leave to appeal refused (2005), 19 C.B.R. (5th) 53 (Ont. C.A.).

6 Calpine Canada Energy Limited (Companies' Creditors Arrangements Act), 2007 ABQB 49.

7 Boutique Euphoria (In the Matter of the Compromise or Arrangement of), S.C. Montréal, [2007] J.Q. no 20435, no 500-11-030746-073, 2007-07-19, Gascon J.

8 Exhibit R-2.

9 Stelco Inc., Re, 2005 CanLII 36272 (ON S.C.); Stelco Inc., Re, (2005), 15 C.B.R. (5th) 288, 2005 CanLII 40140 (ON C.A.).

TAB 22

Case Name:

Stelco Inc. (Re)

IN THE MATTER OF the Companies' Creditors Arrangement Act, R.S.C., c. C-36, as amended
AND IN THE MATTER OF a proposed plan of compromise or arrangement with respect to Stelco Inc., and other Applicants listed in Schedule "A"*
[* Editor's note: Schedule "A" was not attached to the copy received from the Court and therefore is not included in the judgment.]
APPLICATION UNDER the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended

[2005] O.J. No. 1171

75 O.R. (3d) 5

253 D.L.R. (4th) 109

196 O.A.C. 142

2 B.L.R. (4th) 238

9 C.B.R. (5th) 135

138 A.C.W.S. (3d) 222

2005 CarswellOnt 1188

2005 CanLII 8671

Docket: M32289

Ontario Court of Appeal
Toronto, Ontario

S.T. Goudge, K.N. Feldman and R.A. Blair JJ.A.

Heard: March 18, 2005.

Judgment: March 31, 2005.

(79 paras.)

Creditors & debtors law -- Legislation -- Debtors' relief -- Companies' Creditors Arrangement Act -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Civil procedure -- Courts -- Jurisdiction -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Civil procedure -- Courts -- Superior courts -- Inherent jurisdiction -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Corporations and associations law -- Corporations -- Directors -- Appointment or election -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Corporations and associations law -- Corporations -- Directors -- Duties -- Business judgment rule -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Corporations and associations law -- Corporations -- Directors -- Duties -- Fiduciary duties -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Insolvency law -- Proposals -- Court approval -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Administrative law -- Natural justice -- Reasonable apprehension of bias -- Appeal from endorsement reported at [2005] O.J. No. 729 and reasons for judgment reported at [2005] O.J. No. 730 allowed.

Application by two former directors of Stelco for leave to appeal and appeal from the order of their removal from the board of directors. Stelco was engaged in an extensive economic restructuring while under statutory insolvency protection that involved court-appointed capital raising via a competitive bid process. The appellants were involved with two companies that purchased approximately 20 per cent of Stelco's publicly traded shares during the protection period and were subsequently appointed to its board of directors to fill vacancies caused by resignations. As part of the appointment process, the appellants were informed of their fiduciary duties and agreed that their companies would have no further involvement in the competitive bid process. Stelco's employees sought the appellants' removal from the board on the basis that the participation of two major shareholder representatives would tilt the evaluation of the bids in favour of maximizing shareholder value at the expense of bids more favourable to the interests of the employees. The motions judge held that the involvement of the appellants on the board raised an unnecessary risk that their future conduct potentially jeopardized the integrity and neutrality of the capital raising process, and

declared the appointments to be of no force and effect. The judge cited the inherent jurisdiction of the court as the basis for the order. The appellants submitted that the judge had no jurisdiction to make a removal order, and in the alternative, he erred in applying a reasonable bias test to the removal of directors. The appellants further submitted that the judge erred by interfering with the board's exercise of business judgment, and that the facts did not justify the removal order.

HELD: Application for leave and appeal allowed. The judge misconstrued his authority, and made an order that he was not empowered to make. The court had no statutory or inherent authority to interfere with the composition of the board of directors. The judge erred in declining to give effect to the business judgment rule, and was not entitled to usurp the role of the directors and management in conducting the company's restructuring efforts. The record did not support a finding that there was sufficient risk of misconduct to warrant a conclusion of oppression, nor was the level of such risk assessed. There was no statutory principle that envisaged screening the neutrality of the appellants in advance of their appointment to the board of Stelco. Legal remedies were available to the employees of Stelco in the event that the appellants engaged in conduct that breached their legal obligations to the corporation. The applicability of such remedies was dependent on actual misconduct rather than mere speculation. Therefore, an apprehension of bias approach was not appropriate in the corporate law context.

Statutes, Regulations and Rules Cited:

Canada Business Corporations Act ss. 1, 102, 106(3), 109(1), 111, 122(1)(a), 122(1)(b), 145, 145(2)(b), 241, 241(3)(e)

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36 As Amended, ss. 11, 11(1), 11(3), 11(4), 11(6), 20

Appeal From:

Application for Leave to Appeal, and if leave be granted, an appeal from the order of Farley J. dated February 25, 2005 removing the applicants as directors of Stelco Inc., reported at: [2005] O.J. No. 729.

Counsel:

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

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

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

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

John R. Varley, for the Active Salaried Employee Representative

Michael Barrack, for Stelco Inc.

Peter Griffin, for the Board of Directors of Stelco Inc.

K. Mahar, for the Monitor

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

The judgment of the Court was delivered by

R.A. BLAIR J.A.:--

PART I - INTRODUCTION

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

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

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

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

> After careful consideration, and given potential recoveries at the end of the company's restructuring process, the Board responded favourably to the requests by making the appointments announced today.
>
> Richard Drouin, Chairman of Stelco's Board of Directors, said: "I'm pleased to welcome Roland Keiper and Michael Woollcombe to the Board. Their experience and their perspective will assist the Board as it strives to serve the best interests of all our stakeholders. We look forward to their positive contribution."

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

6 The appointments of the appellants to the Board incensed the employee stakeholders of Stelco ("the Employees"), represented by the respondent Retired Salaried Beneficiaries of Stelco

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

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

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

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

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

PART II - ADDITIONAL FACTS

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

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

13 Messrs. Woollcombe and Keiper had been accumulating shares in Stelco and had been participating in the CCAA proceedings for some time before their request to be appointed to the Board,

through their companies, Clearwater and Equilibrium. Clearwater and Equilibrium are privately held, Ontario-based, investment management firms. Mr. Keiper is the president of Equilibrium and associated with Clearwater. Mr. Woollcombe is a consultant to Clearwater. The motion judge found that they "come as a package."

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

15 On November 9, 2004, Clearwater and Equilibrium announced they had formed an investor group and had made a capital proposal to Stelco. The proposal involved the raising of $125 million through a rights offering. Mr. Keiper stated at the time that he believed "the value of Stelco's equity would have the opportunity to increase substantially if Stelco emerged from CCAA while minimizing dilution of its shareholders." The Clearwater proposal was not accepted.

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

17 Subsequently, over a period of two and a half months, the shareholding position of Clearwater and Equilibrium increased from approximately 5% as at November 19, to 14.9% as at January 25, 2005, and finally to approximately 20% on a fully diluted basis as at January 31, 2005. On January 25, Clearwater and Equilibrium announced that they had reached an understanding jointly to pursue efforts to maximize shareholder value at Stelco. A press release stated:

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

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

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

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

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

a) Mr. Woollcombe would no longer be an advisor to Clearwater and Equilibrium with respect to Stelco;
b) Clearwater and Equilibrium would no longer be represented by counsel in the CCAA proceedings; and
c) Clearwater and Equilibrium then had no involvement in, and would have no future involvement, in any bid for Stelco.

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

22 Seven days later, the motion judge found it "appropriate, just, necessary and reasonable to declare" those appointments "to be of no force and effect" and to remove Messrs. Woollcombe and Keiper from the Board. He did so not on the basis of any actual conduct on the part of the appellants as directors of Stelco but because there was some risk of anticipated conduct in the future. The gist of the motion judge's rationale is found in the following passage from his reasons (at para. 23):

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

and W conducted themselves beyond reproach but with the Board continuing to be concerned that they not do anything seemingly offensive to the bloc. The risk to the process and to Stelco in its emergence is simply too great to risk the wait and see approach.

PART III - LEAVE TO APPEAL

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

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

a) whether the point on appeal is of significance to the practice;
b) whether the point is of significance to the action;
c) whether the appeal is prima facie meritorious or frivolous;
d) whether the appeal will unduly hinder the progress of the action.

25 Counsel agree that (d) above is not relevant to this proceeding, given the expedited nature of the hearing. In my view, the tests set out in (a) - (c) are met in the circumstances, and as such, leave should be granted. The issue of the court's jurisdiction to intervene in corporate governance issues during a CCAA restructuring, and the scope of its discretion in doing so, are questions of considerable importance to the practice and on which there is little appellate jurisprudence. While Messrs. Woollcombe and Keiper are pursuing their remedies in their own right, and the company and its directors did not take an active role in the proceedings in this court, the Board and the company did stand by their decision to appoint the new directors at the hearing before the motion judge and in this court, and the question of who is to be involved in the Board's decision making process continues to be of importance to the CCAA proceedings. From the reasons that follow it will be evident that in my view the appeal has merit.

26 Leave to appeal is therefore granted.

PART IV - THE APPEAL

The Positions of the Parties

27 The appellants submit that,

a) in exercising its discretion under the CCAA, the court is not exercising its "inherent jurisdiction" as a superior court;
b) there is no jurisdiction under the CCAA to remove duly elected or appointed directors, notwithstanding the broad discretion provided by s. 11 of that Act; and that,
c) even if there is jurisdiction, the motion judge erred:

(i) by relying upon the administrative law test for reasonable apprehension of bias in determining that the directors should be removed;
(ii) by rejecting the application of the "business judgment" rule to the unanimous decision of the Board to appoint two new directors; and,
(iii) by concluding that Clearwater and Equilibrium, the shareholders with whom the appellants are associated, were focussed solely on a short-term investment horizon, without any evidence to that effect, and therefore concluding that there was a tangible risk that the appellants would not be neutral and act in the best interests of Stelco and all stakeholders in carrying out their duties as directors.

28 The respondents' arguments are rooted in fairness and process. They say, first, that the appointment of the appellants as directors has poisoned the atmosphere of the CCAA proceedings and, secondly, that it threatens to undermine the even-handedness and integrity of the capital raising process, thus jeopardizing the ability of the court at the end of the day to approve any compromise or arrangement emerging from that process. The respondents contend that Farley J. had jurisdiction to ensure the integrity of the CCAA process, including the capital raising process Stelco had asked him to approve, and that this court should not interfere with his decision that it was necessary to remove Messrs. Woollcombe and Keiper from the Board in order to ensure the integrity of that process. A judge exercising a supervisory function during a CCAA proceeding is owed considerable deference: Algoma Steel Inc. (2001), 25 C.B.R. (4th) 194, at para. 8.

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

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

30 The respondents submit that fairness, and the perception of fairness, underpin the CCAA process, and depend upon effective judicial supervision: see Olympia & York Development Ltd. v. Royal Trust (1993), 12 O.R. (3d) 500 (Gen. Div.); Re Ivaco Inc., (2004), 3 C.B.R. (5th) 33, at para. 15-16. The motion judge reasonably decided to remove the appellants as directors in the circumstances, they say, and this court should not interfere.

Jurisdiction

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

32 The CCAA is remedial legislation and is to be given a liberal interpretation to facilitate its objectives: Babcock & Wilcox Canada Ltd. (Re), [2000] O.J. No. 786 (Sup. Ct.) at para. 11. See also, Re Chef Ready Foods Ltd. (1990), 4 C.B.R. (3d) 311 (B.C.C.A.) at p. 320; Re Lehndorff General Partners Ltd. (1993), 17 C.B.R. (3d) 24 (Ont. Gen. Div.). Courts have adopted this approach in the past to rely on inherent jurisdiction, or alternatively on the broad jurisdiction under s. 11 of the CCAA, as the source of judicial power in a CCAA proceeding to "fill in the gaps" or to "put flesh on the bones" of that Act: see Re Dylex Ltd. (1995), 31 C.B.R. (3d) 106 (Ont. Gen Div. [Commercial List]), Royal Oak Mines Inc. (Re) (1999), 7 C.B.R. (4th) 293 (Ont. Gen Div. [Commercial List]); and Westar Mining Ltd. (Re) (1992), 70 B.C.L.R. (2d) 6 (B.C.S.C.).

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

Inherent Jurisdiction

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

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

35 In spite of the expansive nature of this power, inherent jurisdiction does not operate where Parliament or the Legislature has acted. As Farley J. noted in Royal Oak Mines, supra, inherent jurisdiction is "not limitless; if the legislative body has not left a functional gap or vacuum, then inherent jurisdiction should not be brought into play" (para. 4). See also, Baxter Student Housing Ltd. v. College Housing Cooperative Ltd., [1976] 2 S.C.R. 475 (S.C.C.) at 480; Richtree Inc. (Re), [2005] O.J. No. 251 (Sup. Ct.).

36 In the CCAA context, Parliament has provided a statutory framework to extend protection to a company while it holds its creditors at bay and attempts to negotiate a compromised plan of arrangement that will enable it to emerge and continue as a viable economic entity, thus benefiting society and the company in the long run, along with the company's creditors, shareholders, employees and other stakeholders. The s. 11 discretion is the engine that drives this broad and flexible statutory scheme, and that for the most part supplants the need to resort to inherent jurisdiction. In

that regard, I agree with the comment of Newbury J.A. in Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., [2003] B.C.J. No. 1335 (B.C.C.A.), (2003) 43 C.B.R. (4th) 187 at para. 46, that:

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

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

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

38 I do not mean to suggest that inherent jurisdiction can never apply in a CCAA context. The court retains the ability to control its own process, should the need arise. There is a distinction, however - difficult as it may be to draw - between the court's process with respect to the restructuring, on the one hand, and the course of action involving the negotiations and corporate actions accompanying them, which are the company's process, on the other hand. The court simply supervises the latter process through its ability to stay, restrain or prohibit proceedings against the company during the plan negotiation period "on such terms as it may impose."[3] Hence the better view is that a judge is generally exercising the court's statutory discretion under s. 11 of the Act when supervising a CCAA proceeding. The order in this case could not be founded on inherent jurisdiction because it is designed to supervise the company's process, not the court's process.

The Section 11 Discretion

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

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

Powers of court	11(1) Notwithstanding anything in the Bankruptcy and

Insolvency Act or the Winding-up Act, where an application is made under this Act in respect of a company, the court, on the application of any person interested in the matter, may, subject to this Act, on notice to any other person or without notice as it may see fit, make an order under this section.

Initial application court orders

(3) A court may, on an initial application in respect of a company, make an order on such terms as it may impose, effective for such period as the court deems necessary not exceeding thirty days.

(a) staying, until otherwise ordered by the court, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Other than initial application court orders

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

(a) staying, until otherwise ordered by the court, for such period as the court deems necessary, all proceedings taken or that might be taken in respect of the company under an Act referred to in subsection (1);
(b) restraining, until otherwise ordered by the court, further proceedings in any action, suit or proceeding against the company; and
(c) prohibiting, until otherwise ordered by the court, the commencement of or proceeding with any other action, suit or proceeding against the company.

Burden of proof on application

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

(a) the applicant satisfies the court that circumstances exist that make such an order appropriate; and
(b) in the case of an order under subsection (4), the applicant also satisfied the court that the applicant has acted, and is acting, in good faith and with due diligence.

41 The rule of statutory interpretation that has now been accepted by the Supreme Court of Canada, in such cases as R. v. Sharpe, [2001] 1 S.C.R. 45, at para. 33, and Rizzo & Rizzo Shoes Ltd. (Re), [1998] 1 S.C.R. 27, at para. 21 is articulated in E.A. Driedger, The Construction of Statutes, 2nd ed. (Toronto: Butterworths, 1983) as follows:

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

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

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

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

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

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

46 I start with the proposition that at common law directors could not be removed from office during the term for which they were elected or appointed: London Finance Corporation Limited v. Banking Service Corporation Limited (1923), 23 O.W.N. 138 (Ont. H.C.); Stephenson v. Vokes (1896), 27 O.R. 691 (Ont. H.C.). The authority to remove must therefore be found in statute law.

47 In Canada, the CBCA and its provincial equivalents govern the election, appointment and removal of directors, as well as providing for their duties and responsibilities. Shareholders elect directors, but the directors may fill vacancies that occur on the board of directors pending a further shareholders meeting: CBCA, ss. 106(3) and 111.[4] The specific power to remove directors is vested in the shareholders by s. 109(1) of the CBCA. However, s. 241 empowers the court - where it finds that oppression as therein defined exists - to "make any interim or final order it thinks fit," including (s. 241(3)(e)) "an order appointing directors in place of or in addition to all or any of the directors then in office." This power has been utilized to remove directors, but in very rare cases, and only in circumstances where there has been actual conduct rising to the level of misconduct required to trigger oppression remedy relief: see, for example, Catalyst Fund General Partner I Inc. v. Hollinger Inc., [2004] O.J. No. 4722.

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

49 At paragraph 7 of his reasons, the motion judge said:

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

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

51 Court removal of directors is an exceptional remedy, and one that is rarely exercised in corporate law. This reluctance is rooted in the historical unwillingness of courts to interfere with the internal management of corporate affairs and in the court's well-established deference to decisions made by directors and officers in the exercise of their business judgment when managing the business and affairs of the corporation. These factors also bolster the view that where the CCAA is silent on the issue, the court should not read into the s. 11 discretion an extraordinary power - which the courts are disinclined to exercise in any event - except to the extent that that power may be introduced through the application of other legislation, and on the same principles that apply to the application of the provisions of the other legislation.

The Oppression Remedy Gateway

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

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

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

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

The Level of Conduct Required

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

> Director removal is *an extraordinary remedy* and certainly should be *imposed most sparingly*. As a starting point, I accept the basic proposition set out in Peterson, "Shareholder Remedies in Canada"[5]:
>
> > SS. 18.172 *Removing and appointing directors to the board is an extreme form of judicial intervention.* The board of directors is elected by the shareholders, vested with the power to manage the corporation, and appoints the officers of the company who undertake to conduct the day-to-day affairs of the corporation. [Footnote omitted.] It is clear that the board of directors has control over policymaking and management of the corporation. *By tampering with a board, a court directly affects the management of the corporation.* If a reasonable balance between protection of corporate stakeholders and the freedom of management to conduct the affairs of the business in an efficient manner is desired, altering the board of

> directors should be *a measure of last resort*. The order could be suitable where the continuing presence of the incumbent directors is harmful to both the company and the interests of corporate stakeholders, and where the appointment of a new director or directors would remedy the oppressive conduct without a receiver or receiver-manager. [emphasis added]

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

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

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

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

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

> In resolving these competing interests, it is incumbent upon the directors to act honestly and in good faith with a view to the best interests of the corporation. In using their skills for the benefit of the corporation when it is in troubled waters financially, the directors must be careful to attempt to act in its best interests by creating a "better" corporation, and not to favour the interests of any one group of stakeholders.

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

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

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

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

The Business Judgment Rule

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

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

66 In Brant Investments Ltd. v. KeepRite Inc. (1991), 3 O.R. (3d) 289 (C.A.) at 320, this court adopted the following statement by the trial judge, Anderson J.:

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

67 McKinlay J.A then went on to say:

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

68 Although a judge supervising a CCAA proceeding develops a certain "feel" for the corporate dynamics and a certain sense of direction for the restructuring, this caution is worth keeping in mind. See also Clear Creek Contracting Ltd. v. Skeena Cellulose Inc., supra, Sammi Atlas Inc. (Re) (1998), 3 C.B.R. (4th) 171 (Ont. Gen. Div.); Olympia & York Developments Ltd. (Re), supra; Re Alberta Pacific Terminals Ltd. (1991), 8 C.B.R. (3d) 99 (B.C.S.C.). The court is not catapulted into the shoes of the board of directors, or into the seat of the chair of the board, when acting in its supervisory role in the restructuring.

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

> With respect I do not see the present situation as involving the "management of the business and affairs of the corporation," but rather as a quasi-constitutional aspect of the corporation entrusted albeit to the Board pursuant to s. 111(1) of the CBCA. I agree that where a board is actually engaged in the business of a judgment situation, the board should be given appropriate deference. However, to the contrary in this situation, I do not see it as a situation calling for (as asserted) more deference, but rather considerably less than that. With regard to this decision of the Board having impact upon the capital raising process, as I conclude it would, then similarly deference ought not to be given.

70 I do not see the distinction between the directors' role in "the management of the business and affairs of the corporation" (CBCA, s. 102) - which describes the directors' overall responsibilities - and their role with respect to a "quasi-constitutional aspect of the corporation" (i.e. in filling out the composition of the board of directors in the event of a vacancy). The "affairs" of the corporation are defined in s. 1 of the CBCA as meaning "the relationships among a corporation, it affiliates and the shareholders, directors and officers of such bodies corporate but does not include the business carried on by such bodies corporate." Corporate governance decisions relate directly to such relationships and are at the heart of the Board's business decision-making role regarding the corporation's business and affairs. The dynamics of such decisions, and the intricate balancing of competing interests and other corporate-related factors that goes into making them, are no more within the purview of the court's knowledge and expertise than other business decisions, and they

deserve the same deferential approach. Respectfully, the motion judge erred in declining to give effect to the business judgment rule in the circumstances of this case.

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

72 The respondents submit that it makes no sense for the court to have jurisdiction to declare the process flawed only after the process has run its course. Such an approach to the restructuring process would be inefficient and a waste of resources. While there is some merit in this argument, the court cannot grant itself jurisdiction where it does not exist. Moreover, there are a plethora of checks and balances in the negotiating process itself that moderate the risk of the process becoming irretrievably tainted in this fashion - not the least of which is the restraining effect of the prospect of such a consequence. I do not think that this argument can prevail. In addition, the court at all times retains its broad and flexible supervisory jurisdiction - a jurisdiction which feeds the creativity that makes the CCAA work so well - in order to address fairness and process concerns along the way. This case relates only to the court's exceptional power to order the removal of directors.

The Reasonable Apprehension of Bias Analogy

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

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

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

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

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

PART V - DISPOSITION

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

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

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

R.A. BLAIR J.A.
S.T. **GOUDGE** J.A. - I agree.
K.N. FELDMAN J.A. - I agree.

cp/ln/e/qljxh/qlkjg/qlgxc/qlmlt

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

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

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

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

5 Dennis H. Peterson, Shareholder Remedies in Canada (Markham: LexisNexis ' Butterworths ' Looseleaf Service, 1989) at 18-47.

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

7 Now s. 241.

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TAB 23

Indexed as:

Northland Properties Ltd. (Re)

In the Matter of the Company Act R.S.B.C. 1979, c. 59
And In the Matter of the Companies' Creditors Arrangement Act R.S.C. 1970, c. C-25
And In the Matter of Northland Properties Limited, Sandman Inns Ltd., Sandman Four Ltd., Unity Investment Company, Limited, B & W Development Co. (1966) Ltd., T & N Developments Ltd., Petitioners

[1988] B.C.J. No. 1530

31 B.C.L.R. (2d) 35

73 C.B.R. (N.S.) 166

11 A.C.W.S. (3d) 214

Vancouver Registry No. A880966

British Columbia Supreme Court
Vancouver, British Columbia

Trainor J.

Heard: July 29, 1988
Judgment: August 5, 1988

Corporations -- Debtor and creditor -- A and B bonds issued -- B bonds purchased by subsidiary of issuer -- Subsidiary issuing preference shares to vendor of B bonds with provision for issue of C bonds if dividends not paid -- Bond issuers and vendor agreeing that vendor could require subsidiary to repurchase preferred shares on default -- Vendor seeking to invoke agreement -- Subsidiary not repurchasing -- Issuer and vendor seeking orders with respect to constitution of classes of creditors -- A, B and C bondholders put in separate classes -- B bondholders not permitted to vote in reorganization of issuer -- Agreement debt same as B debt for classification -- Bankruptcy Act, R.S.C. 1970, c. B-3, s. 87 -- Company Act, R.S.B.C. 1979, c. 59, s. 183 -- Companies' Creditors Arrangement Act, R.S.C. 1970, c. C-25.

This was a petition for orders with respect to the constitution of classes of creditors. An issuer had issued A and B bonds. A bank holding the B bonds had sold them to a subsidiary of the issuer for preference shares, with a provision for the issuance of C bonds if dividends were not paid on the shares, as well as a put agreement requiring the subsidiary to repurchase the shares on default. The bank purported to exercise the put agreement.

HELD: The A, B and C bondholders were placed in separate classes. The put agreement debt was classified the same as the B debt. The B bondholders were not permitted to vote on the reorganization of the issuer. The C bonds and put agreement debt should share the same voting rights.

R. Clark and R.D. McCrae, counsel for the Petitioners.
E.C. Chiasson, Q.C. and G.W.J. Ghikas, counsel for the Bank of Montreal.

TRAINOR J.:-- The petitioner companies and the Bank of Montreal both seek orders with respect to the constitution of classes of creditors pursuant to the provisions of the Companies creditors Arrangement Act

Over the last several years the petitioner companies and the Bank of Montreal, in an attempt to lend financial stability to the companies entered into three restructuring agreements.

By the first agreement in the fall of 1983 by way of a deed of trust and mortgage in favour of a trustee, Royal Trust Corporation, assets of the petitioner companies were charged. This agreement provided for the issuance of series "A" Bonds. One "A" bond in the amount of $100,000,000 was issued and delivered to the Bank for all present and future indebtedness of the companies.

The second restructuring occurred in June of 1984. It involved the conversion of $60,000,000 of the companies' indebtedness to the Bank to indebtedness evidenced by the issue of a "B" bond in that amount. The "A" bond previously issued was replaced by the issue of a second "A" bond for $40,000,000 in favour of the Bank.

The third restructuring in 1985 involved the incorporation of a new company, 294,536 British Columbia Ltd., ("Subco") whose shares were owned by the parent company Northland and charged in favour of the trustee Royal Trust. Subco was incorporated with a view to purchasing the "B" bonds held by the Bank in exchange for transferring the equivalent value in non-voting preferred shares to the Bank. This transaction was completed on July 1, 1985.

"C" bonds were also issued during the third restructuring such that in the event that Subco was unable to pay dividends on the preferred shares to the Bank, "C" bonds could be issued to the Bank in lieu of dividends. Two "C" bonds were issued totalling approximately $2,000,000.

At the same time, the petitioner companies and the Bank entered into a "PUT agreement" which provided that the Bank could require Northland upon default to purchase the preferred shares back from the Bank.

On January 20, 1988 the Bank purported to exercise its right under the PUT agreement with respect to Northland's obligation to purchase the preferred shares. Northland failed to pay the purchase price of approximately $71,000,000. By the terms of the PUT agreement, that amount is pay-

able by Northland and guaranteed by all of the other companies. It further provides that any securities held by the Bank are available to meet the obligation. The preferred shares are now classed as voting shares by reason of default of more than two quarterly dividends.

There are three matters to be resolved with respect to the parties motion:

1. Do the "A", "B", and "C" bondholders constitute separate classes?
2. Do the "B" bondholders have voting rights?
3. Is the "PUT agreement" debt essentially the same debt as the Subco "B" bond debt?

One of the oft quoted cases on the issue of creditor classification is Re Wellington Building Corporation Limited (1934) 16 C.B.R. 48 in which Kingstone J. accepts the following statements:

> "... I have no doubt at all that it would be improper for the Court to allow an arrangement to be forced on any class of creditors, if the arrangement cannot reasonably be supposed by sensible business people to be for the benefit of that class as such, otherwise the sanction of the Court would be a sanction to what would be a scheme of confiscation. The object of this section is not confiscation ... its object is to enable compromises to be made which are for the common benefit of the creditors as creditors, or for the common benefit of some class of creditors as such.
>
> .....
>
> The Act provides that the persons to be summoned to the meeting, all of whom, it is to be observed, are creditors, are persons who can be divided into different classes, classes which the Act recognizes, though it does not define. The creditors, therefore, must be divided into different classes. What is the reason for prescribing such a course? It is because the creditors proposing the different classes have different interests, and therefore, if a different state of facts exists with respect to different creditors, which may affect their minds and judgments differently, they must be separated into different classes."

The Bank submits that the bonds should be in separate classes as each is characterized by an "identity of interest" which may be determined by examining the characteristics and relative positions of each bond. To that end, the Bank sets out the differences between the "A", "B", and "C" bonds with respect to the actual issuer, the bond's guarantors, the term of the bond, the security given for the bond and the holder of the bond. The Bank posits that this compilation of data with respect to each bond clearly indicates that each bond should be placed in a separate class.

To buttress their position, the Bank makes the following additional points:

1. Section 8.1 of the Trust Deed recognizes the differing interest of "A" and "B" bondholders in that each of them may, independently of one another, require the trustee to declare the amounts owing to be due and payable;
2. Section 3.2(e)(iii) of the Trust Deed stipulates that no "B" or "C" bonds may be issued without the consent of all "A" bondholders.

The Bank relies on Re Wellington, for the proposition that the priority of a particular security is a significant factor in the constitution of a class under the Companies Creditors Arrangement Act. Both the petitioner companies and the Bank agree that the bondholders of "A" and "B" bonds have priority over "C" bondholders.

The petitioner companies submit, that the difference between bonds "A", "B" and "C" are merely ones of form, and not of substance. They submit that as all bondholders look to the same source, so their interests are similar.

Further, the petitioners refer to s. 3.2(f) of the Trust Deed as recognizing a singular interest manifested by the ability of a "B" bondholder to convert, at his option, to an "A" bond.

There is merit in the Bank's priority argument, I find the Bank's chart compelling with respect to the differences in characteristics between the "A", "B" and "C" bonds. I do not see the differences as merely distinction of form rather than substance.

I hold that the "A", "B" and "C" bondholders constitute separate classes for voting purposes.

The second issue is whether the "B" bondholders have voting rights.

The Bank submits that the "B" bonds are held by Subco which is a wholly-owned subsidiary of Northland and that allowing Subco to vote the "B" bonds is tantamount to allowing Northland to vote in its own reorganization. The Bank relies on Re Wellington, supra; Re Dairy Corporation of Canada Ltd. [1934] O.R. 436 (Ont. C.A.); s. 183 of the B.C. Company Act; and s. 87 of the Bankruptcy Act.

The petitioner companies submit that Subco, as holder of the "B" bonds, has voting rights. They say:

1. It is not entirely clear that Northland controls Subco, arguably the Bank has rights which entitle it to control Subco;
2. Subco is a secured creditor and therefore entitled to vote. Arm's length creditors should not have the sole right to determine the petitioner's future;
3. The Companies Creditors Arrangement Act does not preclude Subco from voting.
4. It is not open to the Bank to pierce the corporate veil for their own benefit when the incorporation of Subco was imposed by the Bank on the petitioner.

The following passage from Re Wellington Building Corporation, supra, is instructive:

> "I am of the opinion that the scheme as propounded and which this Court is asked to approve is unfair to the bondholders and that it was really carried through on a pool vote of all the secured creditors at the instigation of the proprietors who are also third and fourth mortgagees and who naturally stand to benefit by the proposal at the expense of the bondholders."

In my view Subco is a subsidiary of Northland and should not vote in Northland's reorganization under the Companies Creditors Arrangement Act.

The third matter concerns the "PUT agreement". The petitioner companies submit that the "PUT" debt, that is the unpaid purchase price for the preferred shares of approximately $71,000,000 is the same debt as the Subco "B" bond debt previously referred to. I accept that submission for the pur-

pose of consideration of the classes of creditors. The same debt cannot give rise to two separate classes. I have stated why the "B" bonds should not give rise to a class of creditors with voting rights. A class should be established for the indebtedness under the PUT agreement of approximately $71 million.

The "C" bonds are in a separate class but the interest represented arises from the dividend payment due on the preferred shares held by the Bank in the PUT agreement. For that reason, I do not think the "C" bonds can be treated as a separate class from the PUT agreement class.

The result is that I recognize two classes with voting rights, namely:

1. The "A" bonds - approximately $40 million.
2. The PUT agreement debt of approximately $71 million to which can be added the amount owing under the "C" bonds.

TRAINOR J.

---- End of Request ----
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Court File No.: **CV-11-9283-00CL**

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 UNIQUE BROADBAND SYSTEMS, INC.

ONTARIO
SUPERIOR COURT OF JUSTICE

PROCEEDING COMMENCED AT TORONTO

BOOK OF AUTHORITIES OF THE APPLICANTS (RESPONDING PARTIES), UNIQUE BROADBAND SYSTEMS, INC. AND UBS WIRELESS SERVICES INC.

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